

2014 Annual Evaluation Review



Annual Report
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2014 Annual Evaluation Review

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NOTE

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

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Abbreviations

ADB	–	Asian Development Bank
AER	–	Annual Evaluation Review
CO ₂	–	carbon dioxide
CoP	–	community of practice
CPS	–	country partnership strategy
DEC	–	Development Effectiveness Committee
DEfR	–	Development Effectiveness Review
DRM	–	disaster risk management
EE	–	energy efficiency
EIRR	–	economic internal rate of return
FIRR	–	financial internal rate of return
GDP	–	gross domestic product
GHG	–	greenhouse gas
IED	–	Independent Evaluation Department
KPS	–	knowledge products and services
MARS	–	Management Action Record System
MfDR	–	Managing for Development Results
MFF	–	multitranche financing facility
MTR	–	midterm review
PCR	–	project completion report
PPER	–	project performance evaluation report
PRC	–	People's Republic of China
PV	–	photovoltaics
PVR	–	project completion report validation report
RE	–	renewable energy
RM	–	resident mission
SME	–	small and medium enterprise
TA	–	technical assistance
XARR	–	extended annual review report

Weights and Measures

GWh	–	gigawatt hour
MW	–	megawatt

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IED remains fully responsible for the report.

Foreword

This 2014 Annual Evaluation Review (AER) comes on the heels of a period of intense reflection in the Asian Development Bank (ADB). The Midterm Review of Strategy 2020 led to valuable commitments to adjust Strategy 2020 to the current realities in Asia and the Pacific. These now need to lead to concrete actions.

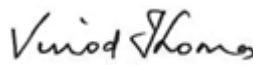
Many of the region's economies continue to grow fast, but there are heavy overhanging clouds. The growth process is being threatened by high pollution levels, climate change, resource depletion, and growing social inequality. Poverty remains deep in many areas, while the growth process does not rely sufficiently on the potential contribution of lower income groups. Real choices need to be made, between short and long term growth, high and inclusive growth, and brown and green growth.

In many ways the year's evaluations touched upon trade-offs and also synergies, particularly the evaluations of the Millennium Development Goals, inclusive growth, private sector contributions to inclusive and environmentally sustainable growth, and access to climate finance. Many of the country program evaluations and validations of country program final reviews also dealt with issues of inclusive and green growth.

The conclusion from Independent Evaluation's *Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term* is that ADB's best contribution lies in supporting broad-based green growth and wider access to growth opportunities and services, particularly of the poor. Betting on green growth may well hold some wins for inclusive growth.

All this comes at a time when ADB's portfolio gives indications of improved performance, as this AER signals. Sustaining and deepening that improvement would rest both on strategic choices in the portfolio and follow-up of implementation supervision.

This AER includes proposals for ADB Management and IED itself on the future derivation and presentation of success rates of operations, to improve their representativeness and timeliness. We are requesting Management to finalize its annual batch of PCRs by end-August each year, and IED would validate this batch in the same year by stepping up the PCR validation program. The AER also includes proposals to improve evaluation recommendations and their follow up. IED will make its recommendations more directly actionable and suitable for the Management Action Record System, and calls on Management to strengthen action planning and reporting.



Vinod Thomas
Director General
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Executive Summary

The 2014 Annual Evaluation Review (AER) draws together evaluation experiences from a pivotal year in the Asian Development Bank's (ADB) existence, one in which there was a transition of Presidential leadership and the start of the Midterm Review of Strategy 2020. Independent Evaluation participated in the midterm review process, as the Board and Management sought an evaluative perspective. The resulting report, entitled *Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term*, presented evidence on inclusive growth, environmental sustainability, private sector development, knowledge management, and operational performance. This in turn was the basis for formulating seven steps that ADB can take to increase its impact in the remaining period of Strategy 2020. The report was offered to the Board and Management in February 2014, and is available on the Independent Evaluation Department's (IED) website.

This AER continues the familiar themes of the past years, with reviews of ADB's operational performance and the follow up to evaluation recommendations. By its synthetic nature, the AER necessarily repeats some of the findings and recommendations presented earlier in thematic and country reports. Following its focus on the sustainability of transport operations in the previous year, the 2014 AER adds a special analysis of the sustainability of energy operations (a significantly growing portfolio in ADB), and a theme chapter on inclusive and environmentally sustainable growth and its trade-offs, which was at the core of the Midterm Review.

ADB's Operational Performance

The 2014 AER assesses ADB's progress in furthering development effectiveness by bringing about better outcomes of individual interventions as well as of country-wide support. These findings and their implications are in line with ADB's midterm review of Strategy 2020 and IED's evaluation relating to it. It is positive and highly significant that ADB has carried out this midterm review and has looked at lessons of the past 5 years to make midcourse improvements. It is also commendable that ADB has committed to prepare an action plan to implement the strategic priorities outlined in the midterm review, and to update its results framework.

One basis for some of the higher evaluations is the project level findings, which ADB's Development Effectiveness Review (DEFr) and the AER bring together. While project performance could signal how ADB's objectives are addressed at one point in time, because of the projects' coverage and vintage, it ought to be seen only as one piece of evidence and needs to be interpreted in conjunction with other information on the strengthening of results at the corporate, country, sector, and thematic levels.

Last year, the 2013 AER drew attention to the apparent lack of improvement in performance between sovereign operations initiated in 1990–1999 and those from 2000–2010. For both decades of operations, a success rate of 67% was reported (this was done using the rating information from unvalidated project completion reports [PCRs] and from IED's validations of these PCRs and project performance evaluations). This year, additional assessments now available for recently closed operations indicate a 69% success rate for operations approved in the period 2000–2010. The success rate

will be revised as more PCRs, validations, and project evaluations come in for operations begun in the 2000s.

When looking only at validations of PCRs and project performance evaluations that IED completed over 2013 alone, a success rate of 68% can be reported (46 out of 68), compared with 62% for such operations validated in 2012 and 47% for those validated in 2011. These improvements leading up to 2013 relate to a sample of projects completed mostly over 2007–2011. The trend is good news for ADB, and may point to lessons being learned and capacity of partner countries increasing.

ADB's DEfR for 2013 has reported on more recent performance developments, which indicate a higher success rate than before, particularly for PCRs from 2010–2012 and 2011–2013. In the period 2007 to 2010, operations reported a success rate of 68% in their PCRs. Using an average adjustment factor applied to 75% of the PCRs (which is based on Independent Evaluation's validations over the past 5 years – see below), the DEfR reports a success rate of 77% for operations with PCRs issued in 2011–2013 (and 70% for 2010–2012). This is close to ADB's performance standard of 80%. By end-2013, IED had validated only 11 of the 67 PCRs issued in 2012 and none for 2013. This is an insufficient sample, but the 11 validations did not yet show a higher success than before. Independent Evaluation's completion of validation of PCRs of 2012 and 2013 will enable verification of an upward trend and its gradient.

The DEfR adjusts unvalidated PCRs by a certain factor based on IED validations in past years, and applies this to unvalidated projects that lie within the 75% sample of the PCRs to be validated. IED also in the past did not adjust the ratings of unvalidated PCRs—the ratings of evaluations and PCRs were aggregated and a success rate derived. We suggest that, going forward, the adjustment be applied to all PCRs in the DEfR while the AER will present only validated ratings. In doing so, care must be exercised in comparing new data with the old.

Furthermore, if ADB can complete its annual batch of PCRs each year by the end of August (in 2013 ADB completed its set by end-September), IED will aim to validate a statistically significant proportion of PCRs (75%–80%) in the same year. In this way, differences between DEfR and AER ratings should in principle be eliminated or nearly so. If Management agrees, this will start in 2015 (in 2014 IED will clear the backlog of PCR validations from 2012 and 2013; in 2015 it will validate 75%–80% of PCRs issued in 2014 and 2015). This move will require additional resources, which IED will obtain by reducing its annual target for detailed project evaluations.

The results for nonsovereign operations seem not to have improved. The operations department is significantly stepping up its self-evaluations, and IED was able to assess a record 20 nonsovereign operations in 2013, 6 of which were rated *highly successful*, 5 *successful*, 5 *less than successful*, and 4 *unsuccessful*. This 55% success rate compares with the 68% success rate for the 31 operations assessed from 2006 to 2012. The AER notes that the success rates fluctuate between years due to the small numbers of XARRs and validations each year. A special reason for the lower success rate in 2013 may be that the assessments covered a relatively large proportion of private equity funds and small and medium enterprise operations.

All 8 nonsovereign infrastructure operations were rated *successful*, but the 12 finance projects had a success rate of 25%. This result mirrors to some extent the situation until recently in ADB's public sector operations in finance – it was 46% over 2010–2012 but improved subsequently to 62% as per the 2013 DEfR (taking into account historical

downgrades for unvalidated PCRs which still have to be verified). The low success rate of nonsovereign finance operations was the result of poor investment performance of private equity funds and small and medium enterprise-related operations, which was in part due to adverse market conditions but, more importantly, the selection of less than suitable fund managers and other financial intermediaries with insufficient experience in the target market segments, resulting in subpar business performance and low achievement of development objectives.

A striking finding of the nonsovereign operations was the overlap between private sector development impact and ADB investment profitability. A large share of infrastructure-related projects had notable demonstration effects and contributed substantially to private sector expansion, competition, new business practices, and institutional development while having good investment returns.

IED reports its findings on six country strategies and operations investigated in 2013. One full scale evaluation of the country program in Pakistan was rated *less than successful*. Five validations of self-evaluated country partnership strategy results in Bhutan, Georgia, India, Nepal and Thailand were all corroborated as *successful*. The 2014 AER notes the large variation in the performance of various country portfolios. Although most of the PCRs from 2012 and 2013 are not yet validated, country programs in the People's Republic of China (PRC) and Viet Nam seem to have been doing well over time. In comparison, programs in other countries, such as Bangladesh, Nepal, and Tajikistan that did not do so well in the past, have improved in recent years. Relatively recent ADB programs in the West Caucasus are also doing well. Improvements in recent mid-tier programs are seen in India, Indonesia, and Philippines.

However, project portfolios in Pacific countries as a group are still performing below average when their decadal success rates are considered (no PCR was issued for an operation in the Pacific in 2013). In 2014, IED is conducting an evaluation of ADB's Pacific approach, which may shed light on the underlying reasons for this performance.

The Pakistan program showed a considerable dip in performance in recent years but shows signs of improvements, as both the DEFfR and the country program evaluation indicate (in 2013 no PCR was issued on any project in the Pakistan portfolio). Other portfolios that need to be watched include Cambodia (82% success for operations approved in the 1990s and 68% success rate of operations approved and so far completed and reviewed in the 2000s), and Mongolia (falling from 65% success for operations in the 1990s to 54% success for operations in the 2000s). In 2014, IED will validate the final review of the Cambodia program, and programs in Indonesia and Timor-Leste. A full country program evaluation for Tajikistan will be completed in 2014; in 2015, evaluations will be done of ADB's programs in PRC and Papua New Guinea.

Evaluation Follow Up

The AER continues to monitor follow-up actions to evaluation recommendations accepted by ADB Management. As in other years, this acceptance is very good. But a disparity between Management's report of the actions implemented and IED's validation of that report continues, with several actions implemented in a rather mechanical sense. By mutual agreement, IED is not party to the formulation of actions in the Management Action Record System (MARS), although it is available for consultation on actions. IED mainly validates the progress reported by Management (once the action is due).

As was the case last year, there is sometimes a watering down of the actions, partly caused by qualified acceptance of broad evaluation recommendations. For instance, if the essence of a recommendation is to increase training, the action eventually entered in the MARS is sometimes no more than a commitment to implement an existing training program. More meaningful follow-up discussions of the key recommendations—as in the successful case of the multitranche financing facility—among Management, IED and the Development Effectiveness Committee (DEC) might be one way to return to the spirit of these recommendations. Another suggestion is for evaluators to make a better distinction between long-term lessons and short-term recommendations so that the latter become more directly actionable and are made suitable for the MARS. IED will work on this in this year's revision of evaluation guidelines.

With these provisos in mind, the conclusion is that over the past 4 years, there has been an average 7-percentage point difference in the implementation rates of management actions as reported by Management, and as validated by IED. The proportion of actions fully or largely implemented in 2012–2013 was 72%, compared to the 76% average during 2010–2011. In 2013, the disparity between ADB assessment and IED's assessment was more pronounced than before. The 13% difference between the 79% that ADB assessed as implemented and what IED validated (66%) was double the share reported for the 4 earlier years. Some actions now seen as expired have been only partly implemented and may need further follow-up. Sometimes, operations departments underestimate the time for an action, and more time allocated would have allowed the MARS to monitor it longer.

A related issue is that of ambiguously formulated actions. A good practice and aid to clarity may be the follow up of reporting them publicly at some stage (currently they are not). For instance, the essence of the new actions agreed upon over the year could be made part of the AER, along with the agreed-upon recommendations and Management responses. They could be reflected in an appendix or linked document. The same document could also detail the various actions that were due over the past year, along with the progress reported by Management, and IED's validation. This would then improve disclosure. If so desired, the names of individual departments and offices could be edited out. Currently, actions are to be conceived 60 days after the DEC meeting. Consultations between Management and IED would be useful on the interpretation of recommendations. This could then also lead to a more straightforward validation of the actions versus the recommendations.

This AER reviewed several evaluations produced between 1 and 3 years ago, to assess whether developments in ADB were in line with the findings and recommendations. It traced developments since the evaluations of Managing for Development Results in ADB (2011), ADB's Microfinance Development Strategy (2012), ADB's Response to Natural Disasters and Disaster Risks (2012), ADB's Social Protection Strategy (2012), the Multitranche Financing Facility (2012), and ADB's Knowledge Products and Services (2012). While there has been progress, the AER also provides some suggestions, as summarized in chapter 3 and detailed in Appendix 3, Linked Document E.

ADB's Energy Operations—Sustainability and Inclusion

Chapter 4 analyzes the evolution of ADB's energy operations and the extent of trade-offs between environmental sustainability objectives (especially regarding climate change) and the objectives of affordable and secure power and inclusive growth. The chapter also reviews energy operations in terms of institutional and financial

sustainability, and how the shift in the portfolio mix may impact future performance. Appendix 3, Linked Document F provides a fuller review of these issues.

Historically, ADB's energy operations have had a large share of projects assessed as *successful* and as *likely to be sustainable*. Of the 83 sovereign loan operations that were completed and evaluated between 2000 and 2013, 80% were considered *successful*. The same proportion was considered *sustainable*. Nonsovereign operations evaluated since 2006 achieved a similar rate, based on their business success, while 93% were considered *successful* overall.

Nevertheless, a number of common problems have been identified as risks to the financial and institutional sustainability of energy operations, with variations across countries and project types: (i) inadequate tariff or lack of cost recovery, (ii) lack of government support for the project or political and regulatory risk, (iii) lack of project maintenance or other operational risk, and (iv) low institutional capacity and weak corporate or financial governance. The problems may be more serious than is suggested by the good sustainability rate of energy projects overall. In some countries, public sector energy provision remains highly subsidized, indebted, experiencing leakages of various kinds, and—as a result—is a major drain on national resources.

The energy program has been responsive to high demand from countries as well as to ADB's own prioritization of infrastructure investments. The share of energy operations in ADB financing increased from 16% over 2003–2007 (\$5.8 billion) to 26% over 2008–2012 (\$16.8 billion). Changes in the composition of the energy portfolio have been equally significant. In a sample of seven countries that account for more than 80% of ADB's energy loans after 2001, the share of renewable energy and demand-side energy efficiency went up from 5% of ADB financing in 2001–2008 to 27% in 2009–2012. By contrast, the share of ADB loans for power generation from fossil fuels fell from 28% to 17%, while the share of coal-fired plants collapsed from 15% to 2% of financing. As a consequence, the energy supplied (or saved) per unit of investment fell by 40%, but greenhouse gas emissions mitigation increased almost five-fold.

There is little indication thus far that ADB's shift to a greener energy portfolio is having a negative impact on the institutional or financial sustainability of projects or their success rate. The real test of the success and sustainability of ADB's shift will be governments and businesses buying in to ADB-financed projects. This result, in turn, depends on ADB's policy dialogue with a country and the subsequent balance reached in the portfolio between environmental sustainability and other key imperatives facing the region's energy development: access to basic energy services for the poor, affordability, and energy security.

While there are some tensions between environmental sustainability and the objectives of affordable and secure energy supply, overall they do not amount to a sharp trade-off. Indeed, there can be many points of convergence between these objectives if the strategies are well designed. In countries where a large segment of the population (usually the rural poor) does not have access to modern energy forms, especially electricity, increasing access may compete with the expansion of cleaner and more expensive utility-scale generating capacity. On the other hand, in isolated rural communities small-scale renewable energy sources may be the low-cost supply option for supplying basic energy services, as has been shown in Bangladesh.

Whereas providing access to electricity to all the population is an immediate objective, the question of affordable electricity is universal. As countries invest in cleaner, and

more expensive, electricity supply, the average cost of supply will increase relative to business-as-usual. As long as the share of more expensive power is relatively small the impact on the average cost would be small, but then so would be the salutary impact on the environment.

The issue of affordability is complex, and the trade-offs will change over time. The chapter makes several observations:

- i. In one recent business-as-usual scenario prepared by ADB, a large drop is projected in energy outlays versus income by 2030. This suggests that there is some margin for an increase in the average cost of electricity supply due to greater clean energy supply, without sacrificing economic growth.
- ii. A key objective of subsidies to promote clean energy is to catalyze a reduction in costs of new technologies. The expansion of the market for new renewable energy technologies has indeed stimulated innovation and economies of scale, which are bringing down costs. For example, the reduction in the cost of solar photovoltaics has already been much faster than was anticipated just a few years ago. Wind power costs have fallen a lot as well.
- iii. The potential for energy efficiency savings is large, and the savings are lower cost than any equivalent supply. Implementing demand-side energy efficiency initiatives is challenging, but it is an area where ADB can add value.

Increasing the use of renewable resources for electricity generation should reduce the region's dependence on imported fuels. It will probably also lead to more trade in electricity between countries in the region, if politics permit. ADB has an established policy of encouraging the integration of regional energy infrastructure. Greater emphasis on renewable energy should reinforce this existing ADB policy.

A key dimension of energy security is the reliability of energy supply—in the power sector, the operation of the grid. Besides the large scale interconnections cited above, reliability can be enhanced by investments in the smart grid and distributed generation (where electricity is generated close to the load), which is enabled by the smart grid and is an important area for new clean energy technologies. Although ADB involvement in these areas has been modest so far, they are also at the intersection between energy infrastructure and the challenge of climate change adaptation—a growing concern for the ADB. Hence, a growing emphasis on clean energy can reinforce another ADB policy objective: improving the reliability of electricity supply in the context of climate change.

Improved accounting of greenhouse gas emissions, other environmental externalities, and energy subsidies in the economic analysis would provide a better basis for project appraisal (ADB has launched a review of methodologies for economic analysis that covers these issues and should be completed in 2015). At the planning level, ADB should seek to sharpen the strategic focus, through both preparing forward-looking studies and learning from experience—rigorously evaluating past projects. In both cases, it is important to add the perspective of market transformation.

The direct impacts of ADB projects by themselves can do little to change the trajectory of developing Asia's growing greenhouse gas emissions. To change the trajectory they must help catalyze broader changes in investment. Market transformation means helping to change a set of practices among market agents and looking at what they are doing outside of the project's immediate envelope. This process is inherently more complex than simply executing a project successfully. It implies long-term commitments.

That is the way ADB has been moving in energy over the past decades—the shift to clean energy is only the most recent example—and it should continue in this direction.

Inclusive and Environmentally Sustainable Growth

The AER's last chapter reviews recent evaluation findings as well as the trade-offs and synergies between inclusive and environmentally sustainable growth operations. It draws on various IED studies and papers, notably one that associates the West and Asia's historical growth pattern with carbon intensive energy sources. This pattern would need to be changed fundamentally in light of the threats of climate change as well as the limits to the exploitation of the related natural resources.

IED's evaluation of ADB's support for inclusive growth notes that the region's economic growth has been effective in lifting people out of poverty. When poverty is widespread, rapid and sustained growth is often the simple answer. However, the nature of growth, for example if it is labor intensive or not, matters a great deal. Furthermore, when poverty becomes more confined to certain pockets and groups, a more targeted approach to poverty reduction is increasingly an appropriate complement to supporting high growth processes. Geographic inequalities have proved to be the most persistent in the region. In most countries, poverty, social deprivations, and inequities are strongly associated with the rural areas.

In this light, the study points out that ADB's priorities have been leaning toward one of the three pillars in ADB's inclusive growth framework—the one promoting high, sustained economic growth (pillar 1). More limited financial support was given to pillar 2 (broadening inclusiveness through greater access to opportunities), and pillar 3 (strengthening social protection). The study stresses that just any type of growth, nor growth alone, can adequately promote social inclusion. Policies and interventions that take into account the country context, improve the quality of growth, broaden access to opportunities, and build strong social safety nets are vital for greater inclusion.

The study urges that ADB support for growth under pillar 1 itself be made more inclusive, i.e., more broad based. Drawing more of the poor into the growth process itself is the more sustainable option. This adjustment involves ADB designing and selecting projects and country partnership strategies that incorporate inclusion objectives. Second, the study calls for an increase in investments for greater inclusion—namely access to pillar 2 opportunities, and for pillar 3, social protection—relative to those under pillar 1.

A related evaluation in 2013 on inclusive and environmentally sustainable growth drew attention to ADB's primary focus of nonsovereign operations on infrastructure and financial markets. The report argues that this result can be consistent with inclusive growth objectives, provided their direct and indirect transmission mechanisms are identified and enhanced. While only a few of the reviewed private sector projects showed evidence of poverty and distributional aspects in their design, the lack of evidence did not necessarily rule out actual poverty reduction and other inclusion impacts. The study found that projects that paid attention to inclusion performed as well, if not better, on investment outcomes than projects that did not reflect inclusion objectives. This result suggests that development impact need not come at the expense of financial success. The report concludes that private sector interventions can be simultaneously pro-growth and inclusive, although such projects may be harder to find. The study formulated several steps to help increase the inclusiveness of outputs developed by private sector operations.

Regarding the need for environmental sustainability and the alleged trade-off with economic growth, not all technology solutions have to be costly. Furthermore, inaction is costly, especially at the global level. Even a 2°C rise in global temperatures imposes a large adaptation cost on the world. The costs of climate adaptation in the region could possibly be as much as \$36 billion–\$40 billion per year, with costs rising sharply under less favorable mitigation scenarios. Beyond pricing and financing issues, climate change aspects need to be handled through better knowledge management, and better supervision and regulatory mechanisms. Likewise, more global regulatory and supervisory oversight is needed to improve the quality of project outcomes. More concessional funding is required to make climate change actions attractive and doable for poor countries that cannot wait for long-term benefits. ADB can help by funding more climate change mitigation and adaptation projects, and by supporting climate finance initiatives. A recent evaluation came to the conclusion that ADB is just at the beginning of its journey in this area.

So far, public sector-sponsored technology research has usually stopped short of application, because experimentation often involves straying beyond government outfits or public laboratories. Ensuring follow-up programs, especially for developing regions, seems to be a promising area for research efforts. Furthermore, getting the prices of energy right is important for technology diffusion and its adaptation. Prices are often distorted because of the presence of subsidies or taxation. Institutions like the International Monetary Fund, the World Bank, and ADB have suggested to many countries that they need to get prices right to begin addressing the fossil fuel problem.

While many countries in the Region have achieved a great deal, a more difficult development trajectory now confronts it. The new transition path that needs to be attained requires reform, innovation, and new technology, in addition to new sources of funding. ADB and the countries for which it works need to reorient their societies to new ways of development.

Responding to these challenges, Independent Evaluation's *Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term* report indicates seven areas where ADB could step up its efforts. Two primary initiatives refer to inclusive growth and environmentally sustainable growth and their operationalization. The other areas identified are regional integration, good governance, synergies, operational performance, and team-work. It is time for ADB and its member countries to search for innovations and a new model in which inclusive growth and environmental sustainability can go hand-in-hand.

Management Response

General Comments

The 2014 Annual Evaluation Review (AER) reviews ADB's operational performance and offers analysis on the sustainability of energy operations and inclusive economic and environmentally sustainable growth. These areas have strong linkages to the Midterm Review of Strategy 2020 (MTR) which has recently been completed. Management has already responded to the conclusions and recommendations made in the individual studies by the Independent Evaluation Department (IED) used for this report. Given the significance of some of the issues, however, we reiterate parts of the same points here, in addition to our responses on the report's broad conclusions.

The AER section on sovereign operations is technical and data-intensive. The use of decadal project success rates data makes the AER stay at somewhat historical level in its perspective rather than providing useful operational implications. It will help if future AERs focus more on key underlying trends and lessons at the aggregate, sector and country levels. Recently completed Project Completion Reports (PCRs) point to a significant improvement in success rating of completed operations (para 45). The AER also notes that IED's validations of PCRs done in 2011, 2012 and 2013 show an upward trend in the success rate. An examination of underlying factors for this trend would be valuable.

ADB's non-lending operations are largely neglected. This would reflect the IED's present evaluation framework which does not pay much attention to ADB's development approach that focuses on country-level development results and efforts to tailor its program of loans, grants and technical assistance (TA) as well as private sector operations to individual country needs and circumstances. This approach is particularly important for smaller DMCs where ADB's grant-financed projects and TA largely characterize the nature of ADB assistance.

Specific Comments

Management Action Record System (MARS): The report notes that Management continues to be receptive to IED recommendations, but that ambiguities in recommendations, disagreements on some of recommendations, and resource implications have prompted Management to issue qualified acceptance for many recommendations. In this context, we welcome IED's plan for a better distinction between long-term lessons and recommendations that are more short term and more directly actionable. As suggested in the report, Management is willing to consult IED if there are ambiguities in the interpretation of IED's recommendations. However, given that the responsibility of formulating action plans rests with the Management, IED's direct involvement in the plan's formulation process may not be appropriate. In this regard, we would like to highlight that clearer and readily actionable recommendations would better serve the purpose of effective follow-up to evaluation recommendations.

The report suggests that the essence of the new actions agreed upon over the year could be made part of the AER, along with the agreed-upon recommendations and Management responses. It further suggests that the same document could also detail the actions that were due over the past year, along with the progress reported by management and IED's validation in an appendix or linked document. We take note of the potential, positive aspects of this proposal and would like to suggest further discussions on its implications and concrete methodology and necessary measures.

Inclusive Economic Growth: The AER repeats findings from the special evaluation study on ADB's support for inclusive economic growth (IEG). However, the AER does not take into account the Management Response to the study whereby the Management, while endorsing most recommendations of the study, also took exception to some of its underlying analysis. The following points are therefore reiterated. First, it appears that there remains a significant difference in how ADB's support on the three pillars of IEG is measured. The AER reports "limited support" for pillars 2 and 3 of the IEG framework. However, the 2013 DEfR shows that ADB's total financing for pillar 2 (inclusive access to opportunities) of inclusive economic growth has increased from 35% in 2010-2012 to 42% in 2011-2013, and in terms of numbers of projects, pillar 1 (creation of opportunities) and pillar 2 are balanced at 49% and 47% respectively. ADB's support for pillar 3 also increased to 7% in terms of both the number of projects and volume of assistance during 2011-2013.

The AER reiterates the special evaluation study's point that ADB's support for growth under pillar 1 itself should be made more inclusive. We believe that ADB's approach to inclusive growth should be tailored to different and diverse development context of each individual country and should be seen in the wider context of ADB's strategy and operational program at the country-level as reflected in the country partnership strategy (CPS), instead of individual project level. While we intend to capture opportunities to make our projects more inclusive wherever possible, different roles and features of projects in pillars 1, 2 and 3 need to be recognized.

Finally, we have consistently disagreed with the observations on private sector operations (PSOs) and inclusion found in paras 193-195 and would like to reiterate our previous concerns. Support for IEG is very much present in PSOs. PSO Department (PSOD) seeks to originate projects that are inclusive. However, we need to combine development objectives, including IEG, with considerations for economies of scale and credit worthiness. The report insists that there is no trade-off between projects being inclusive and having satisfactory investment returns. In this regard, we would like to point out that besides bankability and financial viability of a project, we also need to take into account the cost factor. For example, projects supporting inclusive business, which are usually in a small scale, require no less staff time and efforts than large private sector projects. Therefore, direct interventions that promote "inclusiveness" can only represent a relatively modest proportion of PSOs. And this is another reason why we should try to expand our intervention in this area in a phased manner rather than in a short span of time.

Completion Report Validation and Success Rates: The DEfR reports "adjusted" success rates due to the fact that historically, IED validations lead to lower success rates. The DEfR does this adjustment due to IED's backlog of validations. As mentioned in para. 2 above, irrespective of the difference in aggregation methodology of ratings in DEfR and AER, we note that both assessments point to improvements in project performance in 2013. As for the suggestion that DEfR apply the downgrading adjustment based on IED's past validations to all PCRs and that management finalize its annual batch of PCRs

by end-August each year, we propose further discussions with IED. The discussions, in our perspective, need to consider i) statistically robust sampling for validations, ii) disagreement between the operational departments and IED on some validation findings and iii) historical comparability of the assessments in DEFRs, among others.

ADB's Energy Operations: We acknowledge that ADB's overall energy sector work is evaluated as having positive impact on economic growth and that the portfolio is becoming more sustainable from the environmental perspective. We agree with the suggestion provided on ADB's energy operations to better quantify greenhouse gas mitigation. On highlighting energy efficiency as an area where ADB can add value, we support this, as has already been reflected in the MTR. Finally, on a technical note, the report appears to mix-up greenhouse gas (GHG) emissions with carbon dioxide emissions (CO₂) in a number of places (paras 101, 162, 165).

