



**ASIAN DEVELOPMENT FUND 12 DONORS' REPORT:
SCALING UP FOR INCLUSIVE AND SUSTAINABLE
DEVELOPMENT IN ASIA AND THE PACIFIC**

Asian Development Bank

May 2016

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
ANE	–	accelerated note encashment
CA	–	concessional assistance
COL	–	concessional OCR lending
CPA	–	country performance assessment
CPS	–	country partnership strategy
DEfR	–	development effectiveness review
DMC	–	developing member country
DRF	–	Disaster Response Facility
DRM	–	disaster risk management
DRR	–	disaster risk reduction
DSA	–	debt-sustainability analysis
DSF	–	debt-sustainability framework
FCAS	–	fragile and conflict-affected situations
GACAP	–	Governance and Anticorruption Action Plan
GNI	–	gross national income
IDA	–	International Development Association
IED	–	Independent Evaluation Department
IMF	–	International Monetary Fund
IOC	–	instrument of contribution
Lao PDR	–	Lao People's Democratic Republic
MDG	–	Millennium Development Goal
NPV	–	net present value
OCR	–	ordinary capital resources
PBA	–	performance-based allocation
PBL	–	policy-based lending
PPP	–	purchasing power parity
RPG	–	regional public good
SDG	–	Sustainable Development Goal
TA	–	technical assistance
TASF	–	Technical Assistance Special Fund

NOTE

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

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

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EXECUTIVE SUMMARY

Concessional assistance (CA)-only countries have made good progress on sustaining economic growth and reducing poverty. Years of steady growth have led to a steep decline in the incidence of poverty. CA-only countries have also advanced on the Millennium Development Goals (MDGs). Yet, they continue to face large unmet development challenges. About 6 million people in these countries still suffer from absolute poverty and poor living conditions. They also remain off-track on 41% of the MDG indicators. Weak governance and underperforming institutions continue to stifle the delivery of basic services and hamper private sector development. CA-only countries have limited financing options to address these challenges, and require external financial support.

Recognizing the continued need for grants, Asian Development Fund (ADF) donors and Asian Development Bank (ADB) Management met to discuss the ADF 12 replenishment. Discussions focused on the strategic and operational priorities, and allocation and financial principles governing grants and concessional lending for the ADF 12 period to maximize ADB's development impact. ADF 12 is the first replenishment following the combination of ADF lending operations with the ordinary capital resources (OCR) balance sheet. From 2017 onward, the ADF will be a grant-only operation, while concessional lending operations will be financed from ADB's OCR balance sheet.

Donors endorsed the proposed strategic and operational approach for the ADF 12 period, which builds on the strategic priorities outlined in the Midterm Review of Strategy 2020 and underscores ADB's commitment to align itself with the new international development agenda. Donors welcomed ADB's approach to provide support for the broad international agenda in the context of its own strategic framework and comparative advantage, in collaboration with other development partners.

ADB will use financing from donors and its own resources to expand support for inclusive and sustainable development in CA-only countries, with a focus on fragile and conflict-affected situations (FCAS). ADB will adopt a revised and more outcome-oriented approach to inclusive growth. ADB support will focus on seven key priorities: (i) mainstreaming gender in operations, (ii) strengthening support for FCAS, (iii) promoting food security, (iv) supporting private sector development, (v) improving governance and capacities, (vi) strengthening preparedness and response to climate change and disasters, and (vii) promoting regional public goods.

To implement these priorities, sustainable infrastructure development will continue to be a mainstay of ADB's operations, encompassing investments in clean energy, sustainable transport, water, and urban development. ADB will also expand its social sector development interventions to complement its support for infrastructure and to deepen the inclusiveness of its overall assistance under ADF 12. Such support will be manifested in operations in the education and health sectors, a pilot in the area of regional health security, as well as for social protection.

To enhance ADB's effectiveness in addressing the challenges faced by CA countries, donors endorsed a number of revisions to the allocation mechanism governing ADF grants and concessional lending. Subsequent to the conclusion of the ADF 12 replenishment negotiations, ADB will submit a CA policy for the consideration of ADB's Board of Directors, which will incorporate revisions endorsed by ADF donors. These revisions include the following:

- (i) Increase support for small countries by introducing a base allocation of \$6 million per year to CA countries, and discontinue the 4.5% set-aside for Pacific developing member countries starting from ADF 12. Pacific countries negatively affected will receive allocations in ADF 12 that are at least at the level of resources received during ADF XI in real terms.
- (ii) Provide exceptional support to Afghanistan in ADF 12 at about the same level as in ADF XI.
- (iii) Increase exceptional support to Myanmar in ADF 12 by about 40% from ADF XI.
- (iv) Regularize the Disaster Response Facility for CA-only countries starting with the ADF 12 period.
- (v) Fully adopt the joint International Monetary Fund–World Bank Debt Sustainability Framework for low-income countries for debt-sustainability analyses and make International Development Association gap countries ineligible for ADF grants. To ensure a smooth transition for gap countries affected immediately by the policy change, these countries will become ineligible for ADF grants in 2019.
- (vi) Undertake country performance assessments every 2 years.
- (vii) Establish two reserves for changes in debt distress—one for grant resources at 20% of ADF grant allocations and another for concessional OCR lending (COL) at 5% of the COL resources to enable ADB to respond to volatility in grant demand. To optimize the use of resources, utilization of the grant reserve and its potential alternative use will be reviewed during the ADF 12 midterm review.
- (viii) Establish financing for disaster risk reduction (DRR) and the allocation of up to \$200 million ADF grants over the ADF 12 period to finance DRR. Donors also agreed for grant financing for DRR to be made available to all CA-only countries. DRR financing will be mainstreamed within the main ADF framework and will be integrated into the performance-based allocation process (PBA) process, providing an additional allocation to each CA-only country for DRR purposes. The proposed grant financing for DRR will initially be allocated across all CA-only countries in accordance with their pro-rata shares in the PBA, subject to a 50% portion of their pro-rata share in PBA for countries at low risk of debt distress and an absolute cap of \$20 million per country. The balance in grant resources will be redistributed to grant-eligible countries.
- (ix) Strengthen support for regional health security for all CA countries financed on a voluntary and pilot basis for the ADF 12 period. Financing would amount to up to \$150 million in ADF grants. Donors also agreed to extend the eligibility for grants to all CA countries in support of this initiative. The allocation of resources for regional health security will follow the same principle as the existing regional set-aside and will prioritize grant-eligible countries. For OCR-blend countries, greater ownership, including via a greater contribution of resources from their PBA compared with CA-only countries, would be a necessary condition for the provision of grants.

Donors decided to retain the ceiling on concessional policy-based lending. Donors called for an independent evaluation to assess the effectiveness of policy-based lending operations, after which it might be possible to revisit discussion of the ceiling.

The ADF–OCR combination provides the opportunity for ADB to scale up its assistance to CA countries substantially to contribute to their financing requirements. Overall, ADB intends to deliver over \$28 billion of lending assistance—\$13 billion of COL and \$15 billion of regular OCR lending—to the CA countries during ADF 12. This is a substantial increase in assistance compared to \$23 billion during the ADF XI period.

To match the increase in lending, donors agreed on an ADF grant replenishment of \$3.3 billion for ADF 12. This replenishment will finance ADF country operations (estimated at \$1.7 billion), regional operations (\$0.8 billion), reserves for changes in debt distress (\$0.3 billion), the Disaster Response Facility (\$0.2 billion), and administrative expenses (\$0.3 billion). In addition to the \$3.3 billion in new resources for the core activities of the ADF, \$0.05 billion was contributed to the ADF facility for regional health security.

Donors and ADB also discussed the vital importance of technical assistance in ADB operations. Demand for technical assistance during ADF 12 is set to increase, driven by (i) higher overall assistance levels; (ii) greater assistance for FCAS, education and health operations, and social protection initiatives to promote inclusive economic growth; (iii) environmental operations to address challenges such as climate change and food security; (iv) expanded private sector operations and development and infrastructure investments in the lagging areas; and (v) regional cooperation and integration. To meet this higher demand, donors agreed to replenish the Technical Assistance Special Fund at \$0.5 billion, equivalent to 3% of the proposed CA level of \$16 billion for the ADF 12 period.

The total replenishment amounting to \$3.8 billion will be financed from the following sources: (i) \$2.6 billion from new donor contributions (a reduction of 47% compared with ADF XI), (ii) \$1.0 billion net income transfers from OCR subject to annual approvals by ADB's Board of Governors (an increase of 116% compared with ADF XI), and (iii) \$0.2 billion from income from liquidity investment. Indonesia rejoined as an ADF donor.

I. INTRODUCTION

1. The Asian Development Fund (ADF) 12 replenishment covering 2017 to 2020 takes place at a crucial time. The development agenda is undergoing substantial changes, resulting from the adoption of the Sustainable Development Goals (SDGs, Appendix 1), the Third International Financing for Development Conference, and the 2015 Conference of the Parties on Climate Change.

2. ADF 12 is also the first replenishment following the combination of ADF lending operations with the ordinary capital resources (OCR) balance sheet. From 2017 onward, the ADF will be a grant-only operation, while concessional lending operations will be financed from the OCR balance sheet of the Asian Development Bank (ADB).

3. ADF donors and ADB Management met from October 2015 to May 2016 to decide on the strategic and operational priorities, and allocation and financial principles, for the ADF 12 period. This report records the key agreements reached during these meetings. It focuses on the ADF grant replenishment, and the objectives it aims to achieve in concessional assistance (CA)-only countries that are currently or potentially grant-eligible. Reference is made where appropriate to the broader context governing CA (both ADF grant and concessional OCR operations) and its allocation framework, covering all countries eligible for CA. Altogether, 27 developing member countries (DMCs) are expected to have access to CA during the ADF 12 period (Table 1). Seventeen countries are CA-only countries. Of these, 13 are currently at high or moderate risk of debt distress. Nine CA countries are classified as fragile and conflict affected situations (FCAS).¹

Table 1: Classification of Concessional Assistance Countries

Grants-only Countries^b	CA-only Countries^a	COL-only Countries^d	OCR Blend Countries
Afghanistan	Bhutan	Cambodia	Bangladesh
Kiribati	Kyrgyz Republic	Lao PDR	Federated States of Micronesia
Maldives	Solomon Islands	Myanmar	Mongolia
Marshall Islands	Tajikistan	Nepal	Pakistan
Nauru	Tonga		Palau
Samoa	Vanuatu		Papua New Guinea
Tuvalu			Sri Lanka
			Timor-Leste
			Uzbekistan
			Viet Nam

ADF = Asian Development Fund, CA = concessional assistance, COL = concessional OCR-only, Lao PDR = Lao People's Democratic Republic, OCR = ordinary capital resources.

^a Based on the 2014 Debt Distress Classification for ADF-only Countries.

^b With high risk of debt distress.

^c With moderate risk of debt distress.

^d With low risk of debt distress.

Source: Asian Development Bank. 2013. Classification and Graduation of Developing Member Countries. *Operations Manual*. OM A1/BP. Manila.

¹ FCAS countries include Afghanistan, Kiribati, the Marshall Islands, the Federated States of Micronesia, Myanmar, Nauru, Solomon Islands, Timor-Leste, and Tuvalu (as of 2015). See ADB Fragile Situations Resources Center. <http://fragilesituations.adb.org>

II. DEVELOPMENT CHALLENGES IN CONCESSIONAL ASSISTANCE-ONLY COUNTRIES

4. **Steady but slow economic growth.** CA-only countries overall demonstrated robust growth of 6.3% during ADF X (2009–2012), driven by Afghanistan’s high growth rates in 2009 and 2012. The first half of ADF XI (2013–2014), however, coincided with a significant decline in the growth rates of the CA-only country group. The economic prospects of the 17 CA-only countries are being adversely affected by slower growth in major trading partners, natural hazards such as the impact of droughts and flooding, and lower remittances and constrained public spending in some countries. As a result, the average economic growth of these countries is expected to moderate to 5.8% in 2015 and 5.9% in 2016.²

5. **Declining but persistent poverty.** Years of steady growth have led to a decline in the incidence of poverty in CA-only countries. On the new \$1.90-a-day poverty line (in 2011 purchasing power parity [PPP] terms), the number of poor in CA-only countries is estimated to have fallen from 22 million in 1990 to 6 million in 2012, representing a 71% decline.³ This translates to a reduction in the percentage of population living below the absolute poverty line from 51% in 1990 to 10% in 2012 in these countries.

6. CA-only countries have progressed more slowly, however, on the new \$3.10-a-day poverty threshold. By 2012, 24 million people in CA-only countries still lived in poverty and the number of poor people on this measure fell by only 20% during 1990–2012. The number of people in CA-only countries living between \$1.90-a-day and \$3.10-a-day, and who are vulnerable and susceptible to falling into absolute poverty when subject to shocks, doubled from the 1990 level of 9 million to 18 million in 2012. Continued progress is needed to reach the target under goal 1 of the SDGs to eradicate extreme poverty by 2030.

7. **Need to reduce inequality.** Inequality lessened in CA-only countries, with their median Gini index falling from 38 (based on the earliest available data during the 1990s to the early 2000s) to 33 (based on 2012 or latest available data). Overall, with falling absolute poverty and lower inequality, growth in CA-only countries appears to have supported greater inclusiveness. However, the inclusive growth agenda in CA-only countries is far from being achieved, as the remaining poverty and vulnerability need to be decisively defeated, and much more progress needs to be made on the non-income dimensions of well-being. Sustained progress is, therefore, required by CA-only countries on goal 8 of the SDGs to achieve inclusive and sustainable growth and goal 10 of the SDGs to further reduce inequality.

