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The Fifth General Capital Increase of the Asian Development Bank

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
BPMSD	–	Budget, Personnel, and Management Systems Department
CAREC	–	Central Asia Regional Economic Cooperation
CWRD	–	Central and West Asia Department
DMC	–	developing member country
EARD	–	East Asia Department
ELR	–	equity-to-loan ratio
GCI	–	general capital increase
GDP	–	gross domestic product
GMS	–	Greater Mekong Subregion
GNI	–	gross national income
IED	–	Independent Evaluation Department
MDB	–	multilateral development bank
MDG	–	Millennium Development Goal
MfDR	–	managing for development results
MFF	–	multitranche financing facility
MIC	–	middle-income country
OCR	–	ordinary capital resources
PRC	–	People’s Republic of China
PSOD	–	Private Sector Operations Department
SARD	–	South Asia Department
SERD	–	Southeast Asia Department
SPD	–	Strategy and Policy Department
TA	–	technical assistance
TD	–	Treasury Department
WPBF	–	work program and budget framework

NOTE

In this report, “$” refers to US dollars.

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EXECUTIVE SUMMARY

The Rapidly Changing Economic Context for the Fifth General Capital Increase

The global financial and economic crisis has exposed the continuing challenge of reducing poverty in Asia and the Pacific. Despite being part of the fastest growing and most dynamic region in the world, countries that borrow from the ordinary capital resources (OCR) of the Asian Development Bank (ADB) are still home to 877 million people living on less than $1.25 a day. Even before the current crisis, a further 883 million people in OCR borrowers were living on between $1.25 and $2 a day, and were therefore already highly vulnerable to poverty. The halfway mark to achieving the Millennium Development Goals (MDGs) has now passed, yet many countries in Asia and Pacific still lag behind on key indicators of development. The current crisis has simply exacerbated the challenge of long-term poverty reduction. The World Bank has recently identified 16 countries in Asia as "highly exposed" to the current crisis. Eight of those countries are OCR borrowers, with a combined population of 1.87 billion.

Why OCR Borrowers Are Key to Global Development

Economic recovery in Asia and the Pacific is an indispensable precondition to global economic recovery. If OCR borrowers put in place good economic policies, receive adequate development finance, and resist trade protectionism, they can help lead the global economy out of the current slowdown. Asia and the Pacific is still the fastest growing and most dynamic region in the world, but it will not be among the first to recover without well functioning markets and multilateral assistance that provides financing, including quick-disbursing program loans, strengthens countries' access to capital markets, supports the private sector, manages economic integration, and protects the poor and vulnerable. OCR borrowers are also key to the pace and quality of global development over the medium to longer term. How quickly and how well these countries manage challenges such as poverty reduction and inclusive growth; energy efficiency and clean energy production; urbanization; and productive employment and investment by expanding the private sector's role in the formal economy will determine global as well as regional development outcomes. ADB has an important role to play in ensuring optimal outcomes in all these areas.

Why ADB is a Relevant Development Partner for the International Community

ADB is a relevant development partner for the international community in several key ways. First, ADB was explicitly structured to act as an intermediary between investment needs and savings in circumstances where financial markets are underdeveloped or stressed. Second, ADB provides strong leverage for shareholder's capital: every $1 of paid-in capital has, historically, led to $15 of new lending. Third, ADB's core business lines tie in closely with the current and long-term priorities of its borrowers. Many OCR borrowers want to inject large financial resources into infrastructure, both as an immediate response to the crisis and to ease long-term binding constraints on economic growth. Fourth, the crisis shows that regional economic integration and public goods need to be managed well if development benefits are to be achieved. ADB has a mandate and an internationally renowned track record in this area. Fifth, the quantity, and quality, of public expenditure is critical to development and to preserving social stability, minimizing wastage, and avoiding unsustainable debt. ADB combines high-quality economic and policy analysis and other knowledge products with development finance. Sixth, ADB is increasingly efficient and results-oriented. Its new long-term strategic framework

2008–2020 (Strategy 2020) provides focus and coherence to its future operations. ADB has a corporate results framework, an independent evaluation department, and innovative financing instruments.

Demand for OCR Resources, ADB's Response, and Development Outcomes

The current crisis has increased demand for OCR resources. With credit markets so impaired, developing member countries (DMCs) are turning to ADB for increased assistance. In response to these requests, ADB will take a coordinated approach to provide up to an additional $7 billion to $8 billion of OCR funding support to crisis-affected DMCs in 2009–2010. This is 48% more than the amount planned for 2009–2010 under ADB's work program and budget framework (WPBF). ADB will be able to extend $4 billion of additional OCR crisis response financing in 2009 and a further $3 billion–$4 billion in 2010. Approximately $1 billion of this assistance will be for trade finance, and the remainder will be divided among guarantees, fast-disbursing assistance and support for project investments. However, ADB can only respond promptly and properly with a fifth general capital increase (GCI V). Without a GCI, ADB will have to limit its OCR operations to less than $4 billion from 2010 onwards.

After 2010, ADB expects a gradual decline in crisis requirements from its DMCs. ADB plans to return to levels of lending that would be sustainable under the proposed GCI V after 2010. Nevertheless, ADB expects demand for its OCR loans to remain well above the level of lending it can sustain with a 200% capital increase as the need for development finance was already huge before the current crisis: $4.7 trillion is needed for infrastructure in this region over the next decade. The investment required to address environmental issues is estimated to exceed $100 billion a year, including $30 billion for renewable energy, $28 billion for adaptation to climate change, $14 billion for energy efficiency, and $8 billion for sustainable management of water resources. The development of the region's financial sector will also require sizable amounts. OCR borrowers already face a resource deficit of $53 billion per year in meeting the MDGs. In the 2009–2011 WPBF period, five low-income DMCs—Bangladesh, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam—accounted for 35% of total planned lending and seven lower middle-income countries)—Azerbaijan, the People's Republic of China (PRC), India, Indonesia, the Philippines, Sri Lanka, and Thailand—accounted for about 60% of planned lending. The short-term demand for OCR resources exceeded ADB's current lending capacity even before the global crisis. The estimated gap between ADB's annual lending program under the WPBF 2009–2011 and the "revealed demand" was $4.6 billion for 2009, $8.1 billion for 2010, and $9.9 billion for 2011.

ADB has a coherent approach to its diverse middle-income countries under GCI V. ADB's current OCR borrowers comprise countries with widely divergent needs and circumstances. They include Bangladesh with a per capita gross national income (GNI) of $470 and Azerbaijan with a GNI per capita of $2,550 in 2007. Some are large and populous countries—including the PRC, India, Indonesia, and Philippines—while others are smaller in geographical size and population, including several in the Pacific. ADB has a coherent and differentiated response to such diverse development circumstances.

As stated in Strategy 2020, ADB aspires to help all DMCs make measurable progress under its graduation policy. Once the current crisis has passed, ADB envisages a situation whereby those countries which in 2008 were OCR-only borrowers will have achieved, or be well on the way to achieving, graduation from regular ADB assistance by 2020. For example, PRC continues to limit its borrowing of OCR at an annual level of approximately $1.5 billion, but by 2020, ADB envisages an engagement and relationship with PRC that is not dependent on new lending. “Blend borrowers”—who can borrow from both the Asian Development Fund (ADF) and OCR—will have achieved, or be on a medium-term path to reach OCR-only status by 2020, or be well on the way to doing so. ADF-only borrowers will have become, or be well on the way to becoming, blend borrowers by 2020. It is expected, therefore, that the overall need for OCR financing will increase in the medium term before some middle-income countries start to graduate.

ADB sector lending under GCI V will reflect the more tightly focused priorities agreed under Strategy 2020. ADB envisages that its five core areas of operations will account for 80% of overall lending over the period 2009–2011. OCR public sector projects for regional cooperation and integration will grow to 14% of the total number and 18% of lending volume by 2011. Nearly 22% of projects, supported by TA operations, will address climate change, clean and renewable energy, and energy efficiency improvements, signaling both growth and diversification in the environmental portfolio. ADB lending under GCI V will particularly help strengthen the private sector, a fundamental source of growth and employment for all DMCs. Private sector development and private sector operations to sustain economic growth and create jobs will make up 41% of total OCR projects in terms of number and 43% in terms of volume in period 2009–2011.

Enhancing ADB's Development Effectiveness through Institutional Reform

Institutional reforms are important to ADB. It made a number of commitments as part of the more recent ADF replenishment (ADF X) and has either already delivered these or is on track to do so. ADB will continue to pursue all reforms forcefully. ADB will, among other things:

(i) Provide the Board by mid-March 2009 with a draft human resources action plan with time-bound commitments to implement all major recommendations of the consultant who performed the review of ADB's human resources functions and seek the Board's views on the action plan.
(ii) Create a human resources committee of the Board that follows the Board working group's recommendation.
(iii) Ensure that external and internal candidates for internationally recruited job vacancies are considered simultaneously.
(iv) Ensure there will be no dilution of safeguard standards and seek a broad consensus on all points among shareholders before finalizing any updates to ADB's policy and take the time required to achieve that consensus.
(v) Upgrade the Risk Management Unit to an Office in 2009, and increase its staff to support risk management of ADB’s increased private sector lending.
(vi) Separate the Integrity Division from the Auditor General's Office.
(vii) Review the current policy of not publishing the ADB sanctions list.
(viii) Formalize principles for selecting the outside auditor in future selection processes.
(ix) Ensure implementation of consolidated and extended whistleblower and witness protection provisions.
(x) Broaden ADB’s use of fee-based services, particularly for knowledge products to higher-income DMCs.

ADB's Fifth General Capital Increase and Next Steps

Management recommends an increase in ADB's subscribed capital of 200% with a paid-in portion of 4%. This implies a proposed increase in ADB's subscribed capital from about $55 billion to about $165 billion and an increase in paid-in capital from about $3.9 billion to about $8 billion. Management considers the proposed size of the capital increase adequately takes into account ADB's future role and operational agenda under Strategy 2020, the needs of its DMCs, and the resource constraints facing ADB members. The proposed 200% GCI V will allow front-loaded lending to respond to the financial crisis.

Management envisages that this net income transfer during ADF X will be three times higher than the actual net income transfers during ADF IX, subject to annual reviews of ADB's capital adequacy and net income outlook by the Board of Directors, and approval of the net income allocation by the Board of Governors.

Following Board discussion of this paper on 6 April 2009, the draft report of the Board of Directors to the Board of Governors, containing the draft resolution for GCI V, will be sent to the Board of Governors for its consideration and action. On 29 April 2009, ADB will close the casting of votes and record the status of voting for adoption of the resolution for GCI V. The results of the voting will be reported on 30 April 2009.

I. INTRODUCTION

1. The Asia and Pacific region has some striking features. On one hand, it has been the fastest growing and most dynamic region in the world, with some of the fastest reductions in the number of people living in poverty seen in human history. At the same time, it is still home to nearly 877 million people living on less than $1.25 a day, and a further 883 million highly vulnerable to poverty, living between $1.25 and $2 a day in ADB's OCR borrowing countries.[1, 2] The halfway mark to achieving the MDGs has now passed, yet many countries in Asia and the Pacific still lag behind on key indicators, including those on social development. The ordinary capital resources (OCR) borrowers of the Asian Development Bank (ADB) already face a resource deficit of $53 billion per year in meeting the Millennium Development Goals (MDGs).[3]

2. The Asia and Pacific region presents another apparent paradox. The region has vast investment needs with attendant high economic returns: $4.7 trillion is needed for infrastructure alone in this region over the next decade. Despite this, weaknesses in capital markets, and the absence of efficient financial intermediation have meant that much of the region's large savings and foreign exchange reserves have been invested outside Asia and the Pacific. ADB has historically been able to play a major role by acting as an intermediary between investment needs and savings, and strengthening domestic capital markets to help countries tap their own savings. However, more needs to be done.

3. The current global financial and economic crisis only magnifies these challenges. ADB's developing member countries (DMCs) need to provide public investment to combat the crisis, but the collapse of export earnings, capital outflows, and the freezing of commercial and trade credit have reduced the funding available. ADB has received additional requests beyond its planned lending which, if fully satisfied, would be equivalent to doubling of the current lending level.

4. ADB plans to increase its 2009–2010 operations significantly to help DMCs address the crisis. Specifically, it proposes to increase its nonconcessional operations by up to $7 billion–$8 billion in these two years over ADB's initial planning. This additional OCR financing will address some key market failures and shortage of funds in project financing, the provision of credit enhancements and guarantees, and trade financing. ADB will also provide quick-disbursing program loans to support policy reforms and to provide budgetary support to DMCs. ADB will continue to work closely with other international financial institutions and multilateral development banks (MDBs) and to support broader international goals, including those of the G-20.[4]

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1 Internationally comparable poverty statistics for ADB's DMCs (OCR or otherwise) are based on information for 25 DMCs covered in the World Bank's PovcalNet database, 14 October 2008. These 25 DMCs (OCR and others) comprise 95% of the total population of all DMCs. Of these 25 DMCs, 17 are OCR DMCs. The OCR DMCs without internationally comparable poverty statistics are: Cook Islands, Federated States of Micronesia, Fiji Islands, Marshall Islands, and Palau, which account for only 0.03% of the total population of OCR DMCs.

2 The $1.25 a day poverty line is expressed in 2005 purchasing power parities (PPPs) and replaces the $1.08 per day in 1993 PPPs—more commonly known as the "$1 a day" poverty line. The $1.25 a day poverty line represents the poverty line for measuring extreme poverty globally and is an average of the national poverty lines found in the world's 15 poorest countries. For more details, see Shaohua Chen and Martin Ravallion. 2008. *The Developing World is Poorer than We Thought, but No Less Successful in the Fight against Poverty*. World Bank Policy Research Working Paper 4703. Washington DC. World Bank.

3 The methodologies underlying the estimates are explained in ADB. 2008. *Review of the Asian Development Bank's Ordinary Capital Resource Requirements*. Manila (Working Paper 3-08, 8 September 2008, Appendix 5).

4 The G-20 comprises Argentina, Australia, Brazil, Canada, the People's Republic of China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, the United Kingdom, the United States, and the European Union (EU).

5. The need for ADB's first general capital increase (GCI) in 14 years was clear well before the crisis gripped the global financial system. ADB was already running out of financial headroom to enable it to respond to the vast investment and development needs of the region. A GCI was being considered to enable ADB to implement the more focused strategy laid out in its long-term strategic framework for 2008–2020 (Strategy 2020).[5]

6. ADB's GCI must now be considered both in the context of the immediate need for funding support in response to the crisis and the longer-term need to provide development finance to sustain poverty reduction in the region and achieve the MDGs. Financing for development in the world's most populous region, where nearly two-thirds of the world's poor live, has never been more important or urgent.

II. WHY ADB'S ORDINARY CAPITAL RESOURCES BORROWERS ARE KEY TO ACHIEVING GLOBAL DEVELOPMENT GOALS AND NEED EXTERNAL DEVELOPMENT FINANCE

A. Reducing Global Poverty

7. ADB's OCR borrowers are home to 64% of the world's absolute poor, nearly 877 million people, based on pre-crisis World Bank estimates of people living on less than $1.25 a day (footnotes 1 and 2). The same estimates indicate that another 883 million people, most of whom were rescued from absolute poverty only in the past decade, live on daily incomes of between $1.25 and $2 and are at constant risk of falling back into absolute poverty.

8. The global drive to reduce poverty—or to restrain its renewed growth during the current emergency—cannot succeed without greater development finance to these countries. The daily incomes of millions of people may drop below the $1.25 a day mark because of mounting unemployment and declining economic activity. Overall poverty incidence will almost certainly increase in ADB's OCR borrowers for the first time since the Asian financial crisis of 1997–1998. This would seriously endanger global efforts to achieve the income MDG by 2015.

9. With an estimated 400 million people lacking basic sanitation in cities, 566 million rural residents without access to clean drinking water, and 4 million children dying each year before the age of 5, developing Asia and the Pacific is also central to the global achievement of the non-income MDGs. Progress among the OCR borrowers has been uneven (Figures 1, 2, and 3) and has often been concentrated in rapidly growing areas. Headway in improving health conditions, increasing primary school enrollment, and reducing gender discrimination has been good overall but is uneven across OCR borrowers, some of which are critically behind schedule in reducing infant and maternal mortality, school dropout rates, the spread of HIV, and deforestation.

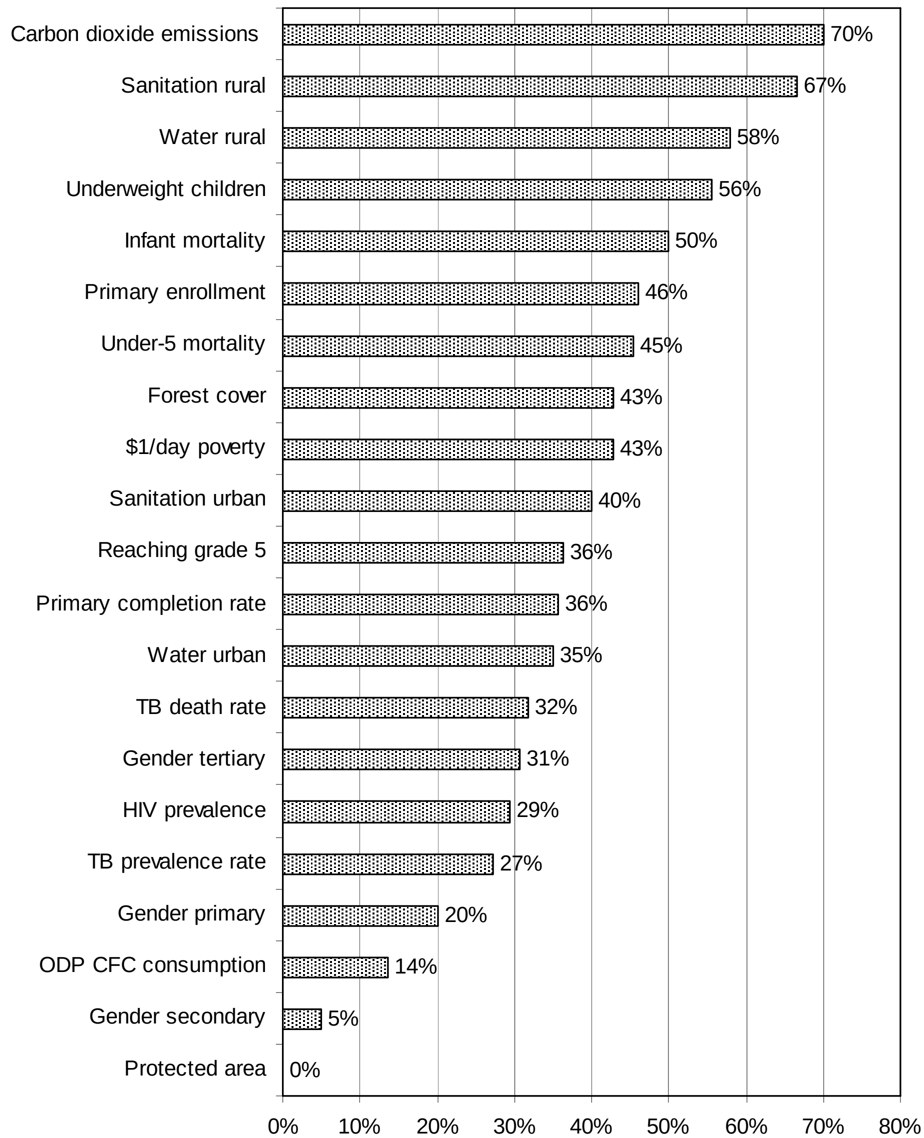
10. Growing disparities between the better-off and the poor, urban and rural populations, women and men, and geographical groups demand concerted attention that will allow excluded populations to join and benefit from growth and development.

11. If OCR borrowers receive adequate and predictable concessional and non-concessional development finance and expertise from development partners such as ADB, they become

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

better equipped to meet these challenges. Several have already demonstrated an unparalleled ability to reduce poverty through growth.

Figure 1: Percentage of Ordinary Capital Resources Borrowers Off-Track in Achieving Millennium Development Goal Indicators, 2007



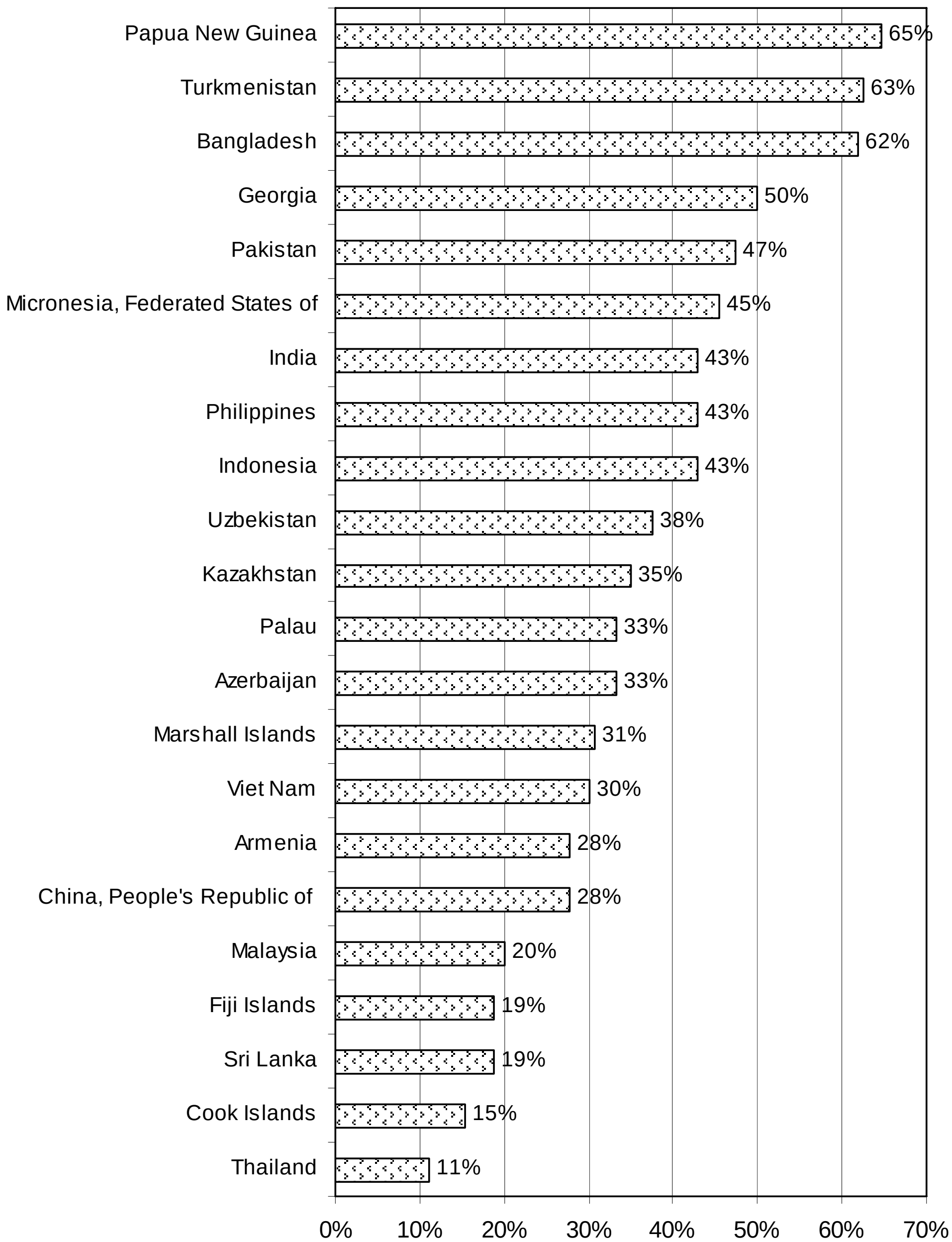
CFC = chlorofluorocarbons; HIV = human immunodeficiency virus; ODP = ozone-depleting potential; TB = tuberculosis.

Notes:

1. Percentage off-track is based on total number of developing member countries (DMCs) with regressing or slow progress status divided by total number of DMCs for which data are available.
2. One indicator, underweight children, has data for 41% of DMCs; five indicators (primary enrollment, reaching grade 5, primary completion rate, $1/day poverty, and gender tertiary) have data for 50%–64% of DMCs; and 15 indicators (rest of the indicators) have data for more than 71% of DMCs.
3. This figure, representing the latest position in 2007, uses the $1 a day measure for poverty.

Sources: Asian Development Bank, United Nations Development Programme, United Nations Economic and Social Commission for Asia and the Pacific. 2007. *The Millennium Development Goals: Progress in Asia and the Pacific 2007.* Bangkok.

Figure 2: Percentage of Millennium Development Goal Indicators Off-Track, By Ordinary Capital Resources Borrowers, 2007

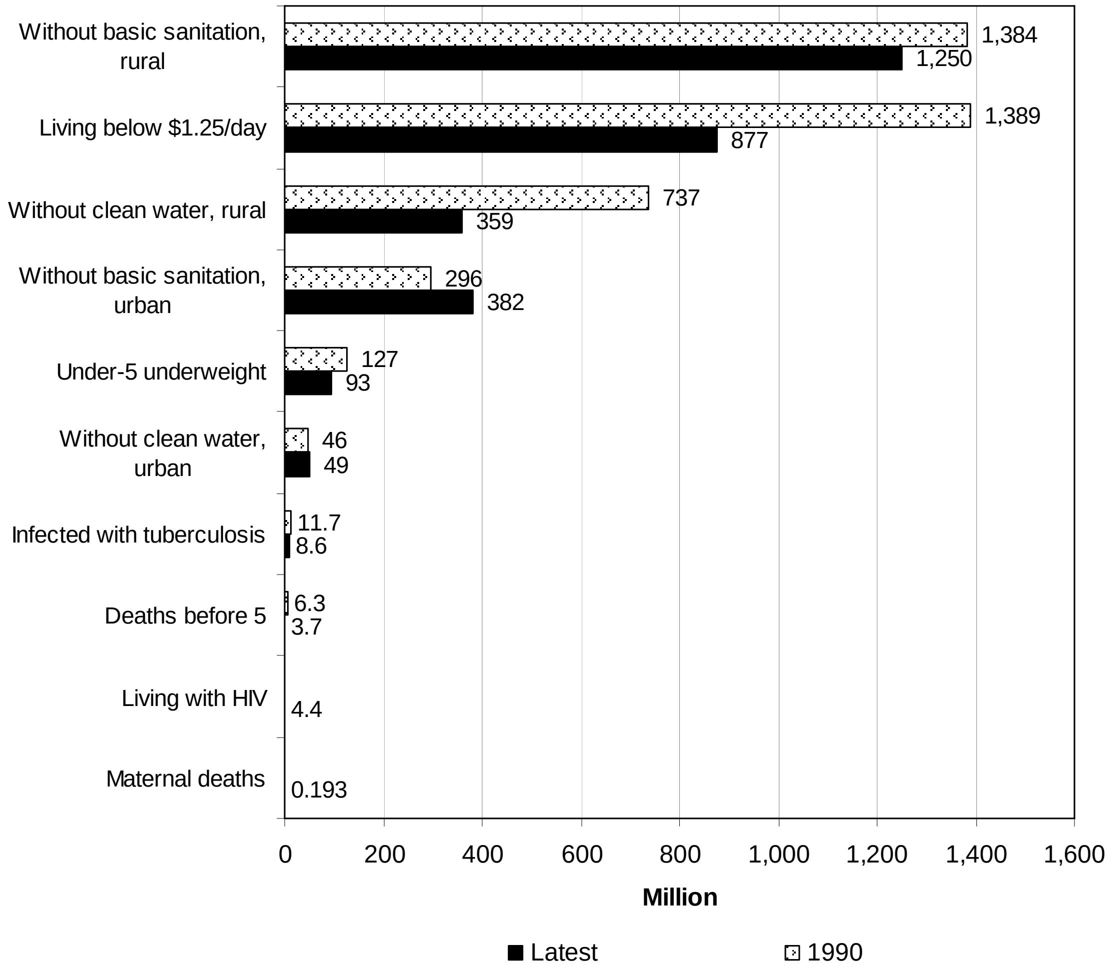


Notes:

1. Percentage off-track is based on total number of indicators with regressing or slow progress status divided by total number of indicators for which data are available.
2. One developing member country (DMC), Turkmenistan, has data for 38% of indicators; 3 DMCs (Cook Islands, Marshall Islands, and Federated States of Micronesia) have data for 52%–62%; and 18 DMCs (the remainder) have data for more than 71% of indicators.
3. This figure, representing the latest position in 2007, uses the $1 a day measure for poverty.