Chair's Summary: Development Effectiveness Committee

On 18 June 2014, the Development Effectiveness Committee (DEC) discussed the 2014 Annual Evaluation Review (AER) which focused on (i) ADB's project performance on both shorter and longer timeframes, (ii) the follow up to evaluation recommendations, (iii) the sustainability of ADB's energy operations, and (iv) tradeoffs between inclusive and environmentally sustainable growth. The discussion centered on the methodology for validating project success rates, the deadline for project completion report (PCR) submission, country program performance, the lack of supervisory staff continuity affecting project performance, the Management Action Record System, environmental sustainability and the role of subsidies, and the interpretation of inclusive and environmentally sustainable growth.

The Director General, Independent Evaluation Department (IED) mentioned that IED will be making a few factual corrections, particularly in the chapter on the sustainability of energy operations before issuing the report publicly.

Project success rates and methodology

Like last year, DEC observed a large difference in project success rates as reflected in the AER and the Development Effectiveness Review (DEfR) respectively, noting that the methodology, scope and adjustment rates used make it difficult to get a clear message regarding ADB's performance. One DEC member put forward that the time period 2007-2010 (with a recorded success rate of 57%) seems to be the only period for which IED has done a sufficiently large number of validations to reach conclusions on ADB's performance with a proper degree of confidence. He emphasized the importance of clarifying and unifying the methodology for greater consistency, raising questions on: (i) the percentage of PCRs that should be validated; (ii) whether and how unvalidated PCRs should be adjusted in terms of their success rate; and (iii) why in the past, the DEfR applied an adjustment only to 75% of unvalidated PCRs, and not 100%. The DEC Chair echoed the concerns, stating that the differing methodologies and data sets are reasons why some DEC and other Board members had suggested a consolidation of the AER, DEfR and the Annual Portfolio Performance Review.

IED cited two issues that need to be corrected in moving forward with the two reports: (i) the practice of mixing self-evaluation and validated success rates, and (ii) applying the adjustment to only 75% of unvalidated PCRs for years in which IED has not done validations yet. IED proposed that the adjustment applies to all PCRs insofar as the DEfR is concerned, while the AER will only discuss the success rates based on validated PCRs and project performance evaluation reports. SPD explained that there could still be differences in success rates presented by IED and ADB, given that DEfR presents rates

exclusively by PCR year, while IED also presents the rates for batches of projects selected on the basis of their approval year. The complication arose from having some success rates based on a mix of self-evaluations and evaluations, and another exclusively based on evaluations. SPD is open to working with IED to arrive at a more suitable approach while cautioning that comparability with past reports may become an issue if the suggestion on adjustments is accepted. A DEC member underscored that it would be helpful if both staff and IED could reconcile methodologies for better comparability, and agreed it would be unwise to mix ratings for unadjusted, adjusted and validated PCRs. Staff indicated that the question of validation would be addressed soon, in consultation with IED, in preparation for next year's report.

Coverage of validations and deadline of PCR submission

A DEC member inquired whether 70% could be a sufficient level of coverage when validating PCRs. Director, IED mentioned that this depends on the number of PCRs, but also that extent of coverage is a judgment call for various organizations. The World Bank for instance, aims for 100% coverage. IED staff explained that in order to arrive at statistically reliable evaluation findings which can serve as a sound basis for suggestions or recommendations on thematic areas, 75%-85% coverage of PCRs leads to more robust findings. DEC members also asked staff whether the August deadline for PCR completion (proposed by IED to allow validation of PCRs of a year *in the same year*, thus eliminating possible differences between AER and DEF), would be feasible. Staff mentioned that although fewer PCRs are completed in the fourth quarter over the last three years, August may not be a realistic target as some bunching of PCRs toward the end of the year could not be avoided. A DEC member expressed concern about IED having sufficient budget to clear its backlog and start with a clean slate next year. Another DEC member expressed reservations on clearing the backlog of PCR validations if this will require additional staff and IED resources. He also suggested that staff and IED consult further about the feasibility of the August deadline. IED responded positively, and also suggested the budget needed for more validation could be taken from the budget for project performance evaluation reports (PPER), by reducing the number of PPER targets.

Country program performance

DEC welcomed IED's focus on country success rates but requested more analysis on why some countries have higher success rates compared to others. One DEC member inquired about the reasons behind the dropping success rates for Mongolia and Cambodia despite their relatively better economic situation. IED explained that it had only signaled this, and that it was based on the table which compared the success rates of completed operations approved in the 1990s versus those in the 2000s. Changing sizes of certain sector programs may influence the drop or rise in ratings. IED mentioned that it will complete a validation of a country partnership strategy final review for Cambodia soon. This could give more information on reasons for the drop. One DEC member wanted more study regarding the generally lower performance of portfolios in the Pacific, and viewed that these countries may need more field-based staff to manage these portfolios.

Staff continuity in project administration

Noting the AER's observations on this, DEC members expressed concern that average staff tenure on projects is less than two years and declining, while the average duration

of project implementation is six years or longer. DEC members agreed that frequent staff changes are seen as important challenges in ADB-client relations; that staff should stay on projects longer; and, that the current Midterm Review action plan should pick up the issue of staff continuity. Staff shared that the ongoing action plan discussions had touched on the need for team leaders to stay on with the project for at least three years, but this would be a challenge given the constant stream of projects coming in and limited staff resources. Staff also cited the vacancy-driven promotion system, which makes it difficult for divisional directors and department heads to retain staff seeking promotion opportunities. Other staff members present thought the situation had improved from some years ago where staff turnover in projects was almost every year. Another staff member was of the view that the situation is being managed better than before through greater collaborative work across teams.

Management Action Record System (MARS)

DEC members noted the weaknesses reported by the AER on actions recorded in the MARS. Noting that the system is now being migrated to eOps from Lotus Notes, a DEC member inquired whether there is scope to integrate MARS information in other aspects of project management (e.g. quality at entry reviews, etc.). DEC members also picked up on some suggestions in the AER such as, public reporting of MARS actions, and the suggestion that Management should consult with IED when formulating action plans. One DEC member was not in favor of public reporting of MARS actions due to reputational risks associated with disagreeing views on the follow up to certain recommendations, and which could affect the constructive dialogue between IED and Management. The same DEC member opined that IED and management should closely consult with each other on agreed actions and that any deviations should be reported to DEC and Board members. Staff expressed that communication and coordination with IED had improved over the years starting with the evaluation approach paper. A draft of the report is then circulated for interdepartmental comments and a subsequent head of department meeting is held before the report would come to DEC and Board. Staff stressed that there are alternative ways to improve the quality of the action plan and its implementation other than making consultation with IED mandatory. The DEC Chair suggested that it may be prudent to inquire about current practice of other multilateral banks in this regard, while noting the importance of showing ADB's commitment to performance and effectiveness publicly. DEC members appreciated the AER's suggestion to make a better distinction between recommendations and lessons, the former needing to be actionable and short term, the latter being more long term.

The DEC Chair inquired whether there is a coordinating system in place within the offices of the directors general to ensure that MARS actions are followed through. He also suggested including regular reporting on follow-up actions as part of DEC meetings starting in 2014, to fill the gap between the time of the recommendations and the time of the due date of the follow up actions. Staff from operational departments confirmed that a coordinating system is in place not only across regional departments but also among sector and thematic experts. The Office of the Managing Director General plays an active role in coordinating MARS actions and follow through, although the idea is to have a focal person in every department. IED suggested discussing follow-up actions in DEC and referred to last year's positive experience with its follow-up meeting on the real-time evaluation of the multitranché financing facility. Staff suggested that if DEC introduces such reporting, DEC may find it more useful to do it on a case-by-case basis rather than across the board, focusing on such instances as where management and IED have differing views, or if DEC has serious concerns about how the matter is handled. The DEC Chair indicated he will discuss options with

other DEC members and reach a decision in close consultation with SPD and the incoming managing director general.

Environmental sustainability and the role of subsidies

Addressing the views expressed by IED in its opening statements, staff reported that environmental sustainability considerations are very much part of project preparation through the environmental impact assessment process. ADB's Economics and Research Department is in the process of updating its guidelines on the economic analysis of projects to account for environmental externalities and include illustrative approaches to capture them. A key issue in the update will be the social cost of carbon and how best to incorporate this in the cost benefit analysis. Staff explained that ADB does not usually take into account subsidies, given that there are producer and consumer subsidies. However, the revised economic analysis is expected to include ways to address this issue.

Inclusive growth and private sector operations

A DEC member encouraged IED to state ADB's contribution to inclusive growth differently, stating that the indirect impact of infrastructure projects under pillar 1 (accelerating economic growth) is more important than recognized by IED; and that ADB's support for pillars 2 and 3 interventions (those improving access to opportunities and providing social protection, respectively) was not 'limited' as the AER had stated, as it comprises 30%-40% of financing. He also viewed that inclusive growth should be evaluated at the country level and not at the individual project level or ADB portfolio level. The DEC member also stressed that IED should evaluate private sector operations performance on the basis of its demonstration effects, and whether they are replicable, instead of its direct and short term poverty reduction impact. IED explained that the AER did not say that the support for pillars 2 and 3 was limited, but 'more limited' than the support for pillar 1. Furthermore, all three pillars have a key role to play in promoting inclusion.

CHAPTER 1

Introduction

1. Moving towards mid-2014, the world economy has not yet fully recovered from the global economic crisis that erupted in 2008. New crises of a less economic nature have come to the forefront which, if not contained, may have ramifications for the world order as much as for developing countries in Asia and the Pacific. The crisis in Ukraine is the most challenging of these, in its impact on the relations between some of the most powerful countries in the world. In Asia, the political developments in Thailand—themselves related to increasing urban-rural and other social disparities—may throw the country's economy off course, with ramifications for surrounding economies. Asia and the Pacific will also benefit from good neighborly relations between the countries of the region, and the deteriorations in several places should not be allowed to worsen.

New crises have come to the forefront

2. Several important national elections were held recently, such as in Pakistan, Bangladesh, Afghanistan and India, or are coming up, notably in Indonesia. 2014 is a crucial year for Afghanistan in particular, marked by the likely withdrawal of all or most coalition forces, notably those of the United States (US).

3. Other noneconomic developments are of a more insidious nature, like the continued and increasing frequency of disasters triggered by natural events such as, in 2013, the major flood and typhoon disasters in north India and in central Philippines. Carbon dioxide (CO₂) levels continue to rise and, when crossing 450–550 parts per million, may lead to global temperature increases beyond 2°C–3°C. The rise in CO₂ and other emissions is becoming very dangerous in places, as air pollution in and around Beijing and in Delhi continues unabated and now significantly exceeds safe levels many days of the year. The synthesis of the Fifth Assessment Report of the United Nations Intergovernmental Panel on Climate Change (IPCC) will be issued in October 2014 and is keenly awaited. Recent reports issued in March and April 2014 are again more confident about human influence on climate change and the damage incurred by it.

4. These events form a dynamic context for the Asian Development Bank's (ADB) development and implementation of country strategies and projects. The relevance of ADB's program and ultimately its impact is dependent on how these events play out. What follows here is an account of progress in economic growth made in 2013 in the world and in the developing Asia-Pacific region—again to set a context for not only a subsequent discussion of ADB's operational performance but also later discussions of *inclusive* growth and *environmentally sustainable* growth.

A. Global Economic Growth

Global economy grew at the rate of 3.0%

5. In 2013, the global economy grew at the rate of 3.0% per annum, just marginally lower than the growth rate of 2012 (3.2%).¹ Following the 2008 global economic and financial crisis, the global economy has been trying to scamper back to a new stable trajectory. The 2013 economic performance embodied a number of significant changes across the spectrum of expectations—some anticipated, some apprehended and others unexpected. Notably, in 2013, the industrial production index exceeded its average recorded in 2007, before the global financial crisis.

6. Positive economic growth was registered by both the US (1.9%) and Japan (1.5%). The Eurozone also turned the corner in the second half and saw a reduction in the overall contraction (-0.4%, against -0.7% in 2012). Its economic performance was better in the second half of 2013. Nevertheless, output gaps remain in advanced economies as the actual performance is below their potential.

Developing Asia and the Pacific region continued to grow at 6.1%

7. Developing Asia and the Pacific region continued to grow at 6.1% per annum, i.e., twice the global rate of growth for 2013. The region has certainly contributed to pulling the global economy out of the recession. As the advanced economies have now resumed growth and final demand for goods and services is expected to firm up, prospects for developing Asian economies' continued growth have also improved.

8. The high point of the economic events in 2013, however, was the massive quantitative easing in the US, which was joined by Japan as well in March 2013. Both economies were flushed with unprecedented levels of liquidity to get them over the hump of recessionary forces. The generous flow of financial resources facilitated a better than expected performance in these economies, especially in inventory building.²

9. The easy money impacted the global financial flows. Some of these spilled over into developing countries and lent buoyancy to their economic performance. The extent of the impact of quantitative easing on Asia was revealed in full, when the US Federal Reserve announced tapering of quantitative easing in May 2013. Financial market volatility intensified. Asian financial markets have come under pressure, with stock markets falling and currencies depreciating, most notably in India and Indonesia.

10. In this milieu, inflation in advanced economies eased further in 2013 (1.3%) providing a stable investment environment. Soft global commodity prices continue to lighten pressure on consumer prices, allowing inflation to ease to 3.4% in developing Asia.

11. It is expected that most of the growth enhancing tendencies of 2013 will be further strengthened in 2014. The growth in the advanced economies will become firm. Final demand for goods and services will be better, and thus, will help with the economic growth of the developing economies. Uncertainty and volatility in the financial markets will be lessened as tapering takes place steadily, although reversal of financial flows will continue to expose some economies to volatility and uncertainty. On the whole, 2013 laid a foundation for a more robust growth except for those economies that had their structural weaknesses exposed after the tapering

¹ Data in this section are sourced from IMF. 2014. *World Economic Outlook Update—An update of the key WEO projections*. Washington, D.C.; and ADB. 2014. *Asian Development Outlook 2014: Fiscal Policy for Inclusive Growth*. Manila.

² Feldstein, M. 2013. "Looking Up in 2014" *Project Syndicate*, December 31. Feldstein notes that nearly half of the third quarter growth in the US was related to building inventories.

announcement. As mentioned, it is hoped that the Ukraine crisis will settle and not escalate.

B. Asia-Pacific Region Economic Growth

12. The developing Asia-Pacific region kept its pace of economic growth in 2013, as mentioned earlier. However, the underlying subregional make-up has changed significantly.³ Both domestic internal factors as well as external factors contributed to the growth performance of the region. Taking a medium-term view based on 2007–2012, the growth rate in the region is moving towards convergence. Some subregional features are briefly described below.

The underlying subregional make-up has changed significantly

13. The People's Republic of China (PRC) led the East Asia region by maintaining economic growth at 7.7% per annum, as in 2012. This was largely driven by enhanced infrastructure investment, and was broadly in accord with the policy guidance that sought to maintain minimum growth at least equal to 7.5%. Policy makers in the PRC are now trying to rebalance the economy gradually more towards consumption-led growth, besides maintaining financial stability in the face of deleveraging moves of the central bank. Efforts are also afoot to restrain borrowings by local governments. Policy reforms in the PRC are drawing global attention, as their impact is likely to be far reaching. Gross domestic product (GDP) growth should benefit from the upturn in developed countries, generating stronger demand for PRC exports despite continuing real renminbi appreciation and higher unit labor costs. GDP growth is projected to decelerate somewhat to 7.5% in 2014—the official target. Growth in Mongolia was boosted by highly expansionary fiscal and monetary policies to compensate for the marked slowdown in coal exports and mine development financed through foreign direct investment, which have been the drivers of growth in recent years.

14. In Southeast Asia, growth is generally moderating on account of several internal and external factors. The Indonesian economy is buoyed by domestic consumption. It faced external financial volatility related to the US Federal Reserve's tapering announcement. The Indonesian rupiah came under pressure, in addition to the lurking political uncertainties due to the impending national election. Consumption levels and tourism came under pressure in Thailand due to the continued domestic disturbances mentioned earlier. The Philippines lost some of its momentum due to the devastating Typhoon Haiyan (Yolanda), which left more than 6,000 dead in the Visayas region. Although many of the poor that were affected will not recover for many years, Haiyan's effects on the Philippine economy are expected to be more short term. The Association of Southeast Asian Nations (ASEAN) economy as a group continued to manage good economic policies but would benefit from a larger share of GDP being invested.

15. In South Asia, the Indian economy started bouncing back after a difficult 2012. The economy grew at the rate of 4.4% in 2013. It was helped by positive monsoonal rains, agricultural output and rebounding exports. Beside factors like chronic infrastructural bottlenecks, fiscal deficit, adverse current account, and lagging policy reforms, the economy was also exposed to international financial volatility, and the Indian rupee came under exchange rate pressure. Consumer price inflation remained stubbornly high, and put pressure on the domestic credit markets, impeding growth. India also had several floods to contend with in 2013, notably the Assam flood and the Uttarakhand flood in June, which left more than 5,700 dead. Political uncertainties in

In South Asia, the Indian economy started bouncing back after a difficult 2012

³ For details, see ADB. 2013. *Asian Development Outlook—Supplement*. Manila.

relation to the electoral process did not allow undivided attention to the much awaited structural reforms. Now that the political outlook has become clearer, the growth is likely to be higher in 2014. Political events continued to cloud policy reforms in Bangladesh, Maldives, and Nepal, with potential ramifications for economic growth.

16. In Central and Western Asia, Kyrgyz Republic (10.5%) and Turkmenistan (10.2%) grew faster than neighboring countries. The services sector in Kazakhstan is shoring up the economy. Turkmenistan benefitted by increased gas exports to the PRC. However, many regional countries are affected by uncertainties on account of developments in Afghanistan. These also added to the difficulties of Pakistan's economy. Apart from severe human loss, domestic social violence continued to frustrate policy resolve and development efforts. International tensions in relation to the Ukraine may weigh heavily on the Central and Western Asian economies and preclude better economic performance in the subregion.

17. The Pacific island economies grew at the rate of 4.8%, moderated from the earlier growth of 6.1% in 2012. Weaker international commodity prices are affecting the Papua New Guinea economy adversely.

18. Going forward, the emphasis in many countries of the Asia-Pacific Region is going to be on the continuation of structural reforms, whether second or third generation. These reforms can enable economies to position themselves for accessing newer technologies and to enhance the productivity of their resources. This potential is best realized in a stable environment and requires skilled and high quality human resources. More than 50% of Asia-Pacific trade is within the region. It can help the individual economies by tapping into the regional network and utilizing commercial opportunities. Mutually compatible policy reforms that promote trade and financial linkages, and render skills and talents mobile are critical for ensuring continued economic growth.

The emphasis in many countries is on the continuation of structural reforms

C. About This Report

19. The purpose of this 2014 Annual Evaluation Review (AER) is to inform ADB's Board and Management on Independent Evaluation's findings and views on ADB operational performance over 2013 and the follow-up given to evaluation recommendations that Management agreed to. Each of these will be discussed in a chapter. After the above roundup of mostly economic growth developments over the year that may affect present and future operations and demand for ADB support, the AER adds a chapter on the sustainability of ADB's energy operations, and one on the trade-offs and synergies between the dual agendas of inclusive and environmentally sustainable growth. The latter chapter presents a synthesis while it also integrates findings of several studies conducted over the past year, notably (i) ADB Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth, (ii) ADB's Support for Inclusive Growth, and (iii) ADB's Initiatives to Support Access to Climate Finance.

The AER continues to review sustainability issues connected with different types of ADB operations

20. The AER continues with a practice started last year to review sustainability issues connected with different types of ADB operations. This year's chapter on energy operations, after last year's chapter on road operations and road maintenance, presents new analysis on financial and environmental sustainability. The chapter also has attention for issues of inclusion by extending networks, the affordability of electricity to the poor, and the benefits of regional energy security. While ADB and the Independent Evaluation Department (IED) have in the past rated the sustainability of

completed operations mainly in financial, economic, and institutional terms, the chapter highlights that the sustainability of energy operations would need to be—and is—increasingly assessed from a climate change perspective.

21. IED has made recommendations in most of its evaluations and Management responds to these whenever a meeting of the Development Effectiveness Committee (DEC) is scheduled to discuss an evaluation. In addition, in the context of ADB's midterm review of Strategy 2020, IED presented a report to Management and the Board in February 2014 called *Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term*.

IED presented a report called Inclusion, Resilience, Change

22. That report brought to bear recent evaluation experience particularly in terms of inclusive growth, environmentally sustainable growth, private sector development, knowledge solutions, and the better use of ADB resources. Actions were suggested in seven vital areas to raise ADB's impact: inclusion, resilience, integration, governance, synergies, outcomes, and teamwork. These are elaborated on in chapter 5 of this AER on inclusive and environmentally sustainable growth.

23. In this context, the AER reviews recent evaluations but does not give new recommendations for ADB Management. It offers analysis, lessons, and suggestions for operations and strategy development. The chapters on inclusive and environmentally sustainable growth and energy operations are intended for discussion because of their operational relevance. The AER hopes that Management and Board will consider the findings and ideas expressed. Appendix 1 offers a listing of all reports issued in 2013, with hyperlinks. Appendix 2 lists the Management Responses issued for 2013 reports and dates and subjects of DEC meetings held, also with the relevant hyperlinks.

The AER reviews recent evaluations but does not give new recommendations

CHAPTER 2

Assessment of ADB Operations

24. This chapter is split into four parts: performance of country programs, sovereign operations, nonsovereign operations, and technical assistance (TA) operations. The AER also offers a brief account of ADB's and IED's use of project ratings in Appendix 3, Linked Document A. The AER cautions that whereas country program analysis can include ongoing operations, the analysis of project operations relies on evaluations and validations of operations completed some time ago—the latest in 2012, but generally 2007–2012.

A. Performance of ADB Country Programs

1. Performance of Project Portfolios by Country

This year's AER looks more at country program performance and trends by country

25. ADB's 2013 *Development Effectiveness Review* (DEFr) paid much attention to trends in sector program performance and that analysis is not repeated here. This year's AER looks more at country program performance and trends by country. Table 1 presents the success rate of portfolios in countries where at least 10 projects approved from 2000 to 2010 have been completed and have a project completion report (PCR).⁴ Success rates by approval year offer some information about possible trends in the quality of design over time, although any developments in the quality of implementation are also sure to play an important role in performance.

26. The table shows that the portfolios of ADB-supported operations (mainly loan operations, and some Asian Development Fund grant operations) for five countries/groups—Bangladesh, PRC, Viet Nam,⁵ the West Caucasus countries, and Tajikistan—have performed well above the DEFr's target of 80%. Their success rates range from 86% to 100%. Furthermore, the ADB programs for India, Indonesia, Lao People's Democratic Republic, and Nepal have also performed above the ADB success rate average of 69%. Programs for Bangladesh, Indonesia, Nepal, and Tajikistan have done well compared with a decade ago.⁶ Programs in PRC and Viet Nam, already performing well in the 1990s have kept up their performance.

⁴ Not all PCRs were validated; unvalidated PCRs include the most recent from 2012 and 2013 and those approved prior to 2007.

⁵ Especially the portfolios of completed projects in Bangladesh and Viet Nam await further validation (validation rate of 47% and 39%, respectively).

⁶ Such a trend is the combined result of a number of factors. For instance in Tajikistan, several factors contributed to this observation, e.g., type of projects (more recent portfolio dominated by infrastructure), strong ownership by the government, and centralized project management units (for all externally funded projects) in the cases of transport and energy. Another factor could be the role of the resident mission, which was established in 2003.

27. This discussion, however, suffers from a basic problem that independent evaluation plans to address, viz. the use historically at ADB and IED of the results of self evaluation and validation together. As this will be corrected from the coming year onwards, caution is in order in looking at the figures in Table 1, particularly for country programs with a relatively low validation percentage. Historically this would imply the possibility that their success rate based in large part on self evaluation is overstated. This means that the success rates reflected for Bangladesh, Kyrgyz Republic, and Viet Nam for example, could be too high and could later be adjusted once more validations are in.

**Table 1: Success Rate by Country for Sovereign Projects
Approved 1990–1999 and 2000–2010 (2000–2010 Sorted by Success Rate)**

Country/Group	Operations ^a Approved in 1990–1999				Operations ^a Approved in 2000–2010			
	Number Approved	Number of PCRs	Success Rate (%) ^b	% Validated	Number Approved	Number of PCRs	Success Rate (%) ^b	% Validated
Bangladesh	48	47	72	47	52	19	100	47
China, People's Republic of	68	65	86	31	89	40	98	58
Viet Nam	24	23	92	57	58	28	93	39
West Caucasus ^c	-	-			18	11	91	73
Tajikistan	3	3	67	67	19	14	86	57
Nepal	27	27	63	41	24	14	79	64
Indonesia	87	84	61	39	44	26	77	73
India	33	29	68	52	60	20	75	50
Lao PDR	25	25	72	52	22	15	73	73
Cambodia	11	11	82	55	29	19	68	53
Sri Lanka	33	32	66	38	40	23	65	61
Philippines	50	49	44	39	24	17	65	53
Kyrgyz Republic	12	12	83	50	16	11	64	27
Uzbekistan	4	4	50	75	25	15	60	93
Afghanistan	-	-			12	10	60	60
Mongolia	18	17	65	88	16	13	54	69
Pacific Countries	55	52	45	27	49	31	45	65
Pakistan	44	42	56	33	56	46	26	76
All Countries	602	578 ^d	67^e	42	693	392	69^f	61

- = no program, PCR = project completion report, Lao PDR = Lao People's Democratic Republic.

^a Operations can be based on one or more loans or Asian Development Fund grants.

^b The latest rating is used, from PCR or project performance evaluation or PCR validation report.

^c Armenia, Azerbaijan, and Georgia.

^d Of projects approved in 1990–1999, 24 do not have PCRs. Fourteen projects were cancelled/lapsed/terminated, six were technical assistance loans, the two remaining projects had supplementary loans with PCRs expected in 2014. One loan is under compliance review and one has no PCR but had disbursements of \$50 million in 1996.

^e For the 244 validated PCRs and projects evaluated combined, the success rate was 64% (15% of PCRs had their ratings downgraded).

^f For the 239 validated PCRs and projects evaluated combined, the success rate was 59% (12% of PCRs had their ratings downgraded).

Source: IED. Based on success ratings recorded from PCRs, PCR validation reports, and project performance evaluation reports when available.

28. Pakistan had the largest portfolio of completed projects but the lowest success rate (26%). As was argued in the recent evaluation of the program, some bad design decisions may have been taken, particularly in the period from 2002 onwards, with the results of improvements after the spring cleaning in 2007–2009 set to kick in only now.

Pakistan had the largest portfolio of completed projects but the lowest success

29. The below-average performance of the Pacific portfolio hides some better country cases (Cook Islands and Solomon Islands).⁷ Worrying is that the data on completed projects in the 1990s and 2000s reflects a performance that seems to be not

⁷ The Cook Islands and Solomon Islands programs both have 100% success with two and three PCRs issued in the 2000s, respectively. (Appendix 6, Linked Document C).

improving.⁸ The three PCRs under preparation in 2013 were not completed by year-end. The assessment can be updated in 2014 and reported in next year's AER. Two portfolios that declined in performance and need to be watched are Cambodia and Mongolia.

2. Country Strategy Assessments Done in 2013

30. In 2013, Independent Evaluation assessed the results of four country partnership strategies (CPSs) in the South Asia and Central and West Asia regions, and one in Southeast Asia. There was a major country assistance program evaluation (CAPE) for Pakistan, and furthermore there were validations of ADB's CPS final review reports for Bhutan, Georgia, India, and Nepal.⁹ In the Southeast Asia program the final review for the Thailand program was validated. These validations were triggered by the need to prepare new CPSs, as the older ones had expired.¹⁰

ADB programs for the six countries were rated successful, except for the Pakistan program

31. ADB programs for the six countries were rated *successful*, except for the Pakistan program, which was rated *less than successful*, as the preceding portfolio analysis had already made likely (Table 2 has a summary of the country ratings). There was a critical Management Response to the Pakistan evaluation,¹¹ and the DEC discussed it in a meeting in December 2013. Forty-two country evaluations have been conducted since 1998. The success of this year's set of country program evaluations is somewhat better than the historical success rate reported by such evaluations (65% for successful or better from 1998 to 2012). Given the recent high success rates so far given (partly validated) to portfolios such as for Bhutan, Georgia, India, and Nepal, the positive validations of ADB work should not come as a surprise. The following paragraphs summarize assessments of the two largest portfolios: Pakistan and India. Similar summaries of assessments of the smaller Bhutan, Georgia, Nepal, and Thailand programs are available in Appendix 3, Linked Document B.

Table 2: Country Performance Ratings (Overall Assessment and Rating by Criterion)

Country	Pakistan	Bhutan	Georgia	India	Nepal	Thailand
Overall Assessment	—	+	+	+	+	+
<i>Criterion</i>						
Strategic Positioning	+	+	—	+	+	+
Relevance	—	+	+	+	+	—
Efficiency	—	+	—	+	—	—
Effectiveness	—	+	+	+	+	+
Sustainability	—	+	+	+	—	+
Development Impact	—	+	+	+	+	+
ADB Performance	—	+	+	+	+	+

+ = performance was within expectations, — = performance was less than what was expected.