8. **Progress needed to achieve the Millennium Development Goals.** CA-only countries are expected to achieve only 59% of the 47 Millennium Development Goal (MDG)-related indicators’ targets by 2015, for which data is available from the United Nations Economic and Social Commission for Asia and the Pacific.

² While the extent of these impacts is not yet fully known, ADB noted that it should be ready to support CA-only countries in times of economic distress and make sure it has the right tool kit to respond. More details are in the chair’s summary of the second ADF 12 replenishment meeting, held on 25–27 February 2016 in Kathmandu, Nepal.

³ In October 2015, the World Bank released a new set of PPP conversion factors for 2011. This led to the revision of the international poverty line. The new poverty line is \$1.90 per person per day, which is consistent with the previous \$1.25 line in 2005 PPP terms in poor countries. The second poverty line of \$3.10 in 2011 PPP has been proposed to compare with the previous \$2.00-a-day poverty line in 2005 PPP. See F. Ferreira et al. 2015. A Global Count of the Extreme Poor in 2012: Data Issues, Methodology and Initial Results. *Policy Research Working Paper*. No. 7432. Washington, DC: World Bank.

9. CA-only countries have done well on selected MDG indicators. For example, the percentage of undernourished people fell by almost three times in CA-only countries from 52% in 1990 to 18% in 2013–2015. However, 27 million people in CA-only countries remain undernourished. Further progress is needed to meet the target under goal 2 of the SDGs to end all forms of malnutrition and hunger by 2030. Under-5 mortality rates also declined significantly in CA-only countries from 130 (deaths per 1,000 live births) in 1990 to 58 in 2013–2015. However, this rate of decline is still not sufficient to achieve the targeted two-thirds reduction in under-5 mortality under the MDGs. Goal 3 of the SDGs takes this target further by requiring a complete end to preventable deaths of newborns and under-5 children by 2030.

10. CA-only countries as a group have made significant progress toward the MDG target for universal primary education. Primary completion rates have risen from 39% in 1990 to as much as 98% in 2015. Gender disparities in primary education have also narrowed. However, gender inequities remain noticeable at the secondary education level (girl–boy ratio of 0.93) and significant at the tertiary education level (girl–boy ratio of 0.86). Progress in these areas is needed to achieve goal 4 of the SDGs on ensuring inclusive and equitable quality education for all.

11. Gender inequities in CA-only countries also remain profound in political representation in national parliament and equality in employment, where the share of women in wage employment is only 37% (in 2015). Goal 5 of the SDGs has raised the bar on achieving gender equity by calling for an end to all forms of discrimination against women and girls everywhere and ensuring equal opportunities for women’s leadership at all levels by 2030.

12. The target for halving the proportion of the population without access to safe drinking water has been achieved in CA-only countries. However, the rate of increase in the percentage of the population using improved sanitation has not been sufficient and most CA-only countries will be unable to meet the MDG target of halving the population without access to basic sanitation. Almost 40% of the population in CA-only countries remains without access to improved sanitation. Progress has to be accelerated to achieve the target under goal 6 of the SDGs to ensure universal access to adequate and equitable sanitation by 2030.

13. A different scale of effort and financing is required to meet the SDGs, which are ambitious and costly to achieve. Developing Asia requires an estimated \$1 trillion annually to meet them.⁴ No single funding source will be sufficient to finance these goals. CA-only (and other countries) will need to tap into a combination of resources, including greater domestic resource mobilization, private transfers, and international official and other development assistance.

14. **Weak governance and institutions.** Progress on governance remains weak in CA-only countries relative to Developing Asia as a whole. Furthermore, several governance indicators—

⁴ This estimate is indicative and broadly derived from the overall estimate of the trillions of dollars required to meet the SDGs globally. The costs associated with meeting the current MDGs, eliminating poverty, and financing infrastructure could be calculated separately to estimate the overall cost of meeting the SDGs in Asia and the Pacific. Meeting the MDGs has been estimated to require over \$100 billion per year in financing, while eliminating poverty at the \$2 per day threshold will require over \$300 billion. Meeting infrastructure needs may require over \$750 billion per year during 2010–2020. See ADB. 2015. *Making Money Work: Financing a Sustainable Future in Asia and the Pacific*. Manila.

including those related to the rule of law,⁵ government effectiveness,⁶ and regulatory quality⁷—have regressed during 2005–2013. The indicator measuring perceptions on the control of corruption has, however, shown improvement over time.⁸ Among CA-only countries for which data are available, Afghanistan, Myanmar, and Tajikistan particularly score low on most governance indicators. Countries in FCAS, in general, are even further behind CA-only countries on governance indicators.

15. **Limited financing options.** CA-only countries face major challenges in mobilizing financial resources to meet their development needs. The capacity of CA-only countries to raise domestic revenues to finance the needed development investments remains weak and inadequate. Their underdeveloped financial sectors limit the possibility of any significant increase in resources from the private sector. Remittances are an important financing source for these countries but they have to be better channeled to address current and emerging investment gaps. Official development assistance transfers remain insufficient. In this context, the Financing for Development Conference noted that an important use of international public finance, including official development assistance, is to catalyze additional resource mobilization from other sources by supporting improved tax collection and helping to strengthen domestic enabling environments and build essential public services.⁹ Several new financing institutions, including the Asian Infrastructure Investment Bank, the New Development Bank, and the Green Climate Fund have recently emerged. However, CA-only countries might find it challenging to access financing from these institutions.

III. THE CASE FOR THE ADF 12 GRANT REPLENISHMENT

16. The large unmet development challenges, in combination with the limited financing options, require continued external financial support for CA-only countries. About 6 million people in these countries continue to suffer from absolute poverty and poor living conditions, and about 24 million subsist on less than \$3.10 a day. These countries also remain off-track on 41% of the MDG indicators, including under-5 and maternal mortality, broader gender equity, and improved sanitation. Weak governance and underperforming institutions continue to stifle delivery of basic services, hamper private sector development, and breed corruption. Adding to these challenges is the ambitious mandate of the new global development agenda that calls for ending poverty, hunger, and other key development problems. The longer reach of the new agenda requires more financing and support to meet the widened development gaps faced by CA-only countries.

17. Following the ADF–OCR combination, ADB plans to increase its concessional OCR lending (COL) to CA-only countries by nearly 60% over the ADF 12 period to support CA-only countries in addressing their development challenges and helping them make progress on the

⁵ The indicator on the rule of law reflects perceptions of the extent to which agents have confidence in and abide by the rules of society—in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

⁶ The indicator on government effectiveness reflects public perceptions on the quality of public services, the civil service and the degree of its independence from political pressures, and policy formulation and implementation.

⁷ The indicator on regulatory quality reflects perceptions on the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

⁸ The indicator on the control of corruption reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests.

⁹ United Nations. 2015. *Outcome Document of the Third International Conference on Financing for Development: Addis Ababa Action Agenda*. Addis Ababa.

SDGs. A strong grant replenishment is required to match the increase in COL. The case for the ADF 12 grant replenishment builds on (i) the need for grant assistance to address poverty, the SDGs, and other development challenges in the region; and (ii) ADB's demonstrated effectiveness in assisting countries address their development challenges. Going forward, ADB will reflect on the future role that ADF grants can play beyond the ADF 12 replenishment in supporting its DMCs to address their development challenges. This work will be conducted in the context of the development of its new long-term strategy.

A. The Need and Rationale for Grant Assistance

18. **Debt sustainability.** Grant assistance is first and foremost required for countries whose capacity to service and repay external debt, even on concessional terms, is limited by persistent current account imbalances and trade deficits, low domestic revenues, and inadequate foreign exchange reserves. Eligibility for ADF grants is governed by the debt-sustainability framework (DSF), which extends grant financing to countries that face a high or moderate risk of debt distress. CA-only countries that face the risk of debt distress, and are consequently constrained in accessing loan and market-based financing, continue to require grants to address their development financing needs. ADB will continue to extend grant assistance to eligible countries under the DSF for its country-based operations, projects financed by the regional set-aside, and projects financed from the Disaster Response Facility (DRF).

19. Of the 13 countries currently at risk of debt distress, seven face a high risk of debt distress and, therefore, receive 100% grant financing.¹⁰ Another six countries are classified as facing a moderate risk of debt distress and receive 50% grant financing.¹¹ ADB projections, based on the latest International Monetary Fund (IMF) debt-sustainability analyses (DSAs),¹² indicate that the number of low-risk CA-only countries is likely to decrease and shift to moderate risk classification. High-risk countries are expected to remain in this category, with a couple of countries likely moving to moderate risk classification. These countries will continue to require grant financing for necessary public investments to mitigate poverty and raise living standards until they develop stable economies and improve their debt-carrying capacities.

20. **Willingness to pay.** Grant financing is also critical in market failures, where the incentives or willingness of countries to borrow are weak or absent because they cannot capture the full benefits expected from a project financed by a loan. Regional public goods (RPGs) and disaster risk reduction (DRR) projects and interventions are strong examples of areas that are likely to be underinvested in by individual countries because they carry externalities and spillovers.

21. While a lack of willingness to pay for these kinds of interventions occurs in all countries, irrespective of their development status, the problem is especially acute in CA countries, which often do not invest at all in these areas because of their limited financing options (para. 15). CA countries therefore need incentives to increase investment in these areas given the collective action problem, externalities, and spillover effects. Grant assistance can support critical measures to help develop cross-border infrastructure and services to expand trade and economic opportunities, address climate change and boost resilience to disasters, and promote regional health security and control of communicable diseases. Grant assistance also plays a

¹⁰ These include Afghanistan, Kiribati, Maldives, the Marshall Islands, Nauru, Samoa, and Tuvalu.

¹¹ These include Bhutan, the Kyrgyz Republic, Solomon Islands, Tajikistan, Tonga, and Vanuatu.

¹² ADB. 2015. Proposed Revisions to the Performance-Based Allocation System. Paper prepared for the First ADF 12 Replenishment Meeting, Manila, Philippines, 28–30 October.

key role in promoting knowledge solutions and policy dialogue on development challenges and issues that have region-wide consequences and implications.

22. **Disaster risk reduction.** The growing frequency of climate change-induced and other disasters requires extending grant support to build greater resilience to such calamities. This includes support for generating and disseminating better and timely disaster risk information; integrating disaster risk concerns in development and investment planning and design; and enforcing protective regulatory measures such as zoning and building codes, particularly in dense urban areas.

23. Grant financing is required to help redress several factors contributing to underinvestment in disaster resilience. First, in the face of limited resources, governments typically favor projects that address short-term development priorities, yield assured near-term benefits, and generate positive streams of direct or indirect income. Second, the nature and scale of disaster risk, opportunities to strengthen resilience, and related net benefits are insufficiently understood.

24. **Regional public goods.** Because of insufficient resources, CA countries tend to underinvest on RPGs. Grant and other resources are needed to help CA countries increase investments in RPGs to mitigate development challenges that spill over national boundaries and those that create and expand economic opportunities. Grant assistance will help create incentives for CA countries to increase investment, capture positive externalities, and mitigate market failure associated with RPGs.

25. **Technical assistance.** Grant financing is also needed for technical assistance (TA) to help countries build institutional capacity and support the preparation and execution of development projects. TA is also crucial in supporting dialogue among DMCs and learning events across the region. TA has been an important funding source for sharing regional knowledge and building far-reaching strategic partnerships. The TA needs of FCAS countries to build local capacities and strengthen public service delivery and financial management systems are especially acute, and need to be financed on a larger scale.

B. The Case for the ADF 12 Grant Replenishment

26. Having established the need for enhanced grant support, the case for providing resources to ADB for the ADF 12 replenishment builds on the relevance, effectiveness, and efficiency of ADB's strategy and operations.

27. ADB is a longstanding development partner of CA-only countries. It has a successful record of delivering assistance and obtaining results in these countries through the previous ADF replenishment rounds. Over 2011–2014, ADB's CA achieved impressive development results in CA-only countries, with 439,000 students benefiting from new or improved educational facilities; 186,000 teachers trained to competency standards; 192,000 new households connected to electricity; 260,000 households with new or improved water supply connections; 2,100 kilometers of provincial, district, and rural roads built or upgraded; and 564,000 new microfinance accounts opened. The success rates of ADB's completed sovereign operations in CA-only countries increased from 60% during 2009–2012 to 67% during 2013–2014. The target is to increase the success rate to 80% by 2016.

28. External assessments of the development effectiveness of ADB's support have been consistently positive and improving over time. The *Quality of Official Development Assistance*

2014 report promotes ADB to the 5th rank on maximizing efficiency in providing effective aid among 31 member countries and multilateral agencies in the Development Assistance Committee of the Organisation for Economic Co-operation and Development.¹³ The *Aid Transparency Index 2014* ranks ADB 5th among 68 donor organizations.¹⁴ A Multilateral Aid Review for 2013–2014 of the United Kingdom’s Aid Committee rates ADB *very good* (the highest possible rating) for overall value for money.¹⁵ The 2013 report of the Multilateral Organisation Performance Assessment Network appreciates the clarity of ADB’s development strategy, its commitment to managing for development results, and its ability to use performance information to revise policies and plan new interventions.