Sources: Asian Development Bank, United Nations Development Programme, United Nations Economic and Social Commission for Asia and the Pacific. 2007. *The Millennium Development Goals: Progress in Asia and the Pacific 2007.* Bangkok.

Figure 3: Ordinary Capital Resources Borrowers, Selected Millennium Development Goal Indicators
(Number of People)



Sources: Asian Development Bank and United Nations Economic and Social Commission for Asia and the Pacific estimates.

B. Restoring Worldwide Economic Health and Securing Future Stability

12. If OCR borrowers receive help to address development problems they cannot yet take on alone, they can help to lead the global economy out of the current slowdown. OCR borrowers also represent perhaps the largest reserve of potential expansion in the global economy. Their role has grown quickly but remains limited—accounting for 11.0% of global GDP, 12.3% of global exports, and 12.0% of global imports. Development finance can help these countries expand internal demand by lowering poverty levels, sparking broader and deeper economic activity, and boosting incomes and domestic consumption. In return, they will become a stronger pillar upon which the global economic and financial systems can build on in good times and be stabilized in bad.

13. To continue increasing developing Asia's contribution to global well-being, and to strengthen global economic and financial resistance to shocks and cycles, ADB's OCR

borrowers need help on many pivotal issues. They must systematically address economic, technological, policy, institutional and governance constraints on medium- and longer-term investment, growth, and development. Reducing real and perceived risks to investment and credit expansion in these DMCs will increase and extend opportunities and potential returns for regional and international capital, as well as contribute to both regional and global growth.

C. Addressing Climate Change, Lowering Carbon Dependency, and Saving the Environment

14. As the world's fastest growing energy consumers and greenhouse gas producers, the OCR borrowers must play a key part in the global tasks of controlling climate change, lowering carbon dependency, and building energy security. OCR borrowers need to move their economies onto low-carbon growth paths by: (a) improving energy efficiency; (b) expanding the use of clean energy sources; (c) reducing fugitive greenhouse gas emissions, such as methane released from landfills; (d) modernizing public transport systems; and (e) arresting deforestation. These economies must also adapt to the unavoidable impacts of climate change—including those related to health—through national and municipal planning, support for insurance and other risk-sharing instruments, and "climate-proofing" projects. Disaster risk management should become a vital part of their development process. OCR borrowers need to plan for sustainable management of forest and other natural resources for provision of clean water supplies, protection of biological diversity, and sequestration of carbon from the atmosphere to offset greenhouse gas emissions to address climate change.

15. Support and innovations for environmentally sustainable growth may generate greater returns in OCR borrowers than anywhere else. Their large populations—now 51% of the world population—are experiencing sustained economic growth, industrialization, urbanization, increases in living standards and household consumption, as well as shifts from biomass to commercial fuels, and surging demand for electricity and fuel for cars, trucks, trains, and airplanes. These strain the global environment, yet OCR borrowers are at a stage of development that will allow them to move more directly to clean and efficient energy and environment friendly technologies. But this will not happen by itself. To be successful, this will require improved policy, investment in new technology, and an improved role for the private sector. OCR borrowers have a vested interest in this global effort since developing Asia and the Pacific faces higher human and economic risks from global warming than any other region.

D. Mitigating and Responding to Natural Disasters

16. The geographical and geophysical characteristics of Asia and Pacific make it particularly susceptible to natural disasters. In an average year, the region sustains $39.5 billion in physical losses. In 2007, eight of the 10 countries with the world's highest number of natural disaster deaths were in Asia, making it the hardest hit continent. Natural calamities sharply increase poverty and seriously retard social and economic progress. Evidence shows that disaster risk reduction can produce substantial economic and social gains and is more affordable than repairing damage from a disaster. The World Bank estimates that countries could save $7 in natural disaster recovery costs for every $1 spent on risk reduction.[6] By 2020, this represents substantial potential savings in private and public expenditure for OCR borrowers that could be invested in other productive and socially beneficial activities. With external assistance, ADB's OCR borrowers can make natural disaster prevention and preparedness activities an intrinsic

[6] ADB. 2008. *Action Plan for Implementing ADB's Disaster and Emergency Assistance Policy.* Manila.

part of their development process, as well as enhance their capacities to identify threats and cope with catastrophes in their most vulnerable regions.

E. Open Regionalism for a Progressive Global Economic System and the Provision of Global Public Goods

17. Developing Asia holds immense untapped potential for the kind of regional and subregional cooperation that speeds and magnifies economic gains by individual nations. Greater regional cooperation can generate productivity gains, create collective demand and larger markets, and set off new ideas to sustain global economic progress. Promoting and delivering open regionalism can also narrow development gaps between neighbors and contribute to global goods. However, it is not an inevitable outcome of economic development. To continue building regional cooperation and integration (RCI), ADB's OCR borrowers will require advice, intermediation, planning, and financial support.

18. Asian regionalism cannot fulfill its great promise unless it addresses disparities within and among countries. This challenge, which is the subject of Strategy 2020's strategic agenda of regional integration, directly involves OCR borrowers as well as those DMCs that only have access to the Asian Development Fund (ADF). Regional cooperation is also useful for addressing critical social and environmental issues directly. It can also help make a strong case for action—as the MDGs did globally—and mobilize national, regional, and global support. Regionally coordinated responses can also help countries reduce the downside risk and emerge faster and stronger from the ongoing global crisis.

F. Need for External Development Finance in Ordinary Capital Resources Borrowers

19. Even before the global financial crisis, ADB's OCR borrowers faced an estimated resource gap of $53 billion a year in their efforts to achieve the MDGs—with the PRC and India accounting for $23 billion of the annual shortfall (footnote 3). In addition, natural disasters cost Asia on average $39.5 billion a year in physical losses. The domestic resources for emergency humanitarian needs and medium-term rehabilitation and reconstruction after these catastrophes are often diverted from priority economic and social programs, further diminishing progress on the MDGs.

20. The capital investments needed to meet broader economic, social, and environmental challenges in OCR borrowers are massive. The region must find $4.7 trillion in infrastructure investment over the next 10 years—$3.1 trillion for new capacity and the rest for capacity replacement. Total investment for addressing environmental issues could reach $100 billion a year, including $30 billion for renewable energy, $28 billion for adaptation to climate change, $14 billion for energy efficiency, and $8 billion for sustainable management of water resources. Sizable amounts are also necessary to develop the region's finance sector. While ADB cannot expect to meet the extent of demand for these purposes, it is engaged in providing advice and demonstration impact through its projects, which can then be adopted or replicated on a larger scale by DMCs.

21. The higher costs of external financing in capital markets due to the global financial crisis are impeding the mobilization of development funds and undermining the ability of DMCs to sustain economic growth, social development, and environmental protection. These constraints make it exceptionally difficult for emerging market countries to finance their budgets and balance of payments. Yet OCR borrowers know that they must not lose sight of their medium- to longer-term development objectives. They remain committed to upgrading their infrastructure,

empowering rural communities, and providing better access to health services and education. They also need fiscal space for targeted fiscal stimulus and social safety net programs to provide relief to the poor and investments that create productive jobs.

III. THE GLOBAL AND REGIONAL ECONOMIC CONTEXT FOR GENERAL CAPITAL INCREASE V

A. Negative Impacts from the Global Financial Crisis

22. The worst financial and economic crisis in more than six decades has ended record growth in ADB's OCR borrowers and had its greatest impact on poor and fragile populations. The region's aggregate gross domestic product (GDP) growth rate could drop substantially from its pre-crisis level of 9% in 2007.[7] Using a baseline scenario where each OCR country's growth in GDP per capita for the years 2008, 2009, and 2010 is identical to that it experienced in 2007, ADB estimates that if OCR countries experience growth in GDP per capita in 2008 and 2009 that is two percentage points slower than that in 2007, there will be 39 million additional $1.25/day poor in OCR countries in 2009 as compared to the baseline scenario. If this slower growth rate were to continue in 2010 as well, there would be 63 million additional poor in OCR countries by 2010 as compared to the baseline scenario.[8] Rising unemployment and falling incomes threaten to reverse earlier reductions in poverty, deepen already growing economic disparities, and prevent the achievement of the MDGs.

23. Declining government revenues and rising public spending, coupled with the risk aversion, higher costs, and contraction of international credit markets, are damaging the fiscal capacity of many OCR borrowers to respond to these threats or to borrow for essential development infrastructure and social services. Trade finance has contracted sharply. Outflows of foreign capital, deflated equity markets, and collapsing demand for exports to developed economies have depressed countries' debt service capacity and the private sector investment crucial to sustaining growth and maintaining advances against poverty and deprivation. Major Asian stock market indices dropped by between 20% and 60% in September and October 2008, and net equity outflows from eight of the region's economies in the January–November period were an estimated $72 billion.[9] Currencies depreciated sharply as a result. World Bank analysis identifies 16 countries in Asia as "highly exposed" to the current crisis.[10] Eight of those countries are OCR borrowers, with a combined population of 1.87 billion people.

24. On the positive side, ADB's OCR borrowers generally have better macroeconomic and financial sector management in place than during the Asian financial crisis of 1997–1998. Lower energy and commodity prices have eased inflationary pressures. Financial institutions have been largely unexposed to subprime mortgages and other toxic credit products. Governments have reacted appropriately to the crisis, within their limited means, with liquidity injections, interest rate cuts, fiscal stimulus measures, and financial policy adjustments. As a result, the

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[7] ADB projected 5.8% GDP growth for Developing Asia in 2009 in the Asia Economic Monitor 2008, December 2008 issue. The projections in the Asian Development Outlook 2009 to be issued in late March by the Economics and Research Department (ERD) are expected to be significantly lower.

[8] Poverty projections for 2009 and 2010 are based on ERD staff estimates, covering 16 OCR countries for which data are available.

[9] ADB. 2009. *Global Financial Crisis and Proposed ADB Response.* Manila.

[10] Bangladesh, India, Indonesia, Pakistan, Philippines, Turkmenistan, Uzbekistan, and Viet Nam are included as "highly exposed" countries. "Highly exposed" countries are defined as those whose projected 2008–2009 real per capita economic growth are below the 2004–2007 level and where 20 per cent or more of households were below the $1.25 poverty line in 2005. (World Bank. *"The Global Economic Crisis: Assessing Vulnerability with a Poverty Lens."* February 2009.)

economies of OCR borrowers should continue to grow in 2009 at rates that will modestly cushion the global impact of recessions in the European Union, Japan, and the USA.

25. Generally, OCR borrowers lack the resources of advanced economies for major stimulus packages or for social protection. The prolonged rehabilitation period expected in global credit markets, coupled with possibly protracted recessions in the developed world, endanger recent advances even in the stronger OCR borrowers. OCR borrowers' asset prices, external reserves, exchange rates, fiscal positions, and financial systems may weaken under sustained pressure or fresh shocks. Growing fiscal deficits and government borrowing in developed countries could crowd out lending for DMCs. Creeping de-globalization of international finance, as rescued or weakened banks in developed countries deleverage and concentrate lending at home, is exacerbating large pre-crisis financing gaps for infrastructure, education, health, and social services, and for maintaining growth and reducing poverty.

B. Risks to Social Stability and Security

26. An inability to fund remedial initiatives and sustain development to contain rising unemployment, poverty, inequalities, and humanitarian emergencies during the crisis could impair social cohesion and political stability. Unrest, already a concern of some OCR borrowing governments, would compound the effects of the crisis on the region’s long-term growth and development.

27. Economic stress, especially rising male youth unemployment, is highly correlated with political and social instability, political violence, and, in extreme circumstances, "fragile" or "failed" states. This is clearly a challenge for Asia where some 500 million were estimated to be unemployed or underemployed even before the current crisis, and some 245 million new workers are expected to enter the region's labor market over the next decade.[11]

C. The Importance of Multilateral and Coordinated Action

28. The international community recognizes that multilateralism is central to the coordinated worldwide crisis response needed to restore global financial stability and growth and to deliver adequate financial development support to emerging markets and developing countries. The G-20 has called on its members to provide the capital resources required for the MDBs to exercise their mandates and comparative advantage to fill financial gaps and to combat the current crisis, as well as to continue promoting inclusive, environmentally sustainable growth, greater private sector participation in development, and improved capacity-building and better governance in their DMCs. In that context, G-20 Finance Ministers have agreed that they should ensure that all MDBs have the capital they need, beginning with a substantial capital increase for the ADB.[12] This support is crucial during an economic disruption when pressures mount for protectionist measures, reductions to financial and assistance flows, or the addition of encumbrances to development assistance—steps that have deepened and prolonged crises in the past.

29. At a testing time for multilateralism and international economic cooperation, GCI V will revalidate and advance the sound, proven form of effective global collaboration that ADB exemplifies. Because of its close, ongoing, multifaceted relationships with their DMCs,

[11] Jesus Felipe and Rana Hasan. 2006. *The Challenge of Job Creation in Asia.* Manila: ADB (Economics and Research Department Policy Brief no 44).
[12] G-20 Information Centre. *G-20 Finance Ministers and Central Bank Governors Communique.* 14 March 2009. United Kingdom.

ADB can respond flexibly and effectively during crises to expedite and redirect new assistance, share critical knowledge and expertise, guide policy, and support urgent development budget financing in sectors such as infrastructure and social safety nets to stimulate rapid growth and poverty reduction, as well as non-income social benefits. ADB believes crisis efforts by the MDBs must be timely, coordinated, and temporary, and should make full, effective use of their individual comparative advantages.

IV. WHY ADB IS A RELEVANT DEVELOPMENT PARTNER FOR THE INTERNATIONAL COMMUNITY

30. ADB's foundation is firmly based on multilateral cooperation. It has made significant efforts in recent years to improve its effectiveness and these efforts have had tangible results (paras. 88–119). ADB has become well suited to respond to the region's development challenges and the current crisis in the following important ways.

A. Strategy 2020 Relevant for Both Crisis and Long-Term Development Needs

31. Strategy 2020's adoption in April 2008 followed a comprehensive review and consultations with all stakeholders on ADB's role and the directions it should take in addressing the key development issues and opportunities in the region. It has proved timely in the current crisis, sharpening ADB's strategic approach to the region's central development challenges. Under Strategy 2020, ADB can contribute to improving both the quantity and quality of government public expenditure and its own development finance by combining high quality economic and policy analysis and other knowledge products with development finance.

32. Strategy 2020 focuses ADB on five core areas: infrastructure; environment, including climate change; regional cooperation and integration; financial sector development; and education. It also puts greater emphasis on drivers of change in the region, including private sector development, good governance and capacity development, gender equity, knowledge solutions, and partnerships. With the adoption of Strategy 2020, ADB is increasingly efficient and results-oriented. Its Strategy 2020 provides focus and coherence to ADB's future operations. ADB has a corporate results framework, an independent evaluation department, and innovative financing instruments.

B. ADB Can Deliver Results Through its Infrastructure Projects

33. ADB's established presence and expertise in supporting OCR borrowers to improve their infrastructure, its leading area of operation under Strategy 2020, positions it well to address both pre-existing constraints on growth, productivity, and competitiveness and the challenges imposed by the current crisis.

34. ADB's strong past record in infrastructure, particularly in transport, communications, energy, and water, and its continuing emphasis on infrastructure development under Strategy 2020 will enable it to respond decisively to an infrastructure deficit in developing Asia and the Pacific that was estimated at $4.7 trillion even before the crisis took hold.

35. Infrastructure will also be central to addressing global climate change and conserving energy. A recently approved $31 million OCR loan to the Philippines, for example, will reduce peak load power demand through energy-efficient lighting. It will produce savings of about

$100 million in annual fuel costs and defer an investment of $450 million in power generation and associated network capacity.[13]

C. ADB Plays a Leading Role in Regional Integration

36. ADB will expand its support for regional integration at several levels under Strategy 2020: as the regional MDB and associate of its DMCs in global discussions; as a provider and conveyor of analysis, policy, and multidisciplinary expertise; as a convener of meetings of its DMCs and member countries on key development issues; and as a provider of funding, ADB can help establish, guide, and strengthen cooperation across developing Asia and the Pacific and within subregions.

37. ADB will also step up activities to manage regional public goods, such as the transparency of financial information, and will continue to build cross-border cooperation on environmental, energy, health, trade, and other development issues.

38. ADB's regional integration agenda not only advances development within the region and the DMCs themselves, it generates benefits worldwide by furthering the globalization of efforts to remove obstacles to growth and address common problems of the international community.

D. ADB Can Fill Crucial Finance Gaps and Help Mobilize Savings

39. ADB's long experience and comparative advantages in one of its fundamental roles—closing the gap created by the region's vast development investment needs and reluctance of commercial and private finance to lend—have never been more important or in demand.

40. Under Strategy 2020, ADB will help OCR borrowers build and improve their underdeveloped capital markets so they can intermediate the region's large savings more efficiently, particularly for long-term infrastructure investments. By helping to strengthen financial risk management, credit standards, and internal control procedures, ADB can catalyze private sector investments and public-private partnerships, and at the time of financial and economic crisis help offset falling government revenues, plummeting capital investment inflows, and the severe contraction and rising costs of the international credit markets.

E. ADB Provides Powerful Leverage in Development Financing

41. ADB's capital structure allows an individual member to pool its capital contributions with those of 66 other members, thereby achieving critical mass in deploying prudentially well-managed resources dedicated to development in Asia and the Pacific with common purpose and accountability. This financial intermediation is amplified further through ADB's strategic participation in private sector operations, public-private partnerships, and guarantee operations

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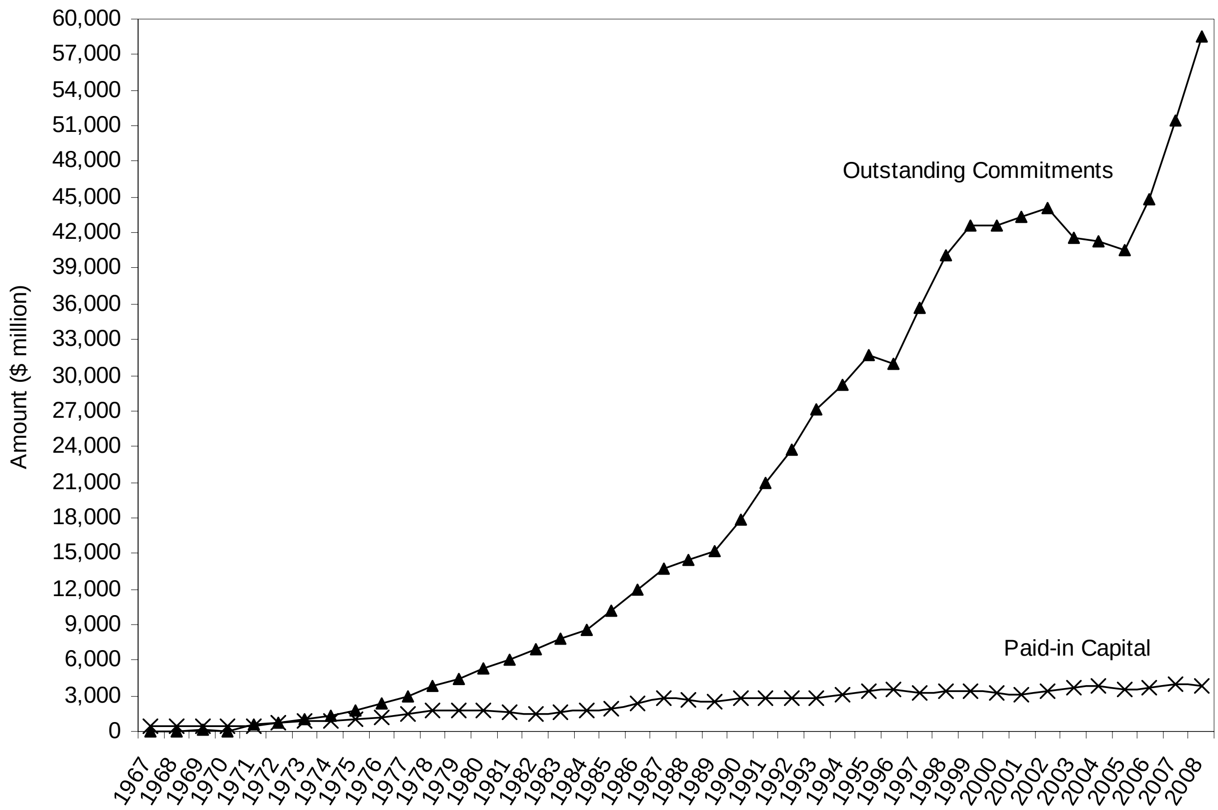
[13] ADB. 2009. *Philippine Energy Efficiency Project*. Manila (approved on 29 January 2009). The project will (i) retrofit about 40 government-owned office buildings with efficient lighting; (ii) procure 13 million compact fluorescent lamps for distribution to residential and other customers to reduce peak power demand; (iii) introduce energy-efficient lamps for public lighting; (iv) set up a laboratory for testing energy-efficient appliances and a lamp waste management facility; (v) establish a super energy service company; (vi) promote an efficiency-building initiative; and (vii) develop and implement a communication and social mobilization program. The Project aims to reduce the peak load power demand by implementing an energy-efficiency program, with a particular focus on efficient lighting that will contribute to greenhouse gas reduction. Carbon credits will be sought following the methodology approved by the executive board of the Clean Development Mechanism.

where ADB's financial participation provides an incentive for many other public and private sources of capital to invest in ADB-assisted programs and projects in the region.

42. Using a small amount of shareholders' paid-in capital, backed by callable capital, ADB has effectively and safely maintained a high level of cash gearing for 40 years by mobilizing a much larger amount of capital that it can lend for long-term development financing (Figure 4). ADB shareholders' cumulative paid-in portion is only about 7% of total subscriptions. As of 31 December 2008, ADB's outstanding loan commitments were 15 times the paid-in equity. GCI V will provide an exceptionally cost-effective vehicle for ADB's members to maximize the efficiency and results of their global development spending, particularly during a period of fiscal constraints. ADB has never made a call on callable capital.

Figure 4: Paid-in Capital and Outstanding Commitments, 1967–2008



Source: ADB, Treasury Department.

V. DEMAND FOR OCR RESOURCES, ADB'S RESPONSE, AND DEVELOPMENT OUTCOMES

43. In preparing for GCI V, ADB estimated the demand for OCR financing for 2009–2020. It based its projections on inputs from the regional departments including their consultations with DMCs and took into account (i) the ongoing financial and economic crisis (ii) ADB's strategic priorities under Strategy 2020, (iii) the national development strategies of the OCR borrowers, and (iv) efforts to increase the catalytic role of ADB's resources, particularly in mobilizing domestic savings and regional and international private capital. The analysis below presents an assessment of three types of demand namely: (i) demand due to the global financial and

economic crisis, (ii) underlying demand for 2009–2011, which is the period of ADB's current work program and budget framework (WPBF), and (iii) long-term demand implications for 2012–2020, which is the period beyond the current WPBF up until 2020.

A. Additional Demand Due to Financial Crisis and ADB's Response

44. The current global financial and economic crisis has increased the importance of ADB’s role. With credit markets so impaired, DMCs are turning to ADB for increased assistance. The internal and external funding shortfalls in ADB’s core area operations, based on internal assessments and requests for assistance that ADB had received from its DMCs, are rising beyond initially planned levels of OCR lending and guarantees. In response to these requests, ADB will take a coordinated approach to provide up to an additional $7 billion to $8 billion of OCR funding support to crisis-affected DMCs in 2009–2010.

45. ADB will be able to extend $4 billion of additional OCR crisis response financing in 2009 and a further $3 billion to $4 billion in 2010. Approximately $1 billion of this assistance will be aimed at supporting trade finance, and the remainder will be divided among guarantees, quick-disbursing assistance, and support for project investments. But ADB cannot respond promptly or properly without a GCI.

46. Requests for crisis-related assistance have also been received from ADF recipients in Central, South, and East Asia and processing of financing is underway. When required, ADB proposes to make use of existing flexibility that will enable it to front-load resources within the first biennium of ADF X so that requests for assistance and levels of operations in 2009 are sustained.[14] Furthermore, in order to help strengthen the ADF resources position, Management plans annual OCR net income transfers that will be three times higher during ADF X than during ADF IX, subject to ADB's Board of Directors' annual reviews of ADB's capital adequacy and net income outlook, and ADB's Board of Governors' approval of the net income allocation.

47. These responses to the crisis will raise ADB's total annual OCR assistance to its DMCs up to $13 billion in 2009 and 2010. This is 48% more than the amount planned for 2009–2010 under the WPBF. ADB plans to mobilize an additional $2 billion in programmatic cofinancing in 2009–2010. It is making arrangements with the Islamic Development Bank, the Japan Bank for International Cooperation, the Republic of Korea, and regional export-import banks, as well as developing framework agreements with interested counterparties covering both trade financing guarantees and infrastructure financing. After 2010, ADB expects a gradual decline in crisis-related demand from its DMCs and plans to return to levels of lending that would be sustainable under its capital adequacy framework through 2020.

B. Underlying Long-term Demand for OCR Resources 2009–2020

48. Underlying long-term demand for OCR resources 2009–2020 is expected to remain robust during the Strategy 2020 period. Based on population and gross national income (GNI) per capita levels, OCR borrowers can be grouped into four distinct clusters (Table 1). The low-income and lower middle-income OCR countries with GNI per capita of $2,000 or less and with large population of 50 million and above are most likely to need more development assistance compared to other OCR borrowers. Further analysis is provided below in the discussion on demand beyond 2011 (paras. 51–52).

[14] In this context, the overall ADF lending and grant level in 2009 may range from $3.1 billion to $3.4 billion.

Table 1: Ordinary Capital Resources Borrowers by Population Size and Income Level

Population Size / Income level	Low Income		Lower Middle Income		Upper Middle Income
	Per Capita GNI below or equal to $500	Per Capita GNI above $500 but below or equal to $935	Per Capita GNI above $935 but below or equal to $2,000	Per Capita GNI above $2,000 but below or equal to $3,705	Per Capita GNI above $3,705 but below $11,455
Large DMCs					
With population 1 billion or above			**India**	**PRC**	
With population 500 million or above but below 1 billion					
Medium-sized DMCs					
With population 100 million or above but below 500 million	**Bangladesh**	**Pakistan**	**Indonesia**		
With population 50 million or above but below 100 million		**Viet Nam**	**Philippines**	**Thailand**	
With population 10 million or above but below 50 million		**Uzbekistan**	**Sri Lanka**		**Kazakhstan[a], Malaysia**
Small DMCs					
With population 1 million or above but below 10 million		**PNG**	**Georgia**	**Azerbaijan, Armenia**	
With population below 1 million				**FSM, Marshall Islands**	**Fiji Islands[a], Palau**

DMC = developing member country; FSM = Federated States of Micronesia; GNI = gross national income; PNG = Papua New Guinea; PRC = People's Republic of China

[a] Below the 2007 threshold level of $6,465 for OCR graduation.

Note: Cook Islands and Turkmenistan are not included due to lack of data. The classification according to low-, lower middle- and upper middle-income groups are based on the World Bank's 2007 threshold levels for classifying income categories.

Legend:

Refers to a low-income or lower middle-income country with a per capita GNI of $2,000 or below and with large population (50 million or above).

Refers to a low-income or lower middle-income country with a per capita GNI of $2,000 or below and with relatively small population (below 50 million).

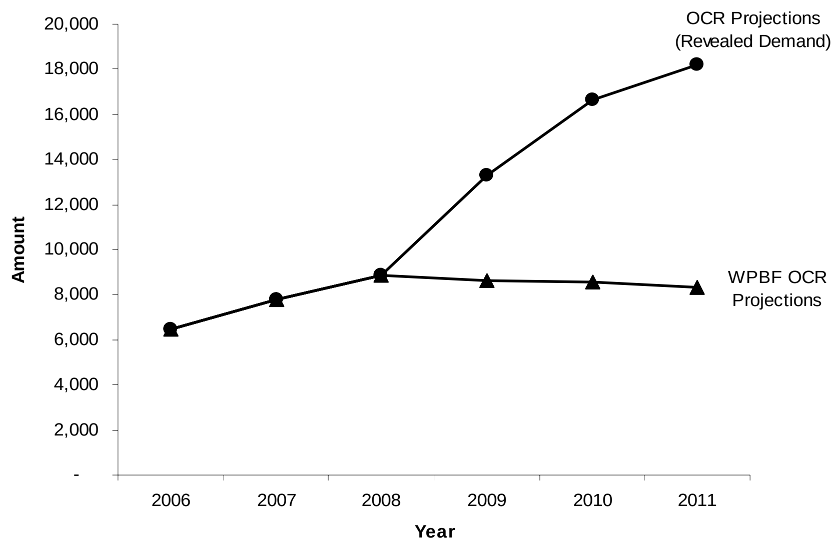
Refers to a lower middle-income country with a per capita GNI above $2,000 regardless of population size.

