Partnership Strategies to Develop Infrastructure, Increase Economic Growth, and Reduce Poverty in Asia and the Pacific

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By Gregory R. Gajewski and Tanya Bathiche[1]

1. Introduction

Coordination between donors, developing member country (DMC) governments, local governments, and key stakeholder groups is critical for progress towards the millennium development goals (MDGs). The Asian Development Bank's (ADB) overarching development objective—poverty reduction in Asia and the Pacific—is supported by three pillars: pro-poor sustainable economic growth, inclusive social development, and good governance. Infrastructure development is a necessary precondition to sustainable pro-poor economic growth which will ensure that more people are lifted out of poverty. This paper outlines the key issues, challenges, and opportunities in infrastructure development. Broad infrastructure needs facing Asia and the Pacific today and for the next decade are illustrated in the second section. It is followed by the third section explaining how infrastructure is critically linked to economic growth, poverty reduction, and achieving the MDGs. The fourth section describes ADB's commitment to help its DMCs to achieve the MDGs through infrastructure development. The fifth section also covers some recent innovations at ADB that will help it to be more effective in helping its DMCs reach the MDGs. The sixth explains the results agenda and donor coordination. The seventh section covers policy, strategy, regulatory and financing issues. Here the importance of having a modern institutional structure governing infrastructure is stressed. The eighth section presents some of ADB's successes in taking a regional approach to development and poverty reduction. The ninth section covers integration of stakeholders, including the governments' of the DMCs, and donor coordination, in developing ADB's programs. Here we discuss the importance of the recent Paris Declaration on Aid Effectiveness in moving ahead the agenda for developing-partner coordination with the recipient developing country. The tenth section examines key cross-cutting issues, such as good governance, capacity building, and inclusiveness. The paper has an Annex on ADB's efforts to promote clean energy through global emissions trading in Asia and the Pacific.

2. Infrastructure Needs in Asia

The estimates for infrastructure required to meet the projected economic growth in Asia and the Pacific vary between $2 trillion and $3 trillion over the next decade. About 65% of this would be for new investment, and the remainder for maintenance. The infrastructure included here are projects in the water, energy, and transportation sectors. These estimates suggest that there is an excess demand for infrastructure in Asia and the Pacific and that the rates of return on such projects are very high. This backlog of infrastructure projects is required to provide the bedrock for the DMCs to grow, reduce poverty, and achieve the MDGs.

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Recently, ADB and other development banks have reemphasized the importance of financing for infrastructure projects. Over the period, ADB's infrastructure financing has evolved from mere bricks and mortar stage to a more comprehensive development package. ADB is committed to assist in infrastructure development using higher standards for environmental protection, resettlement, governance, and anti-corruption. ADB will work with DMCs to ensure that its infrastructure assistance in each country fits the country's approach and priorities. Each country develops infrastructure in a different way. For example, in the People's Republic of China (PRC), infrastructure is planned and developed ahead of economic growth so as to act as a catalyst to growth. In some other DMCs, the approach is more demand-driven, where infrastructure projects are put in place when it becomes apparent that the lack of infrastructure is impeding growth and poverty reduction.

3. Developing Infrastructure is Key to Reducing Poverty and Reaching the MDGs

Many studies confirm that infrastructure development is the foundation for growth and poverty reduction in Asia and the Pacific. ADB and all development partners have agreed and committed to help DMCs reach the MDGs, which are the most widely agreed global development objectives. The MDGs are objectives and, as such, require strategies, projects, and policy reforms to attain these objectives. Surveys of the poor in Asia and the Pacific (and other countries in the developing world) suggest the following order of ranking of their needs: (i) adequate food; (ii) drinking water and water for sanitation; (iii) transportation for market activities, access to schools and hospitals, social functions, and political connections to the rest of the country; and (iv) electricity to power homes and in many cases their planned irrigation projects. All these point to the need for water, transport, and energy infrastructure projects that will help the poor move out of poverty, and help the DMCs meet the MDGs.