29. In 2015, ADB’s Independent Evaluation Department (IED) conducted an evaluation of ADF X and XI operations.¹⁶ The study confirmed that the ADF X and XI strategic priorities agreed by donors and ADB were *highly relevant* to the evolving needs and challenges of CA countries. It emphasized that continued attention to disaster risk management (DRM), private sector development, gender equality, FCAS, governance, and food security will be important for the relevance of the ADF in countries where these remain prominent issues. The study recognized that the ADF has performed well in many areas of operations, and that ADF project-level success rates have improved. It noted that ADF-supported projects in health and social protection, transport, multisector operations, and education have had relatively high success rates. It also noted that the ADF has responded to the changing landscape and that a reformed and better-resourced ADB can make a bigger difference.

30. The study recommended that ADB (i) strengthen support for inclusive growth and environmentally sustainable growth, and scale up climate change adaptation and DRM efforts; (ii) adopt more systematic and operationally relevant diagnostic studies—a knowledge-first approach—to sharpen country and sector programs and improve results on strategic priorities; (iii) strengthen the concessional resource allocation framework; and (iv) build expertise in the key strategic areas to deepen engagements and improve results. ADB Management agreed with the recommendations.

31. Recognizing the scope for improvement in certain areas, ADB continues to reform. Following the Midterm Review of Strategy 2020,¹⁷ ADB is undertaking comprehensive measures to strengthen its operational efficiency and effectiveness, improve internal capacity, respond to the changing business environment, and sharpen ADB’s operational and strategic focus. The objective of the reforms is for ADB to respond better and faster to evolving circumstances in the region.¹⁸

32. Donors noted that ADB has made good progress on internal reforms since the ADF XI midterm review, but that staff capacity should be strengthened across priority sector and thematic areas. Business processes should also be more streamlined to improve efficiency and

¹³ N. Hashmi, N. Birdsall, and H. Kharas. 2014. *The Quality of Official Development Assistance 2014*. CGD Briefs. Washington, DC: Center for Global Development.

¹⁴ Publish What You Fund. 2014. *Aid Transparency Index 2014 Report*. <http://ati.publishwhatyoufund.org/>

¹⁵ Government of the United Kingdom, House of Commons International Development Committee. 2013. *Multilateral Aid Review: Fourth Report of Session 2013–14*. London: The Stationery Office Limited.

¹⁶ IED. 2015. *Corporate Evaluation Study on Asian Development Fund X and XI Operations: Opportunity Amid Growing Challenges*. Manila: ADB.

¹⁷ ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

¹⁸ ADB. 2015. *ADB’s Internal Reforms under the Strategy 2020 Midterm Review Action Plan*. Paper prepared for the First ADF 12 Replenishment Meeting, Manila, Philippines, 28–30 October.

effectiveness, including simplifying procurement processes. Donors also called for a stronger focus on project readiness, completion rate, and quality and speed of implementation to improve project performance. Donors welcomed the improving success rates of ADB's operations and called on ADB to solidify the improving trend from the earlier low success levels. The importance of improving project efficiency and sustainability was highlighted. Donors appreciated ADB's progress on recruiting more women and promoting greater diversity in the institution. They appreciated ADB's efforts to seek the Economic Dividends for Gender Equality (EDGE) certification for workplace gender equality by implementing a targeted action plan. ADB was asked to improve the gender balance at all levels of the organization.

IV. ADB'S APPROACH FOR INCLUSIVE AND SUSTAINABLE DEVELOPMENT IN CONCESSIONAL ASSISTANCE-ONLY COUNTRIES

33. Donors endorsed the proposed strategic and operational approach for the ADF 12 period. The approach builds on the strategic priorities outlined in the Midterm Review of Strategy 2020, which was completed in April 2014 (footnote 17). The midterm review reiterates ADB's core commitment to poverty reduction and inclusive economic growth in DMCs, commits to addressing environmental degradation and building resilience to climate change and natural hazards, strengthens regional cooperation and integration prospects, and promotes sustainable infrastructure development. The midterm review also underscores ADB's resolve to enhance its focus on private sector development and operations and promote better knowledge solutions.

34. The approach highlights ADB's commitment to align itself with the new international development agenda to support CA-only countries in overcoming their still formidable challenges and reaching the next stage of their development. 2015 was a defining year for the new development agenda, defined by the SDGs, the Financing for Development Conference, and the Conference of the Parties on Climate Change. Donors welcomed ADB's approach to provide support for the broad international development agenda in the context of its own strategic framework and comparative advantage, and in collaboration with other development partners.

35. The approach aligns with the anticipated strategic thrusts of ADB's new corporate strategy (currently being prepared), which will support DMCs in progressing toward the SDGs, eliminating poverty, and mitigating inequality and vulnerability. The new corporate strategy is expected to be approved in 2018.

36. ADB will use financing from donors and its own CA over ADF 12 to expand support for inclusive and sustainable development in CA-only countries, with a focus on FCAS countries. ADB will prioritize seven key thematic areas of support and operationalize these areas through customized development investments at the country level, including for sustainable infrastructure and social sector development. Financing assistance will be complemented with knowledge services and an emphasis on partnerships with relevant institutions to provide innovative, value-adding, and synergistic development solutions. ADB will work with a wide range of partners, including the private sector, civil society organizations, and philanthropic agents. Civil society organizations will be actively involved in the design and implementation of projects, particularly those that use grassroots participatory approaches to development, and in the monitoring of project activities and outputs.

A. Strategic and Thematic Emphasis on Inclusive Growth and Sustainable Development

37. ADB will maintain its focus on inclusive growth, sustainable development, and regional integration. Opportunities to better integrate these agendas and identify mutual complementarities across operations will be explored. The Midterm Review of Strategy 2020 underscored the continued validity of these strategic agendas and committed ADB to deepen its support for achieving inclusive growth and sustainable development in Asia and the Pacific.

38. The corporate focus on inclusive growth and sustainable development is operationalized through the country partnership strategy (CPS), which defines the directions of ADB's engagement with a DMC. To embed the emphasis on inclusive growth, ADB revised and improved its guidelines on inclusive economic growth in the CPS in 2015 to ensure that the CPS adequately reflects how ADB will support country objectives and targets on inclusive growth.¹⁹ At the project level, ADB continues to support lagging areas and regions to strengthen the inclusiveness of its assistance in CA countries.

39. Donors called for a revised approach to inclusive growth that is focused on outcomes and is better informed by diagnostics and analysis. Donors and ADB agreed on the need for a focus on results and outcomes, rather than inputs, and a clear articulation of how ADB's interventions will support inclusive growth—especially for poor, vulnerable, and marginalized groups.

40. ADB will support seven thematic priorities to promote inclusive growth and sustainable development during ADF 12: (i) mainstreaming gender in operations, (ii) strengthening support for FCAS, (iii) promoting food security, (iv) supporting private sector development, (v) improving governance and capacities, (vi) strengthening preparedness and response to climate change and disasters, and (vii) promoting regional public goods.

41. **Gender.** ADB has strengthened its operational focus on gender equality under its gender operational plan approved in April 2013,²⁰ and the renewed commitment made in the Midterm Review of Strategy 2020 to direct more investments to women and girls (footnote 17). The percentage of sovereign projects in CA-only countries completed in 2012–2014 that achieved intended gender equality results was 63%.

42. Donors welcomed ADB's efforts and encouraged ADB to deepen gender mainstreaming, including improved measurement of sex-disaggregated data, and to expand investment in gender targeted projects. Moving forward, ADB will intensify its efforts to ensure that gender equality remains at the front and center of its development efforts, and to accelerate progress on closing remaining gender gaps. Over the ADF 12 period, ADB will accelerate efforts to meet the target of 70% of completed sovereign projects delivering the intended gender equality results.²¹ The implementation, monitoring, and reporting of project gender action plans will be strengthened. ADB will continue the two-tracked approach of gender mainstreaming and direct

¹⁹ ADB. 2015. Revised Guidelines on Inclusive Economic Growth in the Country Partnership Strategy. *Compendium of Clarifications*. Manila.

²⁰ ADB. 2013. *Gender Equality and Women's Empowerment Operational Plan, 2013–2020: Moving the Agenda Forward in Asia and the Pacific*. Manila.

²¹ This is the 2016 target for CA operations based on ADB's corporate results framework. This paper employs the 2016 corporate results framework targets where the Midterm Review of Strategy 2020 does not indicate targets for 2020; otherwise, 2020 targets are used.

investments in women and girls. Access of women to economic opportunities and jobs through financial services, business development services, and skills and vocational training—particularly in nontraditional and high-paying sectors—will be a key priority. Interventions to narrow gender gaps in the social sectors, including health, education, and social protection will continue.

43. Projects providing direct gender equality benefits—such as rural electrification, affordable and safe transport services, water and sanitation, street lighting, and time-saving technologies—will be encouraged. Building women’s climate and disaster resilience and supporting women as change agents in climate change mitigation and DRM will be a priority. Pilot activities, partnerships, and knowledge products to attack entrenched gender norms—including violence against women, child marriage, and unequal care work burden—will be considered. ADB will continue to enhance gender equity and mainstreaming in ADB projects and will assess how to strengthen gender-related indicators in the revised results framework.

44. **Fragile and conflict-affected situations.** ADB’s support for FCAS is premised on the importance of understanding the local context for customized support, providing a long-term commitment, ensuring country ownership, and remaining flexible in responding effectively to the unique challenges in FCAS countries. ADB’s *Operational Plan for Enhancing ADB’s Effectiveness in Fragile and Conflict-Affected Situations*²² aims to improve the development impact of ADB support to DMCs experiencing fragility and the effects of conflict on either a national or subnational level. To ground its operations in the political, economic, and environmental realities of FCAS, ADB developed and pilot tested conflict-sensitive approaches in Afghanistan and Nepal;²³ carried out fragility assessments in selected urban settlements in Kiribati and Papua New Guinea;²⁴ and undertook political economy analyses in the Federated States of Micronesia, Papua New Guinea, and Vanuatu.

45. ADB is supporting state-building efforts in FCAS to strengthen and reinforce the foundations for social and economic development. ADB provided more than \$1 billion to FCAS countries during 2013–2014 under the ADF performance-based country allocations,²⁵ with the bulk of this financing allocated to Afghanistan and Nepal. FCAS countries in the Pacific received 8% of the total financing during this period.

46. ADB will strengthen an FCAS-sensitive planning and implementation approach in its operations. A customized risk management framework will provide guidance in managing differentiated risks in FCAS countries. The framework highlights how ADB’s business processes can be customized in each phase of the project cycle to better address or mitigate economic, political, governance, and natural risks.²⁶ An institutional strengthening framework will guide long-term institution building in FCAS countries.²⁷ Donors welcomed ADB’s efforts to strengthen its field presence in the Pacific (now in 12 out of 14 DMCs), which aims to improve coordination and cooperation with development partners and government agencies. The recruitment of staff

²² ADB. 2013. *Operational Plan for Enhancing ADB’s Effectiveness in Fragile and Conflict-Affected Situations*. Manila.

²³ Nepal was considered FCAS in 2013.

²⁴ Papua New Guinea was included in the FCAS list in 2007–2012.

²⁵ Including the portion of post-conflict premium to Afghanistan.

²⁶ ADB. 2014. *Engagement in Fragile and Conflict-Affected Situations: Customized Risk Management Framework*. <http://www.adb.org/sites/default/files/publication/42828/customized-risk-management-framework.pdf>

²⁷ ADB. 2014. *Engagement in Fragile and Conflict-Affected Situations: Institutional Strengthening Framework—A Guidance Note*. <http://www.adb.org/sites/default/files/publication/42830/institutional-strengthening-framework-guidance-note.pdf>

with Pacific expertise, strengthening of field offices, use of local project facilitators, and the in-depth local knowledge of development coordination officers is expected to improve project implementation. A communication strategy will be designed and implemented in selected FCAS countries to inform and engage stakeholders as well as enlist and sustain public support for ADB's development initiatives.

47. Donors called on ADB to continue expanding staff capacity and resources for project management in FCAS that require systematic conflict and/or fragility analysis and better preparation and supervision. Donors in particular called on ADB to strengthen its expertise, staff, and internal incentives for conflict-sensitive project management in FCAS. The need for streamlining internal processes—including those related to procurement—for operations in FCAS, as well as to pay greater attention to project design and conflict sensitivity, was recognized.

48. **Food security.** ADB has maintained significant food security investments in CA-only countries during the ADF XI period, amounting to \$1.3 billion during 2013–2014. A multisector approach has been pursued to promote food security and support agricultural development by involving the entire food supply chain.

49. ADB's food security engagement in CA-only countries during the ADF 12 period will be guided by a new operational plan for 2015–2020.²⁸ Under this plan, ADB will commit an average of \$2 billion annually to support food security in all DMCs and help reduce the vulnerability of the poor to food price increases. Four key areas will be prioritized: (i) increasing productivity and reducing pre- and post-harvest food losses, (ii) improving market connectivity and value chain linkages, (iii) enhancing food safety and quality, and (iv) enhancing the management and climate resilience of natural resources. These areas are linked to key elements of the food value chain (production, processing, distribution, and consumption) and will require innovative and integrated multisector approaches and interventions to address food security issues effectively.

50. ADB will adopt differentiated approaches for strengthening food security, based on specific priorities and needs in DMCs. Such tailored responses, which combine ADB's project interventions with creative knowledge solutions and strong partnerships, will ensure country ownership and results.

