Independent Evaluation ADB

Relevance and Results of Concessional Finance: Asian Development Fund XI and 12

RECOMMENDATIONS

1. Separate the allocation of grants from the allocation of concessional ordinary capital resources lending and reconsider the use of performance-based allocation (PBA) in these processes.
2. Streamline grant set-asides: (i) establish a crisis response window that covers a wider definition of crisis response; (ii) consolidate the regional health security set-aside with the regional pool; and (iii) incentivize the mainstreaming of disaster risk reduction, climate change adaptation, and gender equality as part of good development practice.
3. Scale up support for private sector development (PSD) in countries eligible for concessional assistance and use a more coherent approach: (i) introduce a blended finance window to derisk nonsovereign operations (NSOs) in concessional assistance countries; (ii) create an institutional PSD focal point to strengthen internal PSD coordination, PSD links with NSOs, and PSD analysis in country partnership strategies; and (iii) redefine the monitoring of PSD targets to ensure attention to outputs and outcomes.
4. Increase ADB support and secure additional resources for adaptation to climate change in ADF countries, especially in small island developing states (SIDS) where adaptation costs are high due to limited economic alternatives.
5. Tailor ADB systems to match the needs of fragile and conflict-affected situations (FCAS) and SIDS: (i) dedicate resources to a centralized FCAS function to support operations, knowledge, and systems; (ii) adopt targets for FCAS and SIDS which are differentiated from corporate targets that apply to ordinary capital resources operations; (iii) enhance monitoring, evaluation, and reporting on results in FCAS and SIDS; and (iv) ensure enough staff are deployed on the ground.
6. Continue to provide a post-conflict special allocation for Afghanistan while further adapting implementation arrangements to meet the FCAS nature of the country and carefully monitoring fiduciary risks to enhance development impact.

This evaluation assesses the relevance and results of the use of concessional resources by the Asian Development Bank (ADB) over 2013–2018, the period covered by Asian Development Fund (ADF) XI and the first half of ADF 12. Concessional loans and ADF grants amounted to nearly $21 billion over 2013–2018. ADF XI provided $10.4 billion in concessional loans, $2.5 billion in ADF grants from 2013–2016, and in the first years of ADF 12, ADB committed $6.1 billion in concessional ordinary capital resources loan, and $1.6 billion in ADF grants. Following the transfer of ADF lending operations to ADB's OCR balance sheet in January 2017, ADF 12 became a smaller grant-only facility of $3.3 billion, with grants to 15 countries, mainly small island developing states and fragile and conflict-affected situations. ADF also provides set-asides to a wider group of countries—grant allocations to finance specific development objectives.

KEY MESSAGES

There is a strong rationale for continuing to provide concessional loans and grants to the Asia and Pacific region. ADB's use of concessional resources and the development results that they have contributed to since they were introduced nearly 5 decades ago have been significant. However, Asia and the Pacific remains vulnerable to climate change and natural hazards and without accelerated efforts, is unlikely to meet the 17 Sustainable Development Goals (SDGs) by 2030. Poverty gains could easily reverse. The need to achieve the SDGs provides a strong rationale for continuing to finance concessional loans and grants.

The Asian Development Bank project performance and results achieved so far in ADF XI and 12 are stronger than for previous Asian Development Fund (ADF) periods. However, since ADF is now a grant-only facility, its main beneficiaries are fragile and conflict-affected situations (FCAS) and/or small island development states (SIDS), countries with extremely challenging development contexts, where results are much harder to achieve. This increases ADF relevance but also the challenges in achieving development effectiveness of channeling ADF grant resources through business processes primarily designed for concessional and nonconcessional loans to larger and more advanced countries.

The performance-based allocation system (PBA) is not effective in allocating grants for the current group of grant beneficiary countries. Most grant recipient countries receive allocations as exceptions to the PBA because they are either FCAS and/or SIDS. In each case, the PBA allocation needs to be supplemented to ensure meaningful support to these countries. In addition, about one-third of grants is allocated through thematic set-asides, i.e., financing that is made available for specific objectives independent of the PBA or base allocations and to a wider group of countries.