The links between better roads and water systems, and poverty reduction and economic growth are clear. With energy projects, the links to poverty reduction are more difficult to pinpoint, although the links to economic growth are clear. Energy projects most often do not meet the strict ADB classification as poverty reduction projects. Yet energy projects—by bringing light and heat to the poor households—improve the poor's ability to reach higher educational levels and have a better quality of life. Energy projects also provide power to irrigation projects and other industries that require power for economic growth. This economic growth boosts employment and trade, increasing the demand for all types of labor (including jobs for the poor) in different regions of the country and neighboring countries. Thus, while it is difficult to justify energy projects as tools to reduce poverty in a direct sense, or using narrow definitions of the beneficiary groups, these types of project are pro-poor as well. For these reasons, several experts consider energy as a missing MDG.

Statistical studies in a number of countries, different projects, and various time periods show that increasing the supply of infrastructure reduces poverty and promotes economic growth. Providing well-operated road, water, and power systems accelerate economic growth, poverty reduction, and progress toward reaching the MDGs. However, these studies also show that the positive linkages between increases in infrastructure supply, poverty reduction, and economic growth differ depending on many factors. One of the key factors is the strength of the institutions that build and manage the infrastructure. ADB is increasing its emphasis on this aspect of infrastructure development through new programs on governance and capacity building.

4. ADB is Committed and Actively Pursuing the MDGs

In September 2000 at its Development Summit, the United Nations unanimously adopted the MDGs. These goals—which include the eradication of extreme poverty and hunger, achievement of universal primary education, promotion of gender equality, reduction of child mortality, improvement of maternal health, combating HIV/AIDS and malaria, providing access to safe water, and ensuring environmental sustainability—enshrine poverty reduction as the overarching objective of development. What gives the MDGs their distinctiveness is their focus on results through quantitative and time-bound targets and their emphasis on joint accountability between developed and developing countries for achieving results.

ADB is committed to helping its DMCs to achieve the MDGs. ADB's commitment to MDGs is also reflected in its Poverty Reduction Strategy (PRS), which state that poverty reduction is an overarching objective of ADB operations.

5. Innovation and Efficiency Initiative

As the circumstances in DMCs change, so too must ADB change to be more efficient in spurring economic growth, trade, and poverty reduction. ADB is currently changing how it delivers its interventions in a faster manner, with stronger safeguard policies and more innovative financing options for development projects.

ADB's Board of Directors approved in 2005 the Innovation and Efficiency Initiative (IEI), which is designed to remove bottlenecks in business processes and increase an array of services. It aims to ensure that ADB is client- and results-oriented, efficient, and effective. The IEI focuses on changes in (i) country strategies to improve strategic clarity and results-orientation; (ii) business processes related to the efficient conversion of the project pipeline into investment and non-investment operations; (iii) procurement; (iv) cost-sharing and expenditure eligibility; (v) financial instruments and modalities; and (vi) safeguards.

ADB's strength is its ability to provide both finance and expertise. ADB offers not only loans, risk mitigation guarantees, and equity finance products but also sector knowledge and partnership with countries in the region. To package these assets more effectively, ADB is streamlining its business processes. In particular, the country programming exercise will be strengthened and the project due diligence tasks will be better sequenced. This approach will improve ADB's ability to respond to client needs efficiently and effectively.

ADB has also made changes in cost sharing and expenditure eligibility. For example, ADB will no longer distinguish between local and foreign exchange cost categories at the level of investment plans, but instead will focus on the financing plan itself.

Pilot testing is being done for five new financing instruments and modalities, including a multi-tranche financing facility; direct financing to sub-sovereign, and state-owned enterprises; local currency financing for both public and private sector; a refinancing facility to allow for restructuring and/or expansion of projects; and new forms of cofinancing.

Safeguard policies are central to achieving ADB's mission of sustained development and poverty reduction. ADB is examining the possibility of integrating the existing safeguard policies, focusing greater resources on implementation, and strengthening the capacity of DMCs and resident missions to deliver the safeguard mandate more effectively. The aim is to perform more and better safeguards assessments upfront, keeping ADB in line with best practices in the area.