51. **Private sector development.** ADB continues to expand support for private sector development and operations, with the target of reaching 50% of annual ADB operations by 2020. This increased from 38% in 2010–2012 to 45% in 2012–2014.²⁹ In CA-only countries, the share of ADF-financed operations supporting private sector development and operations increased from 17% in 2010–2012 to 33% in 2012–2014. This has included assistance for infrastructure and clean energy projects, projects that support “inclusive business,” and those that require innovative financing such as credit enhancements.

52. ADB will maintain a clear focus on expanding private sector support in CA-only countries, including upstream support to improve investment climates and business environments and downstream direct investments to increase private sector operations. The target is to increase private sector operations in CA countries to 40% of total approved

²⁸ ADB. 2015. *Operational Plan for Agriculture and Natural Resources: Promoting Sustainable Food Security in Asia and the Pacific in 2015–2020*. Manila.

²⁹ ADB. 2015. *2014 Development Effectiveness Review*. Manila.

operations (by number) by 2020. ADB will strengthen the emphasis on supporting public–private partnerships. ADB’s newly established Office of Public–Private Partnerships has prioritized the extending of transaction advisory services to help prepare public–private partnership projects in DMCs, including CA-only countries Myanmar and Nepal.

53. ADB will also expand access to finance in CA-only countries by supporting financial institutions that provide targeted lending to small and medium-sized enterprises. Inclusive business represents an important area of growth. New inclusive business projects are under processing, including for affordable housing and several with strong gender elements. Investment opportunities in comparatively new sectors for private sector operations—including health, education, and agribusiness—are being explored.

54. To facilitate processing of smaller transactions that are of particular relevance to CA-only countries, the ADB Board of Directors approved in March 2015 the Faster Approach to Small Nonsovereign Transactions, which streamlines the concept review and Board approval process for eligible transactions involving ADB financing of \$20 million or less (\$10 million or less for equity investments).

55. **Governance and institutional capacity.** Recognizing that governance and institutional capacity shortfalls continue to impede the quality, effectiveness, and access to public services necessary for inclusive growth, goal 16 of the SDGs includes a clear reference to the need to “...build effective, accountable and inclusive institutions at all levels.” To anchor governance issues firmly in DMC operations, ADB is placing renewed emphasis on implementing its Second Governance and Anticorruption Action Plan (GACAP II). Recommendations of a GACAP II review completed in 2013 are being pursued to improve the consistency in implementing ADB’s governance and anticorruption policies at the country and sector levels and in the monitoring of risk management plans.

56. ADB will continue to implement GACAP II by systematically cascading risks at country, sector, and project levels to inform risk management plans. Greater attention will be given to (i) assessing country systems for public financial management and procurement to enable ADB’s shift over time toward the use of these systems; and (ii) improving country systems through building necessary capacities, including for strengthening audit and oversight and social accountability mechanisms. A capacity development operational plan for 2015–2020 (under preparation) will boost these capacity development initiatives and help position ADB as a premier regional catalyst of better institutional performance in DMCs.

57. ADB will strengthen the quality and increase the volume of public sector management operations, emphasizing (i) domestic resource mobilization (taxation, non-tax revenues, and public expenditure management) in line with its importance under the new global development financing agenda and growing interest from DMCs; and (ii) investments in systems and institutional capacity, including those that support an enabling environment for private sector and financial markets development.

58. Country performance assessment (CPA) ratings reveal that CA countries have made steady progress on policy and institutional performance over the past decade, including structural reforms, social inclusion and equity, and public sector management. At the same time, available data show that the CA countries continue to lag in terms of policy and institutional reforms.

59. Policy-based lending (PBL) is an important lending modality that ADB uses to support policy dialogue and reforms in DMCs. ADB sought donor guidance to replace the current hard ceiling of the concessional PBL share, set at 22.5% of the entire concessional public sector lending on a 3-year average basis, with the new requirement for ADB Management to report the prospective PBL share to the Board for information. While donors stressed that ADB should continue to be a project-centered institution, they also recognized the usefulness of well-designed PBL to support institutional and sector reforms. Donors highlighted the importance of strong policy dialogue and proper monitoring and reporting mechanisms. Several donors inquired about PBL performance and how the instrument would be used to meet ADF 12 objectives. No consensus was reached on the ADB proposal. Donors called for an independent evaluation to assess the effectiveness of PBL operations, following which ADB will consider its approach to PBL for discussion with the donors at the ADF 12 midterm review, as well as with its Board of Directors.

60. **Climate change and disasters.** ADB plans to double its annual climate change financing from the current \$3 billion to \$6 billion by 2020. Strengthening climate change resilience in CA-only countries by helping them manage climate risks and reduce losses from climate-related disasters is a priority for ADB. ADB's project classification system supports climate mainstreaming by classifying projects based on the anticipated risk that climate variability and change pose to them. The system records the quantified reduction in and avoidance of emissions of greenhouse gases resulting from mitigation measures incorporated in projects. ADB introduced the mandatory climate risk screening of projects in 2014.

61. ADB will continue leveraging assistance to mobilize financing for climate adaptation and mitigation, in line with the goals set under the Conference of the Parties on Climate Change. This will include tapping as well as seeking cofinancing opportunities from dedicated trust funds (such as the Urban Climate Change Resilience Trust Fund established under the Urban Financing Partnership Facility) and external sources (such as the Global Environment Facility, the Green Climate Fund, and the Climate Investment Funds).

62. ADB will (i) increase support for clean energy and sustainable transportation for climate mitigation in CA-only countries; (ii) promote environmentally-smart agriculture, including climate-resilient crop varieties and green/organic technologies, which will also boost inclusion and create economic opportunities for women; and (iii) build capacity in fast-growing urban environments to promote climate resilience in planning and designing infrastructure projects and in delivering social services.

63. Donors recognized that growing vulnerability to disasters in CA-only countries is a major threat, and supported mainstreaming DRR into ADB's operations. CA-only countries have fewer resources to invest in DRR or to ensure that they are prepared to meet relief, early recovery, and reconstruction costs when disasters strike. In 2014, ADB launched an operational plan for integrated DRM, to invigorate its efforts to strengthen disaster resilience.³⁰ One of the three pillars of the operational plan focuses on the integration or mainstreaming of DRR into development. Disaster resilience measures have been embedded in the design of a wide range of projects. These measures address both existing disaster risks and potential changes in the frequency and intensity of extreme climate events as a consequence of climate change. The approach is applied in both development projects and in post-disaster response projects, where it is known as "building back better." In accordance with the operational plan, the integration of

³⁰ ADB. 2014. *Operational Plan for Integrated Disaster Risk Management 2014–2020*. Manila.

DRM is also being institutionalized into ADB's core business processes. ADB will continue to strengthen disaster risk considerations in project concepts and designs to enhance resilience. Existing climate risk screening tools will be expanded to incorporate disaster risk considerations.

64. To help CA-only countries strengthen disaster resilience and overcome the impact of disasters, a DRR financing mechanism will be introduced (para. 82), and the DRF will be mainstreamed under ADF 12 (paras. 85–86). Both financing mechanisms will complement each other. The DRR mechanism will tackle the root causes of disaster risk, while the DRF provides financing for recovery and reconstruction following a disaster. CA-only countries will also benefit from ADB's \$20 million replenishment of the Asia Pacific Disaster Response Fund in May 2015.

65. **Promoting regional public goods.** To continue its strong commitment to the promotion of RPGs, ADB will expand and diversify its support to (i) mitigate financial and disaster risks as well as improve cross-border health security,³¹ (ii) assist CA countries to manage common or shared natural resources, (iii) assist them to implement commitments under COP21 and other similar agreements with regional and global spillovers, and (iv) support pilot programs or projects in these areas. Given the significant needs to address a broader range of RPGs through collective action, ADB's support would facilitate CA countries to become full partners with more advanced DMCs in important collective action development processes and joint investments that are vital to the region's future success in relation to economic, social, and environmental goals. In addition, ADB's increased focus on operationally relevant knowledge work would enable the pilot testing of new RPG initiatives, particularly related to environment and health.

B. Operational Focus on Sustainable and Inclusive Infrastructure and Social Sector Development

66. The strategic and thematic priorities of inclusive growth, sustainable development, and regional integration will be operationalized and implemented through specific sector and project operations. Sustainable infrastructure development will continue to be a mainstay of ADB's operations to implement these priorities. ADB will expand its support for social sector development to complement its infrastructure support and deepen the inclusiveness of its overall assistance under ADF 12. ADB expects to deliver substantial results in each of these sectors in CA-only countries over the ADF 12 period (Appendix 2).

1. Sustainable and Inclusive Infrastructure Development

67. **Clean energy.** ADB's continued engagement in clean energy projects will support goal 7 of the SDGs to "ensure access to affordable, reliable, sustainable and modern energy for all." ADB will maintain its assistance for the Sustainable Energy for All Initiative, which seeks to universalize access to energy by 2030, double the amount of renewable energy in the total energy mix, and double the rate of improvement in global energy efficiency. Several CA-only countries have joined the initiative and with ADB's support, Bhutan and Nepal are developing country action and investment plans to achieve these goals.

³¹ ADB's Operational Plan for Health, 2015–2020 lays out ADB's mandate to expand its support for health-related RPGs. See ADB. 2015. *Health in Asia and the Pacific: A Focused Approach to Address the Health Needs of Developing Member Countries, Operational Plan for Health, 2015–2020*. Manila.

68. **Sustainable transport.** Sustainable urban transport is a growing part of CA transport operations. ADB will increase investments in CA-only countries during ADF 12 in sustainable public transport systems that are accessible, safe, affordable, and environment-friendly. ADB will focus on effective and sustained maintenance of built infrastructure through improved approaches for asset management systems and long-term road maintenance contracts. Gender components are being increasingly and effectively mainstreamed in transport projects, which are now the largest contributor to gender mainstreaming among CA projects. Regional and transborder infrastructure projects are providing better regional connectivity and boosting prospects for greater trade and economic cooperation.

69. **Water management.** Water operations during ADF 12 will improve water security, revitalize irrigation, integrate DRM and climate resilience, lift the capacity of water utilities, and expand sanitation and wastewater management investments.

70. **Urban development.** In line with goal 11 of the SDGs to “make cities and human settlements inclusive, safe, resilient and sustainable,” ADB will increase assistance under ADF 12 to promote the social inclusion, green growth, and economic competitiveness of urban areas in CA-only countries. From an inclusiveness perspective, the focus will be on upgrading slum settlements; strengthening housing, land tenure, and development; and expanding housing finance. From a green growth perspective, the emphasis will be on building the capacities of cities to adapt to and mitigate climate change by (i) using fewer natural resources such as land and water; and (ii) promoting energy-efficient buildings, urban transport, and industry. From a competitiveness perspective, ADB will support the development of urban economic clusters and prioritize investments to address key constraints to urban economic development.

2. Social Sector Development

71. **Education.** The Midterm Review of Strategy 2020 commits ADB to double its education sector operations to reach 6%–10% of total approvals by 2020 (footnote 17). ADB will use these resources to help CA-only countries expand education opportunities, improve learning outcomes, and acquire skills. A strong focus on inclusion in education will be maintained by ensuring that students from disadvantaged groups (female students, students from poor families, remote areas, and ethnic minorities) benefit from ADB’s assistance.

72. **Health.** The Midterm Review of Strategy 2020 commits ADB to increase its health sector operations to 3%–5% of total approvals by 2020. In 2015, ADB approved a new Operational Plan for Health, 2015–2020, which aims to support DMCs to achieve universal health coverage in line with SDG 3 and to strengthen regional health security. ADB will support CA-only countries in health system strengthening to achieve universal health coverage by expanding access to quality health services and by improving DMCs’ preparedness for outbreaks and pandemics.

73. **Social protection.** ADB will mainstream social protection components in sector operations, and identify more stand-alone social protection interventions in CA-only countries. Programs that invest in public financial management to increase spending on social protection and build capacities to implement social protection programs will be pursued. ADB will enhance partnerships with the private sector and deepen collaboration with other international and national development agencies in policy formulation, capacity development, and knowledge generation related to social protection.

V. USE OF ADF 12 RESOURCES

A. Revisions to the Performance-Based Allocation System

74. The performance-based allocation (PBA) system remains the cornerstone of the governance mechanism for concessional resources. To enhance ADB's effectiveness in addressing the challenges faced by CA countries, donors endorsed a number of revisions to the PBA system. Most of these revisions aim to increase resources to small, fragile, and conflict-affected CA countries and to address emerging challenges related to DRM and, on a pilot basis, regional health security. Other revisions improve the efficiency of the allocation process, or are required to implement ADF 12 operations smoothly under the ADF–OCR combination.

75. Subsequent to the conclusion of the ADF 12 replenishment negotiations, ADB will submit a concessional assistance policy³² for the consideration of ADB's Board of Directors. The policy will consolidate and adapt relevant policies for operations applicable to ADF resources to cover their application to include COL. The concessional assistance policy will incorporate revisions endorsed by ADF donors.

76. **Increased support for small countries.** During ADF XI, ADB introduced a minimum allocation of \$3 million per year in the PBA system for CA countries. ADB's experience has demonstrated that ensuring a meaningful amount of support in the smaller Pacific island countries to address unmet country needs has contributed to development in these countries. To enhance its support to small DMCs, and improve the effectiveness and performance incentives of the allocation system, donors agreed to replace the current \$3 million per year minimum allocation with a \$6 million per year base allocation for all CA countries. These enhanced allocations will allow ADB to scale up efforts to ensure key infrastructure is more climate-resilient and environmentally sustainable, and to improve maritime links. They will also allow ADB to support education and health projects in the pipeline and to invest in improving water supply and sanitation and public sector management.