There is an opportunity to leverage private investment in countries eligible for concessional assistance using blended finance. Private sector development (PSD) through nonsovereign operations (NSOs) is a key objective for ADB, but few NSOs have been undertaken in ADF countries because of the high risk of doing so. Both the International Development Association and the African Development Bank have used blended finance and ADB could draw lessons from their experience in developing a similar window.

Fragile and conflict situations in the Asia and Pacific region are not being well addressed by ADB in ADF and non-ADF countries. Fragile and conflict situations are identified through the application of the country performance assessment which is conducted for all concessional assistance countries. This means that ordinary capital resources (OCR) countries with fragile situations are not identified as FCAS.

The refinement of ADF as a grant-only facility has institutional implications especially in relation to staffing and organizational incentives. Concessional resources use the same institutional systems, processes, rules, and staff as nonconcessional resources. Now that ADF is a grant facility focused on countries with highly complex development challenges, the same institutional procedures may no longer be appropriate. The expectation that ADB programs in FCAS and SIDS can meet the same institutional performance targets and standards as other country programs creates the wrong incentives in that it prioritizes approvals and disbursement over finding different and more effective ways of operating in contexts which are highly complex.

ISSUES

Based on current trajectories, Asia and the Pacific will not achieve any of the 17 SDGs by 2030. While most multilateral development banks (MDBs), including ADB, have adopted the SDGs as their overarching results framework, it is unclear what practical changes have resulted in the concessional finance architecture because of the SDGs.

ADF as a grant-only facility is now focused on a smaller group of countries where: (i) significant exceptions to the PBA are required, and (ii) it is much harder to achieve development results using ADB standard business processes. Of the 15 countries eligible for ADF grants, 12 receive allocations that to a significant extent are not performance-based. The same 15 countries that receive country-based grant allocations also receive allocations through a growing pool of funding from thematic set-asides regardless of their capacity to implement. The extent to which the seven ADF priority development objectives apply only to the 15 grant recipient countries needs explicit consideration, particularly given the constraints that these countries face.

The Disaster Response Facility (DRF) is not available to all of the small disaster-prone Pacific island countries that are also highly vulnerable to climate change. Nor could it be used to respond to crises such as the situation facing the Rohingya refugees along the border between Myanmar and Bangladesh (ADB did respond but not through the DRF). Climate change means that many more areas are likely to experience extreme conditions with severe consequences. When set against Strategy 2030 objectives, ADB's staffing capacity in relation to disaster risk management is limited.

The risks associated with NSOs in FCAS and SIDS are high. A blended finance window could provide new opportunities to derisk NSO with high value in terms of achieving the SDGs. The well-known challenges of mixing concessional and commercial financing need to be overcome by establishing new institutional arrangements and calibrating the size of the support to an implementable scale of activities. This means the initial window may need to start small, especially if blended finance is limited to concessional assistance-only countries.

SIDS face sustainability challenges, particularly as a result of climate change, that are not being adequately addressed by the ADF approach to resource allocation. Climate change impact in the Pacific requires a greater focus on adaptation in these countries, although this is likely to be more costly than in other countries due to the limited development alternatives given the small size of these countries' economies and their limited institutional capacity.

ADB is not applying a comprehensive approach to conflict as a development problem in the region. While FCAS countries are identified through their country performance assessments, in line with the approach of other MDBs, these assessments are not conducted by ADB in OCR countries. This means that OCR countries with subnational conflicts, the most common type of conflict in Asia, are not recognized as having fragile situations. While this goes beyond the scope of the current ADF, it suggests that ADB does not have an institution wide FCAS approach. A differentiated approach for these countries is a key feature of Strategy 2030.

ADB's current monitoring and evaluation processes may not be adequate for learning, accountability, and reporting purposes in FCAS and SIDS, the main grant recipient countries. Assessing development results in FCAS and SIDS is challenging. Country conditions can be volatile, ADF programs in Afghanistan and Myanmar are relatively new, ADF allocations to the Pacific have historically been very small, and disbursement ratios are low, so there are few project completion report validation reports per country and over time. As 11 Pacific countries also share a common country partnership strategy, separate country assistance program evaluations are not conducted. ADB's current monitoring and evaluation processes therefore may be inadequate for learning and accountability purposes in FCAS and SIDS, and results in these countries are therefore unlikely to be reflected in ADB's corporate scorecard.