Sources: IED. 2013 completed country assistance performance evaluations and validations of country partnership strategy final reviews (except for Georgia, where validation was made for the Final Review of the country's Interim Operational Strategy. Approval of its first Country Partnership Strategy is expected in 2014).

⁸ The success rates for Fiji Islands and Tuvalu have similarly fallen from 100% in the 1990s (one completed project each) to 50% in the 2000s (two completed projects each). The Samoa program had a 50% success with four PCRs.

⁹ Validations of CPS final reviews include document reviews; discussions with relevant headquarters staff; and a field mission (of generally 2 weeks) to consult with governments, development partners, and ADB resident mission staff, and to conduct some field observations.

¹⁰ Of the six country programs evaluated in 2013, IED already prepared CAPEs for four: Bhutan (2010) *successful*, India (2007) *successful*, Nepal (2009) *less than successful*, and Pakistan (2007) *less than successful*.

¹¹ Management disagreed with the rating of *less than successful* for the transport program, and argued that ADB's ongoing policy dialogue on public sector management reforms was not well reflected in the report.

32. **Pakistan.**¹² This evaluation was requested by the Board and Management largely because the DEfR had for several years reported poor project success rates. IED confirmed the generally poor performance of the \$11.6 billion program approved over 2000–2012 in Pakistan and saw it in part as reflecting the difficult country context. Domestic political and social turmoil and insecurity were two important causes identified.¹³ ADB's project designs, particularly those relying on consultants to deliver implementation, did not fully factor in the difficult security conditions that constrained or made national and international consultants reluctant to work there. Coordination among federal, provincial, and local governments was also seen as particularly problematic; other, more permanent issues affecting project performance were disparities between ADB and the country in the areas of procurement and safeguard standards and practices. But, within ADB itself, two departmental reorganizations had also negatively affected operations, and various strategic shifts in thematic and sector priorities, as well as the approval of new modalities and products over the period, which had been taken on board enthusiastically in ADB's Pakistan program.

IED confirmed the poor performance of the \$11.6 billion program approved over 2000–2012 in Pakistan

33. Country performance was also influenced by an across-the-board spring cleaning exercise over 2007–2009.¹⁴ The exercise led to the quick closure of many loans, and more PCRs, especially those rated *unsuccessful* or *less than successful*. The rationale for this major spring cleaning is corroborated. It improved portfolio quality, which would have been far worse otherwise, and resulted in a leaner, more focused and manageable portfolio for the future. While spring cleaning proved the right step, Independent Evaluation questioned decisions on some loan cancellations/closures that may have prematurely ended development outcomes that could have been realized had ADB continued its support. This may be viewed as a lesson for the future, i.e., spring cleanings will need to be treated with utmost care and with full involvement of the government (including executing agencies). A second major point of the evaluation was that the large attention given to the national governance agenda of a particular government over the period had been too challenging in retrospect, given also that it led to complex program loan operations.

34. Amid the challenges, ADB still made headway in the privatization and profitability of the Karachi Electric Supply Company, boosted private sector investments in power generation, and contributed to the stability of the power system with the completion of some transmission and distribution projects.¹⁵ ADB's persistence of effort in the energy sector over the past 20 years or so was particularly appreciated, since other development partners had wavered more. During the 2005 earthquake and widespread floods in 2010–2012, ADB aptly and effectively responded through emergency assistance for disaster recovery as well as livelihood restoration. Several community-level development projects in agriculture and water supply and municipal services had tangible poverty reduction results, showing that this kind of interventions can work in a difficult context. ADB operations in the finance sector contributed to the growth of the mutual fund and voluntary pension fund industries.

Amid the challenges, ADB still made headway

¹² IED. 2013. *Country Assistance Program Evaluation: Pakistan (2002–2012). Continuing Development Challenges*. Manila: ADB.

¹³ The program also faced natural disasters in 2005 and 2010–2011, and the national and to some extent global financial crisis around 2008–2009.

¹⁴ Pakistan requested ADB to cancel and close slow moving and non-performing projects (at risk) that it believed could not be sustained.

¹⁵ Still, these achievements were obscured by considerable rolling blackouts, underutilized independent power producers, and derated public power sector plants. This had in turn to do with the government's policy to charge below-cost-recovery tariff, and with insufficient power generation.

35. Given the risks in Pakistan linked to extreme natural events as well as the poor human development conditions, and to gaps in public services provision, the evaluation called for a more inclusive program. ADB needs to pursue investments that deliver visible development impacts to the poor, and reduce vulnerability to disasters. ADB was requested to expand its work on urban and municipal services and social protection, and to strengthen the country's disaster response capability. The evaluation also recommended pursuing structural reforms in Pakistan through sector-specific initiatives using a programmatic approach, which means an extended time frame and considerable staff resources. Lastly it was recommended to review its energy strategy including reform achievements, given the still serious structural problems, and explore options such as hydropower development (provided safeguards are fully adhered to), natural gas pipelines, and further privatization. ADB was cautioned, meanwhile, about conducting comprehensive spring cleaning of portfolios across the board, as the Pakistan case had shown that this can easily and inadvertently lead to cutting the effectiveness of some project loans that are prematurely closed. Extensive consultation is also needed, and careful assessment of gains versus losses.

36. **India.**¹⁶ The validation assessed ADB's \$8.6 billion support over 2009–2012 at a time when the country was experiencing macroeconomic imbalances from the global financial crisis coupled with domestic economic issues. Fiscal deficit, low foreign direct investment, inflation, and tightening of monetary policy were leading to slower economic growth. To support the government in addressing binding constraints to growth, two-thirds of ADB operations in the country focused on energy and transport infrastructure. The validation corroborated that ADB's energy support has improved capacity for reliable supply of electricity, operations efficiency, as well as the policy and regulatory environment for future investments. ADB's program also enhanced connectivity through support for highways, rural roads, and railways projects. A socioeconomic impact assessment in the context of rural road projects registered a 9% increase in employment and 2.5 times increase in per capita income, a decline in the number of people below the poverty line, and improvement in school attendance and health indicators in the states of Assam, Chhattisgarh, Madhya Pradesh, and Orissa.

Knowledge solutions have been a notable feature of ADB support in various sectors in India

37. Knowledge solutions have been a notable feature of ADB support in various sectors in India.¹⁷ In agriculture, for instance, project designs included a legal and institutional agribusiness framework that supports a value-chain approach, viable public-private partnership arrangements in postharvest and marketing infrastructure, highly productive and efficient irrigated agriculture, and environmentally and socially friendly coastal protection solutions.

38. The validation recommended that ADB strengthen its strategic programming discussions directly with state governments, enhance synergies and impact of its program by pursuing better results linkages and partnerships with others, increase ADB staff in the field, prepare a framework to synergize ADB's public-private sector operations in the country, and improve the monitoring of the CPS results framework, development impacts and sustainability.

3. Lessons from 2013 Country Partnership Strategy Assessments

39. Lessons highlighted the importance of (i) addressing sustainability, (ii) strengthening efforts to promote poverty reduction and inclusion, (iii) integrating

¹⁶ IED. 2013. *Validation of the Country Partnership Strategy Final Review for India (2009–2012)*. Manila: ADB.

¹⁷ ADB also pursued the government-initiated Finance ++ approach, under which projects became more effective by bringing new knowledge solutions, practices, processes, and know-how to India operations.

disaster risk management, (iv) doing vulnerability assessments for CPSs, and (v) developing realistic strategies and programs in politically turbulent countries.

- (i) **Promoting sustainability in country programs.** Four of the six country assessments found some evidence of countries generating a more sustainable stream of program benefits. In Georgia the effects of appropriate tariff increases were noted, in Bhutan the effects of sourcing of potential revenues to finance operation and maintenance costs, in India the effects of government commitment and support to the same, and in Thailand the effects of a high level of private sector involvement.¹⁸ On the other end, low sustainability of program achievements proved detrimental to developments in Nepal and Pakistan.¹⁹
- (ii) **Promoting poverty reduction and inclusion.** This batch of country assessments noted the development divide that runs across states and provinces and between urban and rural areas (and primary cities and secondary towns). Independent Evaluation emphasized the need to strengthen ADB's inclusive growth orientation for the Thailand program by having explicit inclusion strategies, looking at vital areas for program synergies, and improving clarity of objectives in targeting the poor at the project level (see Chapter 5). Inclusion also implies gender equity, and analysis and actions in this area can also be strengthened, notably in CPSs and the monitoring of country gender strategies.
- (iii) **Integrating disaster risk management.** Country assessments highlighted the need to include disaster risk management in country programs especially for flood and earthquake prone countries (Thailand, Pakistan, Nepal, and Bhutan). In addition to relief and recovery, adequate and sustained disaster risk reduction programs should be given special attention.
- (iv) **Need for vulnerability assessments in CPSs.** These would be useful especially for investment programs, and would help ensure that risks are appropriately dealt with. Some departments have already made progress in this area. The South Asia Department has been applying a climate change risk screening system analyzing site-specific natural hazards and climate-related risks to project investments. The process then identifies potential adaptation options to reduce adverse impacts. This resulted in climate and disaster risk screening of 30 projects in 2013, with 14 projects having an adaptation action report included as supplementary appendix to the report and recommendation of the President to guide detailed design and implementation. In Nepal, this screening tool has been applied at relatively low cost and has been effective in ensuring that climate change and disaster risks are taken into account in ADB operations.
- (v) **Realistic strategies and programs in politically turbulent countries.** While there is no fixed approach to dealing with countries with high levels of political turmoil, the evaluations noted the importance of (i) careful use of policy-based lending, given the likelihood of policy reversals, e.g., in Pakistan; (ii) building consensus within fragmented institutions, e.g., in Thailand; and (iii) ensuring a focused policy agenda, e.g., in Nepal. These factors indicate the need for more realistic expectations in policy dialogue and policy lending in unstable countries. In 2012, IED pointed to the need to treat Afghanistan as in conflict, rather than in a postconflict situation.²⁰

¹⁸ These marked improvements in sustainability ratings from previous assessments for Bhutan and India.

¹⁹ Previous country assessments for Nepal and Pakistan also raised sustainability as an issue in most of its sector programs.

²⁰ IED. 2012. *Country Assistance Performance Evaluation: Islamic Republic of Afghanistan*. Manila: ADB.

40. Some of these lessons further substantiate findings and recommendations that IED articulated in its recent midterm review of ADB's Strategy 2020.²¹

B. Performance of Sovereign Operations

41. A notable feature of this year's analysis is the upward trend noted in the performance of sovereign operations. The assessment is based on (i) the ratings provided by independent evaluations of operations and validations of PCRs conducted in 2013, and (ii) the ratings for completed operations approved in the 1990s and the 2000s. In the past, these validated ratings have been used in conjunction with the ratings of self assessments. Even as there will be a switch to the use only of validated ratings in the coming year, it is noted here that self assessments show a stronger improvement in two more respects: (iii) the ratings of recent – mostly unvalidated – PCRs issued in 2011–2013, and (iv) ADB's ratings of projects under implementation in 2013.

1. Improvements as per Recent Independent Evaluations

42. IED completed 8 project evaluations and 60 PCR validations for sovereign operations in 2013—around 18% each in agriculture and natural resources and in water and municipal infrastructure and services, 16% in transport, and information and communication technology (ICT), 13% in education, 9% in public sector management, and 7% in energy. The rest of the operations evaluated were from the finance, multisector operations, industry and trade, and health and social protection sectors.

Sovereign operations independently evaluated or validated in 2013 yielded a success rate of 68%

43. Sovereign operations independently evaluated or validated in 2013 yielded a success rate of 68%. This was better than the 62% success rate in 2012 and the 47% success rate in 2011. Two factors may have constituted this improvement in 2013: (i) increase in the number and success rate of evaluated transport operations, and (ii) improved success rate for evaluated operations in agriculture and natural resource management, energy, and industry and trade. Whether ADB is also improving long term can be assessed by comparing the success rate of completed operations approved in the 1990s with those in the 2000s.

2. Long Term Improvements, as per a Mix of Ratings of Independent Evaluations and ADB's Self-Evaluations

44. In last year's AER, sovereign operations approved from 1990 to 1999 and those approved from 2000 to 2010 (and completed so far) had the same 67% success rate for projects with validated PCRs or independently evaluated.²² With the addition of information from 48 unvalidated PCRs, 60 project completion report validation reports

²¹ IED. 2014. *Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term*. Manila: ADB.

²² These assessments are based on aggregates of the latest rating of projects as evaluated by PCRs, project completion report validation reports (PVRs), and project performance evaluation reports (PPERs). This was also done in last year's AER, and the larger number of observations now available, particularly for operations approved in 2000–2010, enhances the analysis, while providing backward comparability with the findings of the previous AER. The decade of approval of the sovereign operations is used as the unit of measurement, as this increases the representativeness of the success ratings. Given the relatively small sample of projects independently assessed, especially up to 2006, trends based on annual success rates are far harder to establish with certainty. The approach comparing two decadal slices of operations also permits analysis of projects prepared under similar institutional strategies, directions, and practices. Caution is needed, as evaluations and validations in several periods within the 1990s and 2000s covered only a portion of the total portfolio completed (40%–60% of the total, see also Table 1), and no adjustment factor was applied to the non-evaluated—so the real success rates presented are likely to be somewhat lower than presented here, particularly those of the 1990s.

(PVRs), and 8 project performance evaluation reports (PPERs) completed in 2013, the success rate of operations approved over 2000–2010 has increased to 69%, suggesting an improvement in the success rate for operations in the latter half of the decade (Table 1).²³ Sixty-seven percent of operations have been completed, practically all of which have a PCR (99%) and 61% of which have been subsequently validated or evaluated. The information on decadal success rates is presented here to enable comparison with last year's AER, which used the same method. Going forward, the AER will use its validations and evaluations as the only source of aggregate ratings and may no longer add unvalidated PCR ratings for the assessment of recent trends.

3. Improvements as per Self-evaluations from 2011 to 2013

45. Although most of the PCRs of especially 2012 and 2013 have not yet been validated by IED, their ratings are of interest, particularly for trend analysis. The success ratings improved from between 67% and 70% in 2007–2010 to 79% in 2011, 88% in 2012 and 94% in 2013 (Box 1). Assessing project success trends from the angle of the PCR completion year is the method adopted for the DEFfR. Apart from the clear upward trend, two things are however notable: (i) PCRs completed in the last 2 years in particular have rated projects much more often successful than in previous periods, and (ii) validations by IED have historically come to lower ratings than self-evaluations.

46. The reasons why recent PCRs have rated more operations as *successful* are yet to be investigated fully. A smaller number of PCRs produced in 2013 than usual may have led to a result that could be an outlier.²⁴ On the other hand, there may be an improvement in rates over a significant dip in performance recorded for the past few years, due to factors such as project readiness filters applied to new operations over the past years. However, the 2013 DEFfR did not note any improvements in contract award or disbursement ratios.

47. The success rates IED has recorded based on its own ratings for projects with PCRs in the 1990s upto 2011 have, at between 57% and 76%, not been of the same order as those of the last two annual batches of PCRs. There may be special factors that support higher PCR success rates during 2012–2013: (i) an increase in the number of transport PCRs, which are usually more successful; (ii) a decrease in the number of PCRs from the historically lower performing agriculture sector portfolio (but which also showed some improvement in success rate); (iii) disappearance of Pakistan PCRs from the 2013 PCR harvest; and (iv) no PCRs in 2013 for the Pacific portfolio. The PCRs of 2012–2013 showed large improvements in success rates, especially for projects in energy, finance, multisector, public sector management, and water, and this portfolio accounted for almost half of all PCRs rated. Validations in 2014 will further shed light on whether such improvements are indeed of the magnitude now seen.

48. IED plans to clear the backlog of PCR validations built up in 2014, and will aim to validate PCRs in the same year that they are circulated. Given that validations require considerable work and consultations, IED is proposing to ADB Management that PCRs be circulated to IED no later than end-August. This will allow IED sufficient time to get a good sector-stratified sample and do the validation work until end-December. If this

There may be special factors that support higher PCR success rates during 2012–2013

²³ In the 2013 AER, 75% of the amount approved was rated successful in both decades. This year, 76% of the amount was successful in 2000–2010. Neither the improvement in the value nor in the number of successful operations can be guaranteed at the 95% significance level.

²⁴ This is partly due to Management accepting PCRs only up to end-September 2013 to avoid bunching—the year before it accepted PCRs up to end-October. The main reason seems to be simply a smaller set of completed operations having been targeted for PCRs in 2013 (52), as fewer operations were closed.

is agreed upon, then both the DEfR and AER should be able to report the same success rates in the year after.²⁵

Box 1: Success Rate Trends by Project Completion Report Circulation Year
Sovereign Operations Rated by ADB and IED, and their Success Rates
2000–2006, 2007–2010, 2011, 2012, and 2013

PCR Circulation Year	Independent Evaluation			
	ADB PCR	PPER	PVR	PPER+PVR
Number of PCRs (% of PCRs validated or evaluated)				
2000–2006 (29%)	408	119	0	119
2007–2010 (94%)	261	30	216	246
2011 (71%)	76	0	54	54
2012 (16%)	67	0	11*	11*
2013 (0%)	48	0	0	0
Success Rate (%)				
2000–2006	74	67	0	67
2007–2010	68	67	55	57
2011	79	0	76	76
2012	88	0	55*	55*
2013	94	0	0	0

ADB = Asian Development Bank, IED= Independent Evaluation Department, PCR=project completion report, PPER=project performance evaluation report, PVR=PCR validation report.
 *Too small and incomplete sample; will be completed in 2014.
 Note: IED began validating PCRs in 2007 from an initial 100% coverage to 75% from 2012.

The gap between the success of self- and independently evaluated operations was 7% (74% versus 67%) for PCRs circulated from 2000 to 2006. This increased to 11% (68% versus 57%) for PCRs during 2007–2010. Caution is in order, as the samples are different. Only 16% of PCRs circulated in 2012 have been validated, and none from 2013. While ADB's Development Effectiveness Review (DEfR) applies average adjustment factors for unvalidated PCRs, past practice has been to apply this only to the percentage that would be eventually validated. Also, it is not guaranteed that the factors will remain the same in the next years. The experience with validation is just 6 years old, and fluctuations in adjustment ratios between years have been large. The PCRs' current success rates are much higher than in the period 2006–2010 and before. As mentioned, IED has also registered some likely improvement in the success rates produced by its recent evaluations and validations. But it is not certain that the adjustment for PCRs of 2012 and 2013 will be the same as the past average.

Source: IED database.

IED is not involved in monitoring the progress of ongoing projects

49. The discussion so far has focused on completed operations. IED is not involved in monitoring the progress of ongoing projects, except in some countries where it happens to conduct a country program evaluation or a validation of a CPS final review document. ADB's DEfR 2013 includes an indicator on project performance of sovereign operations at implementation. It rated 7% of operations in 2013 as off-track, and a further 14% as having a potential problem. This mainly concerned disbursement problems. No problems were reported in any of the projects in the 2013 portfolio with respect to safeguard issues or on technical dimensions. The performance was better than in 2012, when 11% of operations were rated off-track, and 20% had a potential problem. Although the finding is in line with the earlier reported broad improvement in success rates, Independent Evaluation flags that it does not fully match the findings of the admittedly small sample of country evaluations conducted in 2013, which rated four of six country programs assessed as *less than efficient*. IED suggests that ADB's

²⁵ In 2014, IED will clear its backlog of PCRs circulated in 2012 and 2013. For 2015, IED expects to validate PCRs circulated in 2014 along with the 2015 batch of PCRs. On the latter, IED will aim to validate a statistically significant proportion of PCRs (75%–80%) in the same year that they are done.

implementation rating system and the needed regular updating of eOperations by project officers may need looking into.

5. Lessons from Evaluations of Individual Public Sector Operations

50. Lessons drawn from eight project evaluations conducted in 2013 are consistent with IED's midterm review finding that ADB needs to pursue a triple bottom line of fostering simultaneously economic growth, social inclusion, and environmental sustainability. The project evaluations and their ratings are briefly indicated in Box 2.

Box 2: Performance Evaluation Reports Completed in 2013 for Sovereign Operations

China's Gansu Clean Energy Development Project—rated *highly successful (highly relevant, highly effective, highly efficient, most likely sustainable)*. Hydropower development provided a low-cost, clean energy source that improved the dependability of electricity supply and contributed to improved air quality (closure of two coal-fired generating units). Its rural distribution component generated socioeconomic benefits to small townships.

Cambodia's Commune Council Development Project—rated *successful (highly relevant, effective, efficient, likely sustainable)*. The project enabled effective management of the democratic development of communes in post-conflict Cambodia with the provision of basic commune infrastructure for administrative services, civil registry system, geographic maps for rational planning, and capacity development for front-line local officials.

Indonesia's Decentralized Health Services Project—rated *successful (relevant, effective, less efficient, likely sustainable)*. The Project led to improved access to primary, district, and provincial health services, including in remote and rural areas.

Papua New Guinea's Smallholder Support Services Pilot Project—rated *successful (relevant, effective, efficient, likely sustainable)*. The project aimed to increase access of smallholder households to agricultural support services. While results of the pilot project were positive, its full potential was not achieved. Given the nature of the project, focus should have been on learning rather than output targets.

Viet Nam's Vocational and Technical Education Project—rated *successful (relevant, effective, less than efficient, likely sustainable)*. The vocational and technical education system was oriented towards a market driven approach. Better results could have been achieved if management capacities of agencies had been taken into account better.

Pakistan's Punjab Road Sector Development Project—rated *less than successful (relevant, less than effective, efficient, less than likely sustainable)*. While the roads were able to generate good impact, no progress was achieved on institutional development. The project was beset with quality at entry concerns, inappropriateness of loan modality, inadequate maintenance allocations and lack of enacted legislation addressing overloading.

Pakistan's Road Sector Development Program—the policy loan was rated *less than successful (less than relevant, less than effective, less than efficient, less than likely sustainable)* while the project loan was rated *successful (relevant, effective, efficient, less than likely sustainable)*. Program design and time allotted to implement the reforms, particularly in road safety and axle load control, proved inadequate. Several policy conditions were not met. There were delays in meeting tranche release conditions. Inadequate outcomes of the reforms in asset preservation made the program less likely to be sustained. Only physical subcomponents met the expected results, not the institutional.

Source: Independent Evaluation Department.

ADB needs to pursue a triple bottom line of fostering simultaneously economic growth, social inclusion, and environmental sustainability

51. The following are key points:
- (i) **Need for optimizing inclusion in growth projects.** Several evaluations have suggested actions to raise the impact further as also articulated in IED's recent midterm review of ADB's Strategy 2020 (footnote 21). On top of the 102-megawatt (MW) hydropower development, the Gansu Clean Energy Development Project successfully gave attention to local communities with the provision of rural electrification, construction of community clinics and schools, and improvements in rural roads that gave women better access to health and education facilities as well as employment opportunities. The evaluation also recognized the project's contribution to poverty reduction in the area (along with other government investments and community initiatives).²⁶ Support to provincial roads in Punjab and Sindh included improving connectivity of the poor through better rural access roads. Notwithstanding implementation issues, the road improvements were able to benefit 3 million inhabitants in Punjab and 5 million in Sindh, mostly poor. Road improvements have ensured better access to markets, economic centers, social services and amenities.²⁷
 - (ii) **Need for good geographical targeting.** This can also enhance inclusion. The evaluation of the health project in Indonesia recognized that ADB support was able to improve access of a greater number of people (including those in remote and rural areas) to primary, district and provincial health services. However, greater impact could have been achieved at the provincial level had investments been more focused on fewer provinces—using poverty and health needs in the government's strategic investment choices.²⁸
 - (iii) **Need for good nongeographical targeting.** In increasing the access of disadvantaged student to education, the evaluated vocational and technical education project in Viet Nam could have deepened its support to school policies to attract poor and ethnic minority students. Value was seen in supporting the provision of scholarship grant and transportation and living cost subsidies, as well as school activities that would facilitate student integration (however, the report also favored geographical targeting in some fields).²⁹ A demand driven approach in the pilot project on smallholder support services in Papua New Guinea proved to be beneficial to farmers as the process led to not only the identification of their local development needs but support from local leaders to address these as well. Unfortunately for this pilot project, ADB had since stopped lending for agriculture projects in the country.³⁰

6. Decentralization of ADB Operations

52. A 2013 evaluation on ADB's decentralization progress discussed whether further operational effectiveness and efficiency gains can be made, and if so, how, given existing resource constraints.³¹ The study found a significant expansion in resident missions' (RMs) network and activities, which had helped raise ADB's profile and country focus. It also noted the successful performance of a small number of

²⁶ IED. 2013. *Performance Evaluation Report: Gansu Clean Energy Development Project in the People's Republic of China*. Manila: ADB.

²⁷ IED. 2013. *Performance Evaluation Report: Punjab Road Development Sector Project in Pakistan*. IED. 2013. *Performance Evaluation Report: Road Sector Development Project in Pakistan (Sindh)*. Manila: ADB.

²⁸ IED. 2013. *Performance Evaluation Report: Decentralized Health Services Project in Indonesia*. Manila: ADB.

²⁹ IED. 2013. *Performance Evaluation Report: Vocational and Technical Education Project in Viet Nam*. Manila: ADB.

³⁰ IED. 2013. *Performance Evaluation Report: Smallholder Support Services Pilot Project in Papua New Guinea*. Manila: ADB.

³¹ IED. 2013. *Decentralization-Progress and Operational Performance*. Manila: ADB.

projects processed by RMs. However, although RMs potentially hold good advantages relevant to project administration, a significant correlation between RM administration and project success could not be established. Thorny methodological issues may play a role (difficulty in establishing a counterfactual, among others).

53. **Progress in decentralization.** From 2000 to 2012, there was notable progress in that there was a significant expansion of RMs, their number more than doubled from 13 to 27, and their staff increased more than fourfold from 162 to 682. However, the bulk of the activities pertaining to project operations are conducted in ADB headquarters in Manila, and that is also where most decisionmaking authority resides. As of 2012, about 90% of projects were processed and 60% administered from headquarters. Most knowledge activities were also conducted in headquarters. Compared with similar regional multilateral development banks, ADB has the lowest percentage of field staff, fewer operational activities, and less authority delegated to its RMs.

From 2000 to 2012, there was notable progress in that there was a significant expansion of resident missions

54. **Expanded resident mission functions.** RMs take the lead in and effectively perform standard functions like stakeholder relations, policy dialogue and support, country reporting, aid coordination, and external relations and information dissemination. They also take the lead in specific functions such as country programming and portfolio reviews. Perception surveys indicate that RMs have effectively performed country program work. RMs were more engaged in project and TA processing and administration in 2012 than in 2007 and 2000. By 2012, all RMs were performing functions beyond their mandates at establishment and more functions than in 2007.³² However, RMs generally act in a support role in operations (except for delegated projects) through back-up or follow-up support to headquarters, and in economic and sector work (except for the Asian Development Outlook and selective economic and sector reports), which is largely centralized in headquarters. They have a limited role in knowledge activities and weak knowledge interactions with headquarters (e.g., communities of practice [CoPs]). Capitalizing on RM's close proximity to stakeholders and knowledge of the local context and systems, they can serve as ADB's front line experts.³³ Feedback from government staff acknowledged RMs' country knowledge and responsiveness and indicated a desire for RMs to be more involved in project design and knowledge products.

55. **Value added to ADB operations.** The small number of projects processed by RMs is not sufficient to make statistical inferences regarding project success. Nevertheless, the high success rate of projects processed by RMs (as compared with those processed in headquarters), suggests the need for revisiting a concern against delegating project processing to RMs.³⁴ Factors contributing to project success included active dialogue with stakeholders, advance procurement action, simplified approval procedures for contract awards and good rapport with the government that facilitates discussions on project designs and risks early on. Regression analysis of data of completed projects also found several factors that have a significant effect on project performance. These are monitoring and oversight during project implementation,

The high success rate of projects processed by RMs suggests the need for revisiting a concern against delegating project processing to RMs

³² These include local capacity development, promotion of subregional cooperation, project monitoring and evaluation, knowledge management, and participating in private sector operations.

³³ RMs' limited exposure to knowledge activities means lost opportunities such as serving as a conduit for communicating country needs and ensuring demand-driven knowledge products and services, and as an ideal venue for sharing knowledge products and services across developing member countries on a just-in-time basis.

³⁴ During 2000–2012, RMs processed 90 projects. Thirteen (11 public sector management projects and 2 multisector projects) had completion or validation reports, with 11 (85%) being rated *successful*. During the same period headquarters had 302 completed projects, of which 192 were rated *successful* (64%).

borrower's project ownership and performance, and political stability within the country—areas that RMs can deal with better than headquarters can during implementation, to ensure project success. One factor in the analysis that supported this was the experience of the RM – older RMs had higher levels of project success.³⁵

56. The study discussed issues that constrain effective ADB services and operations.³⁶ First, clients perceived ADB's operational processes to be complicated and cumbersome, as different departments/units are involved in the project cycle. Second, the timing of project delegation in year 1 or 2 seems to break the continuity of project dialogue and adversely affects implementation activities and performance.³⁷ Third, operational approaches were observed to vary little across regions and individual countries despite variations in development context, needs, and priorities. Finally, apprehensions were raised on career progression and the need to improve information technology in RMs (e.g., eOperations, eTrip, and computing infrastructure).