6. Reform Agenda and Donor Coordination

An ADB working group identified the following activities related to the global reform agenda, including the MDGs and the results of the Paris Declaration on Aid Effectiveness:

- aligning ADB's reform agenda with the national strategies of DMCs;
- establishing indicators on MDGs and poverty reduction, and relevant ADB mandate-related indicators;
- developing DMC capacity to adopt managing for development results (MfDR) processes;
- developing results-based country strategies and programs (CSPs);
- adopting a results-based management process in ADB's economic and sector work;
- harmonizing ADB's reform agenda with those of other international organizations, multilateral development banks (MDBs), and donors; and
- creating a corporate environment and system for ADB-wide implementation of the reform agenda to make ADB be more responsive, more relevant, and more results-oriented.

A number of solutions to achieve results-based management have been put forward. ADB is becoming increasingly results-oriented to make demonstrable improvements in the development impact of operations. The series of management reforms to enhance openness, accountability, and responsiveness include

- establishing a Results Management Unit;
- developing strategic and operational processes/procedures for MfDR;
- mainstreaming MfDR throughout ADB;
- improving human resource management systems and processes and implementing a new human resource strategy;
- aligning operational policies, strategies, and approaches with ADB's key strategic agenda including the enhanced PRS and Long-Term Strategic Framework; and
- improving ADB's approaches to support capacity development in DMCs.

Another important aspect is donor coordination and agreement on the overall approach to infrastructure development. ADB now coordinates more closely with the major donors active in each of its DMCs when preparing CSPs and also aims in the CSPs to match objectives of ADB and DMCs. CSPs lay out the proposed country program by sector for a 5-year period, and are updated annually with a 3-year rolling program of lending and other interventions. As part of the internal reform process, ADB is shifting to less formal annual updates, and a mid-term review of the strategy. Moreover, together with the World Bank and the Japan Bank for International Cooperation (JBIC), ADB has prepared an overall general approach to infrastructure development that uses a "new framework," that focuses on inclusive development, coordination, and accountability and risk management has been prepared. This is given in the new publication *Connecting East Asia: A New Framework for Infrastructure*.

7. Policy, Strategy, Regulatory, and Financing Issues in Providing Needed Infrastructure

DMCs' policies define commitments and set strategies and priorities for the development and maintenance of infrastructure. Policy issues also involve the political economy of infrastructure, i.e., what groups will get the most benefits and who will bear the costs. A strongly related issue is the capability of institutions to provide and maintain the infrastructure and the flow of services from the infrastructure. The policy-making process, the determination of who bears the costs and benefits, and the ability of regulatory and service-providing institutions to adopt more modern management techniques will determine the extent to which infrastructure projects promote growth and reduce poverty. ADB works with stakeholders, governments, and other donors to help improve the policy-making process, influence the political economy of infrastructure, and strengthen and modernize the institutions that provide infrastructure and its services, so that these sectors become more efficient, and have a stronger impact on poverty reduction.

a. Strategy Issues

Overall, ADB assists in shaping the strategy for infrastructure development by having in-country staff work with local stakeholders and governments. ADB integrates the views of national stakeholders and other donors are integrated to help forge strategies for development in each infrastructure sector. From this process, ADB is able to develop CSPs that detail where ADB's loans, grants, and technical assistance fit in with the government's and other stakeholders' perspectives. Paramount through all these processes is reaching the MDGs and specifically reducing poverty.

Below are summaries of ADB's overall strategy by infrastructure sector. These strategies are tailored in the context of the concerned DMC and include the importance and benefits to the DMC.

Energy Strategy

ADB's goal in the energy sector is to increase the availability of energy in a least-cost and environmentally and socially sustainable manner and to improve access to energy for people in its DMCs, particularly the poor. In pursuing this goal, ADB undertakes interventions in the energy sector that will support the overarching objective of poverty reduction. The operational priorities particularly relevant to the energy sector are (i) environmental protection, (ii) good governance, (iii) private sector development, and (iv) regional and subregional cooperation. Environmental improvements are promoted by supporting end-use efficiency, promoting renewable energy, improving technical efficiencies, and switching to cleaner fuels. Other interventions include efficiency through well-sequenced restructuring processes and the creation of an enabling environment for private sector investment that will facilitate development of competitive markets.