77. With the introduction of the \$6 million per year base allocation, projected allocations to all Pacific DMCs, except for Papua New Guinea, are increased from their respective country allocations in 2015–2016, and exceed the current 4.5% set-aside for the Pacific DMCs. Donors agreed to discontinue the 4.5% Pacific set-aside. The discontinuation is in line with IED's recommendation to remove the 4.5% set-aside for Pacific island countries (footnote 16). Donors also agreed that Pacific DMCs negatively affected by the removal of the 4.5% Pacific set-aside will receive their allocations under ADF 12 at the level of resources received during ADF XI in real terms. The additional grant resources will be obtained from the ADF grant reserve and the additional COL resources from the COL reserve (paras. 94–96).

78. **Exceptional post-conflict support to Afghanistan.** The PBA policy recognizes the need for flexibility in allocating concessional resources to post-conflict and reengaging countries. ADB's approach to exceptional allocations to such countries aligns with the International Development Association (IDA) 16 framework, which provides exceptional post-conflict and reengaging assistance to eligible countries (footnote 12).

³² ADB. 2016. Draft Concessional Assistance Policy. Paper prepared for the Second ADF 12 Replenishment Meeting, Kathmandu, Nepal, 25–27 February.

79. Under ADF XI (2013–2016), Afghanistan continues to receive exceptional post-conflict assistance, reflecting the need to sustain ADB operations and build on hard-won but still-precarious progress in post-conflict reconstruction and recovery in the country. This assistance would gradually phase out during 2017–2020. Recognizing the need for a continued strong ADB presence in Afghanistan, donors agreed to suspend the phaseout of post-conflict assistance to Afghanistan for the ADF 12 period. Afghanistan will receive its PBA formula-based allocation plus 7/18 of the post-conflict premium in 2017–2018 as well as in 2019–2020. The post-conflict premium during the ADF 12 period will be calculated as follows: (Post-conflict premium) = (\$847 million)³³ – PBA formula-based allocation. This will enable ADB to provide about the same amount of exceptional support to Afghanistan during ADF 12 as during ADF XI, i.e., \$858 million of post-conflict assistance. The proportion of grant assistance to Afghanistan will continue to be based on its risk of debt distress, in accordance with the ADF grants framework.

80. **Exceptional support to Myanmar.** ADB is providing exceptional support to Myanmar during ADF XI. The exceptional allocation covers the initial 2 years of reengagement (2013–2014) and gradually phases out over the subsequent 3 years (2015–2017). Donors recognized that additional concessional resources are required if ADB is to assist Myanmar in maintaining the reform momentum, reducing the high poverty rate, improving connectivity, overcoming power shortages, and building human capital. They agreed to suspend the phaseout of reengaging assistance to Myanmar during 2017–2020. Myanmar will receive its annual PBA formula-based allocation plus 2/4 reengaging premium in 2017–2018 as well as during 2019–2020. The reengaging premium during the ADF 12 period will be calculated as follows: (Reengaging premium) = (\$524 million)³⁴ – annual PBA formula-based allocation. This will enable ADB to increase exceptional support to Myanmar during ADF 12 to \$1.4 billion, compared with \$993 million in ADF XI.

81. To ensure that resources are used most efficiently, ADB committed to review the special allocations to Afghanistan and Myanmar at the ADF 12 midterm review and adjust them if required. Donors also stressed that increasing allocations should be accompanied by developing absorptive capacity (through increased TA and ADB staff on the ground).

82. **Disaster risk reduction.** Recognizing the growing vulnerability to disasters, donors agreed to provide up to \$200 million of grant financing for DRR during the ADF 12 period. DRR financing will be mainstreamed within the main ADF framework and will be integrated into the PBA process, providing an additional allocation to each CA-only country for DRR purposes. The proposed grant financing for DRR will initially be allocated across all CA-only countries in accordance with their pro-rata shares in the PBA, subject to a 50% portion of their pro-rata share in PBA for countries at low risk of debt distress and an absolute cap of \$20 million per country. The balance in grant resources will be redistributed to grant-eligible countries. Donors also expressed their preference for ultimately allocating DRR resources in line with countries' disaster risk, recognizing that an appropriate indicator does not exist at this point. Once an

³³ The exceptional biennial allocation of \$734 million in ADF XI was a proportional scale-up from that in ADF X. With the approved ADF–OCR combination and the projected larger combined resource envelope in ADF 12, the exceptional biennial allocation of \$847 million could not follow the approach of ADF XI and was recalibrated to enable ADB to provide exceptional support to Afghanistan in ADF 12 at about the same level of post-conflict assistance.

³⁴ Similar to the case of Afghanistan, with the approved ADF–OCR combination and the projected larger combined resource envelope in ADF 12, the exceptional annual allocation of \$524 million was recalibrated to enable ADB to increase exceptional support to Myanmar in ADF 12 to about \$1.4 billion.

appropriate disaster risk indicator is available, ADB will consult with donors on the use of the indicator for the allocation of resources under the DRR financing mechanism.

83. To incentivize countries to invest in disaster risk reduction and mainstream it into their broader expenditure, countries at low risk of debt distress will be provided access to an amount of COL resources at a 2:1 ratio and will be required to utilize either COL, own, or other resources on at least a matching 1:1 basis for every \$1.00 of utilized grant financing. Countries at medium risk of debt distress will be provided access to additional COL resources at a 1:1 ratio to their grant allocation and will be required to utilize at least \$0.50 in COL, own, or other resources for every \$1.00 of grant financing.

84. While there was broad agreement on DRR financing, a few donors expressed reservations, noting the complexity of the allocation mechanism, and requested ADB to monitor the use of resources carefully, in particular the use of grants in countries at low risk of debt distress. ADB committed to monitor progress on the use of DRR resources and implementation of DRR interventions, including through the results framework, and report back to donors at the ADF 12 midterm review.

85. **Disaster Response Facility.** ADB is piloting the DRF during 2013–2016.³⁵ The DRF is ADB's first dedicated financing for early recovery and reconstruction operations, offering a more flexible, predictable, and timely source of financing for this purpose. The strong demand for DRF assistance has reduced the balance of unallocated DRF for 2015–2016 to only \$14 million.

86. Disaster losses are expected to rise over the next few decades as demographic and economic expansion continues in hazard-prone areas with little regard for disaster risk. ADB will need to have ready and regularized resources to reduce disaster risk and support the post-disaster response. In this context, donors agreed to regularize the piloted DRF for CA-only countries, starting from the ADF 12 period. Agreed financing needed for the grant DRF is estimated at \$218 million, or 10% of ADF grant allocations for the ADF 12 period. DRF lending will be funded from the COL reserve. Regularizing the DRF is in line with IED's recommendation to institutionalize and expand the DRF (footnote 16). A number of donors requested that IED evaluate the DRF at the ADF 12 midterm review.

87. **Regional health security.** ADB proposed to strengthen its support for regional health security through grant financing for all CA countries via a set-aside within the ADF contribution framework. Some donors expressed concerns about ADB's comparative advantage in the health sector. ADB clarified that it was uniquely placed to provide support for regional issues, including regional health security, because of its involvement and demonstrated record in several regional cooperation programs.

88. In light of differing views, donors agreed to ADB supporting regional health security for all CA countries provided this was financed on a voluntary and pilot basis for the ADF 12 period, while protecting the existing regional set-aside resources. The financing of up to \$150 million ADF grants will be sourced in two ways: (i) "below the line" voluntary contributions; and (ii) "above the line" contributions, as part of the regular ADF contribution framework.³⁶ The latter contributions would first go toward meeting the financing requirements until the total proposed

³⁵ ADB. 2012. *Piloting a Disaster Response Facility*. Manila.

³⁶ This additional contribution, regardless of "below the line" or "above the line" by a certain country, does not affect other countries' contribution shares.

contributions reach \$2,547 million. Following this, additional contributions would go toward the top-up of the ADF regional set-aside in support of the regional health security, up to \$150 million.³⁷

89. The allocation of resources for regional health security will follow the same principle as the existing regional set-aside, and will prioritize grant-eligible countries. For OCR-blend countries, greater ownership, including via a greater contribution of resources from their PBA compared with CA-only countries, would be a necessary condition for the provision of grants.

90. ADB will closely monitor the use of resources for regional health security and will report to ADF donors at the ADF 12 midterm review meeting. ADB also proposes that IED undertake an evaluation of the use of this financing before the end of the ADF 12 replenishment period.

91. **Debt-sustainability framework.** The ADF grants framework used to determine eligibility for ADF grants aligns with the IDA grants framework. However, ADB deviates from the joint IMF–World Bank DSF by applying its own CPA ratings in place of the World Bank’s country policy and institutional assessment ratings as determinants of the indicative debt burden thresholds. As a result, ADB’s assessment of risk of debt distress in recent years has differed in a few cases from the assessment of the IMF–World Bank joint DSA. To ensure consistent policy messages to the countries, donors agreed to fully adopt the joint IMF–World Bank DSF for low-income countries for DSA by ADB.

92. Under the IDA grants framework, gap countries are not eligible for IDA grants.³⁸ This has resulted in instances where a DMC received ADF grants from ADB, while receiving credit in blend terms from IDA. To ensure consistency of financing terms, donors agreed to align the ADF grants framework with that of IDA in this aspect.³⁹ To ensure a smooth transition for countries affected immediately by the policy change (Bhutan and the Lao People’s Democratic Republic [Lao PDR]),⁴⁰ ADB and donors agreed that they will become ineligible for grants in 2019 instead of in 2017.

93. **Country performance assessments.** Under the prevailing PBA policy, CPAs are generally conducted annually. To be more efficient in the use of its resources, donors agreed that ADB may undertake CPAs every 2 years. Increasing the frequency can be considered if the situation warrants it.

94. **Reserves.** The demand for grants over a replenishment period is difficult to predict, as it is determined by the annual debt sustainability assessments. Experience indicates that grant demand has exhibited substantial volatility as a result of changes in debt distress classification. With the ADF–OCR combination, the separate and smaller pool of ADF grant resources must independently respond to fluctuations in the demand for grants, and there is no longer any flexibility to accommodate increased demand for grants in the event that more countries

³⁷ Additional “above the line” contributions for a particular donor imply additional contributions above the “indicative ADF 12 contributions” detailed in ADB. 2016. ADF 12 Financing Framework Update. Paper prepared for the Second ADF 12 Replenishment Meeting, Kathmandu, Nepal, 25–27 February. p. 4 (Table 4). This would not impact the ADF 12 contribution share of other donors.

³⁸ IDA defines gap countries as countries with per capita gross national incomes above the operational cutoff for more than 2 consecutive years, but not creditworthy for borrowing from the International Bank for Reconstruction and Development, except for small island economies.

³⁹ In FY2016, Bhutan and the Lao PDR are IDA gap countries in Asia and the Pacific.

⁴⁰ As of 2015, Bhutan and the Lao PDR are assessed at moderate risk of debt distress.

experience debt distress. The volume of grants available for commitment is determined up front at the start of the replenishment period, as negotiated with donors. Given the relatively small size of the grant resource pool, this may result in a substantial reduction in grant allocations to existing grant-eligible countries, if more countries become eligible for grants during the replenishment period.

95. To respond to this volatility in grant demand, donors agreed to the need to establish a reserve for changes in debt distress classification. The size of grant reserve was agreed at 20% of ADF grant allocations. This reserve will provide additional grant resources in response to changes in a country's debt distress risk. To optimize the use of resources, the utilization of the reserve and its potential alternative use will be reviewed during the ADF 12 midterm review. At the end of each replenishment, the unused balance of the reserve will be used as part of financing for the subsequent replenishment.

96. In addition, ADB will establish a reserve amounting to 5% of the concessional lending resources. This will finance the DRF for concessional lending countries, and increased demand for COL as countries' debt distress situation improves.

B. Financing Technical Assistance

97. TA is a vital part of ADB operations. It supports ADB's lending and grant operations through project preparation and capacity development, and via strategic and thematic studies. TA also helps to spread expertise and learning across ADB's DMCs, and addresses common development challenges, including disasters and climate change.

98. TA demand during ADF 12 is set to increase, driven by (i) higher overall assistance levels; (ii) greater assistance for FCAS, education and health operations, and social protection initiatives to promote inclusive economic growth; (iii) environmental operations to address challenges such as climate change and food security; (iv) expanded private sector operations and development and infrastructure investments in lagging areas; and (v) regional cooperation and integration. To meet this higher demand, donors supported the proposed replenishment of the Technical Assistance Special Fund (TASF) at \$461 million, or 3% of the proposed CA level of \$16 billion for the ADF 12 period.⁴¹

99. Donors also highlighted the importance of the ongoing TA reforms to improve the effectiveness and efficiency of the TA program. These reforms include (i) strategic allocation of TA resources based on demand and performance, (ii) greater focus on the quality of design and implementation of TA operations, and (iii) special attention to learning throughout the TA life cycle. The reforms aim to improve the TA success rate from 72% in 2014 to 80% by the end of ADF 12.

⁴¹ ADB. 2015. Demand for ADB Financing in Concessional Assistance Countries: Indicative Operational Program, 2017–2020. Paper prepared for the First ADF 12 Replenishment Meeting, Manila, Philippines, 28–30 October.