57. The study made several recommendations. In moving forward with decentralization, ADB needs to strengthen the technical capacity of its RMs and empower them with more core business activities, responsibilities, and authority. Operational support functions like procurement, disbursement, and safeguards should be delegated to regional departments or RMs. ADB needs to use differentiated RM models and types to make operations and business processes more relevant and responsive across countries, development contexts, and operational priorities. Such models can include regional technical hubs (for small and remote countries as in the Pacific and West Asia), joint offices with other development partners (like the ones with the World Bank for some countries in the Pacific), and possibly also field offices additional to country RM offices in the capital cities (for geographically large countries). For knowledge activities, because of their inherent economies of scale, headquarters should continue to take the lead.³⁸ However, to improve services, ADB is advised to increase headquarters-RM connectivity and to get RMs more involved in knowledge management, i.e., identifying, generating jointly with headquarters, and sharing in and across countries. RM participation in the CoPs needs to increase for this, as well as partnering with local think tanks and interactions with headquarters, other RMs and development partners.

ADB is advised to increase headquarters-RM connectivity and to get RMs more involved in knowledge management

7. Findings on Staff Tenure Data from 2013

58. Based on special work done in the context of IED's PVR exercise, the AER reports this year again on trends in staff tenure and their effects on project performance. Data on staff tenure were taken from IED's 295 PVRs produced so far (Appendix 3, Linked Document C). It was found that PVRs done each year record lower staff tenure averages, from 1.9 years on average per project administration officer per project for PVRs done up to end-2011, to 1.8 years for PVRs done up to 2012, and 1.7 years for PVRs done up to 2013. This is a worrying trend, given that continuity in administration arrangements is often suggested to promote a positive context for project implementation.

PVRs done each year record lower staff tenure averages

³⁵ The regression analysis was based on IED's database of 344 completed projects approved since 2000 for which PCR were prepared by 2012.

³⁶ The evaluation based these on perception surveys and interviews with ADB staff, governments, and clients.

³⁷ During 2007–2012, projects were delegated to RMs on average 2.4 years after project approval.

³⁸ The midterm review reconfirmed the need for decentralization and for empowerment of RMs with more technical capacity and authority in order for them to be more engaged in ADB operational activities. The South Asia Department has initiated steps to establish a regional hub in the India RM.

59. Regression analysis done this year for an expanded database of 405 completed projects, which included the information of all PVRs and a sample of project monitoring reports, confirmed a positive though weak relation between average length of staff tenure in a project and project success. The range of number of officers per project was from 1 to 10. An average of 3.8 officers (and median of 2.8) handled a project during the implementation period. The average time an individual project officer spent on a project was 1.8 years. A pairwise correlation test conducted between project success and number of staff turnovers suggested a modestly negative relationship between these two parameters.³⁹ This confirms that frequent staff turnovers adversely affect project success (66% in the sample), albeit many other factors must also play a role (for instance the performance of the executing agency). As noted in the 2013 AER, operations departments have commented that staff turnovers cause discontinuities in project implementation and in client relationships. Comparison with World Bank data showed that the average staff tenure in World Bank projects was about 2.5 years (and 2.4 project officers per project), against a satisfactory outcome rate of 73% in the sample.

Frequent staff turnovers adversely affect project success

C. Performance of Nonsovereign Operations

60. Nonsovereign operations are an increasingly vital part of ADB's portfolio, with a considerable potential for helping shape strategy and results. IED completed 20 evaluations of nonsovereign operations in 2013: 2 PPERs and 18 validation reports of extended annual review reports (XARRs)⁴⁰. This was a big increase from 2012, when IED completed only five. The 20 comprised 12 finance and 8 infrastructure operations. The finance operations consisted of equity investments in four private equity funds and loans or guarantees to eight financial institutions. The infrastructure operations involved an equity investment and loans to one telecommunications company and seven energy companies.

61. **Overall ratings.** Of the 20, 6 were rated *highly successful*, 5 *successful*, 5 *less than successful*, and 4 *unsuccessful*. The success rate of 55% for the 20 projects evaluated in 2013 compares with the 68% success rate for the 31 projects independently evaluated from 2006 to 2012, and the 80% success rate in the Private Sector Operations Department's self evaluation; IED validated the ratings of 5 XARRs with *successful* ratings as *less than successful*.⁴¹ Noteworthy is that the 8 infrastructure projects evaluated in 2013 had a validated success rating of 100% while the 12 finance projects had a 25% validated success rate. (The latter figure compares with a 46% success rate reported for finance sector operations in the public sector over 2010–2012 and a 62% success rate for 2011–2013 as per the 2013 DEF_R [taking into account historical downgrades which still have to be verified]). The main criteria used to evaluate nonsovereign operations are development outcomes and impact, ADB investment profitability, ADB work quality, and ADB additionality.

The success rate of 55% in 2013 compares with the 68% success rate from 2006 to 2012

62. **Development outcomes and impact.** All 11 projects that had positive ratings in outcomes and impact had *successful* or *highly successful* overall ratings while all 9 projects that had negative ratings had *less than successful* or *unsuccessful* overall

³⁹ The p-value is 0.0932 (significant at the 10% level). The correlation coefficient is -0.0835.

⁴⁰ They are listed in Appendix 1; for reasons of confidentiality they are not individually referred to here.

⁴¹ From 2006 to 2012, 26 XARRs were validated and 5 PPERs were prepared for projects that did not have an XARR. Five *successful* XARRs were validated as *less than successful* (a downgrade of 19%). An additional seven XARRs were downgraded from *highly successful* to *successful*. For 2013, aside from the five *successful* XARRs that were validated as *less than successful* (a downgrade of 25%), one *highly successful* XARR was validated as *successful*, while two *successful* XARRs were validated as *highly successful*.

ratings. The subcriteria used to assess development outcomes and impact are: (i) contribution to private sector development; (ii) business success; (iii) economic development; and (iv) environmental, social, health, and safety performance.

63. All six projects that were rated excellent in private sector development were also rated *excellent* in development outcomes and impact. These projects had notable demonstration effects and contributed substantially to private sector expansion, competition, improved functioning of markets, new business practices, and institutional development. Six projects—three investments in private funds and three loans to financial institutions—had negative ratings in this category. One fund did not have the expected catalytic and demonstration effects while the other two’s contribution of the other two toward increasing the supply of risk capital was limited as they were underinvested. Financial institutions were not able to expand their small and medium enterprise (SME) lending activities as planned, in part because of the global financial crisis, which led to less lending to smaller companies, but more importantly because they did not have in place the strategies, policies, products, and systems to pursue this market segment effectively. The ratings of three XARRs were downgraded due to Independent Evaluation finding their contributions to private sector development less significant than the XARRs found them.

All nine projects with negative ratings in development outcomes and impacts also had unsatisfactory ratings in business success

64. All nine projects with negative ratings in overall development outcomes and impacts also had *unsatisfactory* component ratings in business success. Four of these were equity investments in private equity funds—two had negative financial internal rates of return (FIRRs), one failed to make any investment, and one had an FIRR that was below the fund’s weighted average cost of capital (WACC). The failure of these funds was attributed mainly to the poor performance of their respective fund managers. The five other projects were loans or guarantees to financial institutions, four of which were to banks in a Central Asian country adversely affected by the global financial crisis in 2007. The evaluations noted, however, that ADB performed poorly in screening the banks for their creditworthiness.

65. Eight of the nine projects that had negative ratings in business success also had negative ratings in contribution to economic development as their economic internal rates of return (EIRRs) were below the threshold 10% EIRR for a satisfactory rating.

66. Seventeen of the 20 projects had positive ratings in environmental, social, health, and safety performance. Two financial institutions failed to fully comply with environmental reporting requirements and, therefore, received *less than satisfactory* ratings in this category. Another project was given a “no rating possible” because the fund failed to make any investment.

67. **ADB investment profitability.** Six of the 20 projects were rated *unsatisfactory* in this category, 4 of which were equity investments in private equity funds. The other two were financial institutions that defaulted on their loans. Fourteen projects had positive ratings—2 *excellent* and 12 *satisfactory*—indicating that the projects had FIRRs or returns on invested capital that were higher than their respective WACCs. All eight infrastructure projects had positive ratings for ADB investment profitability. There were four instances when ADB investment profitability was positively rated, with borrowers fulfilling their obligations to ADB in line with loan or guarantee terms even though business success was *less than satisfactory*.

68. **ADB work quality.** Eight projects were rated *less than successful* in this category. ADB performed poorly in screening, appraisal, and structuring in seven projects—three

private equity funds, three financial institutions, and one energy project. In the case of the private equity funds, ADB did not do a good job in choosing the fund manager, in structuring the fund, or in assessing the viability of the funds. For the financial institutions, ADB could have more rigorously assessed the operations, practices, and creditworthiness of the borrower banks, two of which defaulted on their loans. For the only infrastructure project with a negative rating here, ADB work had material shortcomings in economic evaluation, technical due diligence, and financial analysis.

69. ADB performed well in the other subcomponents of ADB work quality—85% of the evaluated projects had positive ratings in monitoring and supervision and 95% in role and contribution.

70. **ADB additionality.** ADB performed very well in this category, with 7 projects rating *excellent*, 11 *satisfactory*, and only 2 *less than satisfactory*. In the projects that had positive ratings, ADB finance was seen as a necessary condition for the timely realization of the projects, either directly or indirectly by providing sufficient comfort to attract private financiers. For one of the projects that was rated *less than satisfactory*, ADB participation was critical to the establishment of the fund. However, a positive additionality rating could not be justified, because the fund did not make any investment. In the other negatively rated project, the ADB loan to the financial institution was not deemed necessary, as there were other major international financial institutions that provided not only financial support (debt and equity) but also TA.

71. **Trends in performance.** On a cumulative basis, the success rate⁴² of the 51 projects evaluated from 2006 to 2013 was 63%. The 3-year moving average success rates of nonsovereign operations based on their approval years has been erratic over the years in part due to the low number of approvals until 2005. Success rates also fluctuate due to the small numbers of XARRs and validations each year. A special reason for the 55% success rate in 2013 may be that the assessments on which it is based covered a relatively large number of finance sector operations approved in 2006 and 2007, years in which more such operations were approved than before or after.

The success rate of the 51 projects evaluated from 2006 to 2013 was 63%

72. The 51 evaluated projects represent 42% of the 122 projects approved from 1994 to 2008 that were subject to independent evaluation⁴³ using the new criteria.⁴⁴ Of the 71 projects that have not yet been independently evaluated, (i) 23 have XARRs, but no validations or evaluations were prepared as of 2013 including for the 18 XARRs of 2013; (ii) 20 have reached early operating maturity, but no XARRs were prepared as of 2013; and (iii) 28 had not reached early operating maturity as of 2013.

73. Of the 20 projects evaluated in 2013, a couple including a telecommunication transaction were assessed as having directly promoted greater inclusion, and 5 energy projects environmentally sustainable growth. Through its village phone program, the telecommunication project had provided employment opportunities for women, who

⁴² Success rate is defined as the percentage of projects with overall ratings of *successful* or *highly successful* over the total number of projects evaluated for the period.

⁴³ 122 of the 189 nonsovereign operations projects approved from 1994 to 2008 were subject to independent evaluation using the new criteria; the 67 excluded were (i) 37 cancelled projects with no disbursements made; (ii) 19 projects that are dated and/or have data issues; (iii) 8 projects that have already been evaluated but using the old evaluation criteria; and (iv) 3 ADB contributions to the Asian Finance and Investment Corp.

⁴⁴ Prior to 2006, nonsovereign operations were evaluated like sovereign operations, using the criteria of relevance, effectiveness, efficiency, sustainability, and impact. Starting in 2006, the new criteria for evaluating nonsovereign projects, which are intended to harmonize ADB's practices with those of other Evaluation Cooperation Group members, consist of development impacts and outcomes, ADB investment profitability, ADB work quality, and ADB additionality.

served as village phone operators and at the same time provided telephone service to previously unserved areas of the country. Two of the five energy projects supported the use of clean fuels for commercial, industrial, and domestic use, while the other three supported the use of renewable energy sources (wind). All five were *successful* or *highly successful*.

D. Performance of Technical Assistance Operations

74. IED concluded two performance evaluations of TA clusters in 2013.⁴⁵

75. **Facility-type TAs in the PRC.** The evaluation of facility-type TA in the PRC was started in 2012.⁴⁶ The modality allows quick and flexible responses, as multiple subprojects can be prepared on short notice under the same TA umbrella and can be proactively aligned with emerging national development priorities and issues.⁴⁷ It was pioneered in 2003. ADB has provided six such TA operations to the PRC with a cumulative approved amount of about \$5.6 million. These TA activities rely on dedicated staff in the Ministry of Finance and provide a novel mode of engagement and partnership to contribute to the government's policy reforms and capacity development efforts. This approach to supporting key national macro and sector work has been successful, but requires significant technical support from the RM, which could be provided in this case. If ADB's RMs are able to accommodate such labor-intensive support, then facility-type TA can be a highly successful model that ADB can use for similar engagement in upper- and middle-income countries with relatively strong TA management capacities and a clear need for international perspectives and close interactions with RM specialist staff.

If ADB's RMs are able to accommodate labor-intensive support, then facility-type TA can be a highly successful model

76. **Governance and accountability TAs in Pacific island countries.** The evaluation on Strengthening Governance and Accountability in Pacific Island Countries looked into a two-phased regional TA operation (comprising \$1.6 million for Phase 1 and \$1.9 million for Phase 2) aimed at improving governance, transparency, and accountability in the management and use of public resources.⁴⁸ The TA was to help operationalize the ADB Second Governance and Anticorruption Action Plan, specifically developing governance risk assessments, and supporting regional efforts to strengthen governance and accountability, in particular public auditing through supreme audit institutions.

77. The TA was rated *successful* overall. It met two immediate outcomes on (i) improving governance and anticorruption orientation of CPSs and projects, and (ii) designing a regional program for cooperation and capacity development for supreme audit institutions. But, it was short on a third, viz., enhanced timeliness, standards, and impacts of public audits along with improved capability. This proved to be overly ambitious, as the intended time frame was short, and most supreme audit institutions had low capabilities at the beginning of the TA period. In addition, the timeliness of audits and their use were not solely within the control of the institutions. Future challenges relate to (i) dearth of trained and qualified staff in the audit institutions and

⁴⁵ IED prepares at least one TA performance evaluation report every year. It does not validate Management's completion reports of TAs which numbers around 150 per year. In 2014, IED is conducting an evaluation of a cluster of TAs supporting the social security and pension system in the PRC.

⁴⁶ IED. 2013. *Performance Evaluation Report: Facility Type Technical Assistance in the People's Republic of China*. Manila: ADB.

⁴⁷ Under the five most recent facility-type TA operations, 89 subprojects addressed 11 ADB themes and sectors. Social protection and health, capacity development, environment, governance, and regional cooperation and integration accounted for just over 70% of the use of funds.

⁴⁸ IED. 2013. *Performance Evaluation Report: Strengthening Governance and Accountability in Pacific Island Countries*. Manila: ADB.

the related high staff turnover and absences, (ii) outdated audit methods, (iii) inefficient governance arrangements, and (iv) legislation that does not provide appropriate independence for the audit function. The evaluation recommends continued capacity development support through the Pacific Association of Supreme Audit Institutions, with more targeted support to the weakest institutions.

78. **Learning from evaluations of TAs.** Independent Evaluation drew several lessons from the experience: (i) the need to ensure that project components serve the same overall purpose (these were very dissimilar in the Pacific case); (ii) the need for ample consultations for such TAs during formulation and implementation; and (iii) having realistic project expectations, taking into account the need for a longer implementation period given that capacities are low and variable and there are, especially in the Pacific, many factors not within the beneficiaries' control.

79. A common lesson from this year's TA evaluations is the value of strong and continued support among key stakeholders and development partners so that achievements are built upon and gradually extended. Given that the process as led by RMs enables better ownership by the government, facility-type TA can help formalize the discussion of knowledge products and services in country programming exercises (particularly in middle-income countries). The Pacific audit institutions also benefited from strong ownership. The Pacific Association's members approved a new strategic plan that incorporates the findings of the IED review in September 2013. In November 2013, ADB approved a phase II TA to extend further support to the Pacific Regional Audit Initiative.⁴⁹

80. Later in 2014, an evaluation will be presented on the role of TA in ADB. This will more comprehensively assess the performance of various kinds of TA, among which will also be project preparatory TA, capacity development TA, and policy- and research-related TA, whether regionally or country oriented.

The evaluation recommends continued capacity development support through the Pacific Association of Supreme Audit Institutions

⁴⁹ During interdepartmental review, the regional department stated that improved governance with reduced corruption could be facilitated by enhancing the capacity and creating an enabling environment for independent functioning of supreme audit institutions in the countries. To effect such a change, ADB needs government concurrence to (i) ensure the institutions' independence within that country's constitutional framework, and (ii) enhance the capacity to deliver on institutional mandates as outlined in (i). Any ADB initiative has to be sequential, and its outcome should be staggered.

CHAPTER 3

Follow-Up to Evaluation Recommendations

81. ADB Management and Independent Evaluation continue to implement and monitor agreed-upon recommendations through the Management Action Record System (MARS). This chapter presents the progress made on actions taken by Management in 2013. It draws on MARS entries and a mix of desk reviews and consultations with ADB operations units. The discussion is organized into two parts: First, an update will be given on recent trends in IED recommendations and Management's follow-up. Some highlights will be presented of the validation of Management's assessments of completed actions in 2013.⁵⁰ Second, a short update will be provided on developments after some major evaluations of the last 2–3 years.

82. Since the inception of the MARS in 2008, IED has used a Lotus Notes platform for it in order to track evaluation recommendations and their corresponding Management responses, action plans, and actions taken by Management.⁵¹ Over the years, its isolation from other ICT systems has inhibited readership and usage within ADB. Thus, an integrated solution has been designed to migrate to and host the MARS in the Oracle-based eOperations platform beginning in 2015.

*There is a need
for a more
meaningful
MARS process*

83. There is a need for a more meaningful MARS process. It is conceivable that a certain fatigue with the action plans may be leading to diminished care in either the design or follow-up reporting on actions, i.e., truly reflecting the spirit of recommendation and the agreement expressed in the Management response. This is also visible in the longer times needed to upload actions to the MARS. Based on processed data, assigned departments took longer to upload action plans beginning in 2012. ADB may wish to consider making its individual actions public, including the progress reported. IED for its part will make sure that the recommendations are as actionable as possible and "MARS ready." A more consistent distinction needs to be made between long-term lessons and recommendations that are more short term so that these become more directly actionable and are made suitable for the MARS. Some of the recommendations have been too long term and had better be worded as lessons in the future. IED is in the process of updating project and country evaluation guidelines on lessons and recommendations.

84. The Independent Evaluation Group of the World Bank is publishing the gist of the actions agreed upon for its major evaluations, alongside the Management response. It is also publishing a detailed review of all actions that are due over the year past in its annual Results and Performance report, along with Management's progress report and the validation of this report.

⁵⁰ ADB's Board and Management can look into MARS details as well, since it is an internal database system available to them.

⁵¹ Access to the MARS is available to ADB's Board and staff by typing "MARS" into the browser's URL space.

A. Overall Progress in 2010–2013

85. For the past 4 years, the MARS tracked 164 recommendations drawn from 38 reports on which a Management response was recorded. A reduction in the average number of recommendations for action per year from 49 during 2010–2011 to 34 during 2012–2013 shows a shift towards a leaner but more in-depth program of higher-level evaluations. In addition, IED also deferred several 2013 deliverables to enable timely completion of the earlier noted report on *Inclusion, Resilience, Change*, which was to accompany ADB's own midterm review of Strategy 2020. A more detailed analysis of the MARS is available in Appendix 3, Linked Document D.

86. Management continues to be, in principle, receptive to recommendations, as witnessed by a 90% acceptance rate from evaluations offered in 2013. With an average rate of 96%, the degree of formal agreement for the past 4 years has been very high.⁵² Yet ambiguities in recommendations, disagreements with parts of recommendations, and resource implications⁵³ have prompted Management to issue qualified acceptance for many recommendations (“yes, but”). This suggests that, while the nominal acceptance rate is near perfect (“Management agrees”), all sorts of qualifications made subsequently can effectively restrict or redefine the scope of recommendations (see Appendix 4 for many examples).⁵⁴ This then also gets reflected in the key actions formulated by individual departments implementing or coordinating the actions.⁵⁵ So far, the practice has been that Management has not involved IED in the formulation of its actions, only in the validation of progress reported on the actions taken, when these are done.

87. Over the past 4 years, there has been an average 7 percentage point difference in the implementation rates of actions as reported by Management and as validated by Independent Evaluation. Validation of 203 completed actions⁵⁶ on tracked recommendations from 2010–2013 concluded that 72% were *fully* or *largely implemented* in 2012–2013, which is somewhat lower than the 76% average during 2010–2011. The rate for *fully* or *largely implemented* actions as self-assessed by Management averaged between 80% and 82% over 2010–2013. *Partly implemented* actions as judged by Management have remained the same at 18% over the 4-year period, but validation of the self-assessments shows that the proportion of *partly implemented* actions slightly increased to 24% during 2012–2013 from 22% in 2010–2011 (Appendix 3, Linked Document D, Figure 1).

B. Highlights of 2013

88. In 2013, the disparity between self-assessment of the level of implementation of the actions and validation was more pronounced than before. The 13% difference between what ADB assessed (79%) and Independent Evaluation validated (66%) as *fully* or *largely implemented* was double that of the 4-year historical average. Independent Evaluation confirmed self-assessed ratings for 66% or 19 of the 29 completed actions, downgraded the implementation ratings for 10 (34%), and upgraded no ratings. See

Management continues to be, in principle, receptive to recommendations

The proportion of partly implemented actions slightly increased to 24%

In 2013, the disparity between self-assessment and validation was more pronounced than before

⁵² The degree of agreement by Management for both knowledge evaluations (96%) and country/region-specific evaluations (97%) is similarly high for 2010–2013.

⁵³ IED. 2012. *2012 Annual Evaluation Review*. Manila: ADB. Paras. 135–139.

⁵⁴ IED. 2013. *2013 Annual Evaluation Review*. Manila: ADB.

⁵⁵ Alternatively, formulated actions may benefit from Management decision to restrict or redefine the scope of recommendations in light of implementation realities (e.g., resource and country driven solutions).

⁵⁶ Pertains only to actions that reach their target completion dates. In the MARS, actions can be *fully*, *largely*, or *partly adopted* (means implemented), or *not adopted* (i.e., not implemented).

Table 3 for summary statements of the 29 actions completed and Appendix 3, Linked Document D, Table 6, for more analysis.

89. Further analysis of the various ADB and IED entries on action ratings in 2013 pointed to challenges in interpreting recommendations and Management responses, and in translating them into actionable outputs by concerned departments charged with the tasks. During the stage of securing Management commitment to recommendations, the restriction and redefinition of the scope of recommendations due had its effects on the rating process of some completed actions in 2013.

90. For instance, Management agreed to strengthen microfinance institutions by supporting market infrastructure development. Yet, it qualified that this will be done within a broader approach to financial sector development, as the role and scope of microfinance would vary based on the role of the existing mainstream financial system in a country. This broader scope contributed to an open-ended action, worded as "Financial Sector Development Community of Practice shall consult with the strategy department and other concerned departments to work out within the first half of 2013 an approach to follow up on the recommendation." Subsequently, IED adjusted the rating to *partly implemented*, given that efforts appeared occasional and limited.

91. ADB's planned actions are expected to have reconciled the expectations of the recommendation and the qualifications in the Management response. Some of IED's adjustments of the ratings in 2013 were prompted by misjudged implementation realities of ADB (i.e., country-level context, environment, capacity, operational reality, and prevailing circumstances) which eventually affected the results of its actions.

92. For example, Management agreed to take into account carbon emission effects in project design, review, and appraisal, but noted challenges in developing a suitable method due to the need to first improve current data. The recommendation offered a long-term solution that includes developing estimation tools in coordination with other agencies: exploring possible physical designs in partner countries; and possible incorporation of country-specific carbon emissions data in economic analysis, environmental assessments, and project selection. However, ADB subsequently set a very short (i.e., ambitious) period for implementation of the action. As the action was not yet fully implemented by the time it was due, IED validated it as *partly implemented* at the time of the targeted completion date. As mentioned, Independent Evaluation is not being involved in the translation of the Management response into actions. Another example is given in Box 3.

Table 3: Ratings on Actions on Evaluation Recommendations in 2013

Subject	Summary of Identified Actions by ADB Due in 2013	ADB	IED
Transport infrastructure and sector development	Prepare capacity development TA and projects to develop VIE transport (GMS)	+	+
	Provide support for reorganizing public works department (Cambodia)	++	++
	Work on road maintenance and operation system (Kazakhstan and Kyrgyz Republic), and a transport plan and privatization strategy (Kyrgyz Republic)	++	++
	Develop long-term strategic plans for capacity development of Pacific countries in coordination with other development partners (Pacific)	++	+
	Develop database on transport needs/performance and prices for infrastructure development; enhance capacity in economic analysis (Pacific)	+++	+++
	Continue ADB financing through TA; follow-up financing from World Bank, Australian Agency for International Development, and other partners (Pacific)	+++	+++
Tourism development	Continue implementing tourism project along GMS transport corridors; Integrate the approach into overall development of GMS economic corridors	+++	+++
	Build capacity and sustain learning programs; mobilize more support for this	+++	+++
Reducing carbon emissions	Develop, test, refine and mainstream a sound and relevant methodology for developing transport projects	++	+
Energy infrastructure and sector development	Promote renewable energy, clean fuels, and energy efficiency (GMS); develop small/mini hydro projects; address Electricité du Laos performance/capacity; develop capacity on water quality management; complete and make available a sustainability assessment tool; monitor Nam Theun 2 safeguards (Lao PDR)	+	+
	Implement TA to prepare a policy; assess renewable energy potential; provide financing mechanism for projects; assess transmission network (Bhutan)	++	++
Microfinance development	CoP to determine list of core metrics, and their use	+	+
	CoP will consult within ADB to work out how to follow up on:	+	+
	(a) focusing on client needs and demand		
	(b) strengthening support market infrastructure, and	++	+
	(c) refining the microfinance development strategy	+	—
Achieving MDGs	ADB to initiate a review of the project classification system	++	++
Social protection	Finalize the Social Protection Operational Plan	+++	+++
Country performance (Bhutan)	Assess institutional capacity through PPTA, and incorporate in next CPS	++	++
	Incorporate gender concerns in projects, TA, and the next CPS	+++	+++
	Reevaluate proper model to analyze rural road returns; achieve overall economic and resource efficiency in rural electrification; increase rural productivity and income opportunities in rural connectivity projects	++	++
	Undertake policy dialogue on O&M budgets; incorporate financing of maintenance equipment and TA in new infrastructure projects and next CPS	+++	++
ADF operations performance	Implement various plans as guided by the CPSs/COBPs and results frameworks	++	++
	Strengthen sector assessments on public sector management for CPSs	++	+
	Implement new CPS format with more focus on capacity development results	+++	+++
Multi-tranche Financing Facility performance	(i) Extend MFF expert panels until 2016; (ii) amend staff instructions; (iii) do training needs analysis; (iv) integrate training; and (v) begin MFF training	+++	++
	(i) Improve quality control procedures and reports on measures; (ii) include measures in annual report; (iii) require tranche processing meetings	+++	++
	(i) Devise criteria to cancel, discontinue, or postpone tranche approval when MFF performs poorly; (ii) include criteria in agreement with clients	+++	++
	ADB to work on reforms to improve project documentation; amend processes to ensure that information is accessible prior to approval of MFF loan	+++	++
Nepal irrigation	Address shallow tubewell subsidy through Agriculture Development Strategy; contribute to repair and rehabilitation, and new construction of tubewells	—	—

+++ = fully implemented, ++ = largely implemented, + = partly implemented, — = not implemented,

ADB = Asian Development Bank, ADF = Asian Development Fund, COBP = country operational business plan, CoP= community of practice, CPS=country partnership strategy, GMS= Greater Mekong Subregion, IED = Independent Evaluation Department, Lao PDR = Lao People's Democratic Republic, MDG = Millennium Development Goal, MFF=multitranchise financing facility, O&M = operation and maintenance, PPTA = project preparatory technical assistance, SR = self-assessment rating, TA = technical assistance, VIE = Viet Nam.

Source: Management Action Record System.

Box 3: Broad Recommendations Can Result in Actions that Are Partly Complied With

The 2011 evaluation of Asian Development Fund (ADF) operations^a recommended devising capacity development strategies at the country and sector levels. The justification was that support for capacity development had not achieved envisaged levels of institutional improvement, mainly due to unresolved issues related to sector policies, institutional powers, and incentives for change, which would need to be addressed on the basis of agreed-upon sector-based capacity development strategies. Cross-sector issues in turn would need to be addressed through more effective policy dialogue on public sector management reforms.

The Management response did not fully address the issue of the need for introducing capacity development strategies in ADF countries, but agreed that such strategies “could be better implemented by incorporating capacity development results in sector assessments, road maps and sector results frameworks.” The action plan subsequently read “Strengthen sector assessments, including capacity gap analysis, on public sector management to inform the country partnership strategies and business plans,” and referred to the use of some new guidelines and tools. Concrete quantitative targets were not set. Two years later, when the action was due, Management reported the progress as *largely implemented*, as (it argued) some seven country capacity assessments had been undertaken.

Validation found that the capacity assessments had indeed been done in seven countries (four of which were ADF countries) but as part of a TA on public sector management that was approved before the ADF evaluation, and that was administered by the Regional and Sustainable Development Department. The project was focusing on the strengthening of capacity gap analysis for the Public Sector Management sector only. The validation interpreted the action as dealing with sector assessments in general, and hence rated the action as *partly implemented*. With hindsight, the recommendation could have specified better that it was looking for self-standing capacity development strategies for all ADF countries, which were to be prepared at the time of the new CPSs. Management could have committed to this or not, and could have qualified the type of strategy, given resource constraints and other possible considerations. More discussion on the recommendation and the formulation of the action would have helped.