Sources: ADB, Basic Statistics 2008; World Bank Operational Manual, Operational Policies, OP 3.10—Annex D, updated July 2008.

49. **Underlying Demand 2009–2011.** The near-term demand for OCR resources exceeded ADB's current lending capacity even before the global crisis. The estimated gaps between ADB's annual lending program under WPBF 2009–2011 and the revealed (or requested) demand during operational strategic planning were $4.6 billion for 2009, $8.1 billion for 2010, and $9.9 billion for 2011 as shown in Figure 5.[15]

[15] Data presented in Figure 5 are for 16 major OCR borrowers only. ADB. 2008. *Review of the Asian Development Bank's Ordinary Capital Resource Requirements.* Manila. (Working Paper 6-08, 19 December 2008)

Figure 5: Projected Ordinary Capital Resources Gap, 2009–2011
($ million)



OCR = ordinary capital resources, WPBF = work program and budget framework.
Sources: ADB's Loan, TA, Grant and Equity Approvals database; WPBF 2009–2011, September 2008; ADB Regional Departments.

50. Under the WPBF 2009–2011 for OCR resources, five low-income DMCs—Bangladesh, Papua New Guinea, Pakistan, Uzbekistan, and Viet Nam—accounted for about 35% of total planned lending. Seven lower middle-income countries (MICs)—Azerbaijan, PRC, India, Indonesia, Philippines, Sri Lanka, and Thailand—accounted for about 60% of planned lending.[16] Overall unmet demand was about equal in the two groups and highest in Viet Nam (23%), Pakistan (17%), India (14%), and Indonesia (13%). Infrastructure accounted for 75% of the shortfall ($13.7 billion, including $7.2 billion for transport and communications and $4.2 billion for energy). The financial sector accounted for about 17% of the shortfall.

51. **Demand beyond 2011.** ADB expects annual demand for OCR loans in its core areas of operations, led by infrastructure, to remain at least as high as the 2011 revealed demand of $18 billion during the GCI V program period to 2020. As shown in Table 1, six of the current seven largest OCR borrowers—Bangladesh, India, Indonesia, Pakistan, Philippines, and Viet Nam—are in the low-income or lower half of the middle-income group of OCR borrowers, which suggests they will need sizable development assistance for the medium to long term. They make up about 70% of the current WPBF OCR allocation and 74% of the 2009–2011 revealed demand. None of these countries is projected to graduate from regular OCR assistance by 2020. An average of 36% of their relatively large populations are poor. With the exception of India, their country risk ratings will limit their access to external financing (Table 2). Their capacities to absorb more lending have grown and OCR lending to these six DMCs has accelerated over the 2005–2008 period, increasing by an average annual rate of 26%, compared with 19% for OCR borrowers overall.

[16] These data include public sector lending program of 16 major OCR borrowers only. (ADB. 2008. *Work Program and Budget Framework 2009–2011.* Manila.)

Table 2: Income, Poverty, and Country Risk of Six Major Ordinary Capital Resources Borrowers

OCR Borrower	GNI per Capita[a] ($)	Number of Poor[b] (mn)	% of Poor People[b]	Country Risk Rating[c]
Bangladesh	470	77.4	50.5	6
India	950	455.8	41.6	3
Indonesia	1,650	47.3	21.4	5
Pakistan	870	35.2	22.6	6
Philippines	1,620	19.1	22.6	4
Viet Nam	790	19.0	22.8	4

GNI = gross national income, OCR = Ordinary Capital Resources.
[a] Figures are in 2007 US$ based on World Bank Atlas method.
[b] Refer to recent poverty estimates using 2005 purchasing power parities and $1.25/day poverty line.
[c] Refers to the country risk rating under the Knaepen Package, produced for the purpose of setting minimum premium rates for transactions covered by the Export Credit Arrangement.
Sources: OECD, Country Risk Classifications of the Participants to the Arrangement on Officially Supported Export Credits, valid as of 30 January 2009; WB, PovcalNet Online Poverty Analysis Tool, data downloaded on 9 February 2009; WB Operational Manual, Operational Policies, OP 3.10—Annex D, updated July 2008.

52. No firm or definitive quantitative breakdown of demand for the 2012–2020 period is possible at present.[17] This will be realized over time using the ADB's established three-year strategic operational programming system and reflected in future corporate work program and budget frameworks reported to the Board of Directors. Long-range projections are indicative but indefinite and are especially difficult to define during financial turmoil and economic uncertainty. Projections of per capita GNI (Appendix 1) based on growth rates in the past five years indicate that nine current ADF-only countries, which account for about 4% of ADF borrowing in the 2009–2011 WPBF, may become eligible for OCR borrowing before or by 2020. Blend borrowers[18] will continue to improve their absorptive capacity and request higher OCR lending, while OCR-only borrowers may gradually reduce their OCR borrowing as they approach graduation. Three current blend and OCR-only borrowers that may graduate from OCR eligibility, based on an analysis of projected GNI per capita, account for only about 2% of current OCR lending. Furthermore, the current crisis may diminish the graduation prospects of some of these DMCs.[19] The PRC is generally expected to limit its OCR borrowing to about $1.5 billion a year and ADB envisages a relationship with the PRC by 2020 that will not depend on new lending. Under GCI V, the nature of OCR assistance to the PRC will also change, with ADB steadily increasing its direct responses under Strategy 2020 to impediments to poverty reduction in poorer regions and to environmental issues, including adoption of new technologies and knowledge solutions for energy efficiency and clean energy over time (Box 1).

[17] The second working paper estimated that demand for ADB resources during 2012–2020 ranged from $15 billion in 2012 to $17 billion in 2020.
[18] Under ADB's country classification and graduation framework, a DMC can be classified as a "blend borrower" based on the criteria of per capita gross national income and level of creditworthiness for OCR or market-based resources. Blend borrowers can borrow from both ADF and OCR (ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank.* Manila)
[19] Given the uncertainties of the present crisis, downside risk to these projections is strong. The status of each DMC will be carefully monitored from this perspective.

C. GCI V Operations and Expected Development Outcomes

53. **2009–2011.** ADB will maintain the strategic directions set in WPBF 2009–2011 under Strategy 2020's agenda of poverty reduction through inclusive and environmentally sustainable growth and regional cooperation and integration (Appendix 2).

54. To achieve inclusive economic growth, ADB's infrastructure projects will target economic and social development in urban and rural areas. Substantially expanded water supply and sanitation, rural water resource management, and irrigation projects will increase economic activity, incomes, and social services for the poor, the vulnerable, and excluded groups and areas. Almost 12% of sovereign lending will be to finance projects that support inclusive economic growth by addressing weaknesses in the financial systems of OCR borrowers. Private sector development and private sector operations[20] to sustain economic growth and create jobs will make up 41% of total OCR sovereign and nonsovereign projects in terms of number and 43% in terms of volume by 2011.

55. While the number of education projects will remain stable for the 2009–2011 WPBF period, the share of projects or programmatic lending to improve the quality and coverage of secondary, vocational, and technical education programs will grow. ADB will contribute to improvements in health mainly through infrastructure projects such as water and sanitation and through governance work that focuses on public expenditure management for cost-effective delivery of health programs and services to all population groups. The gender dimension of ADB projects will continue to increase.

56. ADB will increase OCR sovereign operations aimed at environmentally sustainable growth from 30% in 2008 to 50% in 2011 in terms of the number of projects, and from 14% to 40% in lending volume. Nearly 22% of projects supported by TA operations will address clean and renewable energy and energy efficiency improvements, signaling both growth and diversification in the environmental portfolio beyond water and urban sector development. Research to support the climate change agenda will be one of the top ADB knowledge products for 2009–2011.

57. To support regional cooperation and integration, the aggregate sovereign and nonsovereign lending for regional and subregional lending is programmed to increase progressively under the 2009–2011 WPBF. OCR public sector projects for regional cooperation and integration will grow to 14% of the total number and 18% of lending volume by 2011. ADB will pursue this agenda at all levels and through lending and non-lending operations. It will support subregional cooperation in the Greater Mekong area, Southeast Asia, Central Asia, and South Asia, as well as in the Pacific through distinct mandates to meet the specific subregional needs.

58. **2012–2020.** The likely contributions of OCR operations to broader economic and social development in 2012–2020 can be anticipated based on ADB's past performance and new directions under Strategy 2020, as well as on the needs of OCR borrowers. The largest share of GCI V resources will go to ADB's core areas of operation, with blend borrowers (footnote 18) remaining the largest recipient group.

[20] Private sector development activities—typically undertaken by regional departments—usually involve government counterparts and aim at creating an enabling environment and removing constraints to private sector expansion through, for example, policy reforms, public-private partnerships, and improvements in the financial sector. Private sector operations—processed by the Private Sector Department—involve lending, equity investment, guarantees, and B-loans where the counterpart are private sponsors.

59. ADB operations and their development outcomes will be closely linked to national development strategies. Independent evaluations conducted by the Independent Evaluation Department (IED)[21] of the country assistance programs of major OCR borrowers[22] have concluded that OCR operations are increasingly aligned with DMCs' national strategies and reforms. The strategies of OCR borrowers are likely to continue to center on improving infrastructure to sustain growth and private sector development, and to achieve the MDGs. These DMCs are strongly committed to building more productive, efficient economies and are open to creating more business-friendly environments through reforms. Their strategies also highlight private sector development and public-private partnerships, particularly for infrastructure development.

60. The outcomes of future OCR operations can generally be expected to correspond to those achieved in similar sectoral and thematic projects in the past, particularly in the priority activities under Strategy 2020. ADB's OCR operations have brought demonstrable and significant development impacts to large, medium-sized, and small economies, including those of the Pacific subregion (Boxes 1 and 2).[23] In many cases, the outcomes under GCI V in 2009–2020 should improve, given the lessons learned and greater efforts for effectiveness and better planning and implementation, as well as heightened impact from leveraging growing private sector operations (Appendix 2, Section B).

D. ADB's Approach to Middle-Income Countries

61. Even before the current global financial and economic crisis, the international community reaffirmed that middle-income countries (MICs) still face significant challenges in the area of poverty reduction and that their efforts to address those challenges should be strengthened and supported by the United Nations system and the international financial institutions to ensure that achievements made to date are sustained.[24]

62. ADB's current OCR borrowers comprise countries with widely divergent income levels—from about $470 (Bangladesh) to $2,550 (Azerbaijan) per capita GNI in 2007. Some are still low-income countries, while others are mostly at lower- or mid-level MICs. Some are large and populous—including the PRC, India, Indonesia, and the Philippines. Others are smaller in size and population—including several in the Pacific—but facing comparable challenges of socially inclusive and sustainable economic growth. Countries at lower income levels still face numerous development problems and constraints to ending poverty and achieving the MDGs. They have relatively limited access to affordable medium- to long-term private capital. The higher-income countries are generally better equipped financially, institutionally, and in terms of human resources, and usually face fewer systemic development problems. However, these problems are often large and intractable—providing water and sanitation, for example. They also often face new challenges arising from inequitable or unbalanced economic and social progress, as well as the growing complexity of meeting the rising expectations of civil society and the private sector.

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[21] The Operations Evaluation Department (OED) was renamed the Independent Evaluation Department (IED) effective January 2009.

[22] See the following country assistance program evaluations: Bangladesh (January 2003), India (September 2007), Indonesia (December 2005), Pakistan (May 2007), Philippines (June 2008), and Sri Lanka (August 2007).

[23] ADB. 2009. *Investing for our Future: Impact Stories Ordinary Capital Resources.* Manila.

[24] United Nations. 2008. *Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus: Draft Outcome Document of the Conference*. Doha, Qatar.

63. Given the diversity of needs and countries, ADB seeks to maintain overall coherence in the way it engages with MICs, while tailoring the specifics of its engagement to reflect this diversity of needs. This is summarized in Table 3.

Table 3: Developing Member Country Assistance Requirements

Item	Low Middle-Income Countries[a]	Other Middle-Income Countries
Key Issues	• Poverty/employment • Rural productivity/rural modernization • Rural urban migration • Energy supply and alternatives • Environmental degradation • Trade barriers • Undeveloped financial systems • Food security	• Poverty/income disparity • Rural/urban migration • Urbanization • Environmental degradation/climate change • Food security • Global market competitiveness • Energy supply and alternatives
Focus Assistance Areas	• Agriculture/rural development • Governance - Institutional development - Supporting emerging private sector • Expanding/modernizing physical infrastructure development - Water - Transport - Energy - Communications • Social development - Health - Education • Financial sector development	• Private sector enabling environment • Privatization/PPPs (for all Strategy 2020 areas of operation) • Regulatory environment • Governance • Trade • Regional/global public goods • Capital market development • Trade • Partnership/regional cooperation
Products	• ADF loans/OCR loans/ADB and sourced specialist knowledge • Technical assistance • Nonsovereign PPPs • Guarantees • Cofinancing	• OCR loans/sourced specialist knowledge • Technical assistance • Nonsovereign PPPs • Guarantees • Cofinancing

ADB = Asian Development Bank, ADF = Asian Development Fund, DMC = developing member country, OCR = ordinary capital resources, PPP = public–private partnership.
[a] These encompass both low- and lower middle-income countries under the World Bank's classification. See Table 1 with reference to the note.
Source: Asian Development Bank

64. ADB is investing in and promoting development in OCR borrowers based on considerations well beyond that of national economic growth. It is addressing poverty reduction through a diverse set of subnational, human capital, governance, environmental, and regional issues. India, along with other lower-income DMCs, including Bangladesh, Pakistan, and Viet Nam, that are blend borrowers, have per capita incomes approximately at or below the ADF and International Development Association operational cutoff. In these DMCs, ADB focuses strongly on economic infrastructure for sustaining high growth rates that reduce income poverty rapidly and provide basic public services that improve human welfare.

65. In the low middle-income countries, including some smaller MICs in the Pacific, ADB will focus on broad based poverty challenges, including employment generation, governance, and provision of essential physical infrastructure. With larger MICs and OCR borrowers, such as the PRC, India, and Indonesia, ADB's country partnership strategy and operational programs increasingly aim to overcome disparities and inequalities. They focus more directly on bridging divides though the direct participation in economic development of less well-off geographical areas and social and economic groups. ADB also helps develop capacity in those institutions that can contribute to this aim through their policies and operations. In both large MICs, such as the PRC and India, and mid-size OCR borrowers, such as Indonesia, Philippines, and Thailand, ADB is promoting and supporting a more balanced growth strategy that takes environmental costs into account and aspires to a more energy-efficient, less carbon-dependent economy.

66. ADB also encourages and funds policy and institutional reforms in MICs for better private sector and capital market development, which will attract more domestic and international private capital. It is also increasing direct private sector operations, particularly in higher-income countries—Thailand, for example—and in the more developed sectors of such lower-income MICs as India, Indonesia, Philippines, Viet Nam. The expanding private sectors in these countries offer huge potential for mobilizing private finance in Strategy 2020's areas of operation.

67. ADB is placing more attention on regional cooperation and integration in all its OCR borrowers to achieve inclusive and environmentally sustainable growth. In larger MICs, such as PRC and India, whose economies have a dominant impact on subregional and regional trade, investment, and cross-border environmental and health-related outcomes, ADB is fostering more proactive intercountry cooperation and investment that leads to regional public goods.

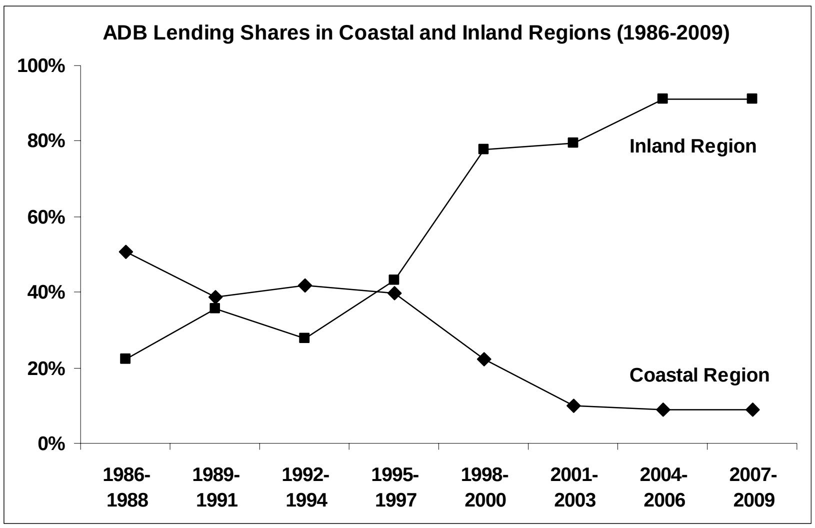
68. In all OCR borrowers, ADB will stress (i) more investment through the use of innovative financing modalities, including public-private partnerships, drawing on greater local resources where feasible; (ii) nonsovereign operations in the public and private sectors; (iii) tapping the carbon market; and (iv) blended cofinancing that provides financial incentives for initial application of pioneering technologies and other knowledge solutions not yet proven under local conditions. To promote greater country ownership and advance aid effectiveness in OCR borrowers within more highly developed, capable institutions and human resources experienced in established sectors, ADB's operations will introduce higher levels of international best practice. In the process, ADB will make fuller use of national capacities and resources in operational planning and implementation. ADB will also incorporate more explicitly in the CPS the transfer of knowledge to other, less-developed OCR borrowers and to ADF-only DMCs. Within ADB, closer cooperation and alignment of strategic operational planning and resource deployment across departments and offices will provide more customized programs of assistance. ADB will broaden the use of fee-based services, particularly for its knowledge products to higher income DMCs.

69. As stated in Strategy 2020, ADB aspires to help all DMCs make measurable progress under its graduation policy: (i) group C borrowers (countries eligible to borrow only OCR resources) in 2008 will have achieved or be on a medium-term path for graduation from regular ADB assistance by 2020; (ii) group B or blend borrowers (countries eligible to borrow ADF resources and OCR) in 2008 will have achieved or be on a medium-term path to reach OCR-only status by 2020; and (iii) group A borrowers (countries eligible to borrow only ADF resources) in 2008 will have achieved or be on a medium-term path to becoming blend borrowers by 2020 (footnote 18). Throughout this progressive process, all of ADB's borrowers

are expected to become OCR borrowers in the future.[25] It is expected, therefore, the overall need for OCR financing would increase in the medium-term before tapering-off with some MICs starting to graduate.

Box 1: ADB's Partnership with the People's Republic of China: A Period of Transition

The relationship between the Asian Development Bank (ADB) and the People's Republic of China (PRC) has shifted over the last two decades from assistance for economic infrastructure and growth in coastal areas to support for increasingly knowledge-driven solutions to extensive deep-rooted poverty, rising social and regional inequalities, and some of the world's most important environmental and energy challenges.



This transition will continue under Strategy 2020 and it is envisaged that the PRC will eventually become primarily a recipient of development innovations, knowledge, managerial expertise, and international standard practices and technology. The PRC will also partner with ADB to become a learning resource for other developing member countries (DMCs) that can benefit from its experience.

ADB will continue to move its operations inland to help the PRC create conditions for inclusive growth in isolated, underdeveloped interior provinces largely untouched by the coastal boom. In these areas, infrastructure and local resources are scarce and massive poverty and inequality persist.

ADB's operations in the PRC will be an important part of its environmentally sustainable growth agenda to cut greenhouse gas emissions and improve energy security. The PRC is the world's second largest consumer of primary energy and its largest consumer of coal. However, it lacks modern technology and methods to avoid high waste and excessive emissions. ADB will work with the Government and the private sector to develop long-term environmental management plans, strengthen administrative institutions, speed up technology adaptation and absorption, introduce environment-friendly incentives through judicious use of pricing and taxation instruments, and facilitate PRC's participation in regional and global policy dialogue on environment protection and management.

The focus on energy efficiency and environmental sustainability will feature in all ADB's transport, urban development, infrastructure, and agriculture and natural resources operations. ADB will provide policy advice, knowledge services, technical assistance, project financing, and risk mitigation services for

[25] Experience in ADB has shown that higher-income OCR borrowers begin to limit, then reduce or even cease, (regular) borrowing before they attain the prevailing per capita income benchmark for graduation from OCR.

energy efficiency and energy conservation, renewable energy (mainly wind, biomass, and hydropower), clean coal technologies, and coal mine methane and coal bed methane. It will also use its funds to leverage external resources, including the Climate Investment Facility.

ADB's $117.4 million Coal Mine Methane Development Project[a] introduced the latest drilling and gas collection technologies to the Sihe Mine in southern Shanxi Province. The project has boosted production of coal and coal-bed methane to feed the largest methane-based power plant in the world (120 megawatts). It is an example of how ADB lending for demonstration projects in the PRC can provide knowledge and examples that lead to further private and public development investments. The project is being considered for Clean Development Mechanism benefits under the Kyoto Protocol and the sale of certified emission reductions is expected to yield about $110 million.

[a] ADB. 2004. *Coal Mine Methane Development Project.* Manila.

Box 2: ADB's Partnership with India: A Flexible Approach with a Focus on the Poor

Assistance from the Asian Development Bank (ADB) to India must be flexible and draw from its approaches to its low-income and middle-income developing member countries (DMCs). ADB must take into account the great disparities between poor regions with meager infrastructure and the rapidly growing states and cities that are home to world-class high-technology enterprises.

Under Strategy 2020, the overriding factor driving ADB's program is the extent of India’s poverty and regional and social inequality. Even though some states have per capita incomes equivalent to those of lower middle-income countries, overall India is a low-income country and home to the largest single concentration of the absolute poor anywhere. Although its leading public sector enterprises, financial institutions, and private companies can compete with the best in the world, India’s socioeconomic indicators can be among the worst.

ADB focuses on traditional public sector lending, with government guarantees for supporting states with high poverty and weak capacity to address development challenges. These include Bihar, Orissa, Jharkand, Uttarakhand, and states in the northeastern region. It also engages in nonsovereign assistance for strong public and private sector entities. This enables the Government to focus on impoverished states and its development priorities.

ADB also facilitates public-private partnerships in infrastructure sectors to plug investment gaps and improve service quality and delivery. Significant capacity building and project preparatory technical assistance is given to new and weaker or poorer clients.

The current ADB program includes assistance to Assam, Bihar, Chhattisgarh, Jammu and Kashmir, Jharkand, Madhya Pradesh, Orissa, Rajasthan, and Uttaranchal. These states, together with those in the northeast, suffer from one or more of the following factors: high poverty incidence, low levels of social development, weak capacity, and poor infrastructure. Of the 13 states where ADB had ongoing, stand-alone operations at the end of 2008, five had poverty rates above the national average of 27.5%. The rates in the remaining eight states were over 20%.

In addition to the core infrastructure sectors of transport, urban, and energy, ADB has started supporting agribusiness and integrated water resources management.

India is an important front in the global battle to control climate change and protect the environment and ADB is significantly scaling up the environmental and efficient, clean energy focus of its program. It is promoting the use of hydropower, solar and other renewable energy forms and helping India lower emissions by supporting the strengthening of the rail and urban transport infrastructure.

VI. ENHANCING ADB'S DEVELOPMENT EFFECTIVENESS

70. To execute Strategy 2020 successfully and make the best use possible of resources under GCI V, over the next decade ADB will continue its systematic work to improve the effectiveness of its assistance, which has helped it to become better development partner and more focused on results.

A. Improving Aid Effectiveness

1. Progress on Paris Declaration Principles

71. ADB is dedicated to meeting all its major commitments under the Paris Declaration by the target date of 2010. ADB regards the adaptation of the Paris principles to local needs and requirements as crucial. With other development partners, it has helped OCR borrowers begin translating the principles into local action**.** ADB also participates in international monitoring and evaluation of progress on implementation of the declaration. It took part in the baseline and monitoring surveys led by the Organisation for Economic Co-operation and Development (OECD) in 2006 and 2008 and in an international reference group to evaluate implementation.

72. ADB’s first monitoring report on its own implementation of the Paris Declaration covered 13 ADF countries and served as a background paper for the ADF X negotiations. The second phase monitoring added four OCR borrowers to the original ADF countries. The results show that ADB’s progress on its Paris commitments has been commendable in most respects but if targets are to be achieved by 2010 greater efforts will be needed to strengthen country systems and capacities to implement projects and programs and to carry out more joint analytical work with development partners.

73. ADB helped organize the Third High-Level Forum on Aid Effectiveness in Accra in September 2008 and coordinated the preparations of its DMCs for that meeting. At the meeting, ADB endorsed the Accra Agenda for Action and, in partnership with the Government of Japan, the OECD's Development Assistance Committee (OECD-DAC), the United Nations Development Programme, and the World Bank, proposed a joint approach to strengthen capacities of the DMCs for development effectiveness in Asia and the Pacific region, through a capacity development facility for development effectiveness, launched in March 2009 in Manila. This facility will support a community of practice and associated services to improve the quality of national aid policy and implementation and the achievement of development outcomes.

2. Managing for Development Results

74. There is clear evidence that ADB is becoming a more results-driven organization. ADB country strategies have included results indicators and targets since the beginning of the managing for development results (MfDR) approach in 2004.[26] Interventions are linked to expected country outcomes and there is a greater focus on results. ADB also monitors its contribution to development outcomes in countries through country development effectiveness briefs. All projects incorporate a results framework or a development and monitoring framework. The framework, a key project results management tool, also helps ensure that project-level outcomes are linked to targets in the country partnership strategy and in sector road maps.

[26] ADB has been guided by the MfDR action plan during 2006–2008. Future MfDR actions will benefit from various MfDR reviews at ADB, including an IED special study on MfDR and ADB's development effectiveness reviews (the most recent of which was: ADB. 2008. *2007 Development Effectiveness Review*. Manila).

75. In 2008, ADB helped 29 DMCs, including 13 OCR and blend borrowers, to support MfDR initiatives and adopt results frameworks for their national development strategies.[27] A readiness assessment tool for MfDR was developed through a regional TA project and pilot-tested in 13 government agencies in Bangladesh, Nepal, Pakistan, and Sri Lanka. It has become an important MfDR instrument in these countries.

76. At the global level, ADB chaired the MDB working group on MfDR and co-chaired the OECD-DAC joint venture on MfDR.

77. In September 2008, ADB became the first multilateral development bank to put in place a corporate results framework.[28] The framework will be used to monitor Strategy 2020 implementation and, when necessary, to guide timely corrective action. A review of ADB's 2007 performance[29] using this framework found that ADB had (i) delivered sector outputs that had contributed to specific development outcomes, particularly in infrastructure projects providing livelihoods, increasing incomes, and enabling better access to health and education, and (ii) improved its operational and organizational effectiveness in most areas.

78. Adoption of the corporate results framework and inauguration of the *Development Effectiveness Review* were two milestones in consolidating ADB's results management. These tools will be vital in ensuring that decisions across ADB are consistently driven by its performance on key results. ADB is cascading its corporate results framework down to department, division, and country levels. A unit-specific framework will guide work planning, implementation, monitoring, and course-correction processes at each level. ADB has also now begun a process to align all its key policies and strategies to Strategy 2020. This will enable it to update its main directional documents in light of the latest international and regional developments and to harmonize its approaches with those of other development partners.

B. Leveraging the Private Sector for Growth and Poverty Reduction

79. ADB's growing engagement with the private sector under Strategy 2020 will build upon a proven record of achievement, effectiveness, and broad development impact in its private sector operations. A review of private sector projects by ADB's IED indicated a project success rate of 92%.[30] Many of ADB's private sector activities have demonstrated innovation, impact, and partnership that is unlikely to have occurred in the absence of ADB. For example, the same IED study found that, on average, nearly $7 had been raised from external sources for each $1 lent by ADB through its private sector operations. Many stakeholders in DMCs consider ADB's private sector involvement to be essential to enhancing creditworthiness of projects and catalyzing commercial funding.

80. Under Strategy 2020, ADB will do even more to help DMCs attract private sector investments that support inclusive growth and improve the environment. The target in Strategy 2020 is for private sector development and private sector operations to represent 50% of ADB's

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[27] These TA projects include those financed from the MfDR Cooperation Fund, established with contributions from Canada, the Netherlands, and Norway.
[28] The framework consists of performance indicators and medium-term targets at four levels: (i) development outcomes for Asia and the Pacific, (ii) ADB's key operational outputs, (iii) ADB's operational effectiveness, and (iv) ADB's organizational effectiveness. (ADB. 2008. *ADB Results Framework.* Manila.)
[29] ADB. 2008. *2007 Development Effectiveness Review.* Manila.
[30] ADB. 2007. *Special Evaluation Study on Private Sector Development and Operations: Harnessing Synergies with the Public Sector*. Manila.

annual operations by 2020. To achieve this, ADB will need to increase synergies between its public and private sector operations. Public-private collaborations have already produced results. For example, the power investments that accounted for a major share of the increase in private sector lending in 2005–2007 were made possible by reforms to unbundle monopolies pursued in collaboration with ADB's regional departments.[31] In future, ADB will promote public-private operations more systematically.