C. Indicative Grant Operations Program for 2017–2020

100. **ADF country operations.** Based on the endorsed revisions to the allocation system, the proposed overall operational level and current debt sustainability assessments, grants allocated directly to countries—base allocations (\$197 million), PBAs (\$802 million), allocations for DRR (\$147 million) and exceptional allocations for post-conflict considerations and reengagement (\$532 million)—are estimated to amount to \$1.7 billion for the ADF 12 period (Table 2 and Appendix 3).⁴²

Table 2: Asian Development Fund Grant Country Allocations

Item	ADF 12 (\$ million)
Country allocations ADF 12 grant countries ^a	1,678
Afghanistan	878
Small island economies ^b	264

ADF = Asian Development Fund.

^a Includes allocations for disaster risk reduction, but excludes set-aside for subregional projects.

^b Consists of the Maldives and eight concessional assistance-only countries in the Pacific.

Source: Asian Development Bank.

101. This operational level presents a substantial increase over ADF XI. Excluding Afghanistan's special allocation, which is kept constant, the overall increase in grant assistance amounts to 94%. Small island economies are the main beneficiaries in terms of increase in grant country allocations, with an increase of over 130%.

102. **ADF regional operations.** Donors agreed to continue setting aside 10% of CA resources for regional programs and projects. About half of the subregional set-aside for CA is expected to be provided as grants, amounting to \$769 million.⁴³ Country allocations and the subregional set-aside combined amount to the total indicative ADF grant allocations of \$2.4 billion (Table 3).

103. **ADF facilities.** Including the \$319 million reserve for changes in debt distress, \$218 million for the DRF, \$53 million for regional health security, and administrative expenses of \$266 million results in an estimated total ADF 12 grant funding requirement of \$3.3 billion.⁴⁴

104. **Technical assistance.** The TASF funding requirement of \$461 million brings the total funding requirement to \$3.8 billion.

⁴² Actual grant allocations to countries during the ADF 12 replenishment period may differ from these estimates, most importantly as a result of changes in debt distress classification and CPAs.

⁴³ The estimated grant share is based on past experience and future demand. During the first 3 years of ADF XI, the grant share of regional projects averaged 40%, peaking at 68% in 2013. Initial estimates of the pipeline of regional projects indicate a grant share of 45%.

⁴⁴ ADB. 2016. Supporting Disaster Risk Reduction. Paper prepared for the Second ADF 12 Replenishment Meeting, Kathmandu, Nepal, 25–27 February.

**Table 3: Asian Development Fund 12 and Technical Assistance Special Fund 6
Grant Funding Requirement**

Item	ADF 12 (\$ million)
Country allocations ^a	1,678
Subregional set-aside	769
1. ADF grant operational program	2,447
2. Reserve for changes in debt distress	319
3. Disaster Response Facility	218
4. Regional Health Security	53
5. Administrative expense	266
Total ADF operations	3,303
6. Allocation to the TASF	461
Total funding requirement	3,764

ADF = Asian Development Fund, TASF = Technical Assistance Special Fund.

^a Includes \$147 million for disaster risk reduction.

Notes:

1. Numbers may not sum precisely because of rounding.
2. Amounts are subject to change pending additional donor pledges.

Source: Asian Development Bank.

105. In addition to grant assistance, ADB will provide COL and regular OCR lending resources to CA countries from its OCR balance sheet. Overall, ADB intends to deliver over \$28 billion of lending assistance—\$13 billion of COL and \$15 billion of regular OCR lending—to the CA countries during the ADF 12 period (Table 4). The larger increase in COL compared with regular OCR lending results in substantially more CA to CA countries over the ADF 12 period. This is in line with ADB's commitment to prioritize the benefits of the ADF–OCR combination to CA countries.

**Table 4: Proposed Ordinary Capital Resources Lending Program for
Concessional Assistance Countries**

Item	ADF XI (\$ million)	ADF 12 (\$ million)	Change %
Concessional OCR loans ^a	9,284	13,245	43
Country allocations to CA-only countries ^a	2,842	4,506	59
Country allocations to OCR blend countries	5,496	7,970	45
Regular OCR loans	13,535	15,147	12

ADF = Asian Development Fund, CA = concessional assistance, OCR = ordinary capital resources.

^a Includes COL resources for disaster risk reduction.

Source: Asian Development Bank.

106. Concessional assistance (ADF grants and COL) will be allocated according to the new concessional assistance policy (footnote 32) and based primarily on performance. The PBA share in ADF 12 is expected to be 77% of total allocations. This comprises country PBA allocations, the reserve for changes in debt distress (which will be allocated through the PBA to countries as they become debt-distressed during the replenishment), and the resources for DRR. This share is about the same as the 76% share of PBA in ADF XI. The subregional set-aside, special allocations to Afghanistan and Myanmar, the base allocation, and DRF will be allocated outside of the PBA.

107. The levels of COL and regular OCR lending may be revised over the ADF 12 period as ADB reviews the classification of countries eligible for CA (Appendix 4).

VI. ADF 12 FINANCIAL MANAGEMENT AND REPLENISHMENT FRAMEWORK

A. Replenishment Size and Financing Framework

108. Donors agreed on a total replenishment size of \$3,764 million, consisting of \$3,250 million for ADF 12, \$53 million for regional health security and \$461 million for the sixth replenishment of the TASF.

109. The replenishment will be financed from three sources: (i) \$2,546 million from new donor contributions (including \$53 million for regional health security), (ii) \$1,038 million from net income transfer from OCR subject to annual approvals by ADB's Board of Governors as part of the annual net income allocation, and (iii) \$180 million income from liquidity investment. New donor contributions account for about 68% of the total replenishment, representing a 47% decrease from ADF XI. OCR net income transfers represent 28% of the total replenishment size, marking an increase of 116% compared with ADF XI. The ADF 12 financing framework is in Table 5.

Table 5: Asian Development Fund 12 Financing Framework

Donor	ADF XI	ADF XI Contribution			ADF 12 Exchange Rate	ADF 12	ADF 12 Contribution		
	Contribution	US Dollar		Share (%)		US Dollar Equivalent	ADF 12 Contribution		
	Share (%)	Equivalent	Unit of Obligation				Share (%)	Equivalent	Unit of Obligation
Austria ^a	0.74	43,211,112	€	32,000,000	0.924274	0.74	22,785,451	€	21,060,000
Belgium ^a	0.60	34,818,704	€	25,785,000	0.924274	0.60	18,392,814	€	17,000,000
Canada ^b	3.33	193,390,860	Can\$	196,750,378	1.349259	3.33	101,955,292	Can\$	137,564,096
Denmark ^{a,b}	0.43	24,937,325	DKr	137,408,931	6.896115	0.43	13,050,826	DKr	90,000,000
Finland ^{a,b,c}	0.50	29,247,711	€	21,659,400	0.924274	0.41	12,659,596	€	11,700,935
France ^b	2.22	128,823,351	€	95,400,165	1.000000	1.86	56,916,216	\$	56,916,216
Germany ^a	3.34	194,186,686	€	143,805,000	0.924274	2.82	86,554,420	€	80,000,000
Ireland ^d	0.46	27,006,945	€	20,000,000					
Italy ^{a,e}	1.58	91,823,613	€	68,000,000	1.000000	1.58	48,409,253	\$	48,409,253
Luxembourg ^a	0.20	11,342,917	€	8,400,000	0.924274	0.20	5,979,962	€	5,527,124
Netherlands ^f	1.39	81,020,835	€	60,000,000					
Norway ^a	0.86	50,251,491	NKr	288,390,000	8.660421	0.86	26,492,503	NKr	229,436,225
Portugal ^f	0.01	500,000	\$	500,000					
Spain ^g	1.15	66,851,911	€	49,507,200					
Sweden ^b	1.37	79,670,463	SKr	536,000,000	8.586911	0.78	24,055,216	SKr	206,560,000
Switzerland ^a	0.91	53,097,479	SwF	48,000,000	1.001285	0.91	27,992,895	SwF	28,028,866
Turkey ^a	0.10	5,790,814	TL	10,600,000	2.901207	0.08	2,305,937	TL	6,690,000
United Kingdom ^h	5.41	314,597,970	£	200,000,000	0.662548	5.42	166,025,707	£	110,000,000
United States ^{a,b}	6.19	359,600,000	\$	359,600,000	1.000000	6.19	189,580,000	\$	189,580,000
Nonregional	30.79	1,790,170,187				26.20	803,156,088		
Australia ^a	11.00	639,531,898	A\$	629,150,610	1.389660	11.00	337,160,029	A\$	468,537,806
Brunei Darussalam ^b	0.11	6,259,922	B\$	8,000,000	1.000000	0.02	500,000	\$	500,000
China, People's Republic of	0.77	45,000,000	\$	45,000,000	1.000000	3.26	100,000,000	\$	100,000,000
Hong Kong, China ^f	0.57	33,139,380	\$	33,139,380					
India ^b	0.52	30,000,000	\$	30,000,000	1.000000	1.36	41,740,000	\$	41,740,000
Indonesia ^b					1.000000	0.46	14,000,000	\$	14,000,000
Japan ^a	35.00	2,034,874,222	¥	157,078,967,822	122.080000	35.00	1,072,781,911	¥	130,965,215,679
Kazakhstan ^d	0.09	5,491,720	\$	5,491,720					
Korea, Republic of ^b	2.89	167,932,667	W	191,256,627,600	1,163.970000	2.89	88,533,779	W	103,050,663,054
Malaysia	0.16	9,578,087	RM	30,000,000	1.000000	0.16	5,049,554	\$	5,049,554
New Zealand ^d	0.56	32,645,180	NZ\$	41,535,962	1.502136	0.26	8,045,210	NZ\$	12,085,000
Singapore	0.15	8,720,890	\$	8,720,890	1.000000	0.15	4,600,000	\$	4,600,000
Taipei, China	0.40	23,036,623	NT\$	694,000,000	32.734787	0.40	12,144,872	NT\$	397,559,800
Thailand	0.08	4,855,036	B	150,000,000	35.902852	0.08	2,559,964	B	91,910,000
Regional	52.31	3,041,065,625				55.04	1,687,115,319		
1. Total Basic Contribution	83.10	4,831,235,812				81.25	2,490,271,407		
2. Supplemental Contributionⁱ						0.10	3,108,251		
3. Structural Gap	16.90	982,690,458				18.65	522,319,767		
4. Contribution Sharing Basis	100.00	5,813,926,270				100.00	3,065,091,174		
5. Supplemental Contribution for Regional Health Security^j							52,500,000		
6. Total Donor Contribution (1 + 2 + 5)		4,831,235,812					2,545,879,658		
7. OCR Transfer^k		480,000,000					1,037,738,000		
8. Income from Liquidity Investment		7,269,139,380					180,000,000		
9. Total Replenishment Size (6 + 7 + 8)		12,580,375,192					3,763,617,658		

ADF = Asian Development Fund, OCR = ordinary capital resources.

^a Contributions are subject to cabinet/government/parliamentary approval.

^b Some donors indicated their intention to participate in the accelerated note encashment program: (i) Finland, France, India, and Sweden to increase their contribution shares; (ii) Brunei Darussalam, Canada, Denmark, Indonesia, and the Republic of Korea to meet their contribution shares; and (iii) the United States to reduce its arrears.

^c Contribution includes €10 million and \$1,278,138.86.

^d Each of Ireland, Kazakhstan and New Zealand has advised that its ability to commit more than indicated is subject to Government and/or parliamentary action and budgetary process, but such circumstance should not be construed as a changed or diminished endorsement of ADF or its desire to continue to engage and collaborate with the Asian Development Bank regarding ADF.

^e Italy will advise in due course its unit of obligation.

^f Each of Netherlands, Portugal, and Hong Kong, China have indicated its desire or intention to contribute to the replenishment, subject to obtaining the authorization of its legislature, with the amount to be confirmed.

^g Spain will not be able to take a decision on its pledge until a new government is formed and all necessary approvals are obtained.

^h Contribution is subject to Ministerial approval.

ⁱ Contribution from Luxembourg (€2,872,876).

^j Contribution from Japan (¥6,409,200,000).

^k Subject to the approval of the Asian Development Bank's Board of Governors.

B. Encashment Schedule

110. **Standard encashment schedule.** A standard encashment schedule has been adopted for promissory notes for donor contributions for each replenishment. Donors agreed to adopt the 10-year standard encashment schedule for ADF 12 (Table 6). The agreed schedule accounts for the weighted cash flows of the following components: (i) projected disbursements of grants approved in the ADF 12 period, (ii) allocation of \$218 million for the DRF, (iii) allocation of \$200 million for DRR, (iv) allocation of 22.5% of the total ADF 12 financial resources (net of DRF and DRR) for policy-based grants and 77.5% of the resources provided as project grants, and (v) annual transfers to the TASF totaling \$461 million. Projected grant disbursements are based on a historical disbursement pattern. The TASF transfer is assumed to be made in four equal annual transfers based on contributions received, in line with the current practice adopted for TASF transfers.

111. At a donor's request, a customized encashment schedule that is neutral in terms of financial impact to the ADF can be established.