^a IED. 2011. *Special Evaluation Study on the Asian Development Fund Operations: A Decade of Supporting Poverty Reduction in the Asia and Pacific Region*. Manila: ADB:

Good coordination should achieve a better rating process and a more effective follow-up to recommendations

93. Diverging yardsticks between ADB’s self-assessment and independent validation of actions used for rating outputs also resulted in some ratings being downgraded. It is critical to overcome differences in interpretations among various parties, such as the authors of recommendations, Management responding to recommendations, individual departments formulating and/or implementing or coordinating the actions, and validators of the actions. Good coordination should achieve a better rating process and ultimately a more effective follow-up to evaluation recommendations. Management may consider involving IED more actively in the formulation of actions after the DEC meeting and in progress reporting, and in the wording of needed changes to actions, if circumstances change. This could then also lead to a more straightforward validation of the action versus the recommendation. One office in ADB could assume a coordinating and quality assurance role in the interpretation of recommendations and actions including their implementation. The office could also be involved in coordinating responses to evaluation approach papers, as disagreements on actions sometimes go back to disagreements on definitions and methodologies from the start. A review of the underlying causes of the 10 actions downgraded in 2013 indicates similar reasons as indicated in the 2011 and 2012 AERs (Table 4).

Table 4: Factors Explaining Non- or Partial Compliance of Actions Due in 2013

Particular	No. of Actions
a) Inadequate time to fully implement actions due to over optimism in setting implementation timeframes and/or open-ended targets	3
b) Need for further or continued actions due to external issues beyond ADB's control and/or aspects not considered in the planned action(s)	4
c) Some actions partly implemented or not implemented at all due to limitations in resources; multiple or open-ended targets suggested by the recommendation; and/or changes in business processes, policies, or priorities	3
Total	10

Source: Independent Evaluation Department.

C. Follow-up to Recently Completed Major Evaluation Reports

94. Independent Evaluation has completed 16 thematic and corporate evaluations over the past 4 years and at least 5 country program evaluations. Appendix 3, Linked Document E gives an update on the status of follow up to and developments after the issuance of some of these evaluations, notably the 2011 evaluation of ADB's Managing for Development Results (MfDR) agenda, and the 2012 evaluations of the microfinance strategy, ADB's response to natural disasters and disaster risks, the social protection strategy, the multitranche financing facility (MFF) modality, and knowledge products and services. It shows that good progress has been made with most of these topics, whether in response to the evaluations or not. It also shows some areas with continuing challenges.

Independent Evaluation has completed 16 thematic and corporate evaluations over the past 4 years

95. Progress on the MfDR agenda in ADB continues to be good, but the validation saw two areas for further improvement: (i) PCR formats need better distinction between output and outcome analysis, and (ii) a more systematic approach is needed to improve national and subnational data collection systems to inform strategies.

96. Some progress was recorded since the 2012 evaluation of ADB's microfinance development strategy, but there was only limited progress with the needed greater demand-side orientation of ADB microfinance interventions, and the needed strengthening of microfinance support institutions and market infrastructure. The recommendation to refine the microfinance strategy was validated as not implemented.

97. The recommendations flowing from the 2012 evaluation of natural disasters are being adhered to by ADB, and progress has been noted, although it is slow—new project designs could pay more attention to disaster risk mitigation than is done at present. Similarly, the recommendations from the evaluation of ADB's social protection strategy could be seen as under implementation, but the proposed reversal of the current approach, to address social protection in countries outside the context of a disaster or economic crisis response—the Strategy calls for this—is not clearly visible.

98. Progress is being made with the recommendations of the 2012 real-time evaluation of the MFF, such as in the areas of training and guidelines and project readiness criteria. Areas of further progress are the timely preparation of PCRs for completed tranches (preferably before or at the time of approval of new tranches) and the preparation of good new PCR guidelines for MFF tranches and MFFs as a whole.

99. Progress with the knowledge agenda in ADB has been moderately good since the 2012 evaluation. Less progress has been seen in the CoP network, which continues to face constraints, and coordination of knowledge products and services between RMs and headquarters. Knowledge activities should also be shown better in budgets.

CHAPTER 4

ADB's Energy Operations— Their Sustainability and Inclusion

Energy is a basic need

100. Energy is a basic need, whether for improving human well-being or for augmenting goods and services. Its availability is, hence, a prerequisite for furthering both growth and inclusive growth but it may be an issue in terms of its effects on the environment. Networks supplying energy need to be expanded to bring relief and business opportunities to the poor and to remotely located vulnerable populations. Energy also needs to be affordable. ADB's *Asian Development Outlook 2013*⁵⁷ stresses that true energy security for Asia rests on three pillars: the adequacy and reliability of the supply of energy, environmental sustainability, and affordable access. This triple nature of the energy challenge calls for a difficult balancing act. The region must actively contain its rising demand by increasing the efficiency of energy use while aggressively exploring new energy sources and technologies, and progressively promoting the regional integration of energy markets and infrastructure. Without a paradigm shift in current energy supply and use, Asia will struggle to deliver the inclusive growth needed to lift millions of its citizens out of poverty.

Energy is a good sector to start addressing climate change and environmental sustainability

101. This chapter focuses on ADB's energy operations and discusses the effects that environmental considerations, particularly climate change, have had on the portfolio. The addition of such a perspective is appropriate because the term "sustainability" has taken on a strong environmental meaning, while energy is widely accepted to play a pivotal role in climate change. Many other sectors of ADB investment may have strong linkages with climate change as well, such as agriculture, transport and water investments. However, the linkages in the energy program tend to be more direct and better documented. For example, project documents already routinely include a key climate change metric—tons of CO₂ equivalent emissions avoided—as well as other relevant indicators. This makes energy a good sector to start addressing climate change and environmental sustainability. The question is also urgent because developing Asia now accounts for more than 35% of global CO₂ emissions, and this share is set to increase significantly, primarily due to energy use.

102. Until now, ADB's energy portfolio has been one of the best performing in ADB's overall portfolio, as is illustrated in Table 5 for sovereign loan operations.

⁵⁷ ADB. 2013. *2013 Asian Development Outlook 2013*. Economics and Research Department. Manila.

Table 5: Sovereign Operations Completed in 2000–2013 Rated for Sustainability by Major Sector

Sector Program (operations rated)	Sustainable (MLS+LS) %	Breakdown by Category (%)			
		MLS	LS	LLS	US
Health and Social Protection(37)	86	8	78	11	3
Education (84)	80	8	71	15	5
Energy (83)	80	18	61	18	2
Transport and ICT (133)	71	8	64	26	2
Finance (65)	68	5	63	25	8
Multisector (67)	67	4	63	27	6
Industry and Trade (26)	65	15	50	23	12
Public sector management (56)	55	14	41	32	13
Agriculture and Natural Resources (166)	54	2	52	40	7
Water and Other Municipal Infrastructure & Services (94)	48	4	44	43	10
TOTAL (811)	65	7	58	28	6

ICT = information and communication technology, LLS = less than likely sustainable, LS = likely sustainable, MLS= most likely sustainable, US = unlikely sustainable.

Notes: There were 859 completed projects/programs in 2000–2013 based on PCR circulation. Forty-eight did not have the latest rating. Latest available ratings are used.

Source: IED database of completion report ratings, updated by IED ratings where available.

103. Possible reasons for the energy program’s comparatively good performance in ADB’s portfolio were described in the 2013 AER and can be briefly summarized here as being: more ADB experience and expertise available than for some other sector programs, fewer country agencies concerned with energy than with the comparable water supply sector, higher technical capacity of energy agencies, and greater control of electricity investments as they feed into a national grid. Notwithstanding, a question remains whether (self-) evaluations of individual energy operations in some countries have an optimism bias, given that in many of ADB’s countries, public sector energy provision remains highly subsidized, indebted, and experiencing leakages of various kinds, and—as a result—is a major drain on national resources.

104. This chapter is, however, more concerned with how this good performance stacks up when also considered more fully against environmental sustainability criteria, especially regarding climate change mitigation.⁵⁸ In addition, will the shift to a more climate-friendly portfolio have an adverse impact on its financial sustainability?

105. The chapter is a summary of a more comprehensive analysis that is included as Appendix 3, Linked Document F. Besides considering the possible interrelations of climate change sustainability with operations’ institutional and financial sustainability, this chapter will also briefly consider the possible trade-offs with energy security and affordability. These were the broad imperatives, besides environmental sustainability, highlighted in ADB’s *Asian Development Outlook 2013*.

Will the shift to a more climate-friendly portfolio have an adverse impact on its financial sustainability?

A. Impact of the Energy Portfolio on Climate Change Mitigation

106. The size and make-up of ADB’s energy portfolio has changed considerably over the years, especially since about 2008. In recent years this change has been driven in good part by Strategy 2020 and ADB’s Energy Policy of 2009, which offered new

⁵⁸ As a crude proxy we have focused here on climate change mitigation. Metrics are not consistently available for other environmental impacts of energy projects. In the future an effort should be made to systematically cover other environmental impacts (such as air and water pollution).

Nonlending operations have played a significant role in energy work

directions and guidelines.⁵⁹ In addition, there were more specific targets, such as the Asia Solar Energy Initiative announced in May 2010 which targeted support for 3,000 MW of solar power by 2013. Implementation of this policy change was facilitated by the establishment of the Clean Energy Financing Partnership Facility with ADB and other external support. The Facility allows for leveraging and catalyzing investments for clean energy projects and the implementation of pilot projects across the Region. Although this review focuses on loan operations, nonlending operations have played a significant role in energy work where ADB has used TA for advocacy of clean energy projects, capacity development, and demonstration of new technologies—often a prerequisite for future lending.

107. ADB has joined international efforts to monitor financing for climate change and the results achieved. As part of its effort, ADB began reporting the Clean Energy components of its lending in 2003 and set a target of \$2 billion in 2013 (which was achieved in 2011). The energy program is one of two sector programs that significantly expanded their share in ADB's financing over the 2000s, from 16% during 2003–2007 (\$5.8 billion) to 26% during 2008–2012 (\$16.8 billion).⁶⁰

108. In a sample of seven countries that account for more than 80% of ADB lending,⁶¹ the increase in average annual lending was almost 140% between 2001–2008 and 2009–2012. By far the larger part was for electricity supply and use—86% of the value of loans approved during 2001–2008 and 82% in 2009–2012.

The share of renewable energy and demand-side energy efficiency projects increased significantly

109. The changes in the composition of the portfolio have also been significant. The share of renewable energy (RE) and demand-side energy efficiency (EE) projects increased significantly, for both electricity and fuels.⁶² The share of RE and demand-side EE⁶³ went from 5% of ADB financing for electricity in 2001–2008 to 27% in 2009–2012. In terms of investment mobilized, their combined share went from 2% to 30%. For fuels, the share of RE (in the form of biomass wastes) and demand-side EE increased from zero to 43% (ADB financing) and zero to 38% (total investment mobilized).

110. At the same time, the share of lending for power generation from fossil fuels fell substantially, from 28% to 17%. While the share of natural gas-fired plants increased slightly (from 13% to 15% of financing), that of coal-fired plants collapsed from 15% to only 2% of financing. The change is even more stark if it is considered that, whereas in 2001–2008 three sub-critical (hence less efficient) coal plants were approved, the only coal-fired plant approved in 2009–2012 was an advanced coal gasification-combined cycle facility requiring substantial technology transfer.⁶⁴

⁵⁹ Policies do not emerge overnight. Strategy 2020 and the 2009 Energy Policy were themselves built from earlier initiatives, including the 2007 Energy Efficiency Initiative, a formal ADB effort with quantified lending targets, and the 2010 Carbon Markets Initiative which helped prepare for carbon financing of many projects over the subsequent few years. At about the same time, the G8 Glen Eagles meeting in 2005 also laid out the Clean Energy Investment Framework for the multilateral development banks.

⁶⁰ ADB. 2013. *Strategy 2020: Implementation Progress 2008-2012*. Manila: ADB.

⁶¹ The seven countries are: Bangladesh, PRC, India, Pakistan, Philippines, Thailand and Viet Nam.

⁶² By fuels/thermal energy we refer to supply of energy to consumers in the form of fuels or heat rather than electricity. It is important to carefully distinguish electricity from fuels when doing an evaluation. See IED. 2014. *Real-Time Evaluation of ADB's Initiatives to Support Access to Climate Finance*. Manila: ADB (Linked Document 5).

⁶³ Demand-side EE refers to EE measures with consumers (industries, commercial, residential households, etc.). Although EE measures may be associated with measures to reduce peak demand, the focus is on reducing energy use to perform an equivalent energy service. Supply-side EE improves the energy supply chain, for example, reducing transmission line losses, upgrading district heating networks, and retrofitting of old plants to generate power more efficiently.

⁶⁴ ADB approved a loan for a super-critical coal-fired plant in Pakistan in 2013.

111. The physical consequences of this shift have been substantial. The average annual energy output from ADB-supported coal-fired plants fell to one-thirtieth, while that from natural gas-fired plants tripled. Coal went from a large negative impact on net emissions savings (i.e., the plants' emissions per gigawatt hour [GWh] were higher than the average emissions per GWh of the country's power system—an indicator known as the average grid emission factor) to a small increase.⁶⁵ Natural gas-fired plants also seemed to become more efficient, since net CO₂ emission savings increased more than the output.

112. The output from other renewables (solar, wind, small hydro, and waste-to-energy)⁶⁶ and demand-side EE increased greatly from a very small base. Though their share of electricity output (GWh) during 2009–2012 was still modest, other RE and demand-side EE projects were, together, the largest source of CO₂ mitigation in the power sector, having increased fifteen-fold relative to the previous period. In the fuels/thermal energy sector, energy from wastes and demand-side EE increased from nothing to account for 20% of energy supplied-or-saved, and 52% of net greenhouse gas (GHG) emissions mitigation. The share of district heating, already a prominent area of financing in 2001–2008, also increased.

113. Table 6 summarizes the information available and adds some indicators that shed light on the expected performance of the projects and the impacts of the change in the portfolio. Two indicators of economic performance stand out. The annual energy supplied per unit of total investment mobilized by ADB lending (GWh/\$ million) fell by 44% in the power sector and 47% in the fuels/thermal energy sector. This decline implies that the new portfolio was, on average, substantially more capital intensive per unit of energy supplied-or-saved (to be expected given the increased share of renewables which, at the same time, have lower operating costs). On the other hand, GHG mitigation per unit of total power investment mobilized by ADB lending almost quintupled. The gross emissions per unit of electricity fell dramatically, by 62%. This led to a sharp increase in the emissions saved per GWh of electricity supplied, from only 39 tons of CO₂ equivalent in 2001–2008 to 345 in 2009–2012.

114. In the fuels/thermal energy sector the trends were quite different. There was not only a large decline in energy supplied per unit of investment, there was also a small decline in the indicator of GHG emissions mitigation per unit of investment mobilized. The decline does not necessarily mean that ADB's emphasis on clean energy has been less clear than in the electricity sector. In fact, the net emissions savings per unit of energy supplied increased significantly (see Appendix 3, Linked Document F).

115. ADB has contributed to the decline in overall grid emission factors in its countries in its loan operations. Beyond the RE technologies that have begun to be commercialized (such as wind energy), ADB has provided TA to support the introduction and demonstration of other potentially transformative clean energy

The annual energy supplied per unit of total investment mobilized by ADB lending fell

GHG mitigation per unit of total power investment mobilized by ADB lending almost quintupled

⁶⁵ The average grid emission factor is an acceptable methodology under the UNFCCC guidelines. This may not be the best counterfactual for all projects, but it is the most robust for comparing many dozens of projects over more than a decade in a large number of countries. In this review, it is important to maintain a consistent standard. The UNFCCC prefers project-specific counterfactuals for large power generation projects and ADB might apply this method. For smaller projects, however, like most renewable energy projects, the grid emission factor can be consistently applied. This would also be the case for transmission and distribution projects. So long as a justification for the specific counterfactual is made and the accounting of baseline and the project's own gross emissions is clear, this flexibility presents no problems. For additional detail, see Linked Document 5 (section B2) of the climate evaluation (footnote 84).

⁶⁶ Geothermal energy is also in this category, but there were no ADB projects using this from 2001 to 2012.

technologies such as carbon capture and storage, integrated gasification combined cycle, smart grid, concentrated solar power, and geothermal.

Table 6: Indicators for Investment Projects in Selected Countries with Quantifiable GHG Impacts

Item	2001-2008	2009-2012
Electricity (Power Generation and Demand-Side Projects)		
ADB's annual average lending in the period (\$ million) ^a	676	1,538
Annual average capital investment mobilized in the period (\$ million) ^a	2,672	3,910
Annual average energy supplied from ADB projects in the period (GWh)	14,421	11,908
Annual average GHG emissions of ADB projects (tCO ₂ e)	9,814,405	3,082,982
Annual average GHG emission savings (tCO ₂ e)	567,851	4,113,584
Annual average GHG savings attributable to ADB (tCO ₂ e) ^b	143,666	1,609,318
Annual energy supplied per unit of investment (GWh/\$million)	5.4	3.0
Annual GHG emission savings per unit of investment (tCO ₂ e/\$ million)	213	1052
Gross GHG emissions per unit of energy (tCO ₂ e/GWh)	681	259
GHG emissions savings per unit of energy produced or saved (tCO ₂ e/GWh) ^c	39	345
Fuel/Thermal Energy (Supply and demand-Side Projects)^b		
ADB's annual average lending in the period (\$ million) ^a	110	328
Annual average capital investment mobilized in the period (\$ million) ^a	535	631
Annual average energy supplied from ADB projects in the period (GWh)	15,961	10,009
Annual average GHG emissions of ADB projects (tCO ₂ e)	3,151,429	3,019,640
Annual average GHG emission saving (tCO ₂ e)	1,590,539	1,732,558
Annual average GHG savings attributable to ADB (tCO ₂ e) ^b	327,163	902,931
Annual energy supplied per unit of investment (GWh/\$million)	29.8	15.9
Net annual GHG emission savings per unit of investment (tCO ₂ e/\$ million)	2,972	2,745
Gross GHG emissions per unit of energy (tCO ₂ e/GWh)	197	302
GHG emissions savings per unit energy produced or saved (tCO ₂ e/GWh)	100	173

GHG = greenhouse gas, GWh = gigawatt hour, tCO₂e = tons of carbon dioxide equivalent.

^a Values in US dollars are in constant 2005 prices.

^b Based on the share of the investment financed by ADB.

Source: IED calculations based on loan documents (for methodology see Appendix 3, Linked Document F).

116. At the same time, these contributions need to be put in perspective. Developing Asia's GHG emissions continue to grow rapidly. This does not mean that ADB has failed. Energy demand is increasing rapidly as incomes increase. At the same time, the inertia of the energy sector is large. It takes time for changes in basic parameters—such as the GHG emissions per unit of energy supplied—to become significant. Many factors contribute to this inertia, beginning with the large stock of capital already invested and the large annual investments needed. It also takes time for new technologies to claim a significant share of new investment and even longer to become a significant share of the installed capacity. The implication is that ADB's policy to support clean energy must be sustained and take a long-term perspective—with an important role for both loan/equity operations and TA and grants. It must also continuously assess lines of action and projects in order to gradually increase their effectiveness in leveraging the desired changes.

ADB's policy to support clean energy must be sustained and take a long-term perspective

1. Comparison of Sovereign and Nonsovereign Operations

117. During 2009–2012⁶⁷ the volume of ADB financing for sovereign operations was much larger than for nonsovereign operations. The former accounted for 72% of financing in the electricity market and 85% in the fuel/thermal market (which was less than 1/5 of the electricity market in terms of volume of financing). However, the share of nonsovereign operations to mobilized investment in the electricity market—46% of the total—was almost as large as that of sovereign operations. The share of GHG mitigation was almost exactly the same. The share of new electricity supply-savings was actually much larger: 64% versus 36%.

118. This result is due in part to nonsovereign operations being, on average, more highly leveraged, i.e., the share of total investment financed by ADB was smaller. In addition, nonsovereign operations were concentrated in non-hydro renewables and generation from natural gas, with some participation in hydro. In contrast, more than 60% of sovereign loans were for transmission and distribution projects for which the attributed energy and GHG benefits are usually small per unit of investment.⁶⁸

119. In the fuel/thermal energy subsector the share of nonsovereign operations in both ADB lending and investment mobilized is much smaller (15%) than in the electricity subsector, while the share of energy added (11%) and GHG emissions mitigation (6%) is smaller yet (see Appendix 3, Linked Document F).

120. In the two new areas wherein ADB's energy portfolio expanded dramatically in 2009–2012—non-hydro renewables and demand-side EE—more than 85% of investment in the former has been through nonsovereign operations, while the reverse is true for demand-side EE.⁶⁹ This is curious, at least at first sight, since demand-side EE projects are mostly with the private sector. Though analyzing the reasons for the predominance so far of sovereign loans for demand-side EE is beyond the resources of this review, the difference in approach may be a consequence of the more complex business and policy context for consolidating a market for demand-side EE projects.

121. Besides being focused in a few sub-sectors, nonsovereign energy operations also tend to be concentrated in a few countries. In the electricity market, there were significant nonsovereign investments in three countries: Thailand (100% of investment), PRC (74%) and Pakistan (38%). The nonsovereign share in India was small (14%). In the fuels market the focus was narrower, mostly in the PRC.

122. Overall, the volume of nonsovereign clean energy investments has been larger than of sovereign since 2006, despite the smaller volume of lending. The share of clean energy in ADB's nonsovereign energy lending has increased dramatically over time, reaching 100% in 2012. The share of sovereign lending has been in the range of 24%–27% since 2006.

The volume of nonsovereign clean energy investments has been larger than of sovereign since 2006

⁶⁷ It is not possible now to systematically distinguish between sovereign and nonsovereign operations for the period 2001–2008.

⁶⁸ Indeed, transmission projects to evacuate power from renewable energy generation projects do not have any energy or GHG mitigation benefits attributed to them under current ADB reporting.

⁶⁹ Sovereign operations accounted for more than 95% of investment in EE in the sample countries. There were two nonsovereign operations approved for funds that might invest in both RE and EE and one focused on EE. These were not included because they had no defined output on which to base energy or GHG calculations. We suspect that the greater part of the RE/EE funds' investments will have been in RE.

ADB's energy operations have historically had a large share of projects assessed as successful and as likely to be sustainable

B. Financial and Institutional Sustainability

123. ADB's energy operations have historically had a large share of projects assessed as *successful* and as *likely to be sustainable*. Considering the 83 sovereign loan operations that were completed and assessed between 2000 and 2013, 80% were considered successful or highly successful. The same share was considered to have been likely sustainable or most likely sustainable. In both cases the performance of energy operations is considerably higher than the average for all ADB operations, for which the respective values were 64% (successful) and 65% (sustainable).

124. As with sovereign operations, the performance of nonsovereign energy projects—with a business success rate of 80%—is better than the average for nonsovereign operations.⁷⁰ In contrast, the relatively low rate of success of operations targeting financial institutions (not to mention private equity) is a matter of concern. Energy projects targeting demand-side EE (and to a lesser extent, new forms of RE) will often have characteristics closer to those of operations with financial institutions than to typical infrastructure projects.⁷¹ This may have consequences for the expected rate of success and sustainability, though it would be premature to draw conclusions without a closer analysis of the key issues involved in the performance of financial operations.

1. Ratings by Energy Subsectors

125. Energy operations include a wide variety of projects. As such one comes across differences in the average ratings of different types of projects, as shown in Table 7 for sovereign operations. Two subsectors had sustainability ratings well below the energy sector's average: district heating and energy sector development. The sample of nonsovereign projects completed since 2006 (when the current evaluation methodology was adopted) is too small to make meaningful comparisons.

Table 7: Sovereign Energy Operations Completed and Rated for Sustainability, 2000–2013, by Subsector

Energy Subsector (number of operations rated)	Sustainable (%)		Breakdown by Category (%)		
	(MLS+LS)	MLS	LS	LLS	US
Conventional Energy/Pipelines (11)	100	36	64	-	-
District Heating (6)	50	-	50	50	-
Electricity Transmission and Distribution (37)	84	16	68	14	3
Energy Efficiency and Conservation (3) ^a	100	33	67	-	-
Energy Sector Development (13)	54	8	46	46	-
Large Hydropower (12)	83	25	58	8	8
Renewable Energy (1)	100	-	100	-	-
Total (83)	80	18	61	18	2

LLS = less than likely sustainable, LS = likely sustainable, MLS = most likely sustainable, US = unlikely sustainable.

^a The subsector "energy efficiency & conservation" here includes only demand-side energy efficiency projects. Notes: Of 93 completed sovereign energy projects from 2000 to 2013, only 83 were rated. The data are based on aggregate results of project completion reports (PCRs), PCR validation reports (PVRs), and project performance evaluation reports (PPERs).

Source: IED database of completion report ratings, updated by IED ratings where available.

⁷⁰ The business success rate has been taken as the nearest proxy for the sustainability rating for sovereign operations. The share of projects considered to be successful was 93%. Besides the business success criterion, this evaluation considers: (i) development impact; (ii) ADB investment profitability, (iii) ADB work quality, and (iv) ADB additionality. Development impact considers (i) private sector development, (ii) contribution to economic development, and (iii) environment, social, health, and safety performance.

⁷¹ The EE and RE projects in question are executed through financial intermediaries, which offer a product that is innovative. At approval it is often unknown what the specific project investments will be.

2. Factors Influencing the Success and Sustainability of Projects

126. The AER did a brief survey of risks and issues cited in project documents that can affect projects' success and sustainability. It found that the citation of risks was substantially higher, on average, for approved projects than completed projects with evaluations. The frequency of citation was also higher in sovereign operations than in nonsovereign operations, whether they be approved or completed. It is not clear whether this is due to sovereign operations presenting a greater diversity of risks or due to differences in reporting. Some of the pre-identified risks were rarely cited: lack of competent project staff, corruption, lack or delay of government subsidy/funding, and technology risks. Among sovereign approved projects, the four most frequently cited risks were (i) institutional capacity, corporate governance, financial governance (61% of projects); (ii) government support for the project or political and regulatory risk (46%); (iii) inadequate tariff or lack of cost recovery (41%); and (iv) lack of interest among investors or of counterpart funding (38%). Project maintenance or other operational risk appears as a distant 5th (cited by 20% of projects).

127. By comparison, the most frequently cited risks for nonsovereign approved projects were (i) project maintenance or other operational risk (48% of projects),⁷² (ii) government support for the project or political and regulatory risk (33%), and (iii) lack of interest among investors or of counterpart funding (18%). Limited demand for the project and inadequate tariff/lack of cost recovery were tied for 4th place (15%). While there is overlap of the top 4–5 risks, the order is quite different. The top risk cited for nonsovereign is the 5th rated risk for sovereign while the top risk for sovereign projects—institutional capacity/corporate governance/financial governance—does not even appear among the first five for nonsovereign, cited in only 6% of the projects.

128. Distilling the discussion above, and giving somewhat more emphasis to the evaluations for completed projects, the most important risks to mitigate appear to be (i) inadequate tariff or lack of cost recovery, (ii) government support for the project or political and regulatory risk, (iii) project maintenance or other operational risk (especially for nonsovereign operations), and (iv) aspects of institutional capacity and corporate or financial governance (especially for sovereign operations). This is from the perspective of the overall energy portfolio. In individual subsectors it may be different.

The most important risks to mitigate appear to be inadequate tariff or lack of cost recovery, and government support for the project or political and regulatory risk

3. Influence of Country Context and Implications for Sustainability

129. The probability of a project's success and its economic sustainability can be strongly influenced by the policies and business environment of the host country. The probability of a project being sustainable is generally lower in countries where financial and institutional governance is weak and the average price received by energy suppliers does not cover the full cost of supply.⁷³

130. Some factors influencing this can be quantified. The most obvious factor is whether average electricity price is lower than the cost of operating and maintaining existing assets and financing needed expansion. The problem of an inadequate average tariff can be exacerbated if losses—especially commercial (unmetered) losses—are high.

⁷² It seems that most of the perceived risk regards operations, rather than maintenance. For example, in the case of renewables the availability of the necessary grid capacity can be a major issue, and several municipal solid waste projects could confront various operational risks regarding supply of fuel.

⁷³ It is the average price which is crucial. There may be cross-subsidies between classes of consumers.

131. In principle, almost all countries that keep electricity prices below cost have subsidy mechanisms to close the revenue gap.⁷⁴ Unfortunately, these mechanisms usually do not cover the entire revenue deficit. The shortfall is likely to become especially large when costs increase (e.g., when fuel prices increase sharply) or the country faces an economic or fiscal crisis. At such times the shortfall can increase dramatically, with pernicious effects on maintenance and investment in new supply.

132. While special covenants may protect individual projects from unpredictable swings in the adequacy of the power sector's revenue, protection may only mean that the disequilibrium is shifted somewhere else in the sector.

133. These are not problems that can be quickly solved given the political difficulties involved. ADB should be (and often is) engaged over the long term with the government, providing TA and advice to address the problem. If the country is showing progress then there are grounds for hoping that the ADB's investments can contribute more fully to achieving their objectives.

134. As such it is important to track the evolution over time, of the severity of these factors—prices lower than costs; high losses; subsidies and subsidy shortfalls. These parameters are also important for preparing a realistic project economic analysis. Unfortunately, in the preparations for the AER little evidence was found that these parameters are in fact being tracked over time, except on an occasional ad hoc basis.