81. Deliberation by the task force on private sector development indicates that synergies between public and private sector operations will be strengthened by: (i) the participation of the Private Sector Operations Department (PSOD) in formulation and reviews of all country partnership strategies, (ii) greater cooperation between the regional departments and PSOD in the project and program concept papers, (iii) more collaboration by PSOD and the regional departments in knowledge product development and dissemination, and (iv) regular exchanges of information between the regional departments and PSOD. A new PSOD division will act as the focal point for coordination with the regional departments.

82. To ensure effective development outcomes as ADB expands its private sector operations, all PSOD operations will be aligned with Strategy 2020 goals and objectives. From a logical framework perspective, the desired impact of PSOD operations will remain poverty reduction in DMCs. The outcome will be more results targeted private sector investments. The outputs will be focused PSOD operations through (i) creating sound enabling environments to facilitate public and private sector investments, (ii) investing in key public goods and services, and (iii) making direct private sector and nonsovereign investments.

83. Measures are being undertaken to enhance the development effectiveness of ADB's private sector interventions (Box 3). ADB is adapting its design and monitoring framework to reflect the challenge of measuring the impact of private sector operations. The framework will be consistent with those of other development institutions. PSOD will track the development effectiveness of all projects through a monitoring and evaluation system starting in the third quarter of 2009.

84. As ADB moves to meet the objectives of Strategy 2020 by catalyzing investments that the private sector might not otherwise be willing to make and expand operations in less-developed economies, ADB will assume greater, but thoroughly assessed, risks. This will require a robust risk management capacity. ADB's current business processes already demand comprehensive due diligence and documentation of key findings on technical, market, financial, economic, legal, and corporate governance, as well as social and environmental aspects of the financing recipient and the investment project. Where the host government has performance obligations, the project is also reviewed from a political risk perspective. ADB will further strengthen its internal credit approval process by ensuring the early engagement of the Risk Management Unit (RMU) in all non-sovereign operations. The RMU will be involved in risk assessment and monitoring throughout the project cycle, including in projects that have become non-performing (paras. 96–104 and Box 6).

[31] ADB. 2007. *Special Evaluation Study on Energy Policy 2000 Review: Energy Efficiency for a Better Future*. Manila.

Box 3: Achieving Development Effectiveness in Private Sector Operations

The Asian Development Bank (ADB) should establish the following goals to achieve development effectiveness in its Private Sector Operations Department (PSOD).

Ensure alignment with ADB country partnership strategies, sector policies, and Strategy 2020

(i) Establish a private sector operations coordination division in PSOD to improve coordination with regional departments and knowledge departments—January 2009.
(ii) Assign senior staff in PSOD to ensure continued and enhanced private sector operations alignment with Strategy 2020—March 2009.
(iii) Assign PSOD staff to participate in formulation of all country partnership strategies, beginning with diagnostic studies that support binding constraint analysis, such as private sector assessments and sector road maps—from April 2009.
(iv) Review PSOD's financial institution and capital market operations to ensure they are aligned with development and poverty reduction objectives—May 2009.
(v) Establish new business processes to review all private sector and nonsovereign operations by PSOD and regional departments— from April 2009.

Improve quality at entry of development outcome indicators

(i) Identify the development logic and outcomes in all concept clearance papers and conduct a preliminary evaluation—October 2008.
(ii) Identify development indicators consistent with those for private sector operations in other multilateral development banks to be tracked after approval for each sector—April 2009.
(iii) Review literature on links between private sector development and poverty reduction to enhance development results measurement—April 2009.

Strengthen monitoring and tracking

(i) Initiate annual monitoring of sector indicators consistent with practices at other multilateral development banks for all private sector projects approved—from July 2009.
(ii) Increase collaboration with ADB's Economics and Research Department in measuring the impact of an ADB private sector project on a pilot basis—first report February 2010.

Increase awareness of PSOD's successful activities and facilitate replication

(i) Regularly distribute completion and evaluation reports on private sector operations—ongoing.
(ii) Highlight successful private sector interventions through publications aimed at clients and other stakeholders—from May 2009.

C. Center of Knowledge and Innovation

85. Knowledge transfer is a potent tool for reducing poverty in OCR borrowers and ADB intends to build on its role as a learning institution and a primary source of development knowledge in Asia and the Pacific. To help meet the growing demand for high-level knowledge and skills across the region, ADB is supporting research on specific development challenges facing OCR borrowers as well as on the design and application of innovative technological solutions, especially in areas related to energy efficiency and climate change.

86. Two of ADB's knowledge products have been particularly well received internationally: *Asian Development Outlook*, which provides a comprehensive analysis of macroeconomic and

development issues of ADB's DMCs, and *Key Indicators*, ADB's flagship annual statistical data book on the region and its development. The critical examination of development issues in *Asian Development Outlook* has stimulated policy discussions among development practitioners and DMC officials and has influenced development agendas.[32] Moreover, ADB, United Nations Development Programme (UNDP) and United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) have published reports and technical papers as part of their regional partnership to accelerate progress towards MDG results in Asia and the Pacific, such as *A Future Within Reach 2008: Regional Partnerships for the Millennium Development Goals in Asia and the Pacific*, and other publications by ADB, UNDP, and UNESCAP.

87. Innovation and constant improvements in knowledge and practices are integral to providing effective assistance to the rapidly growing middle-income DMCs. ADB's knowledge products and services, aligned with its lending operations, add value to project funding. DMCs particularly welcome the introduction of best practices in ADB loans. Since 2008, stronger linkage between knowledge needs from operations and ADB's research agenda is being established through the strategic forums held annually. ADB will further strengthen this linkage by assessing the need for research in its country programming missions.

D. Institutional Reforms to Strengthen ADB Assistance

88. ADB’s reform agenda was adopted in 2004 and has improved the results orientation of its business processes. It has piloted new financial instruments to enable it to respond more effectively to its clients' needs. Implementation of the knowledge management framework and the second information systems and technology strategy 2004–2009 have enhanced internal learning and knowledge sharing.[33] ADB adopted a public communication policy in 2005 to raise its standards of transparency.[34] Also, in September 2008, ADB became the first multilateral development bank to adopt a corporate results framework and issued its inaugural *Development Effectiveness Review* in October 2008 (paras. 77 and 78). ADB has established an Advisory Group on Institutional and HR Management to advise ADB on corporate-wide institutional and human resources alignment as an essential element for the successful realization of Strategy 2020. The Advisory Group is chaired by Mr. Jean Lemierre, former president of the European Bank for Reconstruction and Development.

89. Advancing ADB's institutional effectiveness at all levels of its operations will be monitored under the corporate results framework and progress will be reported annually and made public in the *Development Effectiveness Review*. ADB is committed to institutional transformation and is concentrating its efforts on: (i) improving human resources management, (ii) strengthening its governance and risk management capacity, (iii) reinforcing independent evaluation, (iv) upgrading operational policies, (v) refining financing instruments, and (vi) streamlining business processes and reducing transaction costs.

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[32] In 2008, *Asian Development Outlook* discussed three issues related to workers in developing Asia: (i) whether the region will reap the demographic advantages of its many young people about to enter the work force, (ii) whether it will resolve its skills shortages, and (iii) whether policies will change to keep up with the burgeoning migration within the region. (ADB. 2008. Workers in Asia. *Asian Development Outlook*. Manila.) In 2007, *Asian Development Outlook* examined the evolution of the successful growth experiences of the region, concluding that countries that have sustained fast growth in developing Asia have managed to industrialize successfully and to expand services. (ADB. 2007. Growth Amid Change. *Asian Development Outlook*. Manila.)

[33] ADB's second information system and technology strategy, adopted in June 2004, is also improving the way ADB shares and uses knowledge (ADB. 2004. *Information System and Technology Strategy 2004–2009.* Manila.)

[34] ADB. 2008. *The Public Communication Policy of the Asian Development Bank.* Manila.

1. Improving Human Resources Management

90. In Strategy 2020, ADB committed itself to the systematic implementation of wide-ranging reforms and fundamental improvements to its human resources management. It is working to upgrade staff capabilities, behaviors, and attitudes that strengthen corporate values. Ongoing efforts will be sustained and improved to address career development, performance management, salary and benefits, the skills mix of staff and their learning and development, maintenance of the standards of international civil servants, communication, and issues specific to national officers and administrative staff, resident missions, and human resources management.

91. ADB has taken systematic steps to improve its human resources management. In 2008, it conducted an extensive staff engagement survey. This was followed by an independent external review of the implementation of ADB's human resources strategy 2005–2007[35] by Mercer, an international consulting firm. ADB undertook an internal assessment of the human resources strategy, using Mercer's findings and recommendations and presented its analysis and next steps in a paper that was discussed by the ADB Board of Directors in January 2009.[36]

92. To maintain, recruit, and motivate a workforce with the skills and flexibility required to implement Strategy 2020 effectively, 11 recommendations were proposed by Mercer in its final report of the external review (Box 4). ADB agrees to adopt and plans to implement all 11 recommendations in order to improve its human resources management under the principle that all human resources measures are driven by and aligned to Strategy 2020.

93. On the basis of the Board's guidance and feedback from the informal Board seminar in February 2009, ADB developed a detailed, time-bound human resources action plan and will provide it to the Board of Directors in mid-March 2009 for their comments. The proposed action plan will be finalized with further inputs from the Board and updated as appropriate, based on periodic monitoring and measuring of key indicators and outputs. The action plan also responds to issues raised by staff in the 2008 staff engagement survey and Mercer's human resources strategy review. A staff engagement survey will be conducted every 2 years, with the next scheduled for 2010.

94. Implementation of the action plan will evolve over time.[37] Actions already underway include a skills inventory and recruitment of skills needed for Strategy 2020. In addition, ADB will consider external and internal candidates simultaneously for internationally recruited vacancies to further enhance transparency and facilitate external recruiting. The action plan includes measures to professionalize ADB's human resources functions. Recruitment of a human resources professional as an advisor has also begun.

95. The Board of Directors and Management agree on the urgent need for more effective human resources management. In continuing with its efforts to improve the human resources management, ADB will create a human resources committee of the Board that follows the Board working group's recommendations. ADB Management has demonstrated its commitment to

[35] ADB. 2004. *Human Resources Strategy Paper*. Manila.
[36] ADB. 2008. *Comprehensive Review of the Human Resources Strategy (2005-2007).* Manila.
[37] Mercer identified four critical success factors in implementation: (i) the role of ADB leaders to create momentum for change and alignment between people management and business needs; (ii) clarity of direction at the outset in terms of business and employee requirements and opportunities; (iii) enhancing human resources service; and (iv) evolutionary adjustment to people management in response to evolving strategy and performance requirements of ADB.

human resources changes and improvements through the actions that have been taken to date (Box 5) and through the human resources action plan. Staff members have demonstrated their commitment to ADB's human resources reform efforts through the staff engagement survey and their inputs to the human resources strategy review. There is recognition among staff that human resources management is a joint responsibility of all managers, and not only BPMSD, whose role is to support organizational change by providing managers and supervisors with the human resources programs and tools they need to manage staff effectively and to deliver day-to-day administrative services more efficiently.

Box 4: Recommendations Resulting from the Human Resource Strategy Review

I. "Future State": People Management

1. Develop a "people strategy" to provide a blueprint to help the Asian Development Bank (ADB) secure, motivate, and manage the workforce it needs to accomplish its business goals. It should set out the optimal configuration of the following:

   (i) staff capabilities (experience, competencies, technical, and professional skills);
   (ii) staff behaviors (performance, productivity, teamwork, and cooperation);
   (iii) staff attitudes (values and beliefs about innovation, commitment, and flexibility); and
   (iv) specific practices (recruitment, development, performance management, and rewards).

2. Identify and cascade key performance indicators for the business.
3. Develop a new approach to workforce planning.
4. Drive a new skills mix through ADB.
5. Enhance existing human resources programs to increase employee engagement.
6. Build the capability of managers to support implementation of human resources programs and manage staff effectively.

II. Role and Requirements of the Human Resources Function

1. Develop an human resources function strategy and vision.
2. Redesign human resources organization.
3. Integrate and streamline human resources processes, with better leveraging of technology.
4. Increase human resources capability through additional hiring and development of existing human resources staff.
5. Identify key performance indicators for human resources.

Source: Mercer. 2008. *Comprehensive Review of the Human Resource Strategy (2004-2007) of the Asian Development Bank.*

Box 5: Human Resources Actions Already Undertaken to Address Priority Areas Highlighted by the 2008 Staff Engagement Survey

Concurrently with the comprehensive review of the human resources strategy, Management has approved a number of measures since June 2008 to address priority areas identified by the staff engagement survey:

(i) improvements to benefits (increases in multi-purpose loan ceilings and in the rental subsidy percentage);
(ii) a promotion exercise for national officers and administrative assistants (scheduled for the second quarter of 2009);
(iii) enhancement of the work-life balance (an increase in the duration of special leave without pay under maternity leave, the introduction of an expanded discretionary time off provision, revised flextime arrangements, and piloting of a work from home arrangement);
(iv) better internal communications (launch of quarterly staff web bulletins to disseminate information from the Budget, Personnel, and Management Systems Department);
(v) stronger performance management (introduction of non-monetary recognition awards for vice-presidents and heads of departments);
(vi) improvements to salaries and benefits (interim salary adjustment for local staff and modification of the currency option);
(vii) improvements to rewards and recognition (reintroduction of plaques of appreciation for long serving staff);
(viii) improvements to learning and development;
(ix) strengthening ADB's technical and advisory capacity (through the creation of the lead professional, advisor, and senior advisor positions);
(x) improving human resources management and workforce alignment (through the introduction of a periodic bank-wide grading review for professional staff levels 3 to 6); and
(xi) the introduction of spouse employment on a pilot basis.

2. Ensuring Good Governance and Strengthened Risk Management Capacity

96. ADB continues to practice strong internal control and fiduciary oversight and to fight corruption. The Integrity Division of the Office of the Auditor General is responsible for investigating allegations of fraud and corruption in ADB-financed projects or concerning ADB staff. The Audit Division of the Office of the Auditor General provides analysis on adequacy of internal control and compliance with rules and regulations over ADB's operations and coordinates with the outside auditor on the scope and timing of its statutory audit work. Both divisions align their work programs with the priorities of the Audit Committee of the Board of Directors. To ensure independence and impartiality of work and findings of ADB's audit and investigative functions, ADB will separate the Integrity Division from the Office of the Auditor General.

97. Since 2005, ADB has blacklisted 330 firms and individuals from participating in ADB-financed business for varying periods. ADB aims to strike the right balance between due process and the timely completion of investigations so that project implementation is not impeded unnecessarily. In striking this balance, ADB believes that a realistic likelihood of

detection and enforcement action sends a powerful message.[38] ADB will review its current policy of not publishing its sanctions list to ensure adoption of most effective measures for fighting corruption.

98. To further strengthen anticorruption measures, ADB has recently prepared revised draft whistleblower and witness protection provisions. The redrafting took into account recent developments in best practice at other organizations, including the World Bank, and improved upon the protection already provided to whistleblowers and witnesses in ADB's operational framework. The revised whistleblower and witness protection provisions demonstrate ADB's firm commitment to anticorruption, accountability and good internal governance. The provisions were presented to the Audit Committee of the Board and are expected to be made available in March 2009 on ADB's website for a 60-day consultation period. Subsequently, ADB will ensure implementation of whistleblower and witness protection provisions.

99. ADB's 2008 Annual Report will contain a management assertion on the adequacy of internal control over its financial reporting based on the Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. It includes an opinion from ADB's external auditor, PricewaterhouseCoopers. The opinion states management's assertion that ADB maintained effective internal control over financial reporting as of 31 December 2008 is fairly stated in all material respects in accordance with attestation standards, section AT 501 established by the American Institute of Certified Public Accountants.

100. ADB conducted a competitive and transparent selection process involving the Audit Committee to choose its outside auditor for 2009–2012. All four leading international audit firms competed, and Deloitte & Touche LLP, Singapore was appointed by the Board of Directors. ADB will formalize principles for selecting the outside auditor in future selection processes. The Office of the Auditor General will continue to uphold good governance in ADB operations, in active cooperation with audit departments of comparable organizations, including through regular meetings of MDB/IFI Chief Audit Executive Meeting.

101. Measures have been adopted to strengthen ADB's risk management capacity (Box 6). The Risk Management Unit (RMU) has assumed responsibility for the day-to-day management of ADB's risks and the number of RMU staff has increased from 22 in March 2008 to 28 by March 2009.

[38] Further comprehensive information on investigations of fraud and corruption is available in the Integrity Division's 2008 *Annual Report*, which is available at http://www.adb.org/Documents/Reports/Anticorruption/OAGI-Annual-Report-2008.pdf.

Box 6: Strengthening ADB's Risk Management Function

The Asian Development Bank (ADB) has taken numerous measures to strengthen risk management and risk governance. In 2008, ADB formed a risk committee of senior staff, chaired by the managing director general, to provide management oversight on important risk issues, including ADB's risk profile, limit compliance, and development of risk management policies, methodologies and systems.

The Risk Management Unit (RMU) now gives quarterly presentations to the Audit Committee of the Board on the portfolio's risk exposures, limit compliance, policy and systems development and adequacy of resources.

ADB has improved risk management in other areas.

- **Capital adequacy framework**. ADB has introduced stress testing to ensure that its equity capital is consistent with the portfolio's risks and large enough to absorb a major credit shock. It has also adopted a long-term equity-to-loan target of 26% as a planning tool.
- **Credit risk model.** ADB has enhanced its credit risk model to estimate expected and unexpected losses in the loan portfolio more accurately.
- **Risk rating tools.** ADB is introducing best-practice rating methodologies so it can assign accurate and consistent risk ratings to nonsovereign transactions.
- **Risk-based loan pricing model.** This model will ensure that ADB loan charges for nonsovereign transactions that are sufficient to preserve its capital base over the long term.
- **Portfolio monitoring.** ADB has strengthened the portfolio monitoring function in the Risk Management Unit and is currently undertaking a comprehensive review of all transactions in its nonsovereign portfolio.

102. ADB’s improvements to risk management include an enhanced credit process for nonsovereign operations, covering the approval, management and review of individual transactions, and workouts for nonperforming loans. The process is based on sound banking principles and good corporate decision making. The primary objective is to provide a systematic means of recognizing risk and structuring workouts for nonperforming loans. From project inception to approval, the operations departments will work closely with the RMU to identify and mitigate transaction risks. The RMU must sign off on all new transactions, except in certain limited circumstances, and has final discretion over transaction risk ratings. Following approval, operations departments will prepare a monitoring report for each transaction to be reviewed independently by the RMU. For transactions that deteriorate materially, the operations departments will transfer responsibility to a team of independent corporate recovery specialists.

103. Other planned initiatives to improve ADB's risk management capacity include upgrading the RMU to an office in 2009 and a further increase in its staffing for improving measurement and management capabilities. ADB will introduce an integrated risk management system that will provide an information technology platform to monitor and manage risks more efficiently.

104. ADB is also reviewing its program to combat money laundering and the financing of terrorism. Although ADB is not a deposit-taking institution and its treasury and other operations are consequently less directly exposed to money laundering and terrorist financing activities than those of commercial financial institutions, the potential for indirect, inadvertent or otherwise, exposure still exists for ADB. ADB’s policy on combating money laundering and the financing of

terrorism[39] requires it to strengthen internal controls to safeguard its funds through its anti-money-laundering and financing of terrorism compliance program, which aims to identify, mitigate, and manage ADB's risks. The first phase of an independent review of this program was completed in February, with all relevant staff interviewed. Findings will be reported and recommendations discussed in the second phase, to be undertaken in March 2009. The review is designed to ensure that ADB practices are aligned with international best practices at multilateral financial institutions, that the program is effective, and that staff are aware of internal money laundering and the financing of terrorism risks. In this way, ADB will continue to strive to reach international best practice standards in its operations and to minimize its exposure to reputational, operational, and legal risks.

3. Independent Evaluation

105. To derive maximum benefit from its operational experience, ADB will continue to depend heavily on high-quality, independent evaluation work.

106. ADB undertook a comprehensive review of its evaluation department in 2008 to assess its independence and overall effectiveness. The review was led by an ad-hoc working group consisting of three members of ADB’s Board of Directors and the managing director general. Two external experts were engaged to assist in the process. Although the review concluded that ADB had a clear model for exercising independent evaluation, it noted that the evaluation department’s credibility could be further enhanced by: (i) appointing the director general of the evaluation department upon a recommendation by the Development Effectiveness Committee in consultation with the President; (ii) expanding the nonrenewable term of the director general from 3 to 5 years, with annual performance assessments to be carried by the chair of Development Effectiveness Committee; (iii) strengthening the selection process for the director general through the use of an executive search firm and extensive media advertising; (iv) Board approval of the evaluation department’s budget separately from ADB’s administrative budget; and (iv) renaming the department the Independent Evaluation Department (IED) to reflect its enhanced independent status. The review also called for (i) intensified interactions between IED and operations staff to extend the ownership of evaluation results and accelerate the application of lessons learned; and (ii) a more rigorous system for monitoring progress on implementation of IED recommendations. A revised policy was approved by the Board of Directors in December 2008 to give effect to these changes.

107. A new Operations Manual section on evaluation reflecting the revised policy was published in January 2009.[40] A small task force consisting of representatives from IED, the Office of Information Systems and Technology, the Office of the Managing Director General, and SPD was appointed in October 2008 to develop a more rigorous system for monitoring progress of actions taken on IED recommendations. A management action record system (a new computerized automated tracking system for monitoring actions taken in response to IED recommendations) is being piloted from January to June 2009. IED has prepared detailed guidelines and procedures for data input by user departments. IED and the Managing Director General's Office have been conducting a road show for various user groups since the beginning of 2009. It is envisaged that the system will become fully operational by the second half of 2009.

[39] ADB. 2003. *Enhancing Asian Development Bank's Role in Combating Money Laundering and the Financing of Terrorism.* Manila.
[40] OM Section K1 Independent Evaluation, 1 January 2009.

4. Improvements in Operational Policy

108. ADB is updating its policies and strategies so they are in line with Strategy 2020. This comprehensive alignment aims to enhance ADB's operational efficiency, improve client responsiveness, and optimize the use of ADB's institutional resources. It will concentrate first on areas with substantive implications for the operational goals of Strategy 2020. Currently under review are *The Bank's Policy Initiatives for the Energy Sector*,[41] *Policy for the Health Sector*,[42] *Policy on Education*,[43] and *The Bank's Policy on Agriculture and Natural Resources Research*.[44] A study on ADB's financial sector operations is being completed and will be used to help formulate a strategy on ADB's financial sector assistance to its DMCs.

109. The 1995 energy policy is being updated and aligned with Strategy 2020. The main thrust of the new policy is to support DMCs to meet their poverty reduction objectives through enhancing energy security while facilitating a transition toward low-carbon economies. Policy implementation will focus on (i) promoting energy efficiency and renewable energy, (ii) maximizing access to energy for all, and (iii) promoting energy sector reforms, capacity building, and governance. ADB will continue to promote clean energy in the region. The target of increasing ADB's clean energy program to $1 billion a year was achieved in 2008, establishing a platform for a further increase to $2 billion per year from 2013.

110. The ongoing review and update of ADB's safeguard policies is critically important. The three current policies—the *Involuntary Resettlement Policy*,[45] the *Policy on Indigenous Peoples*,[46] and the *Environment Policy*[47]—have been central to achieving sustained development impacts and poverty reduction.

111. The review and update of safeguard policies is in response to changes in ADB's operating environment and will (i) articulate the safeguard requirements to improve their clarity, coherence, and consistency; (ii) balance a front-loaded procedural approach with one more focused on results during implementation; (iii) make policy implementation more adaptable to ADB's evolving range of lending products and innovative financing modalities; (iv) work toward greater harmonization with safeguard practices in other multilateral finance institutions and tailor safeguard approaches to different clients with different capacities; and (v) improve internal processes and resource allocation.

112. ADB made a consultation draft of a safeguard policy statement publicly available in October 2007, followed by public release of a second draft in October 2008. ADB engaged extensively with interested stakeholders on both drafts, organizing 15 consultation workshops in the region and outside, and received a large number of written submissions. Based on the consultations, comments received, and internal deliberations, ADB prepared a working paper that proposed a consolidated safeguard policy statement that (i) clearly articulates ADB's safeguard policy principles; (ii) expands the coverage of environmental safeguards to include biodiversity conservation and sustainable natural resources management, pollution prevention and abatement, and physical cultural resources; (iii) delineates roles and responsibilities between ADB and borrowers, and provides detailed borrower requirements for delivering

[41] ADB. 1995. *The Bank's Policy Initiatives for the Energy Sector*. Manila.
[42] ADB. 1999. *Policy for the Health Sector*. Manila.
[43] ADB. 2002. *Policy on Education*. Manila.
[44] ADB. 1995. *The Bank's Policy on Agriculture and Natural Resources Research*. Manila.
[45] ADB. 1995. *Involuntary Resettlement Policy.* Manila.
[46] ADB. 1998. *Involuntary Resettlement Policy.* Manila.
[47] ADB. 2002. *Environment Policy.* Manila.

safeguards; (iv) strengthens safeguard implementation by adding new provisions for the establishment of local grievance mechanisms and independent advisory panels for complex and sensitive projects; (v) lays out disclosure and consultation requirements; and (vi) introduces a careful and phased approach to the application of country safeguard systems.

113. The Board gave guidance on the working paper[48] at a Board meeting in February 2009. ADB will make certain that the forthcoming policy paper responds to Board guidance, ensuring that there will be no dilution of safeguard standards, and will seek a broad consensus on all points among shareholders before finalizing any updates to ADB's policy. ADB will take the time required to achieve that consensus and until such consensus is built, ADB operations will continue to follow the existing safeguard policies while strengthening its implementation.

5. Refining Instruments and Modalities

114. To strengthen its chief means of transferring technology and knowledge to its DMCs, ADB revised its policy on TA operations in 2008.[49] The resulting improvements in TA categorization, streamlined processes, clearer documentation, better quality control, and increased emphasis on implementation will maximize results from this highly flexible, wide-ranging development instrument.

115. The Innovation and Efficiency Initiative launched in November 2003 aimed to improve ADB's ability to align services, products, and practices more closely with client priorities and market trends. ADB pilot-tested three new financing instruments starting in August 2005: the multitranche financing facility (MFF), the nonsovereign public sector financing facility, and the refinancing facility. These pilot financing instruments are intended to provide ADB clients and operational staff with alternative means of financing projects and investment programs.

116. MFFs enable ADB to invest programmatically, reduce repetitive business processes, and cut financial and nonfinancial costs of doing business. After examining the results of the MFF pilots, the Board approved the mainstreaming of the MFF in ADB operations in July 2008.[50] ADB’s loan and debt management has also been enhanced, loan charges have been simplified,[51] and local currency lending has been introduced for nonsovereign and subsovereign transactions. ADB will continue to pilot subsovereign and nonsovereign public sector financing in 2009, gathering additional experience before a final decision is taken on whether to mainstream such financing in ADB operations.

6. Streamlining Business Processes and Reducing Transaction Costs

117. To help its DMCs administer and implement projects, ADB launched an e-handbook on project implementation, including ADB policies and procedures, in March 2008. The e-handbook also contains advice on procurement of goods, works, and services.

118. ADB’s resident mission operations have improved their responsiveness and have had more functions delegated to them, according to a 2008 review. The decentralization of staff and budgets has helped to improve country programming and project implementation.[52] ADB

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[48] ADB. 2008. *Safeguard Policy Statement (Working Paper 2-09).* Manila.
[49] ADB. 2008. *Increasing the Impact of the Asian Development Bank’s Technical Assistance Program.* Manila.
[50] ADB. 2008. *Mainstreaming the Multitranche Financing Facility.* Manila.
[51] ADB. 2007. *Review of the Asian Development Bank’s Loan Charges*. Manila.
[52] ADB. 2008. *Review of Resident Mission Operations.* Manila.

stakeholders have reported improvements in the delivery of key products and services, as well as in building stronger client relationships and partnerships.

119. In 2009, ADB will complete an assessment of its recent business streamlining initiatives. It will identify areas where further streamlining of business processes, greater efficiency, quality improvement, and reductions in transaction costs can be achieved. The review covers selected business processes for country programming and strategy preparation, project processing, project implementation supervision, and internal requirements, such as the nature and extent of documentation. Based on the outcome of this review, specific initiatives will be examined in greater detail and implemented in the second half of 2009. The efficiency of ADB's internal processes will also be enhanced through the implementation of the second information systems and technology strategy 2004–2009 (footnote 33). ADB will use this opportunity and the launch of a unified project processing and portfolio management system to improve its responsiveness and efficiency. The outcome of business process streamlining will be monitored under ADB's corporate results framework and annually assessed in the *Development Effectiveness Review*.