Table 6: Standard Encashment Schedule
(% of total donor contributions)

Year	ADF Grant	TASF	Weighted Standard Encashment
1	5.9	25.0	9.7
2	9.4	25.0	12.5
3	13.5	25.0	15.7
4	17.5	25.0	19.0
5	14.3		11.5
6	12.6		10.1
7	9.9		7.9
8	6.6		5.3
9	5.9		4.7
10	4.4		3.6
Total	100.0	100.0	100.0

ADF = Asian Development Fund, TASF = Technical Assistance Special Fund.

Note: Based on the allocation to the TASF of \$461.5 million.

Source: Asian Development Bank.

112. **Accelerated note encashment program.** Donors also agreed to include an accelerated note encashment (ANE) program in line with past replenishments. Under the program, donors may decide to accelerate their encashment schedules and use the expected investment income earned to one of the following three options:

- (i) meet or increase their share;
- (ii) provide supplemental contributions to support regional health security or reduce the structural gap, without attribution to their individual share; or
- (iii) pay for contribution arrears in past replenishments.

113. A uniform discount rate of 1.8% per year will be adopted to all ANE participants regardless of currencies contributed to determine applicable credits or discounts based on donors' selection of the ANE options and preferred payment period, i.e., payment to be

completed over 1, 2, 3, or 4 years. The applicable ANE discounts and credits under the four different payment options are in Table 7.

114. A donor may confirm its participation in the ANE program at the time of (i) submitting its instrument of contribution (IOC), or (ii) making installment payments. In the case of (i), a donor's IOC should indicate its agreement to apply the investment income as well as number or amount of payments. In case of (ii), a donor should notify ADB in writing after the submission of the IOC but prior to each installment payment due dates. In the latter case, the projected investment income will be adjusted to the donor's contribution when the payment is received.

Table 7: Accelerated Note Encashment
(% of total donor contributions)

Year	Standard Encashment Rates ^a (a)	Accelerated Note Encashment Rates ^a			
		Option 1 (1 year) (b)	Option 2 (2 years) (b)	Option 3 (3 years) (b)	Option 4 (4 years) (b)
1	9.70	100.00	50.00	33.00	25.00
2	12.50		50.00	33.00	25.00
3	15.70			34.00	25.00
4	19.00				25.00
5	11.50				
6	10.10				
7	7.90				
8	5.30				
9	4.70				
10	3.60				
Total	100.00	100.00	100.00	100.00	100.00
Discount Rate	1.80	1.80	1.80	1.80	1.80
NPV	92.36	98.97	98.10	97.22	96.38
Donors participating in the ANE program will receive either a credit or a discount (% of face value): ^b					
(i) Credit: $(NPV[b] - NPV[a] / NPV[a])$		7.16	6.22	5.26	4.35
(ii) Discount: $(NPV[b] - NPV[a] / NPV[b])$		6.68	5.85	5.00	4.17

ANE = accelerated note encashment, NPV = net present value.

^a Based on the allocation to the Technical Assistance Special Fund of \$461.5 million.

^b The credit will be used when a donor opts to increase its share (option i), provide supplemental contributions (option ii), or pay for contribution arrears in past replenishments (option iii) while the discount will be used when a donor opts to meet its share (option i).

Source: Asian Development Bank.

C. Set-Aside Liquidity for ADF 12 Commitments

115. Given that annual installment payments of ADF 12 contributions will be due on 1 July 2017–2020 and OCR net income transfers will be made after the ADB Board of Governors' approval in May of each year, no financial resources from contributions or OCR transfers will be available to support ADF operations during the first 6 months of all 4 years of ADF 12. Of the three funding sources for ADF grant-only operations, investment income will be the only funding source for the first half of all 4 years.

116. To ensure ADB has sufficient resources to support new grant commitments temporarily and to meet disbursements in the first half of each year, pending receipt of donor contributions and OCR net income transfers, donors agreed that \$155 million liquidity be set aside as a temporary funding source to bridge finance the gaps in ADF 12. With the projected annual income from the liquidity investment of \$45 million and \$155 million set-aside liquidity, ADB will be able to approve new ADF grants of up to \$200 million in the first half of each year of the ADF 12 period, pending payments from donor contributions and the OCR net income transfer.

117. The set-aside liquidity would be replenished when contribution payments and the OCR net income transfer are received in the latter part of each year. Through the annual replenishment, the set-aside liquidity is expected to be available to meet the same purpose in all 4 years of ADF 12, and would be recycled to bridge similar financing gaps of future replenishments.

VII. MANAGING ADF 12 IMPLEMENTATION

A. Results Framework

118. In November 2015, ADB initiated a review of its corporate results framework to align the results framework to a new corporate strategy (under preparation) and to strengthen its results management system. The review will assess the strengths and weaknesses of the results framework as a performance management tool, identify areas needing improvement, and recommend specific changes. At various stages of the review, ADB will consult key stakeholders, including ADF donors, ADB's Board of Directors, DMCs and civil society. ADB will review the results framework alongside the preparation of Strategy 2030. The current results framework will expire in 2016. For the 2017 Development Effectiveness Review, ADB will extend the targets of the existing results framework. This will serve as a transitional framework before Strategy 2030 is adopted.

119. While the scope of changes to the results framework will depend on the review's final findings, donors urged ADB to (i) align the framework with Strategy 2030 and the relevant SDGs, (ii) revise its approach and improve results measurement with respect to inclusive growth, and (iii) improve results measurement in the areas of DRR, gender equity and gender mainstreaming in operations, and gender balance at ADB. Donors also noted the need to (i) be more outcome-focused; (ii) strengthen linkages among various levels in the results framework; and (iii) consider the results frameworks of other multilateral development banks, including the measurement of cofinancing. Donors asked ADB to report on the performance of ADF grant and COL operations. The review will explore ways to streamline the number of indicators and to extend the duration of the framework to more than 4 years.

B. Assessing and Reporting Progress During Implementation of ADF 12

120. ADB will continue to assess and report on progress in implementing the ADF program through the annual development effectiveness review (DEfR). The DEfR will be guided by the revised results framework, and specific benchmarks and targets established for the indicators. As in the past, ADB Management will use the DEfR to identify areas of ADF operations needing adjustment, which will be reflected in the 3-year rolling work program and budget framework. The DEfR will be submitted annually to the Development Effectiveness Committee of the ADB Board of Directors for discussion. Following that discussion, the review and a summary by the committee chair will be submitted for the ADB Board of Directors to discuss and take appropriate actions. Results of the review will be presented during ADB's annual meeting.

121. ADF donors and ADB Management will continue to review the implementation of the ADF annually, on the sidelines of the ADB annual meeting, and more comprehensively at midterm. The meetings will discuss progress on the ADF 12 implementation plan (Appendix 5).

122. It is proposed that the ADF 12 midterm review be held during the fourth quarter of 2018. The list of topics to be discussed will be finalized in the 2017 annual donor consultation meeting.

SUSTAINABLE DEVELOPMENT GOALS

Goal 1	End poverty in all its forms everywhere
Goal 2	End hunger, achieve food security and improved nutrition and promote sustainable agriculture
Goal 3	Ensure healthy lives and promote well-being for all at all ages
Goal 4	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
Goal 5	Achieve gender equality and empower all women and girls
Goal 6	Ensure availability and sustainable management of water and sanitation for all
Goal 7	Ensure access to affordable, reliable, sustainable and modern energy for all
Goal 8	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
Goal 9	Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
Goal 10	Reduce inequality within and among countries
Goal 11	Make cities and human settlements inclusive, safe, resilient and sustainable
Goal 12	Ensure sustainable consumption and production patterns
Goal 13	Take urgent action to combat climate change and its impacts ^a
Goal 14	Conserve and sustainably use the oceans, seas and marine resources for sustainable development
Goal 15	Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
Goal 16	Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
Goal 17	Strengthen the means of implementation and revitalize the global partnership for sustainable development

^a Acknowledging that the United Nations Framework Convention on Climate Change is the primary international, intergovernmental forum for negotiating the global response to climate change.

Source: United Nations. 2015. *Transforming Our World: The 2030 Agenda for Sustainable Development* (Finalized text for adoption, 1 August). <https://sustainabledevelopment.un.org/post2015/transformingourworld>

PROGRAMMED RESULTS

Table A2.1: Core Operational Results Expected During the ADF 12 Period (2017–2020) from Projects in Concessional Assistance-Only Countries

Results Indicators	Programmed Results, 2017–2020
Education	
Students benefiting from new or improved educational facilities (number)	132,000
Female	54,000
Male	78,000
Students educated and trained under improved quality assurance systems (number)	164,000
Female	68,000
Male	96,000
Teachers trained with quality or competency standards (number)	21,000
Female	9,100
Male	12,000
Energy	
Greenhouse gas emission reduction (tCO ₂ -equiv/yr)	1,089,000
New households connected to electricity (number)	45,000
Installed energy generation capacity (MW equivalent)	1,600
Renewable (MW equivalent)	447
Transmission lines installed or upgraded (km)	1,100
Distribution lines installed or upgraded (km)	4,000
Finance	
Microfinance loan accounts opened/end borrowers (number)	7,000
Female	2,300
Male	4,700
Small and medium-sized enterprise loan accounts opened or end borrowers reached (number)	18,000
Transport	
Roads built or upgraded (km)	5,800
Expressways and national highways ^a	1,700
Provincial, district, and rural roads ^a	4,100
Railways constructed or/and upgraded (km)	450
Use of roads built or upgraded (average daily vehicle-km in the first full year of operation)	3,999,000
Use of railways built or upgraded (average daily ton-km in the first full year of operation)	95,000

Results Indicators	Programmed Results, 2017–2020
Water	
Households with new or improved water supply (number)	214,000
Households with new or improved sanitation (number)	158,000
Wastewater treatment capacity added or improved (m ³ per day)	41,000
Water supply pipes installed or upgraded (km)	2,500
Land improved through irrigation, drainage and/or flood management (hectare)	303,000

ADF = Asian Development Fund, km = kilometer, MW = megawatt, m³ = cubic meter, tCO₂-equiv/yr = tons of carbon dioxide equivalent per year.

^a These standard explanatory data indicators have no targets in the ADB Results Framework and supplement the results framework indicator “Roads built or upgraded.”

Notes:

1. Programmed results refer to an aggregate amount of outputs and outcomes expected to be delivered by sovereign and nonsovereign projects during 2017–2020. Numbers are rounded off.
2. Concessional assistance-only countries comprised 17 countries currently classified as Group A based on the Asian Development Bank Graduation Policy (2013): Afghanistan, Bhutan, Cambodia, Kiribati, the Kyrgyz Republic, the Lao People’s Democratic Republic, the Maldives, the Marshall Islands, Myanmar, Nauru, Nepal, Samoa, Solomon Islands, Tajikistan, Tonga, Tuvalu, and Vanuatu.
3. Numbers may not sum precisely because of rounding.

Source: Asian Development Bank estimates.

**Table A2.2: Core Operational Results Expected During the ADF 12 Period (2017–2020)
from Projects Financed by Concessional Assistance**

Results Indicators	Results from total Concessional Assistance	Results from ADF Grants	Results from Concessional Lending
Education			
Students benefiting from new or improved educational facilities (number)	31,561,000	131,000	31,431,000
Female	15,814,000	54,000	15,760,000
Male	15,748,000	77,000	15,670,000
Students educated and trained under improved quality assurance systems (number)	63,708,000	199,000	63,509,000
Female	32,610,000	91,000	32,519,000
Male	31,098,000	108,000	30,990,000
Teachers trained with quality or competency standards (number)	564,000	17,000	548,000
Female	224,000	7,300	217,000
Male	340,000	9,300	331,000
Energy			
Greenhouse gas emission reduction (tCO ₂ -equiv/yr)	3,461,000	108,000	3,352,000
New households connected to electricity (number)	374,000	117,000	257,000
Installed energy generation capacity (MW equiv.)	2,100	410	1,700
Transmission and distribution lines installed or upgraded (km)	12,000	3,700	8,500
Finance			
Microfinance loan accounts opened / end borrowers (number)	370,000	38,000	332,000
Female	167,000	11,000	155,000
Male	203,000	26,000	177,000
Small and medium-sized enterprise loan accounts opened or end borrowers reached (number)	3,400	200	3,200
Transport			
Roads built or upgraded (kms)	14,000	6,000	8,000
Railways constructed or/and upgraded (km)	487	450	37
Use of roads built or upgraded (ave. daily vehicle-km in the first full year of operation)	14,606,000	2,739,000	11,867,000
Use of railways built or upgraded (ave. daily ton-kms in the first full year of operation)	1,095,000	1,012,000	83,000
Water			
Households with new or improved water supply (number)	1,676,000	159,000	1,518,000
Water supply pipes installed or upgraded (length of network in km)	12,000	1,700	9,900
Households with new or improved sanitation (number)	1,219,000	141,000	1,077,000
Wastewater treatment capacity added or improved (m ³ per day)	950,000	17,000	934,000
Land improved through irrigation, drainage and/or flood management (ha)	2,260,000	368,000	1,892,000

ADF = Asian Development Fund, ha = hectare, km = kilometer, MW = megawatt, m³ = cubic meter, tCO₂-equiv/yr = tons of carbon dioxide equivalent per year.

Notes:

1. Programmed results refer to an aggregate amount of outputs and outcomes expected to be delivered by sovereign and nonsovereign projects during 2017–2020.

2. Numbers may not sum precisely because of rounding.

Source: Asian Development Bank estimates.

INDICATIVE ADF 12 OPERATIONS PROGRAM

Table A3: Operational Program by Country and Region
(\$ million)

Region/Country	ADF XI					ADF 12				
	Grant	Loan	OCR	Total	%	Grant	COL	Regular OCR	Total	%
Central and West Asia	1,112	1,991	4,778	7,881	32.0	1,226	3,122	5,203	9,551	31.0
Afghanistan	858	0	0	858	3.5	878	0	0	878	2.8
Kyrgyz Republic	101	126	0	227	0.9	178	217	0	395	1.3
Pakistan	0	1,245	3,264	4,509	18.3	0	1,802	3,537	5,339	17.3
Tajikistan	153	58	0	211	0.9	169	209	0	378	1.2
Uzbekistan	0	562	1,514	2,076	8.4	0	894	1,666	2,560	8.3
East Asia	0	131	417	547	2.2	0	196	245	441	1.4
Mongolia	0	131	417	547	2.2	0	196	245	441	1.4
South Asia	62	2,787	2,822	5,671	23.0	120	4,307	3,135	7,562	24.5
Bangladesh	0	1,463	1,828	3,291	13.4	0	2,158	2,082	4,240	13.7
Bhutan	45	56	70	170	0.7	53	160	0	213	0.7
Maldives	18	0	0	18	0.1	54	0	0	54	0.2
Nepal	0	788	0	788	3.2	13	1,271	0	1,284	4.2
Sri Lanka	0	481	924	1,405	5.7	0	719	1,053	1,772	5.7
Southeast Asia	0	3,128	3,192	6,319	25.7	122	4,459	3,659	8,239	26.7
Cambodia	0	499	0	499	2.0	13	814	0	827	2.7
Lao PDR	0	273	0	273	1.1	99	316	0	414	1.3
Myanmar	0	993	0	993	4.0	11	1,437	0	1,448	4.7
Viet Nam	0	1,364	3,192	4,555	18.5	0	1,892	3,659	5,551	18.0
The Pacific	95	301	702	1,099	4.5	210	393	845	1,448	4.7
Pacific countries	95	69	41	205	0.8	210	142	46	398	1.3
Papua New Guinea	0	166	568	734	3.0	0	171	686	857	2.8
Timor-Leste	0	66	94	160	0.7	0	80	113	193	0.6
Regional	535	947	0	1,482	6.0	769	769	0	1,538	5.0
Hard-term	0	98	0	98	0.4	0	0	0	0	0.0
Pilot DRF	97	189	0	286	1.2	0	0	0	0	0.0
Subregional	438	660	0	1,098	4.5	769	769	0	1,538	5.0
Nonsovereign	0	0	1,624	1,624	6.6	0	0	2,060	2,060	6.7
Total	1,805	9,284	13,535	24,624	100	2,447	13,245	15,147	30,839	100
Memo items:										
Country allocations	1,270	8,337	11,911	21,518	87.4	1,678	12,476	13,087	27,240	88.3
CA-only countries	1,270	2,842	70	4,181	17.0	1,678	4,506	0	6,184	20.1
OCR blend countries	0	5,496	11,841	17,337	70.4	0	7,970	13,087	21,057	68.3

ADF = Asian Development Fund, CA = concessional assistance, COL = concessional OCR lending, DRF = Disaster Response Facility, Lao PDR = Lao People's Democratic Republic, OCR = ordinary capital resources.

Notes:

1. For ADF XI: actual performance-based allocation for 2013–2016, excluding Armenia and Georgia. For ADF 12: projected performance-based allocation for 2017–2020, including ADF grant and COL amounts for disaster risk reduction.
2. Pacific countries include 10 developing member countries: Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.
3. Data are indicative and subject to further discussion with donors. Numbers may not sum precisely because of rounding.

Source: Asian Development Bank.

EXPECTED REVIEW OF COUNTRY CLASSIFICATIONS

1. **Classification policy.** Under the Graduation Policy of the Asian Development Bank (ADB),¹ country classification is based on two key criteria: per capita gross national income (GNI) and creditworthiness. For per capita GNI, the Graduation Policy adopts the International Development Association operational per capita GNI cutoff, which is currently at \$1,215 in 2014 United States dollars based on the Atlas method.² The creditworthiness of developing member countries (DMCs) is assessed by a creditworthiness assessment committee, which examines the borrowers' ability and willingness to repay ADB on time and in full.³ Based on these criteria, countries have been classified as belonging to group A, B, or C. Group A [concessional assistance (CA)-only] countries can receive Asian Development Fund (ADF) grants or concessional ordinary capital resources (OCR) loans (and in some cases both). Group B (OCR blend) countries are eligible for both concessional and regular OCR lending, but not ADF grants. Group C (regular OCR-only) countries are only eligible for regular OCR lending.
2. **Per capita gross national income.** The process of graduation normally takes about 4 years to complete after a DMC crosses the per capita GNI threshold.⁴ Of the current 27 CA countries, 22 countries have already exceeded the per capita GNI cutoff for at least 1 year as of 2014. Only five of those 22 countries have exceeded the per capita GNI cutoff for less than 4 years; the Lao People's Democratic Republic, Solomon Islands, and Pakistan exceeding the cutoff in 2012; the Kyrgyz Republic in 2013; and Myanmar in 2014.
3. An analysis of the projected per capita GNI of CA countries up to 2024 (the end of the ADF 13) indicates that two of the four remaining countries that are currently below the per capita GNI cutoff would exceed the threshold in that period (Cambodia in 2018 and Tajikistan in 2023). This will leave only Afghanistan and Nepal with per capita GNI below the graduation threshold by 2024.
4. **Creditworthiness.** A proxy indicator of creditworthiness that measures the country's access to financial markets is represented by ratings of the international credit rating agencies. Of the current CA countries, seven are rated by at least one international credit rating agency. Of these seven countries, six are Group B countries (Bangladesh, Mongolia, Pakistan, Papua New Guinea, Sri Lanka, and Viet Nam), and only one Group A country is rated (Cambodia). To address this data gap and serve as a substitute indicator, an analysis of the demonstrated stability of CA countries to attract long-term finance (ratio of net inflows of foreign direct investment to gross domestic product) was undertaken. The analysis shows that, with the exception of Palau, the small island countries—mostly situated in the Pacific (Kiribati, the Maldives, the Marshall Islands, the Federated States of Micronesia, Nauru, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu)—do not demonstrate stability in attracting long-term finance. The remaining countries were assessed to be stable on this criterion.
5. **Bhutan.** Based on the analysis undertaken, Bhutan is a candidate for reclassification review from Group A to Group B during ADF 12. Bhutan's per capita GNI crossed the

¹ ADB. 1998. *A Graduation Policy for the Bank's DMCs*. Manila.

² The Atlas method converts a country's GNI from national currency into US dollars by applying the 3-year average exchange rate to minimize the impact of exchange rate fluctuations on GNI valuation. The GNI figure is also adjusted for inflation differentials and divided by the midyear population to arrive at per capita GNI.

³ ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila.

⁴ ADB. 2013. *Classification and Graduation of Developing Member Countries. Operations Manual*. OM A1/BP. Manila.

operational threshold in 2003, and the country has demonstrated stability in attracting long-term finance. Furthermore, Bhutan's debt situation is expected to improve over the long run because of significantly higher electricity export-related revenues when more of its investments in hydropower projects come on stream.⁵

6. **Sri Lanka.** Sri Lanka is proposed for reclassification review from group B to group C in ADF 12. Sri Lanka has exceeded the per capita GNI threshold since 2003 and is rated by international credit rating agencies. Based on additional analysis, the country has also shown stability in attracting long-term finance. Further, following the launch of international sovereign bond issuance in 2007, Sri Lanka's finance sector has increased its recourse to international capital markets, which signifies the country's growing reliance on international finance on non-concessional terms.

7. **Viet Nam.** Viet Nam is also proposed for reclassification review from group B to group C in ADF 12. Viet Nam has exceeded the per capita GNI threshold since 2010, and like Sri Lanka, is rated by international credit rating agencies. Viet Nam has also shown stability in attracting long-term finance. In Viet Nam, the manufacturing sector has been driven by foreign investment, especially the export-oriented electronics sector. This has underpinned the country's rising growth prospects, even though it has also made Viet Nam vulnerable to downside risks coming from external economic shocks.

⁵ IMF. 2014. *Bhutan Staff Report for the 2014 Article IV Consultation—Debt Sustainability Analysis*.

ADF 12 IMPLEMENTATION PLAN

Focus Area	Key Action	Time Frame	Progress Reporting Mechanism to Donors
I. ADF 12 STRATEGIC DIRECTIONS			
1. Inclusive growth	1.1 Adopt a revised and more outcome-oriented approach to inclusive growth	Along with adoption of Strategy 2030	Board paper on results framework
	1.2 Adopt an approach to inclusive growth in CPS	Ongoing	Quality-at-entry CPS findings
2. Gender operations	2.1 Improve the quality of sex-disaggregated data and gender reporting	Along with adoption of Strategy 2030	Board paper on results framework
3. Fragile and conflict-affected situations	3.1 Enhance staff capacity, including conflict sensitivity expertise for FCAS operations	Ongoing	Report to FCAS steering committee
	3.2 Incentivize staff to work in FCAS countries	Ongoing	Report to FCAS steering committee
	3.3 Incorporate more systematic conflict sensitivity in ADB operations	Ongoing	Quality-at-entry CPS findings Report to FCAS steering committee
	3.4 Adopt simpler processes for FCAS	Ongoing	ADB Operations Manual
4. Private sector operations	4.1 Approve 40% of total private sector operations (by number of projects) in CA countries	Ongoing	DEfR
5. Governance and capacity development	5.1 Integrate analysis of existing problems and countries' potential to increase domestic resource mobilization in all CPSs of CA countries	Ongoing	CPS
	5.2 Evaluate the effectiveness of PBL operations	2017	IED evaluation study
	5.3 Based on IED evaluation, seek donors' guidance on the use of PBL	2017/2018	Discussion paper
6. Climate change	6.1 Double climate financing in all DMCs up to \$6 billion per year by 2020	2020	DEfR
7. Disaster risk reduction	7.1 Establish DRR financing for CA-only countries	2016	Concessional assistance policy
8. Disaster response	8.1 Regularize the DRF	2016	Concessional assistance policy
	8.2 Conduct evaluation of DRF operations	2018	IED evaluation study
9. Regional public	9.1 Establish regional health	2016	Concessional

Focus Area	Key Action	Time Frame	Progress Reporting Mechanism to Donors
goods	security financing pilot in CA countries through the use of regional health grants		assistance policy
	9.2 Review the use of regional health grants at ADF 12 midterm	2018	Paper for ADF 12 midterm by management
	9.3 Conduct IED evaluation of regional health grants before the start of ADF 13	2019	IED evaluation study
II. USE OF ADF 12 RESOURCES			
10. Base allocation	10.1 Increase support to FCAS and small island countries through introduction of base allocation	2016	Concessional assistance policy
11. Post-conflict assistance	11.1 Introduce special allocation to Afghanistan	2016	Board paper
12. Reengaging assistance	12.1 Introduce special allocation to Myanmar	2016	Board paper
13. Post-conflict and reengaging assistance	13.1 Review special allocations to Afghanistan and Myanmar at ADF 12 midterm	2018	Paper for ADF 12 midterm review
14. Resource allocation	14.1 Develop a transition arrangement for Bhutan, Lao PDR and Papua New Guinea,	2016	Board paper
15. Debt sustainability framework	15.1 Fully adopt the joint IMF–World Bank DSF for low-income countries for DSA by ADB and IDA gap country approach	2016	Concessional assistance policy
	15.2 Establish ADF grant and COL reserves for changes in debt distress classification	2016	Concessional assistance policy
	15.3 Review use of ADF grant and COL reserves at ADF 12 midterm	2018	Paper for ADF 12 midterm review
16. Country performance assessments	16.1 Conduct CPAs every 2 years	2016	Concessional assistance policy
III. TECHNICAL ASSISTANCE			
17. Technical assistance	17.1 Enhance effectiveness of TA operations through adoption of TA reform measures	2016	TA reform paper
	17.2 Increase share of FCAS in TA	Ongoing	Work program and budget framework
IV. FINANCIAL MANAGEMENT			
18. Financial policies	18.1 Amend relevant ADF financial policies to support	2016	Board paper

Focus Area	Key Action	Time Frame	Progress Reporting Mechanism to Donors
	implementation of ADF grant-only operations		
V. ADB INTERNAL REFORMS			
19. Improve institutional gender balance	19.1 Implement targeted action plan	Ongoing	DEfR ADB Annual Report
20. Decentralization	20.1 Adopt a more assertive approach to strengthening the resident missions and transfer of project implementation responsibilities	Ongoing	ADB Annual Report
21. Project implementation	21.1 Improve project readiness and quality and speed of delivery	Ongoing	DEfR
22. Staffing	22.1 Strengthen staff capacity in priority sector and thematic areas	Ongoing	DEfR

ADB = Asian Development Bank, ADF = Asian Development Fund, CA = concessional assistance, COL = concessional OCR lending, CPA = country performance assessment, CPS = country partnership strategy, DEfR = development effectiveness review, DMC = developing member country, DRF = Disaster Response Facility, DRR = disaster risk reduction, DSA = debt-sustainability analysis, DSF = debt-sustainability framework, FCAS = fragile and conflict-affected situations, IDA = International Development Association, IED = Independent Evaluation Department, IMF = International Monetary Fund, PBL = policy-based lending, TA = technical assistance.

Source: Asian Development Bank