135. This AER earlier referred to the shift in ADB's portfolio of electricity generation projects since about 2007/08. Unfortunately, the methodology used for economic analysis of projects does not provide an objective basis to judge whether this shift has been economically rational or sustainable. A World Bank study⁷⁵ outlined a basic methodology for comparing low and high GHG-emitting technologies for power generation. A basic premise is that, in comparing the alternatives, it is necessary to put a "social price" on various externalities (the emphasis was on GHG emissions). At the same time, the cost of both alternatives should be considered, *without subsidies*.

136. The subject is discussed in Appendix 3, Linked Document F. The conclusion is that the existing ADB methodologies for economic analysis do not follow this approach, nor do they provide a basis for judging whether the shift to a portfolio with much smaller carbon footprint has been economically rational. In particular, it seems that new guidelines for economic analysis of RE projects would be appropriate. In other energy subsectors the difficulties are less acute. A revamping of methodologies for them is not necessarily proposed. There is a strong logic for the approach currently taken. However, the existing guidelines were developed in 1997 when environmental externality was less of an issue. Analyses in all subsectors would benefit from a more systematic treatment of subsidies (implicit or explicit) and the social costs of externalities (related both to climate change and other environmental impacts). Fortunately, a process has begun to systematically revise the guidelines for economic analysis, which hopefully will address the concerns raised here.⁷⁶

*New guidelines
for economic
analysis of
renewable
energy projects
would be
appropriate*

⁷⁴ Subsidies are pervasive in the power sector valuing more than \$2.3 trillion (about 2.7% of global GDP) spread across 159 countries. Lipton, D. 2013. *Energy Subsidy Reform: Lessons and Implications*. Washington, DC: International Monetary Fund.

⁷⁵ Hamilton, Kirk; Stöver, Jana. 2012. *Economic Analysis of Projects in a Greenhouse World*. Washington, D.C.: World Bank.

⁷⁶ The review of the guidelines (TA 8507, approved in November 2013) is headed by the Economic and Research Department and should be completed by June 2015.

C. Environmental Sustainability and Its Trade-Offs

137. The shift in ADB's energy portfolio has occurred since 2007–2008, but only eight projects approved since that time have been evaluated. Consequently, the sample of RE and demand-side EE is small. Out of 98 completed operations evaluated over the 2000s, only four were RE projects and three were demand-side EE projects.

138. Appendix 3, Linked Document F analyzes the citations of risks in project documents. The review suggests that there is no indication so far that ADB's shift to a more green energy portfolio is having a negative impact on the institutional or financial sustainability of projects or their success rate. This is necessarily a preliminary conclusion, which depends on the contracted feed-in tariffs for RE being maintained in real terms. The real test of the results of ADB's shift in the energy portfolio will be the buy-in of governments and businesses to ADB-financed projects. This in turn depends on the balance reached in ADB's portfolio between environmental sustainability and other key imperatives facing the region's energy development.

139. The *Asian Development Outlook 2013*, in its theme chapter on Asia's Energy Challenge, highlighted three key challenges: (i) adequacy and reliability of energy supply (energy security), (ii) affordable access to energy—especially electricity and clean fuels for residential cooking and heating, and (iii) environmental sustainability. The question can be asked what the trade-offs are. Environmentally superior technologies mostly have a higher initial capital cost and, with the big exception of EE, have a higher levelized cost per unit of energy provided. This will be particularly the case when the technologies are new and do not yet have structured supply-chains or economies of scale. This higher cost creates a tension between environmental objectives and those for energy security and affordable access to energy.

1. Trade-Offs with Affordable Access (Inclusion) Objectives?

140. The challenge of affordable access to energy has two distinct dimensions. The first imperative is to *provide access to modern energy vectors to all the population*. The second imperative is to *provide affordable energy to the economy in general*.

141. **Providing basic access to modern energy vectors.** This imperative is sharpest for electricity. Without electricity, households and businesses are bereft of (or pay dearly for) a host of services provided by electric motors, communications and computing devices, electric lighting (which is far more efficient than kerosene and is higher quality), etc. Communities without access to electricity, which are almost always poor and usually rural, suffer a severe handicap in their efforts to increase their income.

142. Countries in developing Asia vary widely in their level of access to electricity. In some countries (such as PRC and Viet Nam), access is close to being universal. In countries where it is not, providing near universal access is an urgent priority of every government. The existence of a large share of the population without access to electricity can make it problematic to invest on a significant scale in utility-scale plants that are more expensive (such as solar and wind) than the conventional alternatives. This is especially the case in countries where average tariffs are artificially low and utilities have insufficient cash flow to invest in the needed expansion of supply—a situation often found in countries with low electrification rates.

143. By almost any socio-political calculus the expeditious inclusion of these unserved communities has a very high priority. Providing access generally requires some

There is no indication so far that ADB's shift to a more green energy portfolio is having a negative impact on the sustainability of projects

Environmentally superior technologies mostly have a higher initial capital cost

subsidy, due to the higher cost of supplying isolated communities, the small loads and low incomes. This demand will usually, though not necessarily always, trump investment in higher cost generation options for the grid motivated primarily by climate change mitigation objectives. Once the electrification rate is very high (say 95%–98%), this consideration will weigh much less.

The high cost of connecting many isolated rural communities by extending the grid may well open an opportunity for small-scale RE technologies

144. At the same time, however, the high cost of connecting many isolated rural communities by extending the grid may well open an opportunity for small-scale RE technologies. In these circumstances, they are the low cost option to begin supplying electricity (the same may well be true in some island states with very small grids). In Bangladesh this approach has been followed actively. About 2.7 million households have achieved a minimum access to electricity since 2003 with small photovoltaics (PV) systems.

145. The substitution, or improved use, of traditional fuels for residential use—mostly for cooking—is a related issue. The population without access to modern fuels for cooking (and, in some colder climates, heating) is much larger than that without access to electricity. While the consequences for development may be less dramatic than the lack of access to electricity, the lack of modern fuels can have diverse negative impacts including on health, local deforestation and large allocations of low productivity labor. Substitution of traditional biomass fuels (mainly fuel-wood and animal dung) will probably occur via two routes: (i) the use of natural gas liquids such as propane and butane (the route in Latin America); and (ii) improved use of biomass wastes, through gasification in biodigestors or improved stoves for solid fuels.⁷⁷

146. ADB has approved only one loan since 2009 that addresses the problem of household fuel for cooking, though there have been several grants. Given ADB's emphasis on improving the conditions of women and the importance of household fuel for them, it would be appropriate to seek innovative projects in this area, especially for option (ii) since market agents are less organized to implement this option and it involves lower CO₂ emissions.⁷⁸

147. **Providing affordable energy.** The second challenge identified in the *Asian Development Outlook* is to *provide affordable energy to the economy in general*. The emphasis here is on electricity. Whereas providing access to electricity to (almost) all the population appears to be a relatively short-term objective, the question of affordable electricity is universal and extends into the longer term. The discussion here focuses on the average cost of supply. There are other issues of affordability with regard to specific groups of consumers, such as low income consumers, who may receive targeted subsidies. With electricity it is possible to target subsidies with precision and the cost, even of a substantial subsidy for the lowest consumption classes, is generally not large because the very poor consume little electricity per capita.

148. The higher cost of most RE supply and of the most efficient (and clean) fossil fuel generation raises issues of affordability. There are strong political pressures for countries to maintain their energy/electricity prices at the lowest possible level. Indeed, in some countries, the average tariff paid does not cover the existing costs of the system. In such countries it is difficult to imagine a significant expansion of higher cost RE or fossil fuel technologies that would be sustainable if these circumstances were to continue (though individual projects may be sustainable, due to special covenants).

⁷⁷ In this case one is modernizing the use of a traditional biomass fuel, rather than substituting it.

⁷⁸ It has been observed that DMCs may be reluctant to borrow for this kind of project, so grants and TA may play a crucial role

149. Once this obstacle is overcome, there is the more general question of the affordability of electricity and how it may evolve as countries invest in cleaner, and more expensive, supply. This question is relevant to the competitiveness of countries' economies, since electricity is a basic input. As long as the share of electricity supply from more expensive RE is small, this is not much of a problem. However, countries that embark on a policy of subsidizing electricity supply on a large scale from more expensive RE sources run the risk of increasing their average electricity cost more than is economically viable or politically acceptable. The question is too complex to be fully addressed here. However, several broad observations can be made.

150. As concluded in a study for the *Asian Development Outlook 2013*, electricity expenditure as a fraction of GDP per capita will be substantially lower in 2035 than it was in 2012 in most countries.⁷⁹ For example, in the PRC, the expected electricity outlay is projected to fall by about 70% by 2035, in Indonesia by 67%, in India by more than 56%, in Viet Nam by 50%, 38% in Pakistan, and 20% in Thailand.

151. The scenario used in the cited study is considered to be a business-as-usual one. The expected fall in electricity outlay means that there does appear to be some margin for an increase in the average cost of electricity supply, due to a stronger emphasis on clean energy supply, without sacrificing economic growth.

152. One of the objectives of supply-side subsidies, whatever their form, is to contribute to a reduction in costs for the targeted technologies. The expansion of the market for some RE technologies has stimulated innovation and created economies of scale which have brought down costs. The most important examples are wind power and solar PVs. Wind power costs have fallen such that, in good sites, the cost of electricity in India and PRC may already be competitive with coal-fired plants if a modest cost (\$10–\$15/ton CO₂) is attributed to carbon emissions.⁸⁰

153. The ongoing reduction in the cost of power from solar PVs has been even more dramatic, though from a much higher initial cost. The rate of cost reduction since 2006 has been about 29% for each doubling of cumulative production. Solar PV technology is of special interest, because good quality solar resources can be found in almost all of developing Asia. It is unclear how far the solar PV cost reduction process will go, but it has already been much faster than was anticipated just a few years ago.

The solar PV cost reduction process has already been much faster than was anticipated just a few years ago

154. The limiting factor on the introduction of wind and solar will probably not be the cost of electricity where it is generated, but the adaptations needed to incorporate the variable output from these sources. This is part of the broader challenge of energy reliability which is discussed below.

2. Trade-offs with Energy Security Objectives?

155. **Energy security—adequacy and reliability of supply.** The trade in electricity between countries in the region is still minimal, with only a few exceptions, despite encouragement by ADB. The most important aspect of import dependence today is the importation of fuel with which to generate electricity—basically natural gas and coal. This dependence on imported fuel for electricity is clearly set to increase.

⁷⁹ The indicator of affordability as defined here is the fraction of per capita GDP needed to supply 1,000 kWh based on the levelized cost of electricity supply in the scenario (Fueyo et al. 2014).

⁸⁰ The reference is the wholesale price of electricity for utilities in India and that from coal-fired plants in PRC. Wind power busbar costs are about \$60-65/MWh).

156. In general, increasing the use of renewable resources for electricity generation should reduce the region's dependence on imported fuels. At the same time, it will probably also lead to more trade in electricity between countries in the region, if politics permit. In the first instance, countries will develop their domestic RE resources. However, two key RE resources—hydro and wind—are not evenly distributed and the optimal exploitation of endowments will tend to drive increased trade between countries. There is considerable international experience with hydropower that supports this conclusion. There is clearly substantial potential for this kind of trade in South Asia and the Mekong Basin, based on hydro; in the case of wind power, an example would be Mongolia and PRC.

157. The advantages of interconnection and greater electricity trade are not restricted to exporting power from one country to another. Economies can result from exchanging power over a larger area, exploiting the possibilities of complementation of variable output. Complementation results from the fact that when the natural flow of one renewable resource is low in one place, it may be high in another.

158. Other benefits from increasing the integration of power systems in neighboring countries are not related to the development of RE resources, such as access to more reserve capacity, balancing supply and loads across a wider area and, for smaller countries, permitting the entry of larger generation plants. ADB has a policy of encouraging the integration of regional energy infrastructure. The shift towards a greater emphasis on developing RE reinforces this ADB policy.

159. A key dimension of energy security directly concerns the reliability of energy supply. In the case of the power sector this involves above all the design and operation of the grid, although the adequate operation and maintenance of generation assets is also important. While large-scale interconnections enhance reliability, at the opposite end of the scale, distributed generation, where electricity is generated close to the site of the load, can also enhance reliability.

Distributed generation can also enhance reliability

160. Distributed generation technologies range from traditional back-up power (diesel gen-sets), to combined heat and power plants to solar PV systems. Adapting the grid to incorporate a growing contribution from distributed generation will require an upgrade of distribution systems that is part of the wider move to what is called the smart grid. The smart grid involves innovations from metering and the consumer interface with the grid to management of bulk transmission.

So far, ADB's participation in smart grid and distributed generation investments has been quite small

161. So far, ADB's participation in smart grid and distributed generation investments has been quite small, though there has been some TA. However, as ADB goes beyond the phase of supporting pioneer utility scale RE plants, the focus may (and probably should) change towards adapting the grid—building on the bank's large experience with transmission and distribution systems. Besides enabling RE and distributed generation, the smart grid can also make other contributions to reliability, such as improving load management, quickly localizing faults, etc. More broadly, the challenge of reliable supply and initiatives to improve reliability, such as the smart grid and distributed generation, are at the intersection between energy infrastructure and the challenge of climate change adaptation—a growing concern for ADB. Hence, a growing emphasis on renewables can reinforce another ADB policy objective improving the reliability of electricity supply in the context of climate change.

D. Conclusions and Way Forward

162. ADB's portfolio of energy projects has grown considerably over the past decade and has been accompanied by a major shift in the kinds of projects being financed. While there was continuity in the flow of transmission and distribution projects, there has been a big change in the mix of generation projects. Lending for demand-side EE projects has grown to a significant level from almost nothing. As a consequence, the carbon footprint of ADB's operations has fallen substantially and the CO₂ equivalent mitigation per unit of investment has increased greatly. In this and other ways, ADB's energy portfolio is becoming more sustainable from an environmental perspective.

Lending for demand-side EE projects has grown to a significant level from almost nothing

163. No evidence has yet been found that ADB's shift is having a negative impact on the overall institutional/financial sustainability of projects or their success rate—though this conclusion is necessarily preliminary because very few projects approved since the shift began have been evaluated. Overall, the risks that have been most important in the past are likely to remain prominent going forward, though there will be some changes due to the evolution of the region and the characteristics of some newer categories of projects, such as end-use EE.

164. There are some tensions between environmental sustainability and the objectives of adequate, reliable, and affordable energy supply. However, these tensions do not amount to a sharp trade-off between the objectives. Indeed, there can be many points of convergence between these objectives if strategies are carefully identified and adequately defined. Examples discussed earlier include:

- (i) The increased use of renewables should diminish the need for imported fuels. At the same time, the development of some (especially hydro and wind) reinforces the existing ADB policy of encouraging the integration of regional energy infrastructure—which has many benefits for both energy affordability and reliability.
- (ii) Improvements in EE are usually much less expensive than the equivalent expansion of supply. They contribute both to energy affordability and adequate supply.
- (iii) Distributed generation, which includes both RE and efficient on-site fossil fuel plants, can contribute both to energy affordability and security. It is closely linked to the deployment of the smart grid which can make diverse contributions to system reliability and reduce system costs.

The increased use of renewables should diminish the need for imported fuels

165. The tendency is for CO₂ equivalent emissions from energy use in developing Asia to continue to increase in the coming years. Many factors contribute to this trend: (i) even if the share of coal-fired generation falls, the installed capacity will increase; (ii) natural gas will increase its share, especially if non-conventional resources can be tapped. Some of this expansion will substitute for coal, but while natural gas has lower emissions than coal, they are still substantial; (iii) even if RE technologies expand quickly, they start from a very small base, while issues of affordability and reliability (integration in the operation of the grid) can limit their rate of expansion; and (iv) increasing EE has many advantages, but projects are difficult to implement (most agents are low on the learning curve) and many governments do not yet give this approach much priority.

The tendency is for GHG emissions from energy use in developing Asia to continue to increase in the coming years

166. Nevertheless, ADB can still have an impact on how fast GHG emissions increase and influence the pace of a transition to energy systems with a structurally lower

ADB can still have an impact on how fast GHG emissions increase

carbon impact. This will require a sustained commitment and a constant effort to identify areas where there is real potential (be they with fossil fuels or RE) and where ADB brings specific competences or comparative advantages that can leverage the limited financing it can provide relative to the immense investments in energy. Many of these areas may be difficult for implementing projects (examples are demand-side EE or recovering coal bed methane), but that may be precisely where ADB can add most value, if there really is a significant potential to be tapped.

167. The identification of areas for action is an iterative process, involving both planning and evaluation of past experience. On the planning side, the modeling of energy scenarios can provide useful insights for developing strategies. ADB has platforms at hand that, if improved, can facilitate preparing scenarios to compare economic, energy and environmental impacts. This work may facilitate identifying lines of action with the host countries.

168. Pricing of environmental externalities is very deficient today, both for project appraisal and longer term analysis of strategies. GHG emissions are the only externality that is regularly priced but have been done in a haphazard way. ADB should seek to define the social price of the most prominent pollutants as a guideline for the economic analysis of projects. This effort should be harmonized with other multilateral development banks and with countries in the region.

169. Also, in the economic analyses, more attention should be given to the subsidies in the prices paid to energy suppliers, which are used to calculate the benefits. These range from fossil fuel subsidies to subsidized feed-in tariffs for RE sources. In the case of RE projects in particular, it is probably necessary to change the approach taken to calculating the EIRR. As matters stand, it is not possible to judge objectively whether the shift in ADB's portfolio towards a mix with much lower GHG emissions has been economically justifiable even though almost all projects seem likely to pass their EIRR thresholds. The AER believes, overall, that the shift has been economically justifiable—but improved information would be needed to prove it.

170. At a more mundane level, the quantification of the expected impacts of specific projects on GHG emissions is still deficient, though it has improved substantially in recent years. The errors identified have probably led to an *underestimate*, overall, of GHG mitigation. Self- and independent evaluations need to more systematically prepare and present their GHG indicators. For a broader assessment of environmental sustainability, indicators for other environmental impacts (especially air and water pollutants) should be more systematically tracked as well. These indicators are needed to incorporate environmental externalities in the economic analyses of projects.

171. Over the past 2 decades, ADB's financing strategies have gradually increased their emphasis on the transformation of specific energy markets, rather than simply helping to fill a gap in financial capabilities. Broad sector reforms in the power sector were an early example (that continues in some countries). The shift to clean energy is the most recent step in this evolution. This new emphasis seems fundamentally justifiable, but it necessarily takes years for the full results to become manifest. Market transformation is an ambitious and complex challenge which requires a sustained commitment. Since the diverse agents (including ADB) are entering new areas, there is a constant need to adapt and learn from (real-time) experience, not only of specific projects but of broader lines of action. This AER review is a small part of this process.

Inclusive and Environmentally Sustainable Growth

172. In 2008, ADB adopted its Strategy 2020, which introduced the strategic agendas of inclusive and environmentally sustainable growth. In 2012, internal and shareholder interest in the context of a new results framework for 2013–2016 led ADB to further operationalize these agendas, which then resulted in new corporate indicators on operations contributing to inclusive economic growth in December 2012 and new guidelines on inclusive economic growth for country strategies in March 2013.⁸¹ In April 2014, ADB’s system for classifying inclusive economic growth projects was elaborated in a new project classification system. ADB also adopted Environment Operational Directions in 2013 for 2013–2020, and several new environmental indicators were added to the results framework and the classification system.

173. In 2013, Independent Evaluation analyzed and assessed selected aspects of the operationalization of the twin objectives in a series of studies, notably regarding ADB’s Support for Inclusive Growth,⁸² ADB’s Contributions of Private Sector Operations to Inclusive and Environmentally Sustainable Growth,⁸³ and IED’s real-time evaluation of ADB’s Climate Finance Initiatives.⁸⁴ Related topical papers were also completed on Food Security in Asia,⁸⁵ and on Development Imperatives for the Asian Century.⁸⁶ This chapter builds on the findings of these studies, to help define a range of perspectives for ADB to pursue in the future. While drawing attention to the contribution of individual evaluations that have been undertaken within their respective technical disciplines, the discussion in this chapter is largely summative, looking at the issues in an integrated problem-solving mode.

A. Context

174. Early 2014, the world possesses tremendous potential in almost every field—from subatomic particle research to nanotechnologies to cancer and HIV/AIDS treatments. Millions have been moved out of extreme poverty of \$1.25 per capita per day since the 1990s. Rapid economic growth in developing Asia has played a significant role in putting a dent in age-old penury and deprivation. At the same time, many

⁸¹ ADB. 2013. *Guidelines on Inclusive Economic Growth in the Country Partnership Strategy*. Manila.

⁸² IED. 2014. *Thematic Evaluation Study: ADB’s Support for Inclusive Growth*. Manila: ADB.

⁸³ IED. 2013. *Thematic Evaluation Study: Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth*. Manila: ADB.

⁸⁴ IED. 2014. *Real-time Evaluation of ADB’s Initiatives to Support Access to Climate Finance*. Manila: ADB.

⁸⁵ IED. 2013. *Food Security Challenges in Asia*. Topical Paper. Manila: ADB.

⁸⁶ Petri, Peter and Vinod Thomas. 2013. *Development Imperatives for the Asian Century*. ADB Economics Working Paper Series, No. 360.

The pattern of growth has not been optimal in many countries

societal problems have remained intractable, including in nutrition, child development, gender disparities, and sanitation.⁸⁷ As IED's midterm review noted, the pattern of growth has not been optimal in many countries, with inadequate employment generation for and inclusion of women, youth, and marginalized segments of society. Poverty also remains a large problem, in spite of the huge progress made.

Two important threats are environmental degradation and pollution coupled with natural resources constraints, and insufficient growth in some places and insufficiently inclusive growth in other

175. The risks the world faces today range from large events like climate change, to social upheaval and civil unrest due to poor governance coupled with increasing unemployment, persistent poverty for particular groups and areas, and rising inequality. Given the interdependence across nations, these risks transcend the levels of economic development and threaten to engulf the progress in both rich and poor countries. The building up of environmental pollution over the previous decades has correspondingly trawled in the risk of causing a widespread upset, as even small fissures can lead to disaster. On the other side, several governments in Asia are facing increasing public discontent, to an extent that Arab spring-type of societal eruptions are not unimaginable and are, indeed, already happening in one form or other.

176. In addition, the world has been going through a financial and economic crisis in the past 5 years, which has unraveled a number of unexpected issues that have slowed economic growth. In developing Asia, the growth rates of both PRC and India are now significantly lower (2–3 percentage points) than before the crisis. This slowing down threatens to interrupt the process of poverty reduction. In the meantime, macroeconomic, banking, as well as financial and monetary risks continue to weigh down the advanced economies.

177. In simple terms, two important threats to the societal order are (i) environmental degradation and pollution coupled with natural resources constraints, and (ii) insufficient growth in some places and insufficiently inclusive growth in other places.⁸⁸ Both of these embody deep and long-term risks, thereby making it necessary for them to be addressed and managed in the pursuit of sustainable growth. Hence, this AER is addressing this subject here.

B. Inclusive and Shared Growth

178. **Income poverty.** Reducing income poverty has been the overarching focal point of ADB's strategy deliberations since 1999. The *Enhanced Poverty Reduction Strategy of 2004*, and the *Eminent Persons Report* in 2007 noted the progress achieved and the changing nature of poverty in the Asia-Pacific region. Building on these cues, ADB committed itself to the broader strategic agenda of inclusive economic growth. The focus shifted from the reduction of absolute poverty of the dollar-a-day variety to inclusive growth encompassing equal opportunities. In its wake the debate on inequality and the uneven gains from development has come center stage.⁸⁹ This is particularly so since the 2008 global economic crisis. ADB was already aware of these issues at the time of Strategy 2020, but Management and ADB's shareholders have gradually accepted the centrality of the challenge over time, and it is now more fully addressed in ADB's 2014 Midterm Review of Strategy 2020.

⁸⁷ IED. 2013. *Thematic Evaluation Study: ADB's Support for Achieving the Millennium Development Goals*. Manila: ADB.

⁸⁸ It can be argued that governance and public sector management is a third important aspect that needs urgent attention in developing Asia to improve effectiveness and efficiency of public service delivery. IED is presently undertaking an evaluation in this area, which is expected to be complete by December 2014.

⁸⁹ A brief description of the changing emphases in ADB's strategies vis-à-vis poverty reduction is provided in Chapter 3 of IED. 2013. *ADB's Support for Achieving the Millennium Development Goals*. Manila: ADB

179. **Growth as the driver of poverty reduction.** IED's inclusive growth evaluation acknowledges that the region's economic growth has been effective in lifting people out of poverty. This assertion goes back to an important debate in the literature in the early 2000s about growth being good for the poor.⁹⁰ This hypothesis was subsequently re-examined in 2013 with data spanning 118 countries across four decades⁹¹ and the message was reinforced, though in a more nuanced manner. The underlying relationship between growth and poverty reduction had been pointed out by some other economists who maintained that when poverty is widespread, rapid growth is often the simple answer. However, when poverty is confined to certain pockets and isolated areas, a more targeted approach to poverty reduction is appropriate.

180. The Asia-Pacific experience reinforces the general message that high and sustained growth is critical to poverty reduction. The PRC has been a very good example, but the experience in India has also been similar, when average growth was as high as about 8% per annum during the first decade of the millennium. However, those unable to climb out of poverty despite economic growth need targeted poverty reduction programs to meet their specific needs. This is also one of the main points of the inclusive growth evaluation.

181. **Economic shocks.** Compared with the growth rates elsewhere, developing Asia's growth rates appear good although they also suffered a number of shocks that have periodically and seriously interrupted poverty reduction measures. In the early 1990s, 7 of the 10 countries ADB works with in central and western Asia registered negative growth in the aftermath of independence from the former Soviet Union. No economic progress was reported in Afghanistan during this period. During 1997–2002, another group of 10 ADB countries reported combined economic growth of only 0.1% due to the 1997 Asian financial and economic crisis. Only from 2002 to 2007, all regions except the Pacific achieved significant economic growth. This growth spell was interrupted by the global economic and financial crisis of 2008. Consequently, overall economic growth declined by 1.8% per annum to 6.0% for Asia-Pacific as a whole.

182. Fortunately, the most populous regions, i.e., comprising PRC, India and other South Asian countries, continued to render more stable growth consistently over the last 2 decades. This effectively eliminated substantial sources of volatility and economic shocks for most of the poor population in the region, although there are growing inequalities within countries. Finally, there is a clear indication that the range of growth rates of economies had significantly shrunk in the 2000s across the different subregions, implying that a convergence could be taking place in the Asia-Pacific region.

183. **Growing inequalities within economies.** As Asia-Pacific economies moved from pervasive and general poverty to some progress along the economic ladder, the inequalities within economies increased. This led the inclusive growth evaluation to observe that Asia-Pacific's high growth did not necessarily translate to improvements in living standards, and was, instead, accompanied by greater income inequality and inadequate access to opportunities—albeit high growth did reduce poverty significantly. The study reported that income inequality rose in the 1990s through the 2000s, with the population-weighted Gini index (1990–2010) increasing by 1.04% annually.

When poverty is confined to certain pockets and isolated areas, a more targeted approach to poverty reduction is appropriate

Income inequality rose in the 1990s through the 2000s

⁹⁰ A. Kraay and David Dollar. 2001. "Growth is Good for the Poor". *Policy Research Working Papers*. The World Bank. The paper "established as an empirical matter, that when average incomes rise, the average income of the poorest fifth of society rises." See also A. Kraay. 2006. When is growth pro-poor? Evidence from a panel of countries. *Journal of Development Economics* 80 (2006) 198–22.

⁹¹ David Dollar, Tatjana Kleinber and Aart Kraay. 2013. "Growth is Still Good for the Poor", Policy Research Working Papers, 6568, August. "Incomes in the poorest two quintiles, on average, increase at the same rate as overall average incomes."

184. The value of the Gini index seemed to vary significantly from country to country, depending on the pattern of economic growth and distribution of the resulting incomes. For example, annual growth in Gini values had been highest in the case of PRC, followed by other countries like Georgia, Indonesia, Sri Lanka, and Lao PDR. Higher values of the Gini index were indeed challenging the inclusiveness of the growth process, as growing inequalities within economies tend to lessen its impact on poverty reduction. By implication, it necessitated resorting to other measures of social equity, like land reform, taxation of the rich, cash transfers to the poor, poor area development programs, and other special programs for the poor. As several evaluations over the years have borne out, many of these measures were not only costly to adopt, but were also difficult to implement efficiently due to inadequate ownership of reforms, limited domestic implementation capacity, growing complexity of development activities, and the absence of stakeholders' participation, among others. Considered in the global context, inequality in Asia has been relatively more modest in most places, but its rapid rise over the last 2 decades has become a matter of great concern.⁹²

Rural poverty is a particularly riveting subject in the Asia-Pacific region

185. **The rural-urban divide.**⁹³ Geographic inequalities have proved to be the most persistent. They tend to be binding over long periods. In most countries, poverty, social deprivations, and inequities are strongly associated with the rural areas. From the policy makers of the industrial revolution in the nineteenth century to the development planners of modern PRC in the 21st century, all have had to devise measures to cope with the problems of rural poverty and negotiate social exclusion. Given the history of independence struggles and socio-political movements in Asia, rural poverty is a particularly riveting subject in the Asia-Pacific region. It has defied simplistic solutions.

186. As ADB's Framework for Inclusive Growth Indicators has segregated data for rural and urban areas available only for PRC, India, and Indonesia, these countries are the focus in this section. Taking the \$2 per capita per day into consideration, about half of the population in the rural areas of PRC (45.8%) and Indonesia (49%) are still poor, despite their rapid economic performance during the last 2 decades. The share of the poor in rural India is about 73.5%, i.e., three of every four rural inhabitants are poor.