VII. ADB'S GENERAL CAPITAL INCREASE V

A. Lending and Borrowing Headroom Status and Outlook

120. The Board approved a new lending limitation policy in December 2008.[53] Under the policy, the total amount of disbursed loans, approved equity investments, and the maximum amount that could be demanded from ADB under its guarantee portfolio may not exceed the total amount of ADB's unimpaired subscribed capital, reserves, and surplus.

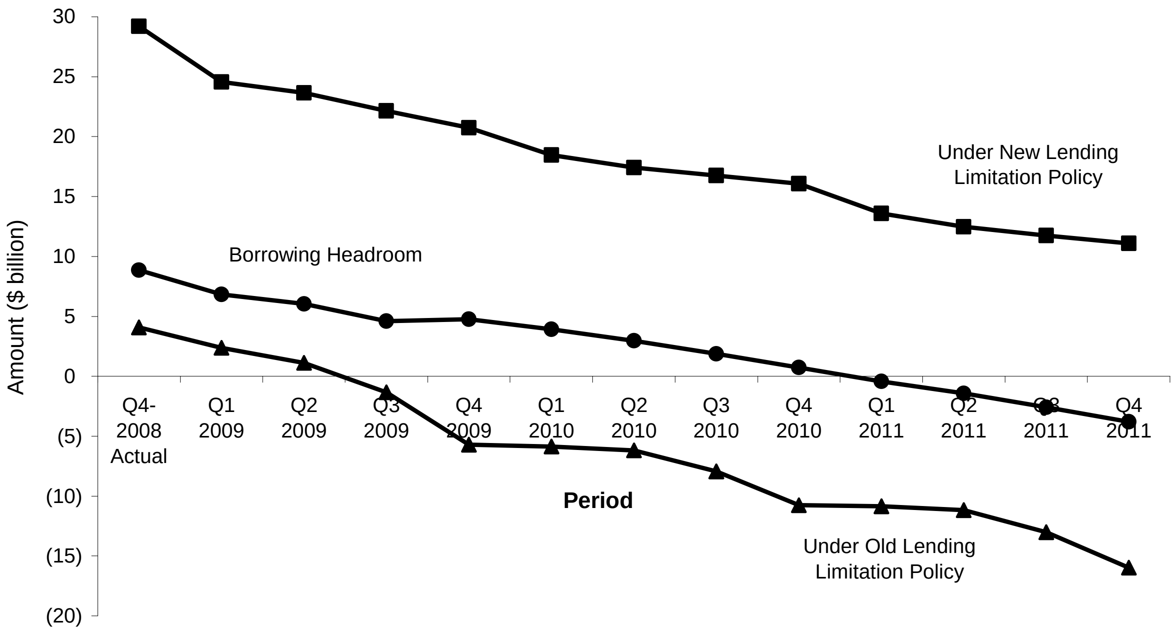
121. The new lending limitation policy has freed up additional lending headroom. Figure 6 shows the lending and borrowing headroom in the absence of a GCI under the current 2009–2011 WPBF. While lending headroom is no longer a constraint, the borrowing headroom is projected to turn negative by the first quarter 2011, thereby constraining ADB's lending operations as early as the first quarter of 2010. Programming discussions on the 2010 lending program will be held in mid-2009. An early resolution of GCI is therefore critical to provide planning certainty on ADB's 2010 lending capacity to DMCs.

B. Proposed Size of the Capital Increase

122. In the light of the above discussions, Management recommends an increase in ADB's subscribed capital of 200%. Management considers the proposed size of the capital increase adequately takes into account the future role and operational agenda under Strategy 2020, the needs of DMCs, and the resource constraints facing ADB members. The proposed 200% GCI V will allow front-loading lending to respond to the financial crisis, as illustrated in Figure 7.[54]

[53] ADB. 2008. *Review of the Asian Development Bank's Lending Limitation.* Manila.
[54] The term "lending" in this context is defined to include loans, equity investments and guarantees.

Figure 6: Lending and Borrowing Headroom Without a General Capital Increase



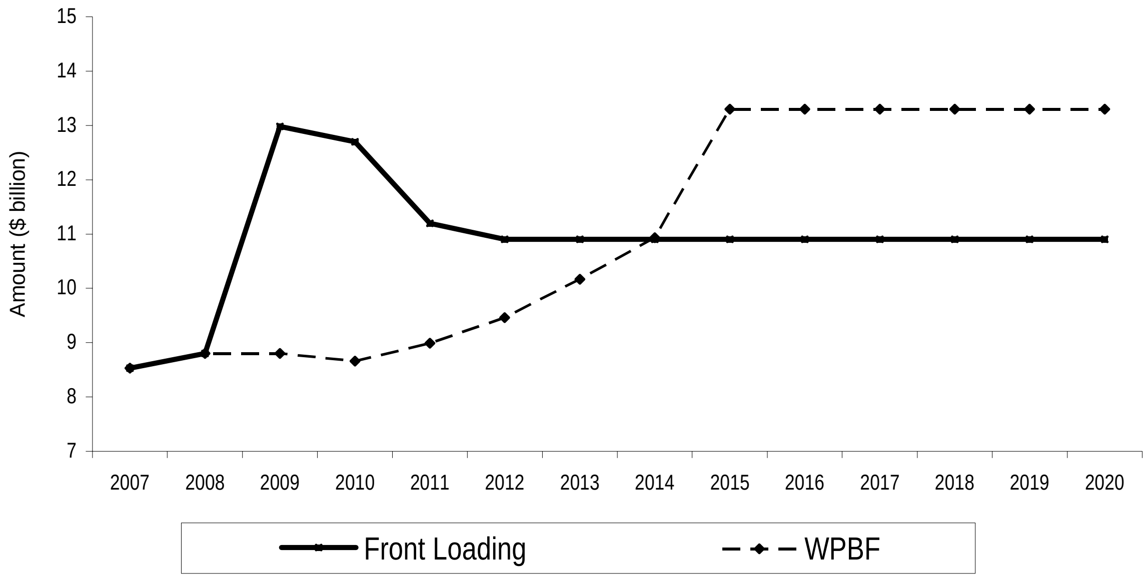
Q = quarter.
Note: Projections as of 31 December 2008. Incorporates increased assistance for 2009 and assumes lending level for 2010–2011 will remain at levels planned under the Work Program and Budget Framework 2009–2011.
Source: ADB Treasury Department.

123. In response to the current financial crisis, ADB has already significantly increased its planned OCR lending in 2009, which is projected to be almost $13 billion, a substantial increase over the original WPBF level of about $9 billion. For 2010 and 2011, a 200% GCI would allow ADB lending of $12.5-13.0 billion in 2010 and about $11.0 billion in 2011. After 2011, a 200% GCI would allow a sustainable level of lending of about $11 billion.[55] Figure 7 also shows the original WPBF lending levels for comparison purposes.

124. Figures 8 and 9 show the development of disbursed and outstanding loans and guarantees and ADB's equity position during the planning period until 2020. Table 4 illustrates the equity-to-loan ratio and headroom situation. Box 7 highlights the key assumptions which underpin the financial projection.

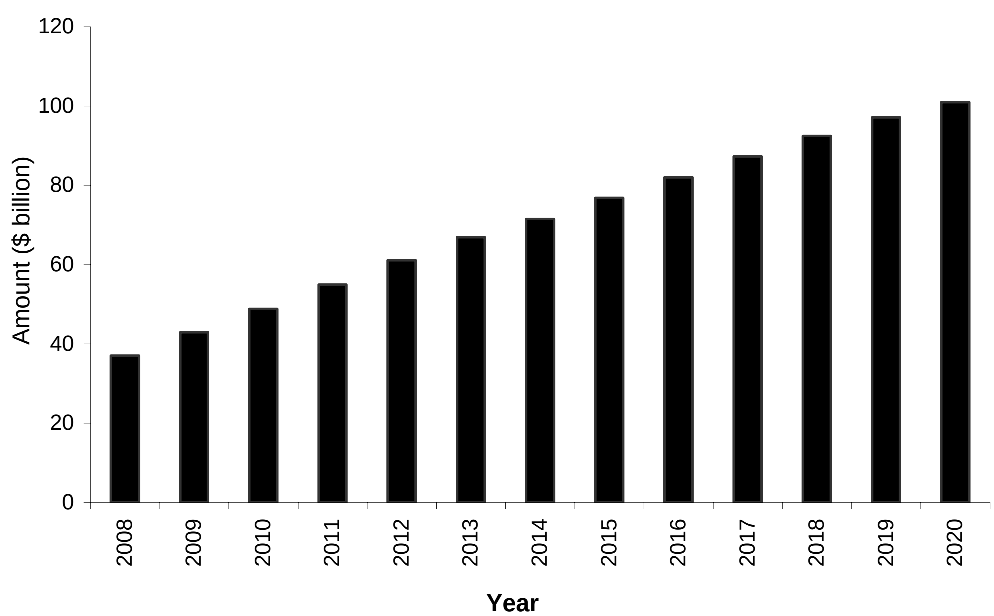
[55] The sustainable level of lending is defined as the annual lending level for a specific planning period that results in a level of financial resources at the end of the planning period that allows the annual lending levels to continue at least at the same levels as during the planning period, without having to resort to another GCI. In practice, the sustainable level of lending concept should be used pragmatically as a financial management tool. While the sustainable level of lending is usually expressed as a single number for a given planning period, overly strict adherence to the sustainable level of lending in any given year is not necessarily required. In any given year, a level of lending beyond the sustainable level of lending would be permissible if (i) such lending is compensated for by lower levels of lending in subsequent years, and (ii) there is no possibility that any of the financial constraints would be violated. The sustainable level of lending shall be regularly reported as part of the annual WPBF Paper.

Figure 7: Possible Lending Scenario 2009–2020



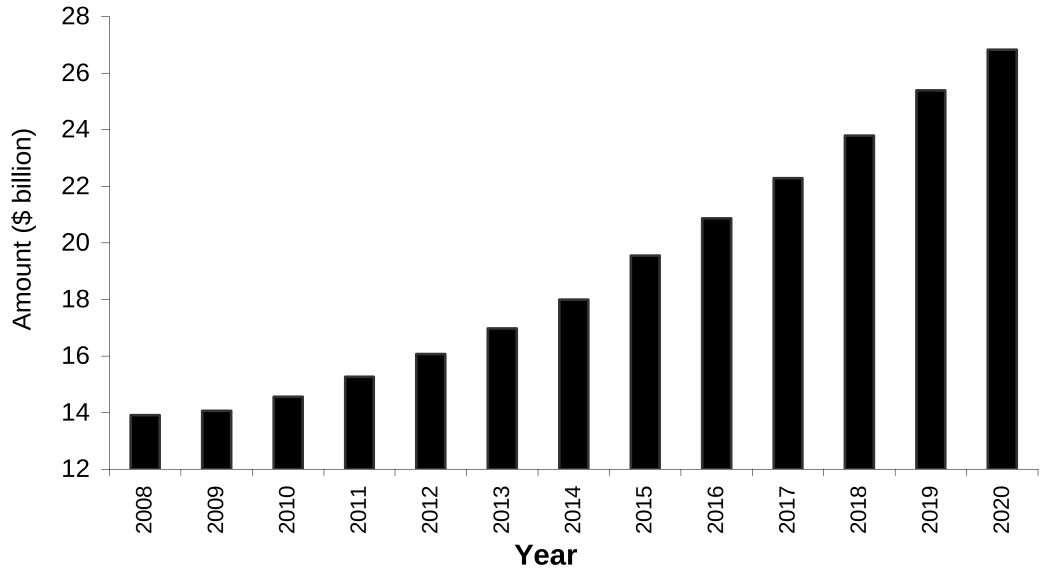
Note: "WPBF" shows the 2009–2011 lending levels as per WPBF 2009–2011 and provides possible lending scenario beyond 2011 that incorporates the planned lending for 2009 as updated in the 19 January 2009 *Operational Resource Parameters 2009*.
WPBF = Work program and budget framework.
Source: ADB Treasury Department

Figure 8: Disbursed and Outstanding Loans and Guarantees



NOTE: Based on projection as of 31 December 2008, assuming front-loading operations in 2009–2011. Guarantee amounts are based on present value of guarantees.
Source: ADB Treasury Department.

Figure 9: Equity



NOTE: Based on projection as of 31 December 2008, assuming front-loading operations in 2009–2011. Equity includes useable paid-in capital, ordinary reserves, special reserves, and surplus.
Source: ADB Treasury Department.

Table 4: Headroom and Equity-to-Loan Projections

	2008 Actual	2010	2015	2020
Lending Headroom ($ billion)	29	118	89	68
Borrowing Headroom ($ billion)	9	66	44	29
Pre-shock ELR (%)	38	30	26	27

ELR = equity-to-loan ratio.
Note: Figures are based on financial information as of 31 December 2008.
Source: ADB Treasury Department.

Box 7: Highlights of Key Assumptions for Financial Projections, 2009–2020

Financial projections for 2009–2020 were based on preliminary financial information for 2008 and the following assumptions.

(i) **Composition of loan and guarantee approvals.** For all scenarios, the proportion of private sector loan approvals is assumed to increase gradually to 40% of total loan approvals by 2020. Annual guarantee approvals are projected to remain $0.5 billion in 2012–2020.

(ii) **Loan disbursements.** Loan disbursements are projected using the historical pattern of project and program loan disbursements. Loans approved under the multitranche financing facility (MFF), which do not have a historical disbursement pattern, are expected to be disbursed over the 6 years following approval of the periodic financing requirement.

(iii) **Lending spread.** Sovereign loan charges are projected to remain at current levels, with waivers maintained over the projection period applicable for existing loans. The lending spread on future nonsovereign loans is projected to be 250 basis points.

(iv) **Loan loss reserve.** Because of the recent financial crisis, the expected loss on nonsovereign loans has been increased to 3.5% (from 2.5% as of 30 June 2008) and is expected to revert to 2.5% by 2015. The expected loss on sovereign loans has been increased to 1.0% and is expected to revert to the previous level of 0.75% by 2015.

(v) **Cancellations.** It is assumed that 5% **o**f all loans (except for those under the MFF), will be canceled over the life of the loan. This is deemed to be financially prudent based on historical levels.

(vi) **Prepayments.** The projected prepayments of $200 million for 2009 and $100 million for 2010 are based on the best estimates of the Asian Development Bank (ADB) Controller's Department. For conservative financial analysis, no prepayments are assumed after 2010.

(vii) **Investment return on US dollar prudential liquidity portfolio.** Based on the current interest rate environment, US dollar investment returns are projected to decrease from 5.3% in 2008 to 3.0% in 2009, and to decrease further to 2.5% in 2010. After 2010, the returns are projected to return gradually to the average historical level of 4.5% by 2015.

(viii) **US dollar London interbank offered rate.** Based on the current interest rate environment, the US dollar London interbank offered rate is projected to decrease in the medium term from 1.75% at the beginning of 2009 to 0.75% by end of 2009 and to 1.0% in 2010 and then to rise gradually to 4.0% by the end of 2015 and remain at 4.0%.

(ix) **Foreign exchange rate.** Except for the US dollar-special drawing rights and the yen-US dollar exchange rates, all foreign exchange rates are assumed to remain constant over the projection period at the foreign exchange rates used for ADB's books and records as of 31 December 2008. The projection uses a 10-year historical average exchange rate of 1.44 for the US dollar-special drawing rights and 112 for the yen-US dollar exchange rates.

(x) **Other income.** Other income consists largely of net gains on sales of equity investments and income from other sources. The projected amount is $23 million for 2009 and $50 million per year thereafter.

(xi) **Administrative expenses.** Administrative expenses are projected to grow by 8.9% in 2009, 9.0% in 2010 and 2011, and 7.0% thereafter, based on the historical average growth rate.

C. Paid-in Capital

125. Management proposes that the capital increase include a paid-in portion of 4.0%. Given the proposed capital increase of 200%, the overall share of the ADB's paid-in capital after the increase will decline from the current level of 7.0% to approximately 5.0%.

126. As in the previous four general capital increases, it is proposed that 40% of the paid-in portion be payable in convertible currency (Article 6.2(a) of the Agreement Establishing the Asian Development Bank [the Charter])[56] and 60% in members' own currencies (Article 6.2(b) of the Charter).

D. Budgetary Implications of GCI V

127. It is essential that adequate internal resources be provided to allow ADB to maintain its operations at an optimal and sustainable level if it is to achieve the objectives of Strategy 2020. At the same time, ADB will need to maintain and improve the quality of its products and services to enhance its development effectiveness. A workforce plan will be developed to align ADB's skills and competencies with the requirements of Strategy 2020. The workforce plan will cover all key areas of operations and will address medium- to long-term skills and capability requirements.

128. Addressing staffing and its related issues will not be resource neutral. The estimated increase in the number of new OCR-funded projects, and project preparatory technical assistance, and the expanding project portfolio under the GCI V scenario need to be translated into an anticipated increase in staff time and positions. In addition, the increase in ADF lending over the program period as well as the requirements for greater attention to ADF project processing and overall portfolio quality must be considered to complete the resource requirement analysis. Further, to implement Strategy 2020, additional requirements must be factored in for qualitative improvements in ADB operations.

129. The staffing and resource needs arising from the comprehensive workforce planning exercise will be explicitly reflected in the forthcoming work program and budget framework (2010–2012) to be presented in the 3rd quarter of 2009. The preliminary analysis shows that about 150 additional staff-years may be required during 2010–2012. Additional staff-years may be required for enhancing knowledge management and for improving project quality but some savings of staff-years can also be anticipated through continued streamlining in business processes and improved IT systems. In its aggregate, it is envisaged that budgetary resource envelope to adequately fund staffing and other resource required, including for strengthening resident mission operations, will entail a higher real budget growth in the next three years than in the past three years' budgets of an average annual real growth of 1.5%.

130. In responding to the financial crisis, it is estimated that lending in 2009 and 2010 may increase up to an additional $7 billion to $8 billion of OCR funding before returning to normal and sustainable lending levels. The resource required for this temporary increase in work program will be provided for separately through the combination of staff, consultants, and other administrative resources funded from the budget's general contingency and carryover provisions.

[56] ADB. 1966. *Agreement Establishing the Asian Development Bank.* Manila.

VIII. CONCLUSIONS AND RECOMMENDATIONS

131. ADB requires a substantial increase in its capital stock to ensure that it continues its lending operations without disruption in 2010 and beyond. It is therefore necessary that it seek an increase in its authorized capital stock and that such an increase become effective in 2009 (Appendix 3).

132. To provide ADB with adequate financial capacity to respond to the needs of the Asia and Pacific region, the following conclusions and recommendations are submitted for consideration and approval of the Board, subject to consultation by Directors with their constituencies:

- (i) The authorized capital stock of the ADB should be increased by 7,092,622 shares;
- (ii) Members should be entitled to subscribe for up to 200% of their allocated shares immediately prior to the effective date of the proposed general capital increase;
- (iii) The callable portion of shares subscribed for under the capital increase should be 96%, and the paid-in portion of such increase should be 4% (Appendix 4). The paid-in portion should be payable in five equal annual installments as per the draft resolution of the Board of Governors (Appendix 5, Annex 1);
- (iv) Of each such installment, 40% should be paid in freely convertible currencies and 60% in the currency of the members; and
- (v) Other terms and conditions for the general capital increase shall be substantially as indicated in the form of the draft resolution of the Board of Governors attached hereto (Appendix 5, Annex 1).

133. If the foregoing recommendations meet with the Board's approval, the President recommends that the attached draft report of the Board of Directors to the Board of Governors (Appendix 5) including the draft resolution of the Board of Governors be considered for approval (Appendix 5, Annex 1).

PROJECTIONS OF PER CAPITA GROSS NATIONAL INCOME

DMC	Benchmark Growth Rate[a]	GNI Per Capita in 2007 US$ as benchmark for 2008[b]	Projections of Per Capita GNI at 2007 prices											
			2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Group A (ADF-only)														
Afghanistan	6.1%	-	-	-	-	-	-	-	-	-	-	-	-	-
Bhutan	6.1%	1,840	1,952	2,070	2,196	2,330	2,471	2,621	2,781	2,950	3,129	3,319	3,521	3,735
Cambodia	6.2%	540	574	609	647	688	731	776	824	876	930	988	1,050	1,115
Kiribati	-0.7%	1,170	1,162	1,154	1,146	1,138	1,130	1,122	1,114	1,107	1,099	1,091	1,084	1,076
Kyrgyz Republic	2.9%	590	607	625	643	661	681	700	721	742	763	785	808	831
Lao People's Dem. Rep.	2.7%	580	596	612	628	645	662	680	699	717	737	756	777	798
Maldives	4.5%	3,200	3,345	3,496	3,655	3,820	3,993	4,174	4,363	4,561	4,768	4,984	5,209	5,445
Mongolia	5.5%	1,290	1,361	1,437	1,516	1,600	1,688	1,781	1,880	1,984	2,094	2,209	2,331	2,460
Myanmar	8.4%	-	-	-	-	-	-	-	-	-	-	-	-	-
Nauru	-5.4%	-	-	-	-	-	-	-	-	-	-	-	-	-
Nepal	3.3%	340	351	363	375	387	400	413	427	441	455	470	486	502
Samoa	2.5%	2,440	2,501	2,563	2,627	2,693	2,760	2,829	2,899	2,972	3,046	3,122	3,200	3,280
Solomon Islands	3.4%	730	754	780	806	833	861	890	919	950	982	1,015	1,049	1,084
Tajikistan	4.9%	460	482	506	531	556	583	612	642	673	706	740	776	814
Timor-Leste	4.0%	1,510	1,570	1,633	1,699	1,766	1,837	1,911	1,987	2,067	2,149	2,235	2,325	2,418
Tonga	0.5%	2,270	2,282	2,294	2,305	2,317	2,329	2,341	2,354	2,366	2,378	2,390	2,403	2,415
Tuvalu	1.8%	-	-	-	-	-	-	-	-	-	-	-	-	-
Vanuatu	2.4%	1,840	1,885	1,931	1,979	2,027	2,077	2,127	2,180	2,233	2,288	2,344	2,401	2,460
ADF Operational Cutoff at 2007 constant prices[b]		**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**	**1,095**
Group B (Blend)														
Armenia	6.8%	2,640	2,820	3,011	3,216	3,435	3,668	3,918	4,184	4,469	4,772	5,097	5,444	5,814
Azerbaijan	7.6%	2,550	2,744	2,952	3,177	3,418	3,678	3,957	4,258	4,582	4,930	5,305	5,708	6,142
Bangladesh	3.5%	470	487	504	522	540	559	579	600	621	643	666	690	714
Georgia	7.2%	1,990	2,133	2,287	2,452	2,629	2,818	3,022	3,239	3,473	3,723	3,992	4,279	4,588
India	5.3%	950	1,001	1,054	1,110	1,169	1,232	1,298	1,367	1,440	1,516	1,597	1,682	1,772
Marshall Islands	1.4%	3,020	3,062	3,104	3,146	3,190	3,234	3,278	3,323	3,369	3,415	3,462	3,510	3,558
Micronesia, Fed. States of	-0.9%	2,460	2,437	2,414	2,391	2,369	2,347	2,324	2,303	2,281	2,260	2,238	2,217	2,196
Pakistan	3.7%	870	902	936	971	1,007	1,044	1,083	1,124	1,165	1,209	1,254	1,300	1,349
Palau, Rep. of	2.9%	8,220	8,458	8,703	8,955	9,215	9,482	9,756	10,039	10,330	10,629	10,937	11,254	11,580
Papua New Guinea	2.1%	850	868	886	905	924	943	963	983	1,004	1,025	1,046	1,068	1,091
Sri Lanka	3.8%	1,540	1,599	1,659	1,722	1,788	1,856	1,926	1,999	2,075	2,154	2,236	2,321	2,409
Uzbekistan	4.5%	730	763	798	834	872	911	953	996	1,041	1,089	1,138	1,190	1,244
Viet Nam	4.7%	790	827	867	908	951	996	1,043	1,092	1,144	1,198	1,254	1,314	1,376

DMC	Benchmark Growth Rate[a]	GNI Per Capita in 2007 US$ as benchmark for 2008[b]	Projections of Per Capita GNI at 2007 prices											
			2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Group C (OCR-only)														
China, People's Rep. of	7.4%	2,380	2,557	2,747	2,952	3,171	3,407	3,661	3,933	4,226	4,540	4,878	5,241	5,631
Cook Islands	1.2%	-	-	-	-	-	-	-	-	-	-	-	-	-
Fiji Islands	0.9%	3,790	3,826	3,862	3,899	3,936	3,973	4,011	4,049	4,087	4,126	4,165	4,204	4,244
Indonesia	3.1%	1,650	1,701	1,753	1,807	1,862	1,919	1,978	2,039	2,102	2,166	2,233	2,301	2,372
Kazakhstan	6.6%	5,070	5,403	5,759	6,138	6,541	6,971	7,430	7,919	8,439	8,994	9,586	10,216	10,888
Malaysia	2.9%	6,540	6,727	6,920	7,118	7,322	7,532	7,748	7,969	8,198	8,432	8,674	8,922	9,178
Philippines	2.8%	1,620	1,665	1,710	1,757	1,806	1,856	1,907	1,959	2,013	2,068	2,125	2,184	2,244
Thailand	3.6%	3,400	3,523	3,651	3,783	3,920	4,062	4,209	4,362	4,520	4,683	4,853	5,029	5,211
Turkmenistan	6.4%	-	-	-	-	-	-	-	-	-	-	-	-	-
OCR Graduation Benchmark at 2007 constant prices[b]		**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**	**6,465**

- = not available; ADF = Asian Development Fund; DMC = developing member country; GNI = gross national income; OCR = ordinary capital resources

[a] Benchmark growth rates were taken from Appendix 2 of the ADB Sustainable Development Working Paper Series No. 2, November 2008, "The World Bank's New Poverty Data: Implications for the Asian Development Bank". For DMCs not included in this study, the same methodology shown in page 11 of the report was adopted in computing for projections of per capita gross domestic product growth rates.

[b] GNI per capita in 2007 US$, the operational cutoff for ADF and the OCR graduation benchmark were taken from the World Bank Operational Manual, Operational Policies OP 3.10 -- Annex D, July 2008.

Sources: ADB, Asian Development Outlook 2008; ADB, ADB Sustainable Development Working Paper Series No. 2, *The World Bank's New Poverty Data: Implications for the Asian Development Bank*, November 2008; ADB Staff estimates; and World Bank Operational Manual, Operational Policies OP 3.10 -- Annex D, July 2008.

GENERAL CAPITAL INCREASE V PROGRAM ALIGNMENT AND DEVELOPMENT OUTCOMES

1. A complete alignment of operations to Strategy 2020 priorities will take place under the fifth general capital increase (GCI V), with very significant adjustment achieved during 2009–2011. Ordinary capital resources (OCR) operations are being aligned to achieve the three complementary strategic agendas of inclusive growth, environmentally sustainable growth, and regional integration under Strategy 2020.[1]

A. Alignment with Strategy 2020

1. Inclusive Economic Growth

a. Promote Sustainable Growth and Expand Economic Opportunities

2. ADB will support economic growth and enhancement of economic opportunities through infrastructure projects, private sector operations, and policy reform, including private sector development. Infrastructure will continue to dominate, with an annual average of $5.7 billion accounting for 80% of overall lending by volume and 82% of the total number of projects under the work program and budget framework (WPBF) 2009–2011 (Figure A1.1). Lending for infrastructure will target economic and social development in urban and rural areas through better physical connectivity to markets and services. Water sector investment will also be substantial: most operations in OCR borrowers will address water supply and sanitation, while the remainder will focus on improving rural water resource management through irrigation and drainage. To help achieve the key goals of environmentally sustainable growth, and to mitigate climate change, many of ADB's energy sector projects will focus on energy efficiency, clean energy, or renewable resources. In some countries, ADB's transport operations will shift toward the more energy-efficient subsectors of railways and urban transport. Many transport projects will have a regional dimension, in response to strong demand for ADB support to establish physical connectivity as a step to regional integration. Overall, ADB proposes to increase its OCR lending for energy efficiency and clean energy projects to $2 billion a year from 2010.