Special attention is given to increasing access to energy for the poor, particularly in rural areas. Investments in the rural energy sector aim to have a direct impact on employment generation by opening opportunities for small and medium enterprises. The availability of environmentally clean forms of energy in rural households as replacement for firewood and biomass will help reduce indoor pollution and contain its adverse impact on health, particularly for women. Through access to electricity and other forms of modern energy, communities will be able to improve various facilities that benefit the poor, such as basic education and primary health care, and increase economic opportunities by raising productivity through the use of mechanized implements. A cleaner environment based on less polluting energy generation will be encouraged to benefit all. Through these various approaches, ADB's energy sector assistance will aim to improve the quality of life of the people, particularly of the poor, in DMCs.

Water Strategy

ADB's water strategy is premised on the Asia and Pacific region's urgent need to formulate and implement integrated, cross-sectoral approaches to water management and development. It seeks to promote the concept of water as a socially vital economic good that needs increasingly careful management to sustain equitable economic growth and to reduce poverty. The conservation and protection of water resources in the region through a participatory approach are at the heart of the policy.

ADB's water strategy has the following key elements:

- promote a national focus on water sector reform;
- foster the integrated management of water resources;
- improve and expand the delivery of water services;
- foster the conservation of water and increase system efficiencies;
- promote regional cooperation and increase the mutually beneficial use of shared water resources within and between countries;
- facilitate the exchange of water sector information and experience; and
- improve governance.

ADB has provided support to a few countries to conduct comprehensive water sector assessments, which are a basic prerequisite for crafting effective national water policies and reforms. ADB has established the Cooperation Fund for the Water Sector (CFWS) to further promote ADB's water initiatives and to finance water sector assessments and policy dialogues between ADB and DMCs that have prioritized the water sector in their development agenda. The CFWS is widely considered within ADB as a significant mechanism for supporting water sector needs and priorities.

Transport Strategy

ADB's goal in the transport sector is to promote equitable and inclusive economic growth through improving access to markets, social services, and information, for people in its DMCs, particularly the poor. In pursuing this goal, ADB undertakes interventions in the transport sector that will support the overarching objective of poverty reduction. The ADB's operational strategies in the transport sector are the (i) establishment of national transport network that all people have access to quality services, (ii) promotion of technical efficiency in transport, (iii) strengthening of institutions to increase the efficiency in transport provision and management, (iv) good governance, (v) promotion of road safety and the reduction of vehicle emissions, (vi) private sector participation in transport, and (vii) regional cooperation.

Due attention is given to maximize the project benefits going to the poor. Transport interventions aim to directly improve the living conditions of the poor, as well as to diversify their sources of income and help increase their productivity. The construction or improvement of transport lowers transport costs, cuts travel time, and enhances the quality of transport services. In turn, transport encourages villagers to travel to markets, make more frequent use of educational and health facilities, and avail themselves of agricultural extension services. Reliable access to input and output markets stimulates higher levels of production in cash crop farming, thereby speeding up the transition from subsistence farming to a market economy. In addition, by reducing the distance that people have to travel to reach major roads, quality transport helps diversify income sources, raise the productivity of poor households, and promote contact with other regions. The development of transport infrastructure is therefore critical for promoting efficient and sustainable economic growth and poverty reduction especially in rural areas and in the country as a whole.

Environmental Strategy

Environmental and social safeguard requirements are important in promoting sustainable infrastructure development. Each proposed project must have a high-quality environmental and social investigation; and if warranted, comprehensive impact assessments and mitigation plans must be incorporated into the project preparation and implementation processes. The overall objective of these policies is to avoid, minimize, or mitigate adverse environmental impacts, social costs to third parties, or marginalization of vulnerable groups that may result from infrastructure development projects. Increasingly, the key stakeholders such as the host governments and projects sponsors engaged in infrastructure development are recognizing the importance of effective environmental and social safeguards. As a result, the environmental and social mitigation plans are now being regarded as integral to project development. Costs associated with environmental and social impact mitigation are generally packaged as part of the project cost and are being implemented during construction and monitored throughout the life of the project cycle.