187. Among the most populated countries, growth is very much urban driven, and the difference between rural and urban areas, as well as between the bottom and highest quintiles, continues unabated. Nonetheless, there is some evidence that the share of consumption in total consumption as well as its growth rate have improved in big economies. ADB may need to take a differentiated and targeted approach to inclusion in its programs, and focus sometimes on poor areas and sometimes on poor populations, at least in the three big countries used here to illustrate the point.

188. In a larger perspective, the problem of rural areas is linked to the problem of food security in Asia. IED produced a topical paper on this subject in 2013, the findings of which are summarized in Box 4.

⁹² For a few countries inequalities lessened over time, but this was a temporary phenomenon. Most Central and Western Asia countries suffered high inequities in the 1990s in the wake of independence from the Soviet Union, which were reduced, but may well now be on the rise again.

⁹³ Data for this section were drawn from ADB. 2013. *Key Indicators. Framework for Inclusive Growth Indicators. Special Supplement*. Economic Research Department. Manila.

Box 4: Food Security Challenges in Asia

For inclusive growth, the problems of food security need to be viewed within the context of the broader transformation of agriculture in Asia, i.e., the transition from a largely agrarian economy to an increasingly urban and nonagricultural economy. During this change, the agricultural share of national income declines much faster than the agricultural share of employment. Policy makers need to be concerned about the risks of rising inequality and about providing opportunities to rural people who cannot find a place in the urban economy.

The paper argued that there is a need to ensure that Asia's 350 million small farmers, those on less than 2 hectares, have the opportunity to thrive in modern food value chains and are not bypassed in the rapidly commercializing economy. The challenge is to involve small, farmers in this competitive process. Although small farms occupy only about 40% of the total farm area, they produce a much larger share of the region's staple crops. Their productivity growth over the past 35 years has contributed to Asia's food security and poverty reduction.

While small farm families can make ends meet, there are limits to how much income they can generate by growing only rice or wheat. In Asia, a successful structural transformation is required for agriculture to evolve from subsistence-oriented production to commercial value-chain driven systems in a dynamic and urbanizing economy. Without this, there is a risk that a large share of Asia's poor will remain mired in a rural poverty trap. If small farmers are to prosper, they must diversify and commercialize as well as raise their productivity. History has shown that a vibrant rural economy, based on both a dynamic agriculture sector and growing rural nonfarm incomes, will facilitate an inclusive structural transformation.

Source: IED. 2013. *Food Security Challenges in Asia*. Manila: ADB.

189. **IED's country program evaluations.** The special assessments done by Independent Evaluation for six countries in 2013 (see Chapter 2 and Appendix 3, Linked Document B) highlight that addressing inclusive growth through a geographical focus in operations could help. It was felt that ADB's Thailand program going forward could be more explicit on the inclusiveness of the development process to address the country's significant development divide. The India program could address better the needs of lagging states to provide more opportunities for development to the poor. The country evaluations also found examples of effective nongeographic measures—reforms that increased access to formal sources of finance for rural and micro-borrowers in Thailand; interventions that addressed unemployment, poverty, and vulnerability in Georgia; and effective joint knowledge work and strategic partnering in Nepal. The inclusion benefits of community-based water supply and agriculture projects were highlighted in the evaluation of the Pakistan program.

190. **IED's 2014 study on ADB's support for inclusive growth** pointed out that ADB's priorities have been skewed toward one of the three pillars in ADB's inclusive growth framework—the one promoting high, sustained economic growth (pillar 1). More limited support was given to pillar 2 (broadening inclusiveness through greater access to opportunities), and pillar 3 (strengthening social protection). The study stressed that growth alone cannot adequately promote social inclusion. Policies and interventions to improve the quality of growth broaden access to opportunities and build strong social safety nets are seen as vital for achieving greater inclusion.

191. The study had a twofold emphasis. First, it urged that ADB support for growth under pillar 1, for example, through infrastructure investment, be made more inclusive. For example, road projects can improve inclusion if they are linked with programs addressing education and health care in the same area. Similarly, water and sanitation

Addressing inclusive growth through a geographical focus in operations could help

Growth alone cannot adequately promote social inclusion

ADB was recommended to help make the growth process itself more inclusive, i.e., by including the lower income groups in it directly

projects have a better chance of reducing water-related diseases if complemented with education efforts promoting hygiene and public health. ADB was recommended to help make the growth process itself more inclusive, i.e., by including the lower income groups in it directly. And second, the study called for an increase in investments for greater inclusiveness—namely, increasing access to opportunities under pillar 2 and expanding social protection under pillar 3—relative to those under pillar 1.

192. Such a shift was to involve designing and selecting projects and country program strategies that incorporate inclusion objectives. The study found scope for ADB making such a shift in project design and strategy formulation in both the public and private sectors in Asia and the Pacific. Doing so would signify a unique contribution by ADB, even if modest in scope, to the region's development trajectory.

193. **Private sector operations and inclusion.** Another evaluation (footnote 83) drew attention to ADB's primary focus on infrastructure and financial markets in its private sector operations and argued that it can be consistent with inclusive growth objectives, provided their direct and indirect transmission mechanisms are identified and enhanced as necessary to meet such objectives. ADB's private sector investment projects are generally expected to generate satisfactory financial and economic returns. Nearly all the supported private infrastructure projects did this, but fewer than half of ADB-supported financial sector transactions—particularly those with SME development objectives—managed to do so for a range of reasons including problems with the selection of appropriate financial institutions and fund managers. Only few transactions sought to directly benefit the poor, women, rural areas, or other disadvantaged areas, and not all of them succeeded, primarily because project approaches did not fully match these objectives.⁹⁴ ADB's private sector department faces limitations in playing a more proactive role in project development and largely relies on private sponsors for inclusive project proposals. While there is some evidence that some of the other nonsovereign operations have also furthered greater inclusion, the potential for such impacts was not necessarily recognized nor likely optimized.

194. Significantly, projects that did pay attention to inclusion performed as well, if not better, than other projects on investment outcomes. This suggests that development impact need not come at the expense of financial success. Interventions can therefore be simultaneously pro-growth and inclusive, but this link may be neither universal nor automatic, depending on country or sector conditions.

195. The study concluded that actions in four areas could help increase the level of inclusion of private sector operations. First, nonsovereign operations in frontier markets as well as for disadvantaged areas in non-frontier markets can be further increased. Second, ADB needs to engage in policy dialogue on sector reforms to remove impediments to private investments in social infrastructure and microfinance. Third, ADB needs to look for ways to increase its engagement with inclusive businesses targeting consumers and producers at the bottom of the income pyramid through the provision of funds and advisory services. Fourth, it would pay for ADB to review its SME-related operations, to ensure adequate development impacts. The study is consistent with other evaluation evidence regarding its assessment of the greater relevance of support for strengthening the enabling environment for private sector investment and development vis-à-vis more direct forms of financial support to a small

⁹⁴ It is recognized that this definition of inclusive growth is not based on the interpretation in Strategy 2020.

group of SMEs.⁹⁵ It concluded that, among other issues, policy dialogue should seek to address constraints that are specific to poor, rural, and female entrepreneurs.

C. Growth and Environmental Sustainability

196. The concerns about the inclusiveness of the growth process in Asia and Pacific are amplified by concerns about its environmental sustainability, and significant trade-offs are generally perceived to exist between short-term and long-term growth, growth and inclusive growth, brown growth and green growth, and fourthly—as a derivative—inclusive growth and green growth. Some of these trade-offs were explored in the chapter on energy operations, and it was noted there that, apart from self-evident trade-offs and choices to be made, there are some synergies to be exploited.

197. Since the beginning of the industrial revolution, economic growth has been an ongoing phenomenon, first driven by exploitation of natural resources, then spurred by greater efficiency in production processes, and finally propelled by technological innovations. The Global Competitiveness Report for 2013–2014 describes these three phases of growth as factor driven, efficiency driven, and innovation driven.⁹⁶ This form of classification is useful in highlighting the role of natural resources under the factor-driven growth phase. Many countries initially exploited their natural resources to get economic growth going. Subsequently, countries combined natural resources with experience (learning by doing) to achieve what is described above as an efficiency-driven growth process. The most advanced stage of economic development is said to take place when growth is pursued further by combining new knowledge, technology, and information with efficiency and natural resources. This third stage leans heavily on technological innovations. A notable concern is that innovations are driven by a wide variety of institutions—state, public enterprises, private national and international corporations, civil society organizations, think-tanks, social enterprises, etc. Such institutions have uneven capabilities and are not uniformly distributed across economies. Yet innovations and new technology are now equally required to tackle environmental sustainability by both developed and developing countries alike.

198. Although natural resources constitute the substrate of growth in all stages, in the first stage they get the process of development ignited. However, the second and the third types of growth are more important for long-term sustainability. Put alternatively, factor-driven growth can initiate the growth process, but it cannot sustain it over a long period. Sustainable growth necessitates a transition across these drivers of growth to a phase that rests on new information, new knowledge, and technology. With economic progress, these sustainability transition systems become more complex, and the Asia-Pacific region is now entering such transitions—necessitating a more differentiated, nuanced, and calibrated response from ADB

199. That the rapid economic growth of the last 2 decades has put tremendous pressure on natural resources in the Asia-Pacific region is well known. As mentioned above, such growth succeeded in pulling millions of persons out of poverty. However, rural and urban development has been accompanied by deforestation, environmental degradation, pollution, and loss of biodiversity. IED's 2012 Natural Disasters and Disaster Risks evaluation noted that since the early 1980s, the Asia-Pacific region has seen increased frequency of meteorological and hydrological disturbances, for which

Significant trade-offs are perceived to exist between short-term and long-term growth, growth and inclusive growth, brown growth and green growth, and inclusive growth and green growth

⁹⁵ IED. 2013. *ADB Support for Strengthening the Enabling Environment for Private Sector Development*. Manila: ADB.

⁹⁶ World Economic Forum. 2013. *The Global Competitiveness Report 2013–2014: Full Data Edition*. Geneva.

CO₂ pollution-induced climate change may be one reason.⁹⁷ There is also a growing scarcity of water, energy, and mineral resources. In short, these environmental consequences of human activities are threatening progress in many ways.

200. But the Asia-Pacific region, still home to two-thirds of the world's poor, has to continue to register economic growth to feed, clothe, and maintain its large population. The region urgently needs to find ways for more sustainable development that will benefit all. In this sense, making choices between inclusive and environmentally sustainable growth is not an acceptable option. There is no alternative but for the region to find and apply innovative methods for securing both simultaneously.

201. Resource conservation efforts expect the consumption of natural resources to take place at a rate lower than their renewal rate. Societies now have to pay back for the natural resources that were used in the past, while securing new opportunities (solar, wind, etc.) created by technology. The process of development will continue to have to pay back for past usage, while borrowing afresh from opportunities created by evolving technologies. Thus, the hope is that new technologies will enable both rich and poor economies to continue to pursue growth by mitigating the negative impacts of earlier exploitation, while contributing to the sustenance of the environment.

202. **The environment Kuznets curve.** The suggestion that in the early stages of development a degradation of environment takes place that can subsequently be reversed as economic development proceeds, takes off from the Kuznets hypothesis and it is termed the environment Kuznets curve. Historically, the advanced economies have gone through this kind of cycle. As noted in Independent Evaluation's report *Inclusion, Resilience, Change: ADB's Strategy 2020 at Mid-Term*, it is too late for today's developing countries to "pollute first and fix later." This model, as implied by the environment Kuznets curve, may well have run its course.

203. There are two main reasons why the "pollute first and fix later" approach should not be encouraged in the 21st century. First, advanced economies have already mined the environment to a very high level. There is little room left for developing countries to exploit the environment further. Second, developing countries have such large populations that if they were to consume natural resources at the same per capita level as their counterparts in the developed world, environmental degradation would take place much faster, perhaps even reaching a tipping point. Hence, there is a need to revisit consumption patterns and lifestyles in both types of societies.

204. Elaborating on the natural resources and economic growth nexus, a Topical Paper originated by IED staff on development imperatives for the Asian century argues that the limitation on earth's carrying capacity is not due to the scale of human activity, but due to the way the economic activity has been organized, for example, around carbon-intensive energy sources (brown growth).⁹⁸ This way of organization of economic activity would need to be changed, and this is where new technologies can hopefully come in, for instance in mitigation of climate change and also, unfortunately, in adaptation to it. While IED, like ADB, has produced studies on climate change mitigation, the climate change finance study (footnote 84) identified useful adaptation and mitigation support in Bangladesh, PRC, India, Timor-Leste, and Viet Nam.

⁹⁷ IED. 2012. *Special Evaluation Study. ADB's Response to Natural Disasters and Disaster Risks*. Manila: ADB.

⁹⁸ See footnote 86. See also Petri, P., and F. Zhai. 2013. Navigating a Changing World Economy: ASEAN, the People's Republic of China, and India. *Asian Development Bank Institute Working Paper*.

205. **Types of interventions.** Evaluation has found that helping countries to respond to the challenge of climate change involves, besides finance and technology, a whole range of instruments including economic incentives; knowledge generation, sharing, and guidance (persuasion); and supervision and regulation (command). Responding to climate change is, in fact, an unequal battle. The forces of nature are infinitely more powerful than human-made institutions, whether in developing countries or at the global level. Hence, all possible means have to be mobilized to shore up climate resilience and move to a low-carbon growth path.

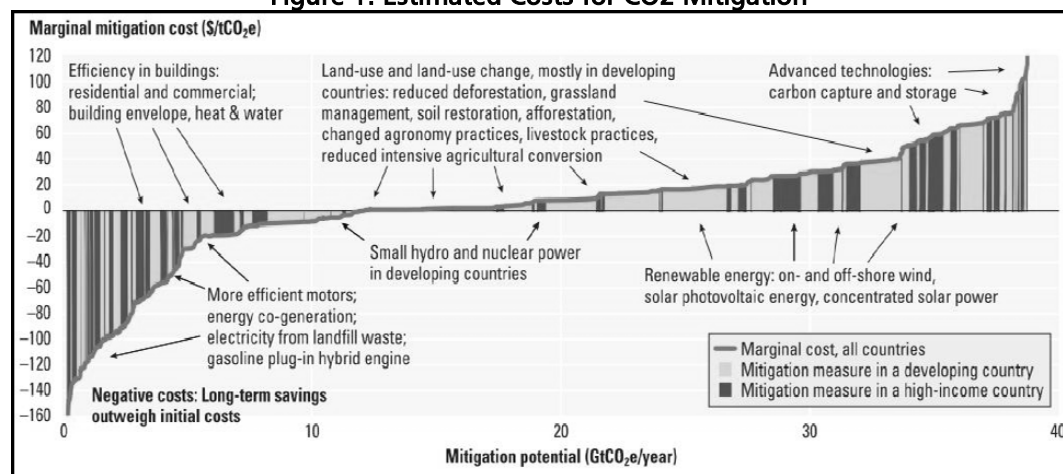
206. Fortunately, not all technology solutions have to be costly, as pointed out in the previous chapter. The earlier quoted Development Imperatives paper points out that a comprehensive cost curve for global CO₂ mitigation has been estimated to show the full range of alternatives (Figure 1). Win-win options, including the elimination of subsidies and other initiatives, would cover about one-third of the mitigation required to reduce emissions by 38 gigatons of carbon dioxide per year, sufficient for a path that stabilizes emissions in the 450-part per million range. Mitigation is not only affordable, but should at first generate solid returns on investment. Eventually net-win projects may be also required, but even so, estimates of costs cluster at 1%–2% of global GDP for policies that will limit global warming to 2°C above pre-industrial temperatures (as per IPCC estimates).

Fortunately, not all technology solutions have to be costly

207. The paper points out that inaction is also costly, especially at the global level. Even a 2°C rise in global temperatures would impose significant adaptation cost on the world, including \$36 billion–\$40 billion per year estimated for Asia and the Pacific, and costs would rise sharply with less favorable mitigation scenarios. Adaptation to changing environmental conditions must begin soon, ranging from improved land use, water management, transport and building construction to insurance and financial systems that enable people to recover their livelihoods more quickly.

Inaction is also costly

Figure 1: Estimated Costs for CO₂ Mitigation



CO₂ = carbon dioxide, GtCO₂ = gigatons CO₂, tCO₂e = tons of carbon dioxide equivalent.

Source: Petri, Peter; Vinod Thomas. 2013. Development Imperatives for an Asian Century. Manila: ADB. Based on World Bank Development Report 2010: Development and Climate Change.

208. **A holistic approach.** Yet such measures will, at best, accomplish only what lies in the economic domain.⁹⁹ Beyond pricing and financing issues, climate change aspects need to be handled either through better knowledge management, (information,

⁹⁹ See Kanbur, R. 2002. "Economics, Social Science and Development" *World Development*, 30(3), pp. 477-286, for an illuminating discussion of a multidisciplinary approach to development policy making.

education and communication) or through supervision and regulatory mechanisms. These two mechanisms are important, as climate science is still growing, and is not fully understood uniformly across countries and communities. Likewise, global regulatory and supervisory oversight is needed; otherwise, it might be tempting for some countries, individuals, or entities to take advantage of newly created opportunities and resources. The post-2015 global development agenda defines sustainable development goals and seeks to address the three dimensions of sustainable development—economic, social, and environmental—in a holistic and balanced manner.

209. **Climate change—infrastructure as the core area.** The scope of climate change is vast and touches virtually every economic sector. Infrastructure, however, constitutes a core area of potential impact. Investments in infrastructure create a resource that pays off for decades and, sometimes, over hundreds of years—this long timeframe and the ingrained inertia of infrastructure create certainty and impart stability to the environment in which development activities can be undertaken with some assurance.

210. Given infrastructure’s prominent presence, multiple usage, and long timeframe, it has a natural interface with public policy, which is often associated with it from its inception to construction, eventual use, maintenance, and pay-offs. Likewise, given its intrusion into natural resources, a number of externalities are associated with infrastructure. These externalities and public policy issues play a significant role in determining the development impact of infrastructure investments, especially in the manner in which infrastructure services are managed in society.

211. These policy issues, combined with new technologies, determine the dynamics of infrastructure investments and pay-offs. The climate change impact of infrastructure can be better managed through appropriate demand and supply mechanisms. When it comes to financing adaptation measures, the international financial institutions have an important role in guiding the demand and supply of infrastructure. If anything, the provision of infrastructure is presently constrained by a lack of investible funds.

ADB has initiated a system that ascertains a certain minimum level of rigor to screen infrastructure and other projects for risks and threats from climate change

212. Although available climate finance is less than requirements, ADB is beginning to gain useful experience with managing and accessing climate change funds. ADB can broaden the mitigation portfolio, which has focused largely on supply-side clean energy, and explore opportunities to scale up sustainable transport and demand-side EE.¹⁰⁰ ADB can also scale up support for adaptation in areas such as food security and water security. The importance of infrastructure in both mitigation and adaptation interventions is clearly evident (Box 5).

213. ADB has initiated a system that ascertains a certain minimum level of rigor to screen infrastructure and other projects for risks and threats from climate change. The system incorporates a detailed risk-screening software tool, but this tool cannot be used to assess mitigation options during construction of proposed infrastructure and other projects (footnote 84).

D. Transition toward Sustainable and Inclusive Development

214. The transition to future global economic development faces serious challenges concerning the lack of inclusive growth with social equity, and environmental degradation. Both aspects are structurally interrelated and need to be attended to

¹⁰⁰ADB also needs to increase support for sustainable land resources management, including forests.

simultaneously. Addressing just one of the two does not relieve the situation. If equitable development is not pursued, global economic growth will slow down for want of sufficient demand. It will also not help to leave the poor regions as they are. Given their demographics, doing so would see them inflicting more environmental damage via the cutting down of trees, the burning of wood, and the pollution of water tables, for instance. Meanwhile, a cut-back on the use of fossil fuels without a switch to more efficient systems or alternative energy, would severely impact global production systems. Sustainable development requires both global and local cooperation, good governance, and development of appropriate technology.

If equitable development is not pursued, global economic growth will slow down for want of sufficient demand

Box 5: ADB's Real-Time Evaluation of ADB's Climate Finance Initiatives: Some Findings

- Climate Finance requirements are massive, and the size targeted for mobilization by 2020 (\$100 billion annually) is challenging but feasible. The targeted size is more than 50 times larger than annual financial flows from all climate funds in 2010–2012.
- Agencies such as ADB will primarily function as financial intermediaries to the Green Climate Fund (GCF), which has been set up as the apex body for promoting a paradigm shift towards low-emission and climate-resilient development in developing countries. It is to initiate mobilization of funds by December 2014, and key policies and procedures are under way to enable the GCF to receive and manage funds. The GCF will manage financial flows from the adaptation and mitigation financing windows and its Private Sector Facility. Under these new arrangements, the GCF will be the centerpiece of the global climate finance architecture, with the other components being multilaterals, bilaterals, other institutions, and private finance. ADB will have the opportunity to access climate finance and increase its private sector operations.
- The GCF will make financial transfers to developing countries through international agencies and developing country-based financial intermediaries.
- ADB has embarked on a large number of climate change initiatives that include the development of strategies and policies in the area of climate finance, and enhancing portfolio administration. They have been supported by initiatives in the areas of knowledge management, new product innovations, and strengthening organization and staffing arrangements to support climate change.
- Climate Change has featured prominently in ADB strategies, policies, and plans since Strategy 2020. ADB rightly recognizes the need for a holistic approach to meet the needs for sustainable development and the challenge posed by climate change, although the design of supporting interventions that incorporate such holistic approaches is at an early stage. However, as of end-2013, a few interventions that integrate holistic and cross-sectoral approaches have been designed or planned or implemented, including those supported through the Pilot Program for Climate Resilience, the adaptation window of the Climate Investment Fund.
- ADB has managed several funds dedicated for climate change interventions and staff have accessed these funds for a large number of interventions, but these activities do not provide the relevant experience in project documentation that is required for accessing climate finance from externally managed funds.
- The operations departments recover only a part of the administrative fees that external climate funds provide for project cycle management. This practice does not provide incentives to the operations departments to access external funds.
- ADB has limited but useful experience leveraging climate finance with private capital and cofinancing from other development partners.

Source: IED. 2014. *Real-Time Evaluation of ADB's Initiatives to Support Access to Climate Finance*. Manila: ADB.

215. The recent technology-led relocation of industrial production systems in Asia-Pacific has facilitated the establishment of value-chain based production networks and spread of the process of economic development, which eventually reduced poverty in the region. However, these initial forays of technological diffusion in the region have so

far been confined to profit-making sectors. The spread into social technologies including education, health, sanitation, and governance has been sporadic and patchy. In light of the demography of developing countries, this is a serious limitation that needs to be addressed, especially for inclusive growth with social equity.

Public sector-sponsored technology research usually stops short of application

216. As far as innovation and knowledge generation is concerned, public sector-sponsored technology research usually stops short of application, because experimentation often involves straying beyond government outfits or public laboratories. Similarly, given the huge initial investments involved, private sector research is hard-pressed to exit for the nearest profit-making opportunity. As a result, irrespective of its origin, technology research often leaves a number of potential applications unexplored. Ensuring follow-up programs, especially for developing regions, seems to be a promising possibility for both types of research efforts. Could it be that these low-hanging fruits harbor valuable solutions to the difficult problem of inclusive growth and environmental sustainability?

The presence of subsidies or taxation serves as an incentive or disincentive for utilizing particular technologies

217. **Pricing correctly.** Prices have an important role in technology diffusion and its adaptation. The presence of subsidies or taxation serves as an incentive or disincentive for utilizing particular technologies. Subsidies for fossil fuel are often cited as incentives for its excessive use, leading to very brown, though to some extent inclusive growth. Institutions like the International Monetary Fund, the World Bank and ADB suggest getting the prices right to begin addressing the fossil fuel problem. But, in much of development history, new technologies have kept emerging and have helped propel product markets, even as the related price systems seldom have had complete bases for pricing all dimensions of the product. This partial price-technology link in turn contributes to unsustainable product markets. These information asymmetries distort the spillover effects of technology, and are seldom factored in when determining prices. This contributes to wastage of natural resources or public health. Both subsidies and taxes have significant roles as instrument of functional public finance.

While many countries in Asia and the Pacific have achieved a lot recently, a more difficult development trajectory now confronts them

218. Thus, while many countries in Asia and the Pacific have achieved a lot recently, a more difficult development trajectory now confronts them. For example, merely opening up the rural areas with wide, paved roads, as a simple infrastructure project is hardly helpful if the water table is shrinking away, or if the auto-energy bill is not affordable. In other words, given that higher order constraints (climate change and natural disasters) are becoming binding, relieving the lower order constraints in isolation may not be catalytic for development, as it once was.

219. The new transition needs reform, new technology, and new pathways to development. Some of the key words are solar PVs and battery technology, wind power, smart grids and regional cooperation agreements, micro hydel, geothermal, biomass residues and waste usage, smart green subsidies and taxation, EE, information technology, mass transit, (agro-)forestry, and natural resource management. The cheaper and cleverer these technologies and practices become, the better their potential for widespread use and inclusive growth. ADB and its members need to reorient societies on the new ways of development. This is a daunting task.

E. What Can or Should ADB Do?

220. Responding to these challenges, Independent Evaluation's recent report *Inclusion, Resilience, Change* indicated seven areas in which ADB could step up (Box 6). The two most important ones lead to recommendations to further operationalize inclusive and environmentally sustainable growth in the region. The areas also include

regional cooperation and integration, good governance, operational performance, and team work. ADB’s contribution to direct investment in gender and development needs to be enhanced. An inclusive approach also implies more investments focused on rural areas. It is time for ADB and its member countries to search for innovations in which inclusive growth and environmental sustainability can go hand-in-hand.

221. IED’s inclusive growth study observes that ADB’s country partnership and strategy documents should undertake a more rigorous analysis of the country situation to be able to fashion new approaches to economic development. Improvement in the quality of country level analysis, through better prepared CPSs, could help in identifying appropriate solutions to the countries’ problems. Intensive efforts for mainstreaming inclusive growth objectives in the CPSs are already being made in several countries.

It is time for ADB and its member countries to search for innovations in which inclusive growth and environmental sustainability can go hand-in-hand

Box 6: 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— <i>the 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 country contexts. Play a stronger role as a knowledge broker.

Source: IED. 2014. *Inclusion, Resilience, Change: ADB’s Strategy 2020 at Mid-Term*. Manila: ADB.

Appendixes

APPENDIX 1: INDEPENDENT EVALUATION DEPARTMENT REPORTS COMPLETED IN 2013

Table A1.1: Evaluation Studies^a

Type/Title	Approval Date
A. Annual Report (1) <u>2013 Annual Evaluation Review</u>	24-May-13
B. Corporate Evaluation Study (1) <u>ADB's Decentralization: Progress and Operational Performance</u>	22-Oct-13
C. Thematic Evaluation Study (3)	
1. <u>ADB's Support for Achieving the Millennium Development Goals</u>	26-Apr-13
2. <u>ADB Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth</u>	19-Aug-13
3. <u>ADB Support for Strengthening the Enabling Environment for Private Sector Development</u>	28-Dec-13
D. Country Assistance Program Evaluation and CPS Final Review Validation (6)	
1. <u>India: Country Partnership Strategy 2009–2012 Final Review Validation</u>	15-Feb-13
2. <u>Nepal: Country Partnership Strategy 2010–2012 Final Review Validation</u>	08-May-13
3. <u>Thailand: Country Partnership Strategy 2007–2011 Final Review Validation</u>	20-Jun-13
4. <u>Georgia: Validation Report of the Final Review of Country Operations, 2008–2012</u>	07-Nov-13
5. <u>Country Assistance Program Evaluation for Pakistan</u>	08-Nov-13
6. <u>Bhutan: Country Partnership Strategy Final Review Validation</u>	20-Dec-13
E. Project/Program Performance Evaluation Report (10)	
1. <u>BAN: Grameenphone Telecommunications Project and Grameenphone Telecommunications Expansion Project (I7143/Loan 7194)</u>	18-Mar-13
2. <u>VIE: Vocational and Technical Education Project (Loan 1655)</u>	18-Apr-13
3. <u>PNG: Smallholder Support Services Pilot Project (Loan 1652)</u>	12-Aug-13
4. <u>CAM: Power Transmission Lines Co., Ltd./Power Transmission Project (I7256/Loan 2337)</u>	16-Dec-13
5. <u>PRC: Gansu Clean Energy Development Project (Loan 2013)</u>	19-Dec-13
6. <u>PAK: Punjab Road Development Sector Project (Loan 1928)</u>	24-Dec-13
7. <u>PAK: Road Sector Development Program (Loans 1892/1893)</u>	24-Dec-13
8. <u>PAK: Road Sector Development Program (Policy Loan) (Loan 1891)</u>	27-Dec-13
9. <u>INO: Decentralized Health Services Project (Loan 1810)</u>	27-Dec-13
10. <u>CAM: Commune Council Development Project (Loan 1953)</u>	27-Dec-13
F. TA Performance Report (2)	
1. <u>PRC: Facility-Type Technical Assistance in the People's Republic of China</u>	17-Apr-13
2. <u>REG: Strengthening Governance and Accountability in the Pacific</u>	27-Dec-13
G. Topical Working Paper (4)	
1. <u>Food Security Challenges in Asia</u>	09-Oct-13
2. <u>Evaluation Lessons on Transition: Possible Implications for Myanmar</u>	27-Dec-13

ADB = Asian Development Bank, BAN = Bangladesh, CAM = Cambodia, CPS = country partnership strategy, ERD = Economics and Research Department, IED = Independent Evaluation Department, INO = Indonesia, PAK = Pakistan, PNG = Papua New Guinea, PRC = People's Republic of China, REG = regional, TA = technical assistance, VIE = Viet Nam.