3. Under the "revealed demand" scenario in Figure 1,[2] infrastructure will represent about 75% of projects by number and 74% by volume. The combined transport and energy sectors will have an average share of 44% of the infrastructure projects by number and 58% by lending volume during 2009–2011, with the water sector, including irrigation and drainage, contributing 21% by number of projects and 11% by volume. Other OCR borrowers[3] are also projected to have strong demand for energy, transport, rural infrastructure and municipal development projects that will need to be funded partly from nonconcessional sources.

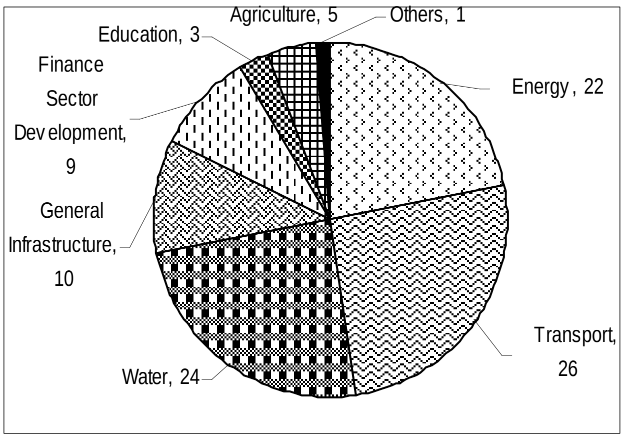
4. Finance sector operations are expected to grow significantly and make up nearly 12% of sovereign loans by volume under WPBF 2009–2011. For example, the Southeast Asia Department (SERD) will continue to process program loan clusters aimed at developing capital markets, while the Central and West Asia Department (CWRD) will target development of the legal and regulatory framework for the banking and nonbanking sectors, including pensions and insurance. The finance sector operations of the South Asia Department (SARD) will facilitate

[1] The discussion below on the content of ADB's planned work program is based on the WPBF 2009–2011 (ADB. 2008. *Work Program and Budget Framework 2009–2011.* Manila).
[2] Revealed demand projections in this figure refer to estimates of 10 major OCR borrowers: Bangladesh, the PRC, India, Indonesia, Pakistan, Papua New Guinea, the Philippines, Sri Lanka, Thailand, and Viet Nam.
[3] Other OCR borrowers are Armenia, Azerbaijan, Fiji Islands, Georgia, Kazakhstan, and Uzbekistan.

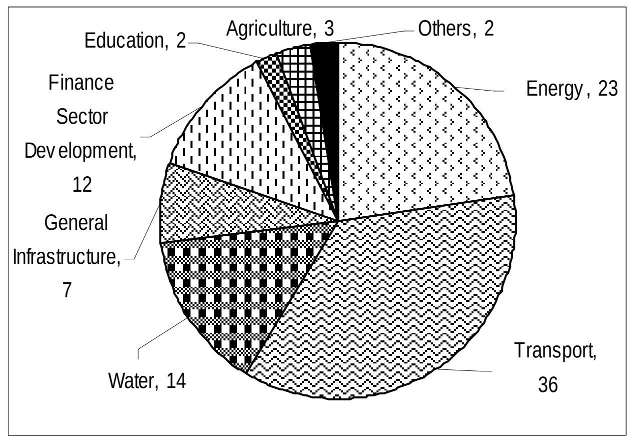
infrastructure project financing facilities, strengthen public resource management, support rural finance and small and medium-sized enterprises, and improve governance management practices. ADB's Private Sector Operations Department (PSOD) operations will complement policy advice provided through the operations of the regional department. PSOD will act as a catalyst by facilitating investment, stimulating competition, and promoting new ideas in pursuit of economic growth and, ultimately, poverty reduction. Under the revealed demand scenario, the finance sector will account for about 18% by volume, excluding nonsovereign operations. Additional requirements from other OCR borrowers are also projected to promote access to financial services and support for public finance management.

Figure A1.1: Pipeline Sector Distribution for 2009–2011 Average
(WPBF pipeline versus revealed demand)

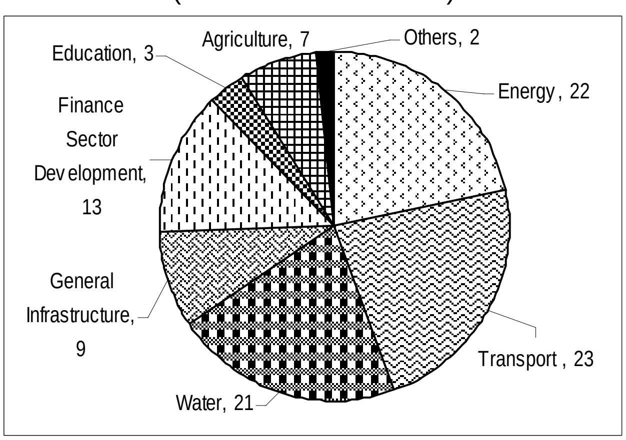
A. OCR Sovereign Lending – WPBF
(% of Number of Loans)



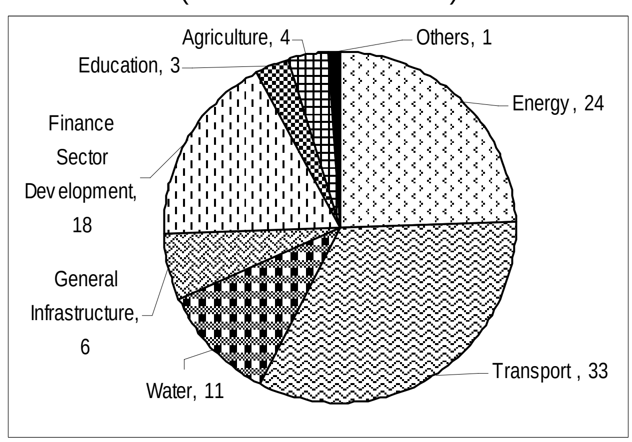
B. OCR Sovereign Lending – WPBF
(% of Volume of Loans)



C. OCR Sovereign Lending – Revealed
(% of Number of Loans)



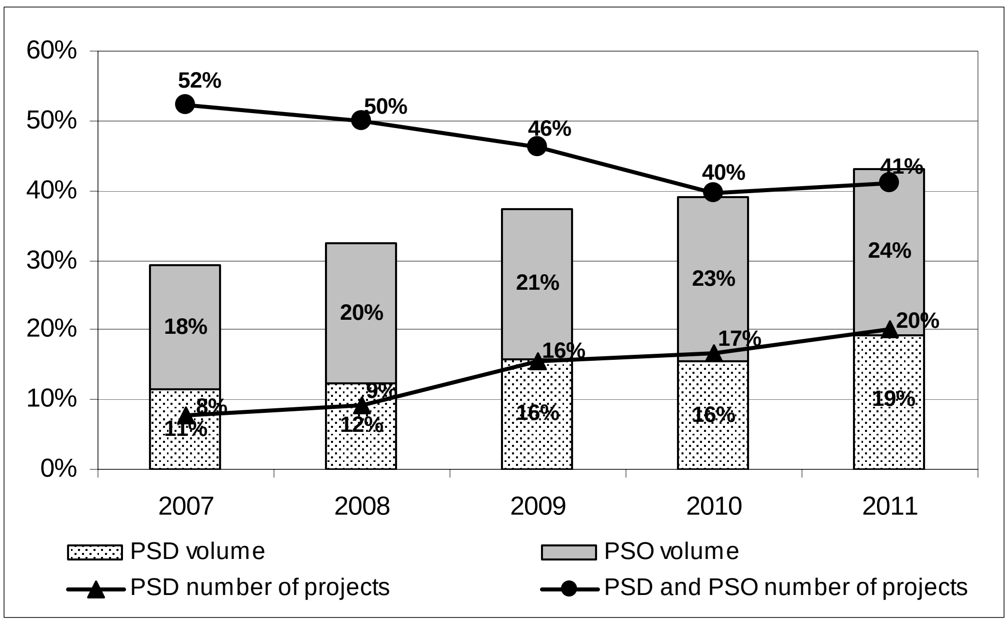
D. OCR Sovereign Lending – Revealed
(% of Volume of Loans)



OCR = ordinary capital resources, WPBF = work program and budget framework.
Note: Revealed demand projections in this figure refer to estimates of 10 major OCR borrowers: Bangladesh, PRC, India, Indonesia, Pakistan, Papua New Guinea, Philippines, Sri Lanka, Thailand, and Viet Nam.
Source: Asian Development Bank.

5. Private sector development and private sector operations under the WPBF 2009–2011 will account for an average of 41% of total OCR sovereign and nonsovereign projects in terms of number of projects and 43% in terms of volume (Figure A1.2). The priority sectors will continue to be (i) energy, with the focus on renewable energy and energy-efficiency improvements; (ii) urban infrastructure, particularly water supply and transport; and (iii) finance, especially banking, investment funds, trade finance, and microfinance. The coverage of the PSOD portfolio grew from 13 countries in 2004 to 19 in 2008 and is scheduled to expand to 24 by 2011. Careful selection of transactions in new markets will reduce portfolio concentration in the larger DMCs. PSOD will pay particular attention to opportunities to leverage private sector operations and aims to increase the amount financed through syndications known as B-loans. The current strengthening of coordination between PSOD and the regional departments will continue, allowing improvements in the enabling environment through policy reforms to benefit specific private sector operations.

Figure A1.2: Private Sector Development and Operations Share of Total OCR Sovereign and Nonsovereign Operations
(% volume and number)



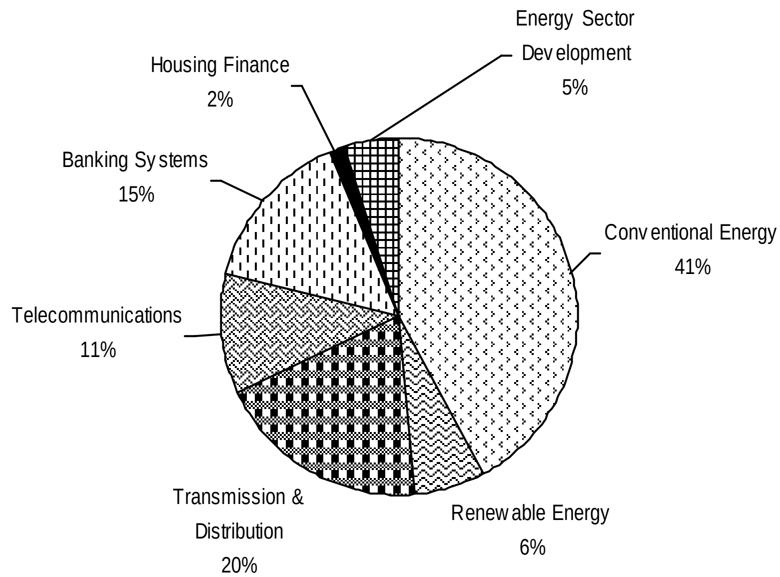
OCR = ordinary capital resources; PSD = private sector development; PSO = private sector operations
Note: Private sector operations include nonsovereign private lending, equity investments, guarantees, and B-loans.
Source: Asian Development Bank

6. ADB's operations departments will continue to seek strategic interventions through public-private partnerships, focusing on energy, transport, water, the disposal and treatment of wastewater and solid waste, power distribution, and other urban services. These public-private partnership projects will contribute to poverty reduction by improving the delivery of essential services to the poor and the public, and by allowing scarce budget resources to be used for programs that target poverty. The emphasis for 2009–2011 will be on strengthening policy frameworks in DMCs and the administration of the PSOD portfolio, while building ADB's internal capacity. Recommendations from the task force on private sector operations will be

implemented to build an institution capable of expanding private sector operations that are more focused on results and development impact, particularly for the poor.

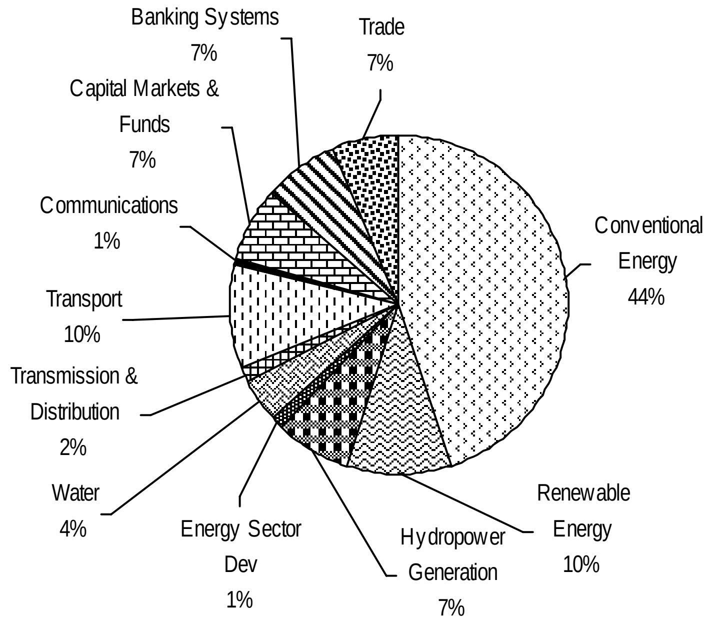
7. PSOD's operations are being fully aligned with Strategy 2020 to achieve poverty reduction through inclusive growth, environmentally sustainable growth, and regional integration. It will intensify its focus on the five core operational areas (Figures A1.3 and A1.4), thus capitalizing on ADB's core competencies.

Figure A1.3: Private Sector Operations Department YTD September 2008 Approvals, Alignment with Strategy 2020



PSOD = Private Sector Operations Department, YTD = year to date.
Source: Asian Development Bank's PSOD.

Figure A1.4: Private Sector Operations Department 2009 Indicative Pipeline Alignment with Strategy 2020



PSOD = Private Sector Operations Department, YTD = year to date.
Source: Asian Development Bank's PSOD.

8. PSOD plans to expand and diversify its country coverage to include lower-income and smaller economies, bringing its knowledge and experience to a wider range of DMCs. Significant demand for infrastructure financing will persist in all DMCs to 2020. PSOD, together with public sector operations, will continue to act as a catalyst in creating an enabling environment for infrastructure investments. Simultaneously, it will help lower the risks associated with individual transactions through ADB involvement. With the aim of achieving more inclusive growth, PSOD will also partner with the private sector to enable delivery of public services in such sectors as education and health. In larger and more developed DMCs, PSOD will increasingly be geared toward promoting regional and public goods, making innovative investments in improving energy efficiency, mitigating climate change, and building regional cooperation.

b. Enhance Social Inclusion and Improve Access to Opportunities

9. The number of education projects will remain stable for 2009–2011 under both WPBF and the revealed demand scenarios. The needs of individual DMCs will guide ADB's operations. Project or program lending to enhance the quality and coverage of secondary, vocational, and technical education will grow. SERD will begin operations in post-secondary education in selected countries, while maintaining assistance for secondary, vocational, and technical education. SARD will continue to support primary education and skills development. The East Asia Department (EARD) will develop projects to address education in all subsectors in Mongolia. CWRD will encourage a programmatic approach to education by shifting financing of social services away from direct project financing. Instead, it will provide program loans to public administrations that are willing and able to establish strategies and plans for the sector. These will include definitions of service coverage and standards, credible systems and procedures, transparency and efficiency, and performance indicators.

10. ADB will move its emphasis in the health sector toward indirect support for health outcomes by optimizing the health impacts of infrastructure projects, particularly in water supply, sanitation, and waste management. It will design projects to mitigate such potential adverse effects as traffic accidents, the spread of vector-borne diseases in urban settings, and the HIV transmission when populations become more mobile. ADB's direct support for health will be based on DMC demand as reflected in individual country partnership strategies. However, ADB will concentrate on program-based loans that improve governance, public expenditure management, and cost-effective delivery of health programs and services. Direct stand-alone interventions will be highly selective and largely based on private sector operations in association with reliable sponsors and service providers. They will emphasize the creation of regional public goods through communicable disease control, and will be undertaken in partnership with programmatic approaches. The sector-wide approach planned by ADB's Pacific Department provides a good example. An operational plan consistent with Strategy 2020 has been prepared to guide ADB's involvement in the health sector.

11. ADB's growing attention to the gender dimensions of its projects will help generate inclusive growth. Preliminary estimates show that about 25% of sovereign loans and ADF grants under the WPBF will include a thematic emphasis on gender and development, and/or other effective gender-mainstreaming elements. ADB will stress projects that (i) provide direct services, especially education and skills enhancement, health, and water supply; (ii) make economic and financing opportunities more available; and (iii) promote access to markets and enhance productivity through the provision of better transport, energy, and rural infrastructure. To firm up gender mainstreaming across ADB operations, interventions will be distributed evenly across all sectors.

12. ADB has started to implement the Gender and Development Plan of Action 2008–2010 approved in December 2007.[4] The plan of action includes a series of initiatives and targets in three key areas: (i) mainstreaming in country strategies and lending; (ii) policy dialogue and capacity development; and (iii) organizational effectiveness (including staffing and staff training). Training will be carried out to strengthen regional departments' staff skills and each regional department will appoint a dedicated gender specialist.

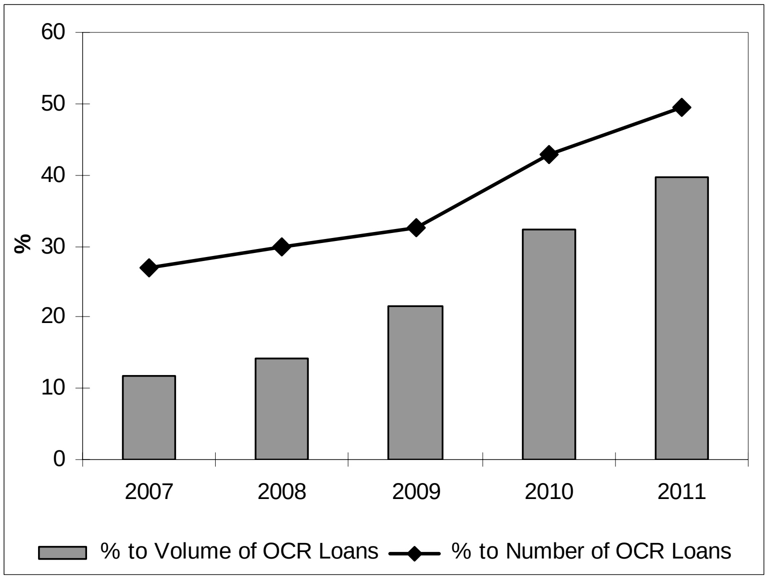
2. Environmentally Sustainable Growth

13. The share of OCR sovereign operations addressing the environment will grow substantially under the WPBF scenario from 30% in 2008 to 50% in 2011 in terms of number of projects, and from 14% in 2008 to 40% in 2011 in terms of volume (Figure A1.5). Strategy 2020 directs ADB to help DMCs respond to the threats to economic growth and poverty reduction posed by global climate change by reducing the intensity of the region's greenhouse gas emissions and by helping developing Asia adapt to the inevitable negative impacts of climate change. ADB will pay attention to environmental quality in the region's rapidly expanding urban areas and to the sustainable management of natural resources. Under the WPBF, a substantial share of operations with an environmental theme will continue to be in the water and urban sector in 2009–2011. More projects will address clean and renewable energy, as well as energy-efficiency improvements. These will be supported by technical assistance (TA) operations providing both growth and diversification to the environmental portfolio.[5] Under the revealed demand scenario, about 52% of the number of projects in the 10 major OCR

[4] ADB. 2007. *Gender and Development Action Plan (2008-2010).* Manila.
[5] The project classification system will be reviewed to ensure that ADB operations in these areas are accurately classified and accounted for, since operations addressing climate change were not previously tracked.

borrowers will focus on environmental sustainability during the 2009–2011 period.

Figure A1.5: Projects Addressing Environmental Sustainability
(OCR sovereign lending, % of volume and number)



OCR = ordinary capital resources.
Source: Asian Development Bank.

3. Regional Cooperation and Integration

14. Under Strategy 2020, ADB will progressively raise aggregate public and private sector lending for regional and subregional projects to at least 30% of operations by 2020. Stimulating regional integration will help accelerate economic growth, reduce poverty and economic disparities, raise productivity and employment, and strengthen institutions. OCR public sector projects that address regional cooperation and integration will increase significantly to 14% in terms of number and 18% in terms of volume by 2011 (Figure A1.6), with the transport and energy sectors accounting for the bulk (reflecting interest in cross-border infrastructure links).

15. ADB will prepare a new regional cooperation strategy in 2010 for the Greater Mekong Subregion (GMS). In addition to continuing subregional infrastructure development, it will focus more closely on competitiveness, and social and environmental concerns. Through other arrangements, ADB will also promote regional cooperation between countries in Southeast Asia in trade, investment, tourism, environment, human resource development, and connectivity.[6] SARD will advance similar themes at the subregional, regional, and interregional level,[7] and it will encourage networking among think tanks to generate policy recommendations on regional cooperation and integration issues. CWRD will help the Central Asia Regional Economic Cooperation (CAREC) program make the transition from strategy definition to project financing, particularly in transport, energy, and trade facilitation, with climate change becoming a central CAREC issue. EARD will continue to support the participation of the PRC in the CAREC and

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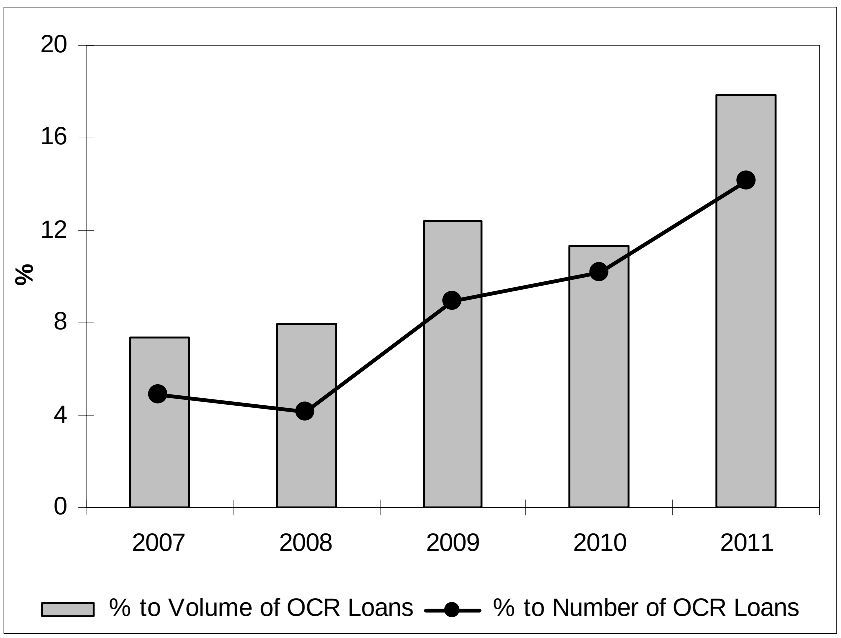
6 Particularly through the Brunei Darussalam-Indonesia-Malaysia-Philippines East Association of Southeast Asian Nations (ASEAN) Growth Area and the Indonesia-Malaysia-Thailand Growth Triangle.

7 Subregionally through the South Asia Subregional Economic Cooperation Program, regionally through the South Asian Association for Regional Cooperation, and interregionally through Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation.

GMS initiatives. ADB's Pacific Department will partner with bilateral aid agencies, the World Bank, and the International Finance Corporation to develop a Pacific regional infrastructure facility. It will promote dialogue and subregional pilot activities on audit, infrastructure regulation, and trade. ADB will also support broader efforts at generating regional public goods. For example, it will combat corruption through the ADB and OECD Anti-Corruption Initiative for Asia-Pacific. ADB will also address environmental issues to generate regional public goods. In an effort to build sounder financial markets, ADB will continue to support such regional efforts as the ASEAN Surveillance Process, the Chiang Mai Initiative for provision of short-term liquidity, and the Asian Bond Markets Initiatives. Other regional cooperation initiatives, such as the Brunei Darussalam, Indonesia, Malaysia, Philippines, East ASEAN Growth Area (BIMP-EAGA), address both trade facilitation and regional public goods management, including natural resource management.

Figure A1.6: Projects Addressing Regional Cooperation and Integration
(OCR sovereign lending, % of volume and number)



OCR = ordinary capital resources.
Source: Asian Development Bank.

4. Continued Alignment with Strategy 2020 during 2012–2020

16. ADB's operations in OCR borrowers in 2012–2020 will build on the realignment it plans to carry out in 2009–2011, and they will respond to what will almost certainly be continued strong demand in the focus areas of Strategy 2020. Long-range projections serve as general guidelines at the best of times; they are difficult when the prolonged impact of financial turmoil and a global slowdown are yet to be fully assessed. However, in the operational areas of Strategy 2020, demand beyond 2011 will remain at least as high across the OCR borrowers as revealed demand for the 2009–2011 programming period. This demand will likely grow. A quantitative breakdown of firm long-term demand for this period cannot be estimated at this

point beyond that indicated in the first working paper.[8] However, based on ADB's past performance and the expressed needs of OCR borrowers for Strategy 2020 resources and services, it is possible to provide a broad analysis of likely outcomes and contributions of OCR operations to broader economic and social development in 2012–2020.

17. The core areas of operation will continue to receive a large share of the ADB resources, with "blend borrowers" retaining their position as the largest group of borrowers. The share of nonsovereign operations will continue to grow. This continued shift in portfolio composition under Strategy 2020 will match the long-term priorities of the borrowing countries to meet their development challenges in 2012–2020. These operations are expected to contribute to the attainment of the Millennium Development Goals (MDGs), led by:

(i) rural and urban infrastructure, including in Asia's largest cities;
(ii) responses to climate change and rising demands for clean energy, clean fuels, safe sanitation, and clean drinking water;
(iii) an expansion of the role of the private sector in service delivery and other economic activities previously confined to the public sector, such as education, including promotion of public-private partnerships;
(iv) robust and effective capital markets and finance sectors to promote private sector operations; and
(v) creation of "open regionalism" to narrow disparities between DMCs and to transform many of the least-developed parts of Asia and the Pacific.

18. ADB operations and their development outcomes will be closely linked to national development strategies. Independent evaluations conducted by the Independent Evaluation Department (IED)—the country assistance program evaluations of past country strategies of some of the major OCR borrowers[9]—conclude that OCR operations are increasingly aligned with DMCs' national strategies and reforms. The strategies of OCR borrowers for 2009–2020 are expected to continue to center on improving infrastructure to sustain growth and private sector development, and in some cases to achieve the MDGs. They are strongly committed to building more productive, efficient economies, and are open to creating more business-friendly environments through reforms. Their strategies also highlight private sector development and public-private partnerships for infrastructure development in particular. The long-range directions of ADB's assistance will be governed by the demands and needs in individual OCR borrowers as discussed below.

B. Development Outcomes in Major OCR Borrowers

19. ADB's future operations are reflected in its country partnership strategies for major OCR borrowers, some of which already extend to 2012, and will build on the contribution its operations have already made directly or indirectly to national development outcomes and outputs.[10] In the Central and West Asian Region, ADB's operational focus generally will be on three areas that are fully aligned with Strategy 2020: (i) infrastructure (transport, energy, and

[8] The first working paper estimated that demand for ADB resources during 2012–2020 ranged from $15 billion in 2012 to $17 billion in 2020 (ADB. 2008. *Review of the Asian Development Bank's Ordinary Capital Resource Requirements.* Manila). .

[9] Country Assistance Program Evaluations: Bangladesh (January 2003), India (September 2007), Indonesia (December 2005), Pakistan (May 2007), Philippines (June 2008), Sri Lanka (August 2007).

[10] Periods of ADB country partnership strategies: Bangladesh 2006–2010, India 2009–2012, Indonesia 2006–2009, Pakistan 2008–2012, People's Republic of China 2008–2010, the Philippines 2005–2007, Sri Lanka 2009–2011, Viet Nam 2007–2010.

irrigation); (ii) urban services (water supply and sanitation, urban transport); and (iii) reforms (finance and public management). The recent financial crisis has reinforced the need for ADB to sustain engagement in all three areas. Selectivity in the Central and West Asian Region is sharpened by using MFFs for investments, and cluster loans for macroeconomic and sector reforms. The financial crisis and its regional impact underscore the need to sustain investments in infrastructure and to increase investments and assistance for sector and macroeconomic adjustments.

20. Because many OCR borrowers are still low-income countries or lower middle-income countries with large numbers of poor, their country partnership strategies show the continued need for support to achieve the MDGs. ADB's support for larger middle-income countries will contribute to the global agenda on climate change and other environmental issues through a gradual shift over the medium to long term to projects of a public goods nature, such as climate change initiatives. To address climate change issues, ADB will use its funds to leverage external resources, such as from the Climate Investment Facility and the proposed Clean Technology Fund. Complementary to this, ADB is shifting its operational focus in the transport sector from expressways to rural road networks and urban transport systems, while promoting more energy-efficient transport modes such as railways. More attention will be paid to such issues as road safety and vehicular emission reduction. The country partnership strategies of all OCR borrowers also reflect a transition toward more private sector operations to boost economic efficiency and sustain growth in the region, and better deliver public services.