Despite the improvements achieved so far, the effects of infrastructure projects on the regional and global picture is not always positive. Motor vehicles, power plants, and ships emit sulfur oxides, carbon wastes, and other polluting chemical compounds. This is where developing the market to internalize environmental externalities, such as trading sulfur oxides or carbon emissions can play a key role. This requires building new institutions and strengthening the existing institutions in DMCs. For example, the European Union has a well-developed market for carbon emissions trading but for DMCs, the capacity to measure emissions, much less be able to market their emissions rights as under the *Kyoto Protocol* (see Annex) is inadequate.

Targeting the Poor through Policy Implementation

ADB strategies are implemented through projects that are customized to address the needs of a particular DMC. Utilizing an effective strategy involves targeting who benefits and who bears the cost for these projects. Where relevant, while designing the projects, ADB makes necessary assessments on poverty and MDG aspects of the project. In some cases, ADB has also used distribution and poverty impact analysis for infrastructure projects. This type of analysis can also shape a project performance monitoring system to ensure that the expected share of the benefits reaches the poor as the project is implemented. In addition, by showing the project's net benefits, the results can be used to help shape the design of future projects of a similar nature.

b. Regulatory Issues

Historically, infrastructure was provided by the public sector due to the natural monopoly of these services or lack of adequate returns to potential private sector suppliers. All players involved at that time were public sector institutions and employees, whose relationship was defined and regulated by the governments. New technologies and management practices allow the infusion of competition in infrastructure by unbundling natural monopolies and increasing the ability of private firms to make a reasonable return. At the same time, the entry of the private sector in providing the infrastructure required new and independent regulatory institutions that could govern the public-private and private-private relationships involved in the business. These regulatory institutions need adequate capacity, fairness, and credibility to generate private sector confidence. Thus, institutional and regulatory issues dominate how efficient infrastructure is built and services delivered.

Often new institutions and regulatory frameworks in DMCs lack capacity or need to establish a strong track record to elicit strong private sector interest in the related infrastructure projects. Existing institutions need to be strengthened to reduce the perceived risk by private investors. Further, new institutional arrangements need to be built in several areas to increase the role of private sector in providing infrastructure. However, virtually all DMCs have a long way to go to reach this goal. As mentioned earlier, ADB has several pilot projects promoting private-sector participation in providing infrastructure services, which involve building or strengthening such institutional frameworks.

For transport projects, weak institutional capacity and low regulatory standards will often result in lack of private financing in this sector. They can also result in creation of roads that do not serve the poor adequately. As the institutions and regulatory framework improve, a road management plan and a rolling maintenance program are developed and used by the public roads authority to implement its works. These plans and programs apply transport economics, and the issue is to ensure that the roads authority has the capacity to manage and update these tools. Eventually, as the country develops, the roads authority will use a competitive process to allow a concession to levy toll on a high-traffic volume road.

For water projects, the story is similar. The weaker the institutions and regulatory environments, the more high-cost the projects will be, and the more unlikely for them to be financially viable for the private sector to build or operate them. At the most advanced level, the water utilities will be owned by private companies, works will be carried out by private companies using competitive bidding procedures, and water tariffs will be set for better cost recovery. The utilities will have good maintenance plans so that leakages from the system are minimized. In remote areas, water users groups will help provide and maintain water systems in a participatory function. The government will assume regulatory functions or independent regulatory institutions will be establish to ensure that the utilities do not set tariffs based on their monopolistic positions. Further, advancements includes planning water use on a river basin basis, and managing water resources in an integrated manner. While discount tariffs can be set for the poor, there can be other more efficient ways to help the poor.

Energy systems show the same basic pattern as water and transport. If institutional arrangements and regulatory environment are stronger, the private sector will play a greater role. Meters will measure users' consumption accurately, service will be good, and price will be set to cover costs. Going from a fully government-owned and -operated system to one in which the private sector plays a large and appropriate role is a difficult transition. Interventions must be tailored to the degree of development in the DMC, and its absorptive capacity to enact proposed reforms.

c. Financing Issues—Critical To Balance Cost Recovery with Poverty Reduction and Institutional Strengthening