^a Evaluation reports are available at www.adb.org/site/evaluation/resources.

Source: Independent Evaluation Department database.

Table A1.2: Validation Reports^a

Loan/Grant No. Country	Project Name	PCR Circulation Year
A. Project Completion Report Validation Reports for Sovereign Operations		
1821/1822 MON	<u>Agriculture Sector Development Program and Project</u>	2009
1908 MON	<u>Second Education Development Project</u>	2009
1871 IND	<u>Private Sector Infrastructure Facility at State Level Project</u>	2009
1788 LAO	<u>Decentralized Irrigation Development and Management Sector Project</u>	2010
1994 LAO	<u>Small Towns Development Sector Project</u>	2010
1854 PAK	<u>North-West Frontier Province Urban Development Sector Project</u>	2010
2006 KAZ	<u>Rural Area Water Supply and Sanitation Sector Project</u>	2010
2229 PAK	<u>Mega City Development Project</u>	2010
2053 TAJ	<u>Education Sector Reform Project</u>	2010
2215/0030 AFG	<u>Fiscal Management and Public Administration Reform Program</u>	2011
2119/2120 AZE	<u>Urban Water Supply and Sanitation Project</u>	2011
1909 INO	<u>Poor Farmers' Income Improvement Through Innovation Project</u>	2011
1903 UZB	<u>Western Uzbekistan Rural Water Supply Project</u>	2011
1996 PRC	<u>Wuhan Wastewater Management Project</u>	2011
1919 PRC	<u>Songhua River Flood Management Sector Project</u>	2011
2208 UZB	<u>Kashkadarya and Navoi Rural Water Supply and Sanitation Sector Project</u>	2011
1782 BAN	<u>Northwest Crop Diversification Project</u>	2011
1647 IND	<u>Rajasthan Urban Infrastructure Development Project</u>	2011
1999 SRI	<u>Distance Education Modernization Project</u>	2011
2380 UZB	<u>Rural Basic Education Project</u>	2011
2351/2467 ARM	<u>Rural Road Sector Project</u>	2011
0021 REG	<u>HIV/AIDS Prevention and Capacity Development in the Pacific</u>	2011
1882 MLD	<u>Information Technology Development Project</u>	2011
1887 MLD	<u>Outer Islands Electrification (Sector) Project</u>	2011
1910/1911 SRI	<u>Aquatic Resource Development and Quality Improvement Project</u>	2011
2296 PRC	<u>Gansu Heihe Rural Hydropower Development Investment Program—Erlongshan Hydropower Project</u>	2011
2086 LAO	<u>Northern Community-Managed Irrigation Sector Project</u>	2011
1945 CAM	<u>Greater Mekong Subregion: Cambodia Road Improvement Project</u>	2011
2205/2206 AZE	<u>East-West Highway Improvement Project</u>	2011
1556/1557 IND	<u>Mumbai and Chennai Ports Project</u>	2011
1668 PHI	<u>Southern Philippines Irrigation Sector Project</u>	2011
2138/2139 SRI	<u>Financial Markets Program for Private Sector Development</u>	2011
1844 LAO	<u>Second Education Quality Improvement Project</u>	2011
2270 PAK	<u>Private Participation in Infrastructure Program</u>	2011
2072/2073 INO	<u>Neighborhood Upgrading and Shelter Sector Project</u>	2011
2184 INO	<u>Road Rehabilitation - 2 Project</u>	2011
1969/1970/1971 REG	<u>Greater Mekong Subregion: Mekong Tourism Development Project</u>	2011
1921/2088 TUV	<u>Maritime Training Project</u>	2011
2335 PAK	<u>Earthquake-Displaced People Livelihood Restoration Program</u>	2011
2148/2149/2150 BAN	<u>Small and Medium Enterprise Sector Development Program</u>	2011
1884/1885 BAN	<u>West Zone Power System Development Project</u>	2011
2664 GEO	<u>Social Services Delivery Program</u>	2011
0083/0164 LAO	<u>Private Sector and Small and Medium-sized Enterprises Development Program Cluster (Subprograms I and II)</u>	2011
1958/1959 IND	<u>Madhya Pradesh State Roads Sector Development Program</u>	2011
2409 BAN	<u>Emergency Disaster Damage Rehabilitation (Sector) Project</u>	2011
1894/1895/1896 SRI	<u>Small and Medium Enterprise Sector Development Program</u>	2011
1726 KGZ	<u>Agriculture Area Development Project</u>	2011
2183 REG	<u>Establishment of the Pacific Aviation Safety Office Project (Pacific Region)</u>	2011
2133 PAK	<u>Restructuring of the Technical Education and Vocational Training System Project (Balochistan)</u>	2011
1942/1943 BAN	<u>Dhaka Clean Fuel Project</u>	2011
2218 MON	<u>Financial Regulation and Governance Program</u>	2012
2060/2061 PAK	<u>Southern Punjab Basic Urban Services Project</u>	2012

Loan/Grant No. Country	Project Name	PCR Circulation Year
2040/2041/2042 SRI	<u>Rural Finance Sector Development Program</u>	2012
1964 INO	<u>Sustainable Capacity Building for Decentralization Project</u>	2012
2008 NEP	<u>Community-Based Water Supply and Sanitation Sector Project</u>	2012
2124 TAJ	<u>Irrigation Rehabilitation Project</u>	2012
2191 UZB	<u>Information and Communications Technology in Basic Education Project</u>	2012
2192/2193 INO	<u>Local Government Finance and Governance Reform Sector Development Program</u>	2012
2268/0059 NEP	<u>Rural Finance Sector Development Cluster Program</u>	2012
2134 PAK	<u>Sustainable Livelihoods in Barani Areas Project</u>	2012
B. Extended Annual Review Reports for Nonsovereign Operations^b		
7255/2336 KAZ	JSC Bank Center Credit	2011
7250/2322 MLD/SRI	South Asian SME Leasing Facility	2011
7229/2233-03 AZE	Private Banks and Leasing Companies in Azerbaijan (Accessbank)	2011
7170 REG	Mekong Enterprise Fund	2011
7246 KAZ	Guarantee Facility for Fixed-Rate Notes Issued by Alliance Bank JSC and Secured by Diversified Payment Rights	2011
7235/2235 KAZ	Term Loan Facility JSC Alliance	2011
7273/2405 PHI	Acquisition and Rehabilitation of the Masinloc Coal-Fired Thermal Power Plant	2011
7138/7211/2169 IND	Infrastructure Development Finance Company	2011
7236/2236 KAZ	Term Loan Facility JSC BTA Bank	2011
7226 REG	ADM Maculus Fund II L.P.	2011
7258/2341 AZE	Debt Financing to Bank of Baku	2011
7215 AFG	Afghanistan Renewal Fund Limited	2012
7227 IND	Urban Clean Fuels Project	2012
7245/2256 IND	Dahej Liquefied Natural Gas Terminal Expansion Project	2012
7156/7157 THA	Thai Recovery Fund and Thai Recovery Management Company (formerly Thailand SME Investment and Restructuring Fund and Thailand SMW Fund Management Company)	2012
7253/2326 IND	Tata Power Wind Energy Financing Facility	2012
7277/2417/2434 IND	Gujarat Paguthan Wind Energy Financing Facility	2012
7285/2435 PRC	Inner Mongolia Wind Power Project	2012

AFG = Afghanistan, ARM = Armenia, AZE = Azerbaijan, BAN = Bangladesh, CAM = Cambodia, GEO = Georgia, IND = India, INO = Indonesia, KAZ = Kazakhstan, KGZ = Kyrgyz, LAO = Lao People's Democratic Republic, MLD = Maldives, MON = Mongolia, NEP = Nepal, PAK = Pakistan, PCR = project completion report, PHI = Philippines, PRC = People's Republic of China, REG = regional, SRI = Sri Lanka, TAJ = Tajikistan, THA = Thailand, TUV = Tuvalu, UZB = Uzbekistan.

^a Evaluation reports are available at www.adb.org/site/evaluation/resources.

^b Evaluation reports will be uploaded once redacted versions are available.

Source: Independent Evaluation Department database.

APPENDIX 2: EVALUATIONS DISCUSSED BY THE DEVELOPMENT EFFECTIVENESS COMMITTEE IN 2013

Topic	Management Response	Date of DEC Meeting	DEC Chair Summary
SES: Real-Time Evaluation Study of the Multitranche Financing Facility	<u>15 January 2013</u>	17 January 2013	<u>17 January 2013</u>
IES: Shallow Tubewell Irrigation in Nepal: Impacts of the Community Groundwater Irrigation Sector Project	<u>4 February 2013</u>	19 February 2013	<u>19 February 2013</u>
Validation Report: Validation of the Final Review of Country Operations: Armenia, 2006–2011			
2012 Development Effectiveness Review		9 April 2013	<u>9 April 2013</u>
Thematic Evaluation Study: ADB's Support for Achieving the Millennium Development Goals	<u>15 May 2013</u>	22 May 2013	<u>22 May 2013</u>
2013 Annual Evaluation Review	<u>11 June 2013</u>	19 June 2013	<u>19 June 2013</u>
2012 Annual Portfolio Performance Review		26 June 2013	<u>26 June 2013</u>
Thematic Evaluation Study: ADB Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth	<u>4 September 2013</u>	11 September 2013	<u>11 September 2013</u>
IED Work Program 2014–2016			
Corporate Evaluation Study: Asian Development Bank Decentralization Progress and Operational Performance	<u>7 November 2013</u>	14 November 2013	<u>14 November 2013</u>
Country Assistance Program Evaluation Pakistan, 2002–2013 Source: Independent Evaluation Department.	<u>26 November 2013</u>	4 December 2013	<u>4 December 2013</u>

APPENDIX 3: LINKED DOCUMENTS

- A. **The Use of Project Success Ratings**
<http://www.adb.org/sites/default/files/A-Use-of-Project-Success-Ratings.pdf>
- B. **Summaries of Validations of Country Partnership Strategy Final Review Reports for Bhutan, Georgia, Nepal, and Thailand**
<http://www.adb.org/sites/default/files/B-Summaries-of-Validations-of-CPS-Final-Review-Reports.pdf>
- C. **Data on Staff Tenure from Project Completion Report Validations, 2008–2013**
<http://www.adb.org/sites/default/files/C-Data-on-Staff-Tenure-2008-2013.pdf>
- D. **Review of IED Recommendations and Management Actions**
<http://www.adb.org/sites/default/files/D-Review-of-IED-Recom-and-Mgt-Actions.pdf>
- E. **Follow-Up to Recently Completed Major Evaluation Reports**
<http://www.adb.org/sites/default/files/E-Follow-up-Recently-Completed-Major-Evaluation-Reports.pdf>
- F. **Issues Surrounding Sustainability of Energy Operations**
<http://www.adb.org/sites/default/files/F-Sustainability-of-Energy-Operations.pdf>

APPENDIX 4: MAJOR EVALUATION RECOMMENDATIONS AND MANAGEMENT RESPONSES IN 2013

Table A4. Summary of Recommendations and Management Responses for Thematic and Country Evaluations

No.	Report Title/Recommendation	Management Response
Recommendations Accepted or Agreed to by Management		
Country Assistance Program Evaluation Pakistan: 2002–2012 Continuing Development Challenges		
1	Given Pakistan's current situation, ADB's portfolio should include significant investments in pursuing a visible development impact on the poor and reduce vulnerability to disasters. Reforms in several sectors remain highly necessary, but ADB should prepare any program lending or technical assistance for these very carefully and with a long-term perspective, given the difficult experience of the recent past. ADB needs to pursue inclusive economic growth that is environmentally sustainable, while finding a balance among the programs of both the government and other development partners. For poverty reduction and human development-oriented social protection, ADB may need to use the limited ADF to which Pakistan has access, and technical assistance (TA) grants, if the government is reluctant to borrow nonconcessional funds.	Management agrees that support for human development, governance, and natural disaster is a priority. ADB's current operations cover these areas. For example, ADB has recently approved a \$430 million loan to Pakistan for the social protection project. Pending successful midterm review, this project can be replicated or expanded. Appropriate support in the recommended areas will be further discussed during the upcoming country partnership strategy (CPS) formulation. With regard to reducing vulnerability to disasters, Pakistan has made some progress in recent years, following the devastating earthquake in 2005 and floods in 2010 and 2011, with broad-based support from many development partners. As such, ADB's role is yet to be defined further in the broad context of the aid community's role.
2	ADB should pursue structural reforms as sector-specific programs using a programmatic approach. Reforms in various sectors should not be lumped together into one large program. Budgetary support for stabilization should be provided through the countercyclical support facility in times of crisis. The programmatic approach requires an extended timeframe and considerable staff resources. Policy conditionalities need to be carefully selected in dialogue with the government and key stakeholders through a transparent process that strengthens accountability. Implementation experience with past program loans needs to be carefully reviewed. ADB should also look into other modalities to pursue reforms in sectors. A cluster loan approach could be one option, and another the standalone operation as used by the World Bank. Finally, policy-based lending needs dedicated specialist staff in the Resident Mission (RM) to support reforms and monitor progress.	This is already reflected in ADB's ongoing energy sector operations, which envisage both a long-term program cluster and a series of integrated project loans, complemented by private sector investments.
3	While cancellations of loans may be beneficial if they are slow moving or the situation has changed, comprehensive spring cleaning of portfolios across the board may inadvertently lead to cutting the potential effectiveness of some project loans that are prematurely closed. Efforts to improve disbursement efficiency and instil more discipline in implementation should be accompanied by extensive consultation with clients at various levels and by careful assessment of the gains versus the costs of incomplete outcomes). Given the context of Pakistan, long project approval and implementation periods should be factored in.	Management concurs that efforts to improve disbursement efficiency and instil more discipline in project implementation should be accompanied by extensive consultations with clients at various levels and careful assessment of gains versus losses, with decisions to be taken on a case-by-case basis under specific circumstances. ADB's current portfolio in the country is much more streamlined and no comprehensive spring cleaning is envisaged in the foreseeable future.

No.	Report Title/Recommendation	Management Response
4	ADB's energy strategy in Pakistan and its reform achievements need to be reviewed to see if a course change is needed. Although ADB's energy strategy has been supported by the aid community, it has not been fully implemented. The government has shown its political will by settling a major portion of past dues and taking difficult decisions to raise tariffs. ADB can therefore use this opportunity to support implementation of the action plan formulated in the July 2013 National Energy (Power) Policy. While ADB's private sector operations strategy needs to consider its continuing primary reliance on energy operations, the Karachi Electric Supply Company experience demonstrates that it should be possible to improve the operational efficiency of power sector entities over the next few years. In the medium term, however, ADB could explore options such as (i) hydropower development, (ii) natural gas pipelines, and (iii) further privatization. All of these need feasibility studies first.	Management agrees in principle. As the lead development partner in energy, ADB has been in continuous dialogue with the government, to move forward with a reform agenda developed through the Friends of Democratic Pakistan Energy Task Force forum. Management believes various projects, that have been recently completed, contributed to the stability of the transmission and distribution systems in Pakistan. However, these investments may not be sustainable without the government's commitment to undertaking further reforms. ADB will continue to pursue necessary analysis, policy dialogue and aid coordination to ensure that appropriate policy measures and effective investment projects are put in place together to achieve energy security and sustainability in the country. The scope of ADB assistance may be adjusted to match the dynamic evolution of sector needs, as appropriate.
5	As part of its infrastructure support, ADB should consider expanding its work in urban and municipal services and social protection, given their effect on human development indicators. Municipal and social sectors interventions should generally be blended with community-level engagement and the use of nongovernment organizations should not be discarded. Social protection systems need special attention and close monitoring of impact on the eligible poor. ADB TA could also be used for innovative approaches to the strengthening of social services. Some interventions could be done in partnership with others that have a greater staff presence outside Islamabad.	Management agrees that this recommendation reflects the government's priority, and ADB's operational strategy for Pakistan. The government has prioritized investments in urban areas to provide basic infrastructure and services, and to improve the livelihood of the population of the cities. Community-level engagement is a useful approach to connect ADB assistance to those needing help the most. Such approaches have been used in collaboration with client/customer groups in city-based interventions, whereas in larger cities other institutional approaches such as those involving corporate entities and management contracts are required as the primary intervention.
6	ADB could help strengthen Pakistan's disaster response capability by increasing its support. It should strengthen the risk analysis in its projects in this area and further mainstream disaster risk mitigation measures in infrastructure projects. ADB has wide experience in the area of disaster management and could offer greater knowledge transfer (e.g., capacity development and other institutional support). ADB should consider supporting the new National Disaster Management Authority set up after the 2010 floods, and work more closely with several ministries and agencies to improve the disaster resilience of infrastructure and the preparedness of communities.	Management agrees in principle. However, ADB's role in this area needs to be carefully devised in consultation with other development partners. Pakistan has made considerable progress in disaster management in recent years. Nevertheless, Pakistan is one of the world's most natural disaster prone countries, and disaster management is thus high on the strategic agenda. In this context, ADB is examining the feasibility of introducing international and regional disaster risk insurance in the country. With its infrastructure investment projects, ADB will also continue to apply appropriate standards and make efforts to ensure quality of construction to mitigate disaster risks.
Corporate Evaluation Study on ADB Decentralization: Progress and Operational Performance		
7	Strengthen the technical capacity of RMs and delegate more operational responsibility to them, in particular project and technical assistance processing and administration. For this, RMs need to attract sector specialists, especially for sectors in which ADB is the lead development partner. For cost effectiveness considerations, national experts in countries where	Management agrees with the intent of the recommendation to ensure sufficient sector specialist presence to meet country sector priorities and portfolio support needs. This pertains not only to the number of staff in RMs, but more importantly, their capacity and responsibilities. However, budgetary implications

No.	Report Title/Recommendation	Management Response
	<p>such skills are available may be placed in RMs as vacancies open up. Some staff positions that are vacant at headquarters could be moved to RMs, especially where portfolios are large, while giving more recognition and operational responsibility to experienced RM national staff. In addition, ADB may refine its human resource policy to provide more incentives for international staff to rotate between headquarters and RMs as career progression steps, and give national staff more technical responsibilities with more career opportunities.</p>	<p>also need to be carefully assessed. Shifting staff positions from ADB headquarter to RMs may result in additional costs. Several regional departments (RDs) are already outposting headquarter sector division staff to RMs, as well as hiring in RMs specialists for sector and thematic areas. Management believes that there could be benefits from further delegation of processing and implementation of projects. However, ADB is a relatively small institution, and sector specialists generally work on more than one country. Transferring sector specialists to RMs may result in further fragmentation of expertise and loss of synergies across the board.</p>
8	<p>Differentiate the types of RMs to enable ADB operations and business processes to be more relevant and responsive to different types of countries, development contexts, and operational priorities. There are three options: (i) For areas far from headquarters, ADB can consider regional hubs (real and virtual) to house selected sector specialists from key sectors, and procurement, disbursement, and safeguard specialists with regional responsibilities. (ii) For smaller, less developed, and geographically scattered developing member countries (DMCs), ADB needs to extend the number of joint offices with other development partners, or to open satellite offices with a reporting line to a regional office or to a larger RM in the vicinity. (iii) For other DMCs with a large geographical area and a large portfolio, ADB may consider extending its local presence to other locations.</p>	<p>Management agrees that regional hubs, such as our Pacific Liaison and Coordination Office in Sydney, have been found to be feasible, and they are being explored in a number of regional departments. Extended missions to further strengthen country presence have been established in the past as such needs arose (e.g., in the wake of natural disasters).</p>
9	<p>Delegate direct operational support functions to RDs or RMs by increasing their capacity to undertake these functions. For RMs with significant portfolios, the direct operations support departments should increasingly delegate their activities and responsibilities (procurement, disbursement, and safeguards) to the RDs. This may be done by outposting staff and/or transferring authority to RMs or regional hubs or by placing dedicated staff with support functions under the management of each region. Using a risk-based approach, the capacity and authority of such staff may be enhanced by extending opportunities for training. A gradual approach with close monitoring would be cost effective and would enable delegation of projects to RMs much earlier than is currently done. Associated fiduciary risks should be considered carefully, and more oversight mechanisms to maintain corporate standards need to be put in place.</p>	<p>Management agrees in principle. Procurement, disbursement, and safeguards are areas where quick feedback is often required by DMCs, and RMs could play an important role. The Operations Services and Financial Management Department has placed four of its procurement staff in the front offices of the RDs. However, caution needs to be exercised in cases where the RD's headquarters sector specialists are needed to manage a set of complex projects or a particular aspect of projects such as safeguards. The decision to delegate such function to RMs needs to be made on a case-by-case basis in line with the mix of expertise needed at headquarters and in the RMs. Further decentralization of support department functions should also be explored, with due consideration of balancing costs and benefits.</p>
10	<p>Increase headquarters-RM connectivity and coordination and RMs' participation in knowledge activities. RMs are ideal for identifying local knowledge demand and also for sharing knowledge products and services across DMCs. However, the knowledge channels between ADB headquarters and RMs are currently weak. Two options for strengthening</p>	<p>Management agrees that practical means need to be sought to better link RM staff to headquarters-based communities of practice and other headquarters knowledge activities. It needs to be recognized that RMs are increasingly coordinating more knowledge management activities at the country level through the preparation of country</p>

No.	Report Title/Recommendation	Management Response
	knowledge services are highlighted: (i) Increase RM participation in the communities of practice and give RMs a larger role in partnering with local think tanks and in coordinating joint knowledge activities with in-country partners. (ii) Increase the 2-way interactions between headquarters and RMs and internal partnerships across knowledge departments, operations departments, and RMs.	knowledge plans based on the CPS. They are also actively being involved in the preparation of country-related and thematic knowledge products as well as knowledge sharing and dissemination at the country level, including for knowledge embedded in projects.
Thematic Evaluation Study on ADB's Support for Achieving the Millennium Development Goals		
11	Stretching the current priorities. ADB has stressed its operations related to environmental sustainability. Continuing to steer its main investments in transport and energy in this direction would increase ADB's role in environmental sustainability in the region. ADB may also wish to consider reviewing the lower prioritization of key millennium development goal (MDG) targets for which need outstrips the current efforts of governments and development partners.	Management agrees but this should not stretch ADB's resources too thinly. ADB is already strengthening the links between its infrastructure investments and outcomes related to education, gender equality, health, and the environment. ADB's new corporate results framework includes targets in basic infrastructure to provide access to roads, electricity, water, and sanitation as well as to improve the environment and address climate change. The issue is not to lower prioritization of MDGs, but to assess the effectiveness of the specific approaches adopted by ADB to support development outcomes in selected sectors during the midterm review of Strategy 2020.
12	Achieving synergies. To maximize synergies among goals, ADB could consider balancing its so far more substantial support for income generation (although it is also declining) with non-income human development goals such as education and health, also as this would develop the human capital base required for enhanced income goal progress.	Management intends to provide greater demand-based support for education and health, particularly through the Work Program and Budget Framework (WPBF) for 2013–2015. Through this WPBF, ADB will continue to retain sufficient flexibility in CPSs to provide support to the health sector.
13	Building alliances. Connectivity with the efforts of others is crucial to help bring about MDG outcomes. ADB should review its strategy of developing partnerships to support noncore sectors to see whether these are providing sufficient support, especially where off-track or slow MDGs are concerned.	Management agrees that partnerships (including with the private sector) on MDGs can be strengthened to leverage complementarities. As suggested, Management will review strategies for partnerships on Strategy 2020's core and other areas of operations to increase their effectiveness during the Strategy 2020's midterm review.
14	Confronting the lagging indicators. Targeting lagging indicators in the region, such as sanitation and carbon dioxide (CO ₂) emission, would be in line with ADB's commitment to the MDGs and with Strategy 2020.	Indicators on carbon emissions and sanitation are already well recognized in ADB's relevant operational plans and financing programs. ADB will continue to implement a focused approach targeting selected lagging indicators within the areas and sectors prioritized by Strategy 2020 for maximizing development impact.
15	Data and analysis. The problem of data is substantial, with many DMCs not able to track their progress due to unavailability of data. ADB can make a bigger effort in this area. A second issue, particularly pertinent to the huge variation among Asian countries, is that goal setting needs to consider different starting points. ADB, through its knowledge agenda, could bring this into the discussion of the post-2015 agenda and make resources available to define baseline data for countries, and assist country-led processes of nationalization of the MDG targets.	Management agrees with the need for better monitoring and tracking of the MDGs and related indicators. While the MDGs have exponentially increased demands for data from DMC official statistical systems, not enough support has been forthcoming to official systems. Efforts to fill this gap include: (i) close collaboration with development partners; (ii) TAs to strengthen DMCs' national statistical capacity on areas relevant to MDGs; and (iii) collaboration with multilateral institutions on data issues and capacity development for monitoring and

No.	Report Title/Recommendation	Management Response
		reporting of indicators and outcomes.
16	Project classification. ADB needs to ensure accurate application of the Project Classification System to facilitate better monitoring of MDG support and related outputs. More verification of classifications made by project officers ought to be organized. Training could be given to ensure that officers understand the parameters when classifying a project as a targeted or general intervention.	Management agrees with the recommendation. The Strategy and Policy Department has initiated a review of the project classification system in coordination with the Regional and Sustainable Development Department and other relevant departments. The review and any recommended changes to the classification system would be evidence-based and forward-looking in anticipation of the post-2015 development framework.
17	Setting a floor. In line with the recently articulated ZEN Approach for the Post-2015 Framework, a focus on the DMCs whose progress falls furthest below a minimum standard for basic goals could be warranted. ADB may consider using the allocation for noncore areas and more of its concessional Asian Development Fund (ADF) resources to support countries with the most need to achieve a minimum level for income, hunger, education, health, basic infrastructure, gender equality, and environmental protection. This may imply a different organizing principle for a portion of ADF, based less on a country's poverty status, and more on lagging MDGs or post-2015 goals.	This suggestion is duly noted. ADB is deeply involved in the global discussions on the framework and will consider defining its approach and stance on the subject in coordination with other development partners. It notes that country-level customization of the MDGs is already taking place, with countries in the region customizing MDGs by adding goals or raising standards under existing goals through stronger targets and indicators known sometimes as MDG+ indicators. Management, however, feels it is premature at this time to discuss changes to the organizing principles and financial allocations of the ADF in support of post-2015 until the new development framework itself becomes clear, there is agreement within ADB, and the ADF donors are taken on board.
Thematic Evaluation Study: ADB Private Sector Operations: Contributions to Inclusive and Environmentally Sustainable Growth		
18	Operationalizing inclusive and sustainable growth. Private Sector Operations Department (PSOD) needs to update its internal business strategy to help operationalize inclusive and sustainable growth objectives.	Management disagrees on the need to update PSOD's business strategy. It will continue to look at this in the context of an evolving corporate strategic framework, e.g., midterm review of S2020, and will review and implement suggestions on operationalizing inclusive and environmentally sustainable growth, as appropriate. PSOD is already addressing inclusive growth through selected highly demonstrative projects with inclusive elements. It completed a regional TA on inclusive business with Regional and Sustainable Development Department (RSDD) and is now working to operationalize its recommendations. While PSOD is making concerted efforts to promote inclusive and environmentally sustainable growth, such transactions can only make up a modest proportion of private sector operations due to inherent constraints. ADB is engaged in policy dialogue to remove constraints to private sector investments in social infrastructure and finance. PSOD agrees that additional emphasis could be placed in these areas and that policy dialogue to establish a conducive environment for clean energy and energy efficiency operations could be enhanced.

No.	Report Title/Recommendation	Management Response
19	Due diligence. PSOD and ADB need to (i) improve their analysis of project contributions to inclusive growth and related transmission channels, and (ii) strengthen their capacity for technical and economic feasibility assessments of clean energy projects.	Management agrees that ADB can still improve. Procedural examples highlight efforts in these areas. Sector and economic analyses for each PSOD transaction identify development challenges facing the country and sector. PSOD undertakes comprehensive due diligence on clean energy projects, e.g., assessing technical and economic feasibility. External independent lenders' technical advisers are also systematically engaged to review technical viability. To further strengthen economic and financial analyses, PSOD coordinates with Economics and Research Department and RSDD, especially on the valuation of environmental costs and benefits, and social discount rates for clean energy projects. The treatment of environmental and social safeguards is one of key ADB contributions to its interventions.
20	Monitoring development outcomes. PSOD needs to strengthen the monitoring of PSO development outcomes by (i) improving the inclusion of relevant outcome statements and indicators in project design and monitoring frameworks, and (ii) systematically collecting required monitoring reports from private sponsors and fund managers.	Management disagrees as the recommendation is redundant in the context of current efforts being implemented. While recognizing there is room for improvement, substantial effort has been made since 2009. There is now a dedicated Development Effectiveness and Safeguards Team to help strengthen the development rationale of non-sovereign operations. Each PSOD transaction has a design and monitoring framework (DMF) with a concise and logical outcome statement, with indicators to measure associated development objectives. PSOD also formally tracks and reports contributions to ADB's corporate results while its legal agreements (since 2013) has a clause requiring private sponsors to report on development results described in the DMF.

ADB=Asian Development Bank, MARS = management action record system.

^a This study had no recommendations, but has suggestions or has proposed measures that Management accepted or agreed to and which are therefore tracked in the MARS.

Source: Management Action Record System, available to ADB's Board and staff at:

<http://lnadbg1.asiandevbank.org/oed001p.nsf/MARSearch?OpenForm>