21. The outcomes of future OCR operations can generally be expected to correspond to the outcomes of similar sectoral and thematic projects in the past, particularly in the priority sectors and activities under Strategy 2020. For this reason, ADB's record can provide a view of the prospective benefits of GCI V. In addition, outcomes should improve in 2009–2020, given the lessons learned and greater efforts at effectiveness and more precise targeting and planning, as well as the heightened impact likely to be gained by leveraging growing private sector operations. ADB's corporate results framework is articulated in its first *Development Effectiveness Review*, which includes outputs generated by ADB operations in transport, energy, water, education, and finance.[11] For GCI V, based on these and other past outputs from Strategy 2020 target sectors, ADB's contribution to development outcomes can be projected under each of its strategic agendas.

22. **People's Republic of China.** The focus of ADB's program will be on infrastructure, regional integration, and environmental issues. It aims to promote (i) inclusive and balanced development; (ii) resource efficiency and environmental sustainability; (iii) regional cooperation, including regional public goods; and (iv) private sector development. ADB will focus on transport, urban development, water supply and sanitation, energy, agriculture and natural resources, and finance. ADB will continue to help the Government to improve the policy and legal environment for enhancing financial intermediation and for promoting public-private partnerships, particularly in infrastructure. At the same time, as the policy environment becomes more conducive for public-private partnerships and nonsovereign operations, ADB will build capacities at subnational governments in these areas. ADB's regional cooperation programs will also enable the PRC to participate in regional programs in the GMS and Central Asia.

23. **India.** ADB's focus will continue to be on crucial infrastructure, including agriculture and water resources, and the promotion of greater efficiency through nonsovereign operations and

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[11] ADB. 2008. *2007 Development Effectiveness Review.* Manila.

public-private partnerships in a number of areas, including social sectors. ADB has recently been expanding its operations in states with high levels of poverty and weak capacity to address development challenges. It will assist the Government in capacity building, project design and implementation, and in value-added areas (e.g., public-private partnerships and nonsovereign operations), in line with the development priorities laid down in its 11th Five Year Plan.

24. **Indonesia.** ADB proposes to work with the Government in five operational areas derived from an analysis of constraints on Indonesia's development: (i) better infrastructure and infrastructure services, including rural infrastructure, with progress indicated by levels of public and private investment and improvements in sector regulation; (ii) a deeper financial sector, as indicated by improvements in domestic resource mobilization to meet long-term financing needs; (iii) more decentralization, reflected in regional spending and enhancements to financial reporting; (iv) accelerated achievements of MDGs, as indicated by improvements in water supply and sanitation, health, and education; and (v) better environment and natural resources management, reflected in enhancements in water and marine resources management and reductions in pollution. ADB will aim to leverage much greater private sector participation, and to enhance the quantity and quality of public service delivery.

25. **Pakistan.** ADB will focus on four critical areas.

(i) **Reforms and investments in key infrastructure sectors (including energy, transport, and the National Trade Corridor) and water resources.** The planned assistance in these sectors will reduce the cost of doing business and strengthen the underlying competitiveness of the economy.
(ii) **Reforms to catalyze a structural transformation of the economy.** These reforms will aim to reduce distortions, accelerate market creation, and address governance and institutional bottlenecks. They will target the delivery of inclusive social and financial services at provincial and local levels, as well as a better enabling environment for private investments.
(iii) **Development of the urban and rural economy for balanced development.** Pivotal interventions in cities and secondary towns will help unleash their economic potential, while improving the quality of life of poor urban citizens and strengthening agriculture value chains that benefit the rural poor.
(iv) **Better implementation of development interventions for greater aid effectiveness and sustainable development results**. Promoting regional cooperation, and integrating safeguards and gender concerns in operations, will be crosscutting themes of future ADB operations in Pakistan.

26. **The Philippines.** ADB will be more selective in its operations in Philippines than in the past. To improve fiscal policy, ADB will continue to support fundamental public finance management reforms, as well as other finance and governance reforms to lay the groundwork for greater private sector investment. ADB will build on its support to advance energy reforms and develop capital markets, as well as to enhance the enabling environment for the private sector.

27. **Sri Lanka.** ADB will be involved in fewer sectors than in the past, and will focus on the two areas identified in the Government's 10-Year Development Framework: (i) strengthening the investment climate; and (ii) achieving socially inclusive development. Governance, including piloting an innovative approach to capacity building, and private sector development through improvements in the investment climate, are the two major crosscutting themes of ADB's country partnership strategy. To strengthen the investment climate, ADB will seek to increase the competitiveness of the private sector and the level of private sector investment by

addressing the main bottlenecks—poor infrastructure and a volatile macroeconomic environment. To achieve socially inclusive development, ADB will seek to expand access to high-quality services in water supply, power, and transport; and to improve education in lagging regions, thus promoting inclusive growth and helping to mitigate the impact of the conflict.

28. **Thailand.** The thrust of ADB's partnership with Thailand will be to focus on the further development of efficient infrastructure, effective capital markets, a skilled labor force, and a conducive environment for private sector development. These factors are necessary for shaping the magnitude, direction, and sustainability of Thailand's future economic growth and development, and to prevent a large number of poor from sliding back into poverty**.**

29. **Viet Nam.** ADB will focus on removing bottlenecks to private sector investment by developing infrastructure; improving the enabling environment through regulatory reforms; and strengthening financial and market institutions, and human resources. ADB will help the Government to achieve its poverty reduction goals by promoting pro-poor, business-led economic growth. Sustaining vigorous growth, fueled by entrepreneurship, is crucial to creating jobs and income-generating opportunities. This underpinned previous successes in reducing poverty and will continue to do so in future.

GENERAL CAPITAL INCREASE V PROCEDURES

GCI V	Indicative Timeline
1. Circulation of the paper *The Fifth General Capital Increase of the Asian Development Bank* (including the Report of the Board of Directors to the Board of Governors and Draft Resolution of the Board of Governors) to the Board of Directors	16 March 2009
2. Board Discussion	6 April 2009
3. Transmittal of the Board of Directors Report and Resolution for Postal Voting to the Board of Governors	6 April 2009
4. Deadline for Casting of Votes	29 April 2009
5. Recording of Votes Discussed by the Board of Directors	30 April 2009
6. Annual Meeting:	4–5 May 2009 (Bali, Indonesia)
7. News Release	Before or After the Annual Meeting
8. Subscription Deadline	31 December 2010
9. Payment Period	Details provided in the draft resolution (Appendix 5, Annex 1)

QUESTIONS AND ANSWERS

1. Provide information on previous general capital increases (GCIs) of the Asian Development Bank (ADB), including details on GCI size, paid-in portion, amount in convertible currency and in members' own currencies, and reserved shares (if any).

Table A4.1: Overview of Previous General Capital Increases

Capitalization	Date of Adoption	Board of Governors Resolution No.	Authorized No. of Shares	Authorized GCI (%)	Paid-In Portion (%)
Original Capital	22 August 1966		100,000		50
GCI I	30 November 1971	46	165,000	150	20
GCI II	29 October 1976	104	414,800	135	10
GCI III	25 April 1983	158	754,750	105	5
GCI IV	22 May 1994	232	1,770,497	100	2
Other Capital Increases			341,264		
Total			**3,546,311**		

GCI = general capital increase.
Source: Asian Development Bank Treasury Department.

Paid-in capital in convertible currency and in members' own currencies. At the time of the original capital and in the Agreement Establishing the Asian Development Bank (the Charter),[1] 50% of the paid-in amount was to be in gold or convertible currency (article 6.2(a) of the Charter), and the remaining 50% was to be in the currencies of members (article 6.2(b) of the Charter). Although articles 6.2(a) and 6.2(b) of the Charter are still being referred to for payments, in all of the four previous GCIs, the paid-in amount consisted of 40% in convertible currency and 60% in currencies of members.

Reserved shares for new members and/or existing members: GCI I (14,193 shares), GCI II (0), GCI III (0), and GCI IV (50,000 shares).

[1] ADB. 1966. *Agreement Establishing the Asian Development Bank.* Manila.

2. What is the current cumulative paid-in percentage? What will be the cumulative paid-in percentage after the proposed GCI V?

The current cumulative paid-in percentage is 7.0029%. With the proposed 200% GCI, along with the 4% paid-in contribution, the cumulative paid-in percentage will be 5.0010%.

3. What are the milestones in the GCI process?

(i) Board of Directors' approval of *The Fifth General Capital Increase of the Asian Development Bank* (including the Report of the Board of Directors to the Board of Governors and Draft Resolution of the Board of Governors);
(ii) Board of Governors' adoption of the resolution on GCI authorization through the affirmative vote of two-thirds of the total number of Governors, representing not less than three-fourths of the total voting power of the members;
(iii) shareholders' subscription to GCI shares (by 31 December 2010);
(iv) shareholders' payment of 6.2(a) funds (40% of paid-in amount in cash in freely convertible currency and 6.2(b) funds (60% of paid-in amount) in promissory notes in the currency of members); and
(v) encashment of 6.2(b) promissory notes according to the resolution.

4. What are the major differences between the GCI V draft resolution and that for GCI IV?

(i) The installment period and date have been simplified.
(ii) The terms of payment have been clarified and the encashment schedule of 6.2(b) funds for freely convertible currencies has been included (Appendix 5, Annex 2).
(iii) The date for determining exchange rates has been changed from the installment due date to the billing date.
(iv) An option for members to pre-fix the exchange rate has been added.
(v) An option for members to accelerate payments in freely convertible currencies has been added.

5. When will the proposed capital increase be considered effective?

The proposed capital increase will become effective upon the adoption of the draft resolution by the Board of Governors with the requisite numbers and votes (see Q.3(ii)). Following such adoption or GCI authorization, ADB's authorized capital will increase by the amount of new shares authorized in the draft resolution. Members may then subscribe for the new shares until 31 December 2010. However, GCI authorization has no immediate impact on ADB's subscribed capital and related lending authority and borrowing authority. Changes to ADB's subscribed capital result directly from the individual subscription by members for the new shares.

6. Will ADB provide detailed information on the subscriptions to GCI V?

Following the effectivity of GCI V, ADB will provide an information pamphlet with the following details on GCI V: (i) additional shares to be subscribed for, (ii) subscription date, (iii) subscription documents, (iv) effectiveness of subscriptions, (v) procedures for subscription payment, (vi) amount of subscription payment, (vii) the final resolution on GCI V adopted by the Board of Governors, (viii) share entitlement of members, (ix) suggested form of instrument of subscription, representation and undertaking, and (x) additional information on procedures for payment of subscriptions to paid-in shares. The information pamphlet will be in line with the information provided at the time of GCI IV subscription.

7. How does "GCI authorization" differ from "GCI subscriptions"?

Following GCI authorization, shareholders have the right, but not the obligation, to subscribe for the new shares on a pro-rata basis. GCI subscriptions refer to the decisions of individual shareholders to subscribe for the new shares, which would result in an obligation to pay the paid-in amount, and the callable capital when called. Upon the effectiveness of a shareholder's subscription, the voting power of such shareholder is adjusted with corresponding changes to ADB's subscribed capital and related lending authority and borrowing authority.

8. Who is required to vote on the resolution authorizing the capital increase? What is the period within which a member needs to respond to the voting request?

The Governor or Alternate Governor of the member is required to vote on the resolution authorizing the capital increase. **Each member needs to respond within 23 calendar days from the date of the request.**

9. What documents are needed for "GCI subscriptions"?

(i) An instrument of subscription whereby the member subscribes for the number of paid-in and callable shares specified in such instrument.
(ii) A representation that the member has duly taken all legislative and other internal action to enable it to make such subscription.
(iii) An undertaking that the member will furnish ADB with such information as requested.

10. Can a member decide to subscribe for fewer shares than allocated and/or offered, e.g., half of the allocation?

Yes. Members can choose to subscribe for **shares up to the maximum allotted shares**. Members are expected, but not obliged, to take up their allocated shares in a GCI. If a member does not take up its allocation of shares, its voting power drops proportionately.

11. What is the formula for calculating the number of shares each member is entitled to subscribe for?

The calculation of the number of additional shares each member would be entitled to subscribe for under the proposed GCI is based on the number of actual shares subscribed for immediately prior to the effectivity of the proposed capital increase.

Additional Member Shares = truncate[a] (number of member shares prior to effectivity * GCI size percentage)

[a] Truncate means fractions are omitted.

12. How is the subscribed amount for a member calculated?

The authorized capital stock of ADB is defined in Article 4.1 of the Charter "in terms of United States dollars of the weight and fineness in effect on 31 January 1966" (the 1966 dollar), and the value of each share is defined as $10,000 in 1966 dollars. The capital stock has historically been translated into United States (US) dollars (ADB's unit of account) on the basis of its par value in terms of gold. From 1973 until 31 March 1978, the rate arrived at on this basis was $1.20635 per 1966 dollar. Since 1 April 1978, at which time the Second Amendment to the Articles of Agreement of the International Monetary Fund (IMF)[2] came into effect, currencies no longer have par values in terms of gold.

Pending ADB's selection of the appropriate successor to the 1966 dollar, for purposes of ADB's financial statements, the capital stock has been valued in terms of special drawing rights (SDR) at the value of the current US dollar as computed by the IMF, with each share valued at SDR.

13. What are the formulas used to calculate a member's number of paid-in shares and number of callable shares?

A member's number of paid-in shares and number of callable shares will be based on the member's number of additional shares subscribed for and the "paid-in percentage".

Number of Paid-In Shares	=	rounding[a] (number of additional shares subscribed for by a member * paid-in percentage)

[a] Rounding means that the fractions of shares in excess of 0.50 are rounded to the next higher number.

Number of Callable Shares	=	the number of additional shares subscribed for by a member less the number of paid-in shares

14. How is the paid-in amount determined?

Shareholders can opt to pay their paid-in shares in terms of the following:

(i) 12,063.50 current US dollars per share; or

(ii) 10,000 SDR per share, with SDRs translated into currencies at the prevailing exchange rates as mentioned below.

Option 1: US Dollar Valuation (historical SDR)

Shareholder's Paid-In Amount in USD equivalent	=	paid-in shares * 12,063.5

[2] IMF. 1978. *Second Amendment to the Articles of Agreement of the International Monetary Fund.* Washington, D.C.

Option 2: Current SDR Valuation

Shareholder's Paid-In Amount in USD equivalent	=	paid-in shares * (10,000 * SDR– US dollar foreign exchange rate)

Note that in both the options the exchange rate to be applied between different currencies or between the US dollar and any currency or between the SDR and any currency for the purpose of determining subscription payment amounts shall be the rate used by ADB for translation purposes in its books of account as of the date on which ADB prepares the relevant billing statement to each subscribing member, such date being usually 30 days before the date when payment is due (see question 28 on exchange rate fixing).

The choice between the two options can be made at the time of each installment payment. Based on exchange rates at the time of writing, it would be more economical for a subscribing member to choose the US dollar valuation option. However, such a choice would result in higher notional maintenance of value (MOV) liabilities.

Table A4.2 presents the indicative paid-in amounts at 200% GCI size with 4% paid-in amount. The paid-in amount is valued under option-1 (US Dollar valuation i.e. historical SDR).

Table A4.2: Approximate Paid-in Amount at 200% GCI Size with 4% Paid-in Amount

Member	Current Number of Shares Subscribed (31 Dec 2008)	GCI V Subscriptions[a] Additional Number of Subscribed Shares	Additional Number of Paid-in Shares	Paid-in Amount (US$ million) 6.2a (40%)	6.2b (60%)	Total
A. Regional						
Afghanistan	1,195	2,390	96	0.5	0.7	1.2
Armenia	10,557	21,114	845	4.1	6.1	10.2
Australia	204,740	409,480	16,379	79.0	118.6	197.6
Azerbaijan	15,736	31,472	1,259	6.1	9.1	15.2
Bangladesh	36,128	72,256	2,890	13.9	20.9	34.9
Bhutan	220	440	18	0.1	0.1	0.2
Brunei Darussalam	12,462	24,924	997	4.8	7.2	12.0
Cambodia	1,750	3,500	140	0.7	1.0	1.7
China, People's Rep. of	228,000	456,000	18,240	88.0	132.0	220.0
Cook Islands	94	188	8	0.0	0.1	0.1
Fiji Islands	2,406	4,812	192	0.9	1.4	2.3
Georgia	12,081	24,162	966	4.7	7.0	11.7
Hong Kong, China	19,270	38,540	1,542	7.4	11.2	18.6
India	224,010	448,020	17,921	86.5	129.7	216.2
Indonesia	192,700	385,400	15,416	74.4	111.6	186.0
Japan	552,210	1,104,420	44,177	213.2	319.8	532.9
Kazakhstan	28,536	57,072	2,283	11.0	16.5	27.5
Kiribati	142	284	11	0.1	0.1	0.1
Korea, Republic of	178,246	356,492	14,260	68.8	103.2	172.0
Kyrgyz Republic	10,582	21,164	847	4.1	6.1	10.2
Lao People's Democratic Rep.	492	984	39	0.2	0.3	0.5
Malaysia	96,350	192,700	7,708	37.2	55.8	93.0
Maldives	142	284	11	0.1	0.1	0.1
Marshall Islands	94	188	8	0.0	0.1	0.1
Micronesia, Federated States of	142	284	11	0.1	0.1	0.1
Mongolia	532	1,064	43	0.2	0.3	0.5
Myanmar	19,270	38,540	1,542	7.4	11.2	18.6
Nauru	142	284	11	0.1	0.1	0.1
Nepal	5,202	10,404	416	2.0	3.0	5.0
New Zealand	54,340	108,680	4,347	21.0	31.5	52.4
Pakistan	77,080	154,160	6,166	29.8	44.6	74.4
Palau	114	228	9	0.0	0.1	0.1
Papua New Guinea	3,320	6,640	266	1.3	1.9	3.2
Philippines	84,304	168,608	6,744	32.5	48.8	81.4
Samoa	116	232	9	0.0	0.1	0.1
Singapore	12,040	24,080	963	4.6	7.0	11.6
Solomon Islands	236	472	19	0.1	0.1	0.2
Sri Lanka	20,520	41,040	1,642	7.9	11.9	19.8
Taipei,China	38,540	77,080	3,083	14.9	22.3	37.2
Tajikistan	10,134	20,268	811	3.9	5.9	9.8
Thailand	48,174	96,348	3,854	18.6	27.9	46.5
Timor-Leste	350	700	28	0.1	0.2	0.3
Tonga	142	284	11	0.1	0.1	0.1
Turkmenistan	8,958	17,916	717	3.5	5.2	8.6
Tuvalu	50	100	4	0.0	0.0	0.0
Uzbekistan	23,834	47,668	1,907	9.2	13.8	23.0
Vanuatu	236	472	19	0.1	0.1	0.2
Viet Nam	12,076	24,152	966	4.7	7.0	11.7
Subtotal (A)	**2,247,995**	**4,495,990**	**179,841**	**867.8**	**1,301.7**	**2,169.5**
B. Nonregional						
Austria	12,040	24,080	963	4.6	7.0	11.6
Belgium	12,040	24,080	963	4.6	7.0	11.6
Canada	185,086	370,172	14,807	71.4	107.2	178.6
Denmark	12,040	24,080	963	4.6	7.0	11.6
Finland	12,040	24,080	963	4.6	7.0	11.6
France	82,356	164,712	6,588	31.8	47.7	79.5
Germany	153,068	306,136	12,245	59.1	88.6	147.7
Ireland	12,040	24,080	963	4.6	7.0	11.6
Italy	63,950	127,900	5,116	24.7	37.0	61.7
Luxembourg	12,040	24,080	963	4.6	7.0	11.6
The Netherlands	36,294	72,588	2,904	14.0	21.0	35.0
Norway	12,040	24,080	963	4.6	7.0	11.6
Portugal	12,040	24,080	963	4.6	7.0	11.6
Spain	12,040	24,080	963	4.6	7.0	11.6
Sweden	12,040	24,080	963	4.6	7.0	11.6
Switzerland	20,650	41,300	1,652	8.0	12.0	19.9
Turkey	12,040	24,080	963	4.6	7.0	11.6
United Kingdom	72,262	144,524	5,781	27.9	41.8	69.7
United States	552,210	1,104,420	44,177	213.2	319.8	532.9
Subtotal (B)	**1,298,316**	**2,596,632**	**103,863**	**501.2**	**751.8**	**1,253.0**
Total (A + B)	**3,546,311**	**7,092,622**	**283,704**	**1,369.0**	**2,053.5**	**3,422.5**

GCI = general capital increase.

[a] For subscription and payment details, please refer to the draft Board Resolution. Paid-in capital amounts are based on US$ valuation at $12,063.50 per share.

Source: ADB. 2008. *Annual Report 2007*. Manila; and ADB's Treasury Department.

15. What role does maintenance of value play in capital subscriptions?

The MOV principle applies to all of a member's currency holdings, irrespective of source, up to an amount equivalent to the paid-in portion of the member's subscription (and not to callable capital). Capital subscription payments are preserved in the shareholders' original payment currencies and are revalued periodically to reflect changes in the exchange rate of payment currencies against SDR. The resulting differences imply either ADB's claim from the shareholder (notional receivable of ADB) or the shareholder's claim from ADB (notional payable by ADB). The net aggregate of such differences is reported as notional amounts to maintain the value of currency holdings in the capital and reserves portion of ADB's balance sheet. As of 31 December 2008, the total MOV (net notional receivable amount) was $564 million, i.e., 3.7% of ADB's capital and reserves of $15.269 billion.

Currently, there is no provision for settlement of such MOV amounts. Thus, the MOV principle and the associated responsibility of ADB and its shareholders with respect to the settlement of the amounts are considered more notional than real.

16. Provide a working definition of "freely convertible currencies," and list the freely convertible currencies for the purposes of the resolution.

For the purposes of the resolution, a currency is considered freely convertible when it has met one or more of the following generally accepted criteria:

1. The government allows both residents and non-residents to purchase unlimited amounts of any foreign currency with their domestic currency and vice-versa.
2. The currency can be freely exchanged for other currencies or gold without special authorization from the central bank.
3. The currency is traded in international foreign exchange markets and widely used in international transactions.

17. Explain the subscription dates.

Following the effectivity of the GCI (i.e., after Board of Governors' adoption of the resolution on GCI V), a member can subscribe for up to its allocation of shares (Appendix 5, Annex 2). The member can subscribe at any time by providing the documents noted in the draft resolution (Appendix 5, Annex 1) on or before 31 December 2010.

18. Explain the payment installment dates.

First Installment Date	=	**specified quarterly dates following subscription effectivity date of a member up to or plus 90 days[a]**

[a] The payment date shall be the closest of any one of the following prescribed dates: 1 April 2010, 1 July 2010, 1 October 2010, 1 January 2011, or 1 April 2011. In case the prescribed payment date falls on an ADB holiday, the following working day will apply as the new prescribed payment date for the purpose of the resolution.

Example: If a member's effective subscription date is on 3 April 2010, the subscription effectivity plus 90 calendar days would be on 2 July 2010. Therefore, the latest payment date would be on 1 October 2010, and the earliest payment date would be on 1 July 2010.

All subsequent installment dates will be the anniversary years of the first installment date.

19. What is the proposed payment amount for GCI V? When do the paid-in amounts need to be paid?

As in the four previous GCIs, the subscribing member shall pay the paid-in amount in the following manner: 40% in freely convertible currencies (6.2(a) funds), and 60% in the member's national currency (6.2(b) funds). The terms 6.2(a) and 6.2(b) funds refer to the corresponding Charter provisions relating to the payment arrangements in convertible currency and the currencies of members..[3]

(i) **6.2(a) funds (freely convertible currency), 40% of paid-in amount.** A member whose currency is freely convertible should make its 6.2(a) payments in its own currency. For developed members, 6.2(a) funds are paid in cash in their own national currencies. For developing members, 6.2(a) funds are paid in cash (in US dollars or other freely convertible currencies), or in their own national currencies provided that such currencies are freely convertible. Payments would be in five equal annual installments according to installment schedules noted in the draft resolution (Appendix 5, Annex 2).

(ii) **6.2(b) funds (currency of the member), 60% of paid-in amount.** Article 6.3 of the Charter requires ADB to accept, from any member *whose payments under article 6.2(b) are not needed by ADB for the conduct of its operations*, non-negotiable, non-interest-bearing demand notes in lieu of such payments. According to article 6.3, such notes or obligations shall be payable to ADB at par value upon demand. ADB has been accommodating all its members by accepting demand notes for 6.2(b) funds in *all national currencies*. While the 6.2(b) notes in freely convertible currencies are encashed uniformly according to an agreed encashment schedule (Appendix 5, Annex 2), the 6.2(b) notes in other national currencies that are not freely convertible are encashed upon demand.

Example of Installment Payments:
(Assuming the first installment payment date is 1 April 2010)

Payment of Paid-in Shares	**Installment No.**				
	1	**2**	**3**	**4**	**5**
6.2a - cash in freely convertible currency 6.2b - promissory notes in currency of the subscribing member	01-Apr-10	01-Apr-11	01-Apr-12	01-Apr-13	01-Apr-14

[3] At the time of the original capital and in the Articles of Agreement, 50% of the paid-in amount was in convertible currency (6.2(a) funds), with the remaining 50% of the paid-in amount in the currency of the member (6.2(b) funds). Although articles 6.2(a) and 6.2(b) of the Charter are still being referred to for payments, in all the four previous GCIs, 40% of the payment was in 6.2(a) funds (convertible currencies) and 60% in 6.2(b) funds (currencies of members).

Encashment of 6.2b Promissory Notes					
currencies that are not freely convertible	←		Upon demand		→
			Installment No.		
currencies that are freely convertible	1	2	3	4	5
	01-Apr-15	01-Apr-16	01-Apr-17	01-Apr-18	01-Apr-19

Note: The first installment payment date above could be 01 April 2010 or 01 July 2010 or 01 October 2010 or 01 January 2011 or 01 April 2011 depending on the effectivity of the subscription.

20. Clarify the different exchange rates: current SDR, 1.20635 and 1.44 used in the GCI discussions.

(i) Capital stock and callable capital are valued in current SDR.
(ii) Paid-in capital for the purpose of payment is based on the member's option valued at historical SDR (1.20635) or current SDR.
(iii) The GCI paper[4] valued the capital stock and callable capital at a SDR-US dollar exchange rate of SDR=US$1.44 (a 10-year historical average) for operational planning purposes.

21. When do shareholders need to pay the callable capital?

ADB has never called on its callable capital. ADB would only call on this capital if it were unable to service its obligations on borrowings and guarantees from other sources. ADB’s financial operations are conducted in such a manner that the risk of this capital ever being called on is minimal. Callable capital itself does not provide ADB with the working capital to fund loans; it is mainly used to back ADB’s borrowings in the capital markets. However, shareholders are obliged to pay the callable portion upon a call on such callable capital.

22. How are the voting shares calculated?

ADB has two kinds of votes: basic and proportional. The basic votes of all members are equal. The number of proportional votes of each member is equal to the number of shares held by that member. The total voting power of each member is the sum of its basic and proportional votes.

Based on article 33 of the Charter:

(i) voting power has two components: (a) basic votes, and (b) proportional votes
(ii) total voting power = total basic votes + total proportional votes
(iii) proportional votes = number of shares of capital stock held by the member
(iv) basic votes = number of votes distributed equally among all members
(v) total basic votes = 20% (total basic votes + total proportional votes)

Let: B = total basic votes, P = total proportional votes
If B = 20% (B + P); 0.8B = 0.2P
B = 25% * P
Total basic votes = 25% * total proportional votes

[4] ADB. 2008. *Review of the Asian Development Bank's Ordinary Capital Resource Requirements.* Manila.

Steps in computing voting powers:

(i) Total basic votes = 25% * total proportional votes
(ii) Basic vote per member = total basic vote/number of members (should be a whole number)
(iii) Voting power of each member = basic vote per member + proportional votes (number of shares subscribed)

23. Can a member pledge a subscription on a conditional basis (e.g., "subject to parliamentary ratification")?

No.

24. When are the voting shares of a member calculated? Are they calculated at the effectivity of subscription of that member?

A member's voting shares are calculated when both the conditions have been met: the approval of the GCI and the effectivity of a member's subscription.

25. What is the impact of "unsubscribed" shares on an existing member's voting rights?

If a member does not take up its allocation of shares, its voting power drops proportionately. The "unsubscribed shares" will not be automatically allocated to the other existing members. However, their respective voting power will increase proportionately.