Financing of infrastructure comes down to either the users paying the cost, or the taxpayers paying the cost, or some mix of these two. Donors finance a fraction of the infrastructure needs in Asia and the Pacific, varying from country to country. The main problem is to mobilize private funds, and reform the institutional structures in the DMCs to allow the private sector to play a major role in providing infrastructure. The key is not the ownership or financing methods, but how to balance the risks and rewards so that both the public and private sectors benefit, and the consumers are served. Most important, the poor must be served if they are to escape poverty. While this approach on heavily involving the private sector in the provision of infrastructure is evident in developed countries, this is not so in Asia and the Pacific. Still there are cases, such as Malaysia and Thailand, where local currency denominated bonds have been floated with ADB's assistance to help shoulder the cost of infrastructure provision. In addition, public-private partnerships (PPP) have been established where the private sector is quite involved in providing infrastructure services. Still, the public sector will have to raise the bulk of the funds for infrastructure through taxes and nationally-backed bonds.

The private sector was more involved in infrastructure finance before the 1997 Asian financial crisis, and since then has not completely recovered its interest in these types of investments in the region primarily because of uncertainties. While the financial markets have stabilized, the regulatory reforms undertaken since 1997 have not changed the incentives for the private sector to boost its financing of infrastructure. Privatization has been slow, governments have been unpredictable, property rights for private investors remain unclear, and many private sector deals were tainted with corruption. Moreover, these types of arrangements between the public and private sectors are difficult to structure. The intricacies and difficulties of PPPs are discussed below.

While forming PPPs is promising, it is worth mentioning that about 50% of these deals never reach the financing stage. Of those financed, about half need to be renegotiated as the projects are built and implemented. The keys to PPPs are that the private sector can lower the cost of construction and operation, and can share the project risks with the public sector. The nature of these partnerships will depend on the expected returns. Where the returns are large, such as a new ring road around Bangkok, private investments in construction of the project may be feasible. In other cases, private participation may be limited to operation and maintenance. The governments need to plan private sector participation based on these considerations. Transfer of ownership is not necessarily the key issue in PPP. Rather the efficient building, maintenance, and management of the asset are the key issues. The next very important feature is how future renegotiations of the PPP will be done: experience suggests that the private partner wants a renegotiation when they incorrectly underestimated the project risk and want greater public sector support. At the same time, if the private partner overestimated the risk, or realizes larger-than-expected returns, the public partner should also have the right contractually to renegotiate the deal so that the returns and risks are equitably shared.

Private sector participation will be much more substantial when the legal and regulatory environment is strengthened and developed further. However, the private sector must see that these rules are used impartially and consistently before private resources will be used to support infrastructure projects. As the DMCs move closer to these goals, ADB sees a bright future for PPPs in infrastructure finance.

Still, given the public good nature of several infrastructure, the public sector has a continuing role to provide infrastructure. The public sector must always provide certain functions. Most roads in DMCs fall into this category. Experience also suggests that while the public sector has a continuing role in infrastructure provision, greater private sector participation promises higher efficiency and additional finances.

d. Other Institutional Strengthening

Apart from the regulatory framework, other related institutions need to be strengthened so that the private sector can take its appropriate role in providing infrastructure. For example, foreign purchase of local municipal bonds or foreign deposits into banks, which specialize in mobilizing private capital for infrastructure projects managed by the public sector in DMCs, need to have strict capital requirements and regulations that meet international standards.

Processes to bring about good governance and institutional strengthening are complex and very context-specific. The country and institutions at hand need to be carefully analyzed before developing and applying programs to improve governance. While there is a high degree of emphasis on improving institutions in the central governments, most countries are going through a process of devolution of authority to the local government units (LGUs). These LGUs often suddenly find themselves with the responsibility of providing infrastructure and related services; they lack the capacity to manage these new responsibilities and the power to raise revenue to support the new requirements of their communities. A balanced approach is needed in supporting those institutions with the greatest needs. In the Philippines, for example, the LGUs are responsible for building and maintaining the sub-national roads in their districts and sub-districts, but they lack the capacity and acceptable revenue-raising methods to fulfill this role. ADB needs to play a greater role to support the LGUs. These need to be tailored to the context of the local situation and the national government's macroeconomic situation.

8. A Regional Approach Throughout Asia

ADB encourages regional economic cooperation and integration by providing infrastructure and