26. What happens to the unsubscribed portion of shares?

The shares authorized by the resolution, and which shall not have been subscribed for in accordance with paragraph 2 of the resolution, shall be reserved for initial subscriptions by new members, and for special increases in the subscriptions of individual members, as may be determined by the Board of Governors pursuant to paragraphs 1 and 3 of article 5 of the Charter.

27. What is the difference between a GCI and a special capital increase? Does ADB have any plans for a special capital increase?

A GCI does not normally result in a change in relative shareholdings or voting rights. A special capital increase is designed to enable members to adjust their shareholdings or voting rights relative to other members.

Discussions on a special capital increase, if necessary, shall be a separate topic.

28. Explain the steps for exchange rate fixing. What are its implications?

The exchange rate fixing option is provided for all members' 6.2(a) installment payments to accommodate their planning for budget appropriations. The exchange rate may be fixed for any installment amount up to a year in advance of the date when payment is due and at a rate to be determined by ADB. A member may request ADB to fix the exchange rate and provide a suitable date in accordance with its budget cycle. ADB will bill the member subsequent to the specified fixing date based on the ADB book exchange rate. ADB will give effect to the difference in the agreed exchange rate and the exchange rate on which the payment is due on the date when payment of the subsequent installment amount is due; no adjustment will be made for the final installment amount.

29. Explain the steps for accelerated payments. How is a discount rate determined? What are its implications?

All members are given the option to accelerate the encashment of their 6.2(a) and 6.2(b) payments in freely convertible currencies. The option to accelerate payments is provided to support the shareholders' budget appropriation process. A member who wishes to use this option should provide ADB a written request with details on the freely convertible currency and accelerated amount of such encashments at least 45 days prior to its first installment due date. ADB will provide the member with the discount rate in the freely convertible currency, and bill the member 30 days prior to the installment due date. The discount rate will be determined conservatively using a 2-year yield less a volatility spread margin based on 5-year historical yields. The income generally and notionally expected to be earned as a result of such accelerated encashment, based on the discount rate, will be used as partial payment of the member's paid-in portion.

30. What happens if a member cannot make a decision on its subscription by the end of the GCI subscription period?

Unless the Board of Directors extends the GCI subscription period, the member will forgo its right to subscribe for its allotted shares.

31. What happens if a member fails to provide a specific paid-in capital or if there are delays in the payment of the paid-in amount?

Unless the Board of Directors extends the general and/or specific payment period, the member's proportional shares may be reduced temporarily or permanently on a pro-rata basis.

32. Why is a 90-day period needed between the subscription date and the first installment payment date?

ADB usually provides a 90-day time interval between the subscription for shares (effectivity of an individual member's subscription) and the date of the first installment payment. The subscription documents needed for the effectivity of the subscription already include a representation that the member has duly taken all legislative and other internal action to enable it to make such a subscription. Therefore, in many cases, governments of members should have already obtained legislative or budgetary authorization for the first installment of their paid-in capital even before their instruments of subscription have been deposited with ADB.

33. Why are exchange rates fixed at the time of the billing instead of at the due date (as in the previous GCIs)?

In the previous GCIs, the default exchange rate was the exchange rate as of the installment due date. The provisional billing dates and the installment due dates varied across countries, depending on the timing of subscriptions. A provisional billing using an exchange rate as of the provisional billing date was followed by a billing adjustment following discussions with each member. Fixing the exchange rate as of the billing date (30 days before the known installment due date) is preferred because it is administratively simpler for members and ADB. It also provides an equitable and transparent processing mechanism. The notional maintenance of value will still apply irrespective of the date of exchange rate fixing.

34. Why does the paid-in portion need to be deposited in five annual installments? GCI IV had more options (four, five, or six annual installments). Please explain.

The option to provide payments in five equal annual installments is in line with the GCI IV option of five annual installments. This simple payment option along with other payment features (e.g., the specified installment payment dates, exchange rate fixing, and accelerated payment) should help members plan their budget appropriations. Note that the encashment of freely convertible 6.2(b) funds in five equal annual installments after the encashment of 6.2(a) funds effectively distributes the relevant member's paid-in capital encashments into 10 annual installments, thereby reducing the member's burden.

35. How will ADB update members on the status of subscriptions and payments?

The "status of subscriptions," including information on members' subscriptions, installment payments, payment options chosen (with information on exchange dates and discount rates as applicable), and encashments. will be included in the quarterly reports of the Treasury Department (or more frequently if necessary).

REVIEW OF ASIAN DEVELOPMENT BANK'S RESOURCE POSITION AND PROPOSAL FOR A FIFTH GENERAL CAPITAL INCREASE

(Draft) Report of the Board of Directors

I. INTRODUCTION

1. The Board of Governors of the Asian Development Bank (ADB), at its thirty-third Annual Meeting in 2000, considered the Report of the Board of Directors on the resources of ADB,[1] and adopted Resolution No. 270:

> " That the Board of Governors, recognizing the need for a study of the Bank's future resource requirements to finance its ordinary operations, requests the Board of Directors to initiate such a study and to report its findings and recommendations to the Board of Governors for consideration."

2. Pursuant to this Resolution, the Board of Directors submitted annual reports to the Board of Governors on the resources of ADB.[2] On 7 April 2008, the Board of Directors approved the long-term strategic framework 2008–2020 (Strategy 2020). On 6 May 2008, the Board of Directors reported to the Board of Governors the status of ADB's resources and the need to study ADB's financial resources including a capital increase.[3] This was before the crisis gripped the global financial system.

3. This report contains the findings and recommendations of the Board of Directors resulting from the study of ADB's ordinary capital resources (OCR). These findings indicate that an increase in the capital stock of ADB is now necessary in order to (i) ensure that ADB will be able to respond to the needs of its developing member countries (DMCs) affected by the current crisis, and (ii) effectively implement Strategy 2020 to achieve its vision of a region free of poverty. The report, therefore, includes a draft resolution (Appendix 5, Annex 1) for consideration and action by the Board of Governors.

4. The proposed capital increase will support ADB's OCR operational requirements under Strategy 2020. The size and composition of the proposed capital increase are discussed in the following paragraphs. In formulating the capital increase proposals, the Board of Directors has carefully reviewed and considered ADB's past operations, the resource requirements of its DMCs for 2009–2020, the absorptive capacities of DMCs, the desirable scale of ADB operations during 2009–2020, and the availability of OCR funds on the basis of the current and expected capital subscriptions. The Board of Directors has also reviewed and considered ADB's operational and institutional effectiveness as well as its financial policies to ensure efficient and prudent use of its capital.

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[1] ADB. 2000. *Thirty-Third Annual Meeting: Resources of ADB*. Manila;

[2] ADB. 2001. *Thirty-Fourth Annual Meeting: Resources of ADB*. Manila; ADB. 2002. *Thirty-Fifth Annual Meeting: Resources of ADB*. Manila; ADB. 2003. *Thirty-Sixth Annual Meeting: Resources of ADB*. Manila; ADB. 2004. *Thirty-Seventh Annual Meeting: Resources of Asian Development Bank*. Manila; ADB. 2005. *Thirty-Eighth Annual Meeting: Resources of the Asian Development Bank*. Manila; ADB. 2006. *Thirty-Ninth Annual Meeting: Resources of the Asian Development Bank*. Manila; ADB 2007. *Fortieth Annual Meeting: Resources of the Asian Development Bank*. Manila; and ADB. 2008. *Forty-First Annual Meeting: Resources of the Asian Development Bank*. Manila.

[3] ADB. 2008. *Forty-First Annual Meeting: Resources of the Asian Development Bank.* Manila.

II. ADB'S OPERATIONS

5. As of 31 December 2008, ADB had approved loans amounting to a cumulative total of $143,528.4 million ($138,403.4 million for sovereign loans and $5,125.0 million for nonsovereign loans) covering 2,147 projects in 41 DMCs.[4] These loans covered various sectors of economic development, including infrastructure, energy, water supply and sanitation, urban development, education, health, and the financial sector. Of the total loans approved, 1,242 loans amounting to $107,175.9 million were from ordinary capital resources and remaining 1,221 loans amounting to $36,352.5 were from the concessional Asian Development Fund. ADB had also approved 263 grant projects for $4,084.53 million. In addition, ADB had approved a cumulative total of $3,545.8 million for 6,599 technical assistance (TA) grants (including regional activities), of which $1,628.8 million had been provided from the TA Special Fund, $1,115.5 million from the Japan Special Fund, $26.9 million from ADB's Special Funds, and $774.6 million from other multilateral and bilateral sources with ADB acting as the administrator or the executing agency.

6. In order to determine the desirable scale of ADB operations for 2009–2020, studies were undertaken on the estimated external resource requirements of the region in the context of an effective delivery of Strategy 2020. In response to calls from the international community, ADB will respond to the needs of the crisis-affected countries in order to protect the poor and the most vulnerable by substantially increasing its annual OCR operations to $12.5 billion–$13.0 billion in 2009 and 2010. From 2011 to 2020, if normal circumstances resume, ADB expects its annual OCR operations to return to $11 billion or below.

III. ADB'S ORDINARY CAPITAL RESOURCES

7. ADB's authorized capital stock is defined in Article 4.1 of the Articles of Agreement Establishing the Asian Development Bank (the Charter)[5] "in terms of United States dollars of the weight and fineness in effect on 31 January 1966" (the 1966 dollar) and the value of each share is defined as 10,000 1966 dollars. The capital stock has historically been translated into the current United States dollar (ADB's unit of account) on the basis of its par value in terms of gold. From 1973 until 31 March 1978, the rate arrived at on this basis was $1.20635 per 1966 dollar. Since 1 April 1978, at which time the Second Amendment to the Articles of Agreement of the International Monetary Fund came into effect, currencies have no longer had par values in terms of gold. Pending ADB's selection of the appropriate successor to the 1966 dollar, the capital stock has been valued for purposes of ADB's financial statements in terms of the special drawing right (SDR) at the value in current United States dollar as computed by the International Monetary Fund, with each share valued at SDR10,000.

8. ADB has had four previous general capital increases (GCIs). The first was in 1971 (Board of Governors' Resolution No. 46), the second in 1976 (Board of Governors' Resolution No. 104), the third in 1983 (Board of Governors' Resolution No. 158), and the fourth in 1994 (Board of Governors' Resolution No. 232). ADB's authorized capital stock as of 31 December 2008 comprised 3,546,311 shares amounting to $54,890.2 million. All the authorized shares had been subscribed. Of the subscribed capital, 249,424 shares amounting to $3,860.6 million were in the form of paid-in shares, and the remaining 3,296,887 shares amounting to $51,029.5 million were in the form of callable capital.

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[4] In this report, "$" refers to US dollars.

[5] ADB. 1966. *Agreement Establishing the Asian Development Bank.* Manila.

9. The new lending limitation policy approved by the Board of Directors on 15 December 2008 has freed up additional lending headroom. Under this policy, the total amount of disbursed loans, approved equity investments, and the maximum amount that could be demanded from ADB under its guarantee portfolio may not exceed the total amount of ADB's unimpaired subscribed capital, reserves, and surplus. While lending headroom is no longer a constraint, the borrowing headroom is projected to turn negative by the first quarter 2011, thereby constraining ADB's lending operations as early as the first quarter of 2010. Programming discussions on the 2010 lending program will be held in mid-2009. An early resolution of GCI is therefore critical to provide planning certainty on ADB's 2010 lending capacity to DMCs.

IV. PROPOSED CAPITAL INCREASE

10. To provide the additional headroom required by ADB to enable it to continue its OCR operations in the coming years, an increase of 200% in capital stock is needed. Taking into account the desirability of having additional income to boost its reserves as well as the need to maintain a general perception in the capital markets of the willingness of the members to provide support to ADB, it is proposed that, as in the past, a part of such increase should be in the form of paid-in capital. The Board of Directors considers that the paid-in portion should be equal to 4% of the proposed increase, and the remaining 96% should be in the form of callable capital.

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11. Following the effectiveness of a member's subscription, such member may make payment for its paid-in shares in five equal annual installments, with the first installment payment date being 01 April 2010. As in the four preceding GCIs, the subscribing member shall pay 40% of each installment in a freely convertible currency,[6] which shall be deemed payable and paid under Article 6.2(a) of the Charter. The remaining 60% of each installment shall be paid in the subscribing member's currency, which shall be deemed payable and paid under Article 6.2(b) of the Charter.

12. Pending a decision on the outstanding question of the valuation of ADB's capital stock and subject to adjustments when the question is resolved, subscription payments for paid-in shares under the proposed capital increase may be made, at the option of the subscribing member in terms of

(i) $12,063,55 per share; or
(ii) SDR10,000 per share, with SDRs translated into currencies at the exchange rates prevailing on the billing date of each payment.[7]

13. To provide flexibility in their budget planning process, members have the option to (i) fix the exchange rate for payments under Article 6.2 (a) of the Charter to be applied between the different currencies, or (ii) prepay any installment amount of freely convertible currencies paid under Article 6. These options are further detailed in the draft resolution (Appendix 5, Annex 1).

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[6] Where such currency is not the currency of the subscribing member, the currency will be selected in consultation with ADB.

[7] In the event that a member must establish its liability with respect to its callable shares, ADB is prepared to accept mutually satisfactory arrangements for this purpose prior to or at the time of subscription, pending a resolution of the valuation of ADB's capital and without prejudice to the member's position on the valuation of ADB's capital. Notwithstanding these provisional arrangements, ADB will continue to express the value of its capital stock at SDR10,000 per share, with SDRs translated into currencies at current exchange rates until the capital valuation question is resolved.

14. A schedule showing the number of shares to which each member would be entitled to subscribe for under the proposed increase in the authorized capital stock is presented in Appendix 5, Annex 2. The proposed increase for each member is the number of shares equivalent to 200% of such member's subscribed shares immediately prior to the date of adoption of the draft resolution (Appendix 5, Annex 1).

15. The total number of additional shares proposed is 7,092,622, consisting of 283,704 paid-in shares and 6,808,918 callable shares. Based on the provisional valuation method stated in para. 12, item (ii), and using the exchange rates adopted by ADB as of 31 December 2008, the proposed capital increase would amount to $109,780 million of additional capital stock. With the proposed increase, ADB's total authorized capital would be 10,638,933 shares amounting to $164,670 million.

V. FINDINGS AND RECOMMENDATIONS

16. The proposed capital increase is equivalent to 200% of the shares subscribed immediately prior to the date of adoption of the draft resolution (Appendix 5, Annex 1), with 4% of the increase in the form of paid-in shares and the remaining 96% in the form of callable shares. Of the paid-in portion, 40% should be payable in freely convertible currency and 60% in national currency. Payment for paid-in shares subscribed for under the capital increase should be made in the manner described in paras. 11–13.

17. To give effect to the capital increase outlined above, the Board of Directors submits a draft resolution for the consideration of the Board of Governors (Appendix 5, Annex 1), and recommends that the resolution be adopted. Since the resolution is intended to increase the authorized capital stock of ADB, its adoption requires an affirmative vote by two-thirds of the total number of Governors representing not less than three-fourths of the total voting power of the members, as provided in Article 4.3 of the Charter.

18. The Board of Directors considers that, since a decision on this matter should be taken as soon as possible, the special procedure in Section 3 of the By-Laws of ADB should be invoked. Accordingly, the Board of Directors has authorized the President to transmit to each Governor the text of the draft resolution together with this report (Appendix 5, Annex 1), with a request for a vote by facsimile or e-mail within 23 calendar days of the date of such request.

DRAFT RESOLUTION

INCREASE IN AUTHORIZED CAPITAL STOCK AND SUBSCRIPTIONS THERETO

WHEREAS:

The Board of Directors of the Bank, having undertaken a study of the Bank's future resource requirements in accordance with Resolution No. 270 of the Board of Governors, has submitted a Report thereon to the Board of Governors;

The Board of Governors, having considered such Report and its related appendices and attachments, generally endorses the conclusions embodied therein and has concluded that it is necessary to increase the authorized capital stock of the Bank;

The value of the capital stock of the Bank is expressed in the Articles of Agreement of the Bank "in terms of United States dollars of the weight and fineness in effect on 31 January 1966" (1966 dollars), but the pre-existing legal basis for translating 1966 dollars into current United States dollars or into any other currency has ceased to exist and no decision has been made on the appropriate successor to the 1966 dollar;

NOW, THEREFORE, the Board of Governors hereby

RESOLVES THAT:

The authorized capital stock of the Bank be increased and the shares of capital stock so increased be made available for subscription on the following terms and conditions:

1. Increase in Authorized Capital Stock

1(a) The authorized capital stock of the Bank shall, on the Effective Date as defined in paragraph 4(a) of this Resolution, be increased by 7,092,622 shares, each share having a par value of $10,000 in terms of United States dollars of the weight and fineness in effect on 31 January 1966.

1(b) Of the shares authorized by this Resolution, the number of whole shares up to, but not in excess of, 200 percent of the shares subscribed for by each member immediately prior to the Effective Date, shall be made available for subscription by members in accordance with paragraph 2 of this Resolution.

1(c) The shares authorized by this Resolution which shall not have been subscribed for in accordance with paragraph 2 of this Resolution shall be reserved for initial subscriptions by new members and for special increases in the subscriptions of individual members, as may be determined by the Board of Governors pursuant to paragraphs 1 and 3 of Article 5 of the Articles of Agreement of the Bank.

2. Subscriptions

2(a) Each member shall be entitled to subscribe for, at par, a number of whole shares up to, but not in excess of, 200 percent of the number of shares subscribed for by such member, immediately prior to the Effective Date. Each such subscription shall be on the terms and conditions set forth in this Resolution, and in all events shall comprise paid-in and callable shares in such proportions that 4 percent (as near as may be) of the shares subscribed for shall be whole paid-in shares and the balance shall be callable shares.

2(b) Each member wishing to subscribe pursuant to this Resolution shall deposit with the Bank the following documents in a form acceptable to the Bank:

(i) an instrument of subscription whereby the member subscribes for the number of paid-in and callable shares specified in such instrument;

(ii) a representation that the member has duly taken all legislative and other internal action necessary to enable it to make such subscription; and

(iii) an undertaking that the member will furnish such information as the Bank may request concerning such action.

Such documents shall be deposited on or before 31 December 2010 or such later date as the Board of Directors may determine.

2(c) Each instrument of subscription shall become effective and the subscription thereunder shall be deemed to have been made on the date on which the Bank notifies the subscribing member that the documents deposited by such member pursuant to paragraph 2(b) of this Resolution are satisfactory to the Bank.

3. Payment for Paid-in Shares

3(a) Except as otherwise determined by the Board of Directors, payment for the paid-in shares subscribed for pursuant to this Resolution shall be made in five equal annual installments, provided that:

(i) as determined by the subscribing member, the first installment shall be paid on any of the payment dates of 01 April 2010 or 01 July 2010 or 01 October 2010 or 01 January 2011 or 01 April 2011 that either (x) falls within 90 days after the date on which the member's subscription becomes effective pursuant to paragraph 2(c) of this Resolution, or (y) immediately follows the end of such 90 day period; and the remaining installments shall be paid not later than the respective anniversaries of the first payment date; and

(ii) a member may, after consultation with the Bank, make payments on terms more favorable to the Bank than those stipulated in the foregoing provisions of this paragraph.

3(b) Of each installment, the subscribing members shall pay:

(i) 40 percent in a freely convertible currency which, where such currency is not that of the subscribing member, shall be selected by the member in consultation with the Bank; such payment shall be deemed payable and paid under Article 6, paragraph 2(a), of the Articles of Agreement of the Bank; and

(ii) 60 percent in the currency of the subscribing member; such payment shall be deemed payable and paid under Article 6, paragraph 2(b), of the Articles of Agreement of the Bank; provided that, any notes or obligations payable in freely convertible currencies and accepted by the Bank in accordance with Article 6, paragraph 3, of the Articles of Agreement of the Bank, in lieu of amounts to be paid in the currencies of members under Article 6, paragraph 2(b), shall, subject to the provisions of Article 24, paragraph 2(ii), of the Articles of Agreement of the Bank, be encashed in five equal annual installments, with the first installment to be paid within one year after the date of the last installment pursuant to paragraph 3(a) of this Resolution and the remaining installments to be paid not later than the respective anniversaries of the first payment date.

3(c) Pending a decision on the question of valuation of the Bank's capital stock, payment for the paid-in shares subscribed for pursuant to this Resolution shall be made, at the option of the subscribing member:

(iii) in terms of 12,063.50 current United States dollars per share; or

(iv) in terms of 10,000 Special Drawing Rights (SDR) per share.

The option of the subscribing member to make subscription payments in terms of either US$12,063.50 per share or SDR10,000 per share may be exercised at the time of each installment payment.

All payments made pursuant to the foregoing provisions of this paragraph shall be subject to adjustment when the question of valuation of the Bank's capital stock is resolved.

3(d) Except as otherwise determined by the Board of Directors, the exchange rate to be applied between different currencies or between the SDR and any currency for the purpose of determining subscription payment amounts under this Resolution shall be the rate used by the Bank for translation purposes in its books of account as of the date on which the Bank prepares the relevant billing statement to each subscribing member, such date being usually 30 days prior to the date when payment is due.

3(e) At a subscribing member's request, the Bank may agree with such member to fix the exchange rate to be applied between the USD and the freely convertible currency or between the SDR and the freely convertible currency with respect to any installment amount of freely convertible currencies paid under Article 6, paragraph 2(a), of the Articles of Agreement of the Bank. The exchange rate may be fixed for any installment amount up to a year in advance of the date when payment is due and at a rate to be determined by the Bank. The Bank will give effect to the difference in agreed exchange rate and the exchange rate on which the payment is due on the date when payment of the subsequent installment amount is due; no adjustment will be made for the final installment amount.

3(f) At a subscribing member's request, the Bank may agree with such member to provide a suitable discount for prepayments of any installment amount of freely convertible currencies paid under Article 6 of the Articles of Agreement of the Bank. The member concerned must communicate its request to the Bank at least 45 days prior to the payment date for the first installment as described in paragraph 3(a)(i) of this Resolution. The discount shall be determined on a case by case basis, taking into account, among other factors, appropriate market yield and volatility spread margin for the currency concerned.

4. Other Provisions

4(a) For the purposes of this Resolution, the Effective Date shall be the date on which this Resolution is adopted by the Board of Governors.

4(b) Subject to the provisions of this Resolution, the Articles of Agreement of the Bank shall apply mutatis mutandis to the increase in shares authorized by, and to the subscriptions and payments made under, this Resolution as if such shares were part of the original capital stock of the Bank and such subscriptions and payments were initial subscriptions to and payments for such stock.

FIFTH GENERAL CAPITAL INCREASE[a]
SHARES ALLOCATED FOR SUBSCRIPTION
(Number of Shares)

Members	Share Allocation Before GCI V (a)	Capital Increase at 200% Paid-in at 4%[b] (b)	Callable at 96%[c] (c)	Total (d)	Share Allocation After GCI V (e = a + d)
A. Regional					
Afghanistan	1,195	96	2,294	2,390	3,585
Armenia	10,557	845	20,269	21,114	31,671
Australia	204,740	16,379	393,101	409,480	614,220
Azerbaijan	15,736	1,259	30,213	31,472	47,208
Bangladesh	36,128	2,890	69,366	72,256	108,384
Bhutan	220	18	422	440	660
Brunei Darussalam	12,462	997	23,927	24,924	37,386
Cambodia	1,750	140	3,360	3,500	5,250
China, People's Rep. of	228,000	18,240	437,760	456,000	684,000
Cook Islands	94	8	180	188	282
Fiji Islands	2,406	192	4,620	4,812	7,218
Georgia	12,081	966	23,196	24,162	36,243
Hong Kong, China	19,270	1,542	36,998	38,540	57,810
India	224,010	17,921	430,099	448,020	672,030
Indonesia	192,700	15,416	369,984	385,400	578,100
Japan	552,210	44,177	1,060,243	1,104,420	1,656,630
Kazakhstan	28,536	2,283	54,789	57,072	85,608
Kiribati	142	11	273	284	426
Korea, Republic of	178,246	14,260	342,232	356,492	534,738
Kyrgyz Republic	10,582	847	20,317	21,164	31,746
Lao People's Democratic Rep.	492	39	945	984	1,476
Malaysia	96,350	7,708	184,992	192,700	289,050
Maldives	142	11	273	284	426
Marshall Islands	94	8	180	188	282
Micronesia, Federated States of	142	11	273	284	426
Mongolia	532	43	1,021	1,064	1,596
Myanmar	19,270	1,542	36,998	38,540	57,810
Nauru	142	11	273	284	426
Nepal	5,202	416	9,988	10,404	15,606
New Zealand	54,340	4,347	104,333	108,680	163,020
Pakistan	77,080	6,166	147,994	154,160	231,240
Palau	114	9	219	228	342
Papua New Guinea	3,320	266	6,374	6,640	9,960
Philippines	84,304	6,744	161,864	168,608	252,912
Samoa	116	9	223	232	348
Singapore	12,040	963	23,117	24,080	36,120
Solomon Islands	236	19	453	472	708
Sri Lanka	20,520	1,642	39,398	41,040	61,560
Taipei,China	38,540	3,083	73,997	77,080	115,620
Tajikistan	10,134	811	19,457	20,268	30,402
Thailand	48,174	3,854	92,494	96,348	144,522
Timor-Leste	350	28	672	700	1,050
Tonga	142	11	273	284	426
Turkmenistan	8,958	717	17,199	17,916	26,874
Tuvalu	50	4	96	100	150
Uzbekistan	23,834	1,907	45,761	47,668	71,502
Vanuatu	236	19	453	472	708
Viet Nam	12,076	966	23,186	24,152	36,228
Subtotal (A)	**2,247,995**	**179,841**	**4,316,149**	**4,495,990**	**6,743,985**

GCI = general capital increase.

[a] The proposed increase in the authorized capital stock is based on the sum of allocated proportional shares to each member. Each member is allocated a whole number of proportional shares equivalent to 200% of subscribed shares immediately prior to the effective date of GCI V.

[b] The number of paid-in shares is 4% of the shares allocated for subscription. Fractions of shares of 0.50 or more are rounded to the next higher number.

[c] The number of callable shares is the difference between the total number of allocated shares and the number of paid-in shares determined according to footnote b above. In the event of a member subscribing to a smaller number of shares than those allocated in the Schedule, the ratio of 4:96 between paid-in shares and callable shares must be maintained.

Source: Treasury Department, Asian Development Bank.

Fifth General Capital Increase Shares Allocated for Subscription—Continued

Members	Share Allocation Before GCI V (a)	Capital Increase at 200% Paid-in at 4%[b] (b)	Callable at 96%[c] (c)	Total (d)	Share Allocation After GCI V (e = a + d)
B. Nonregional					
Austria	12,040	963	23,117	24,080	36,120
Belgium	12,040	963	23,117	24,080	36,120
Canada	185,086	14,807	355,365	370,172	555,258
Denmark	12,040	963	23,117	24,080	36,120
Finland	12,040	963	23,117	24,080	36,120
France	82,356	6,588	158,124	164,712	247,068
Germany	153,068	12,245	293,891	306,136	459,204
Ireland	12,040	963	23,117	24,080	36,120
Italy	63,950	5,116	122,784	127,900	191,850
Luxembourg	12,040	963	23,117	24,080	36,120
The Netherlands	36,294	2,904	69,684	72,588	108,882
Norway	12,040	963	23,117	24,080	36,120
Portugal	12,040	963	23,117	24,080	36,120
Spain	12,040	963	23,117	24,080	36,120
Sweden	12,040	963	23,117	24,080	36,120
Switzerland	20,650	1,652	39,648	41,300	61,950
Turkey	12,040	963	23,117	24,080	36,120
United Kingdom	72,262	5,781	138,743	144,524	216,786
United States	552,210	44,177	1,060,243	1,104,420	1,656,630
Subtotal (B)	**1,298,316**	**103,863**	**2,492,769**	**2,596,632**	**3,894,948**
Total (A + B)	**3,546,311**	**283,704**	**6,808,918**	**7,092,622**	**10,638,933**

GCI = general capital increase.

[a] The proposed increase in the authorized capital stock is based on the sum of allocated proportional shares to each member. Each member is allocated a whole number of proportional shares equivalent to 200% of subscribed shares immediately prior to the effective date of GCI V.

[b] The number of paid-in shares is 4% of the shares allocated for subscription. Fractions of shares of 0.50 or more are rounded to the next higher number.

[c] The number of callable shares is the difference between the total number of allocated shares and the number of paid-in shares determined according to footnote b above. In the event of a member subscribing to a smaller number of shares than those allocated in the Schedule, the ratio of 4:96 between paid-in shares and callable shares must be maintained.

Source: Treasury Department, Asian Development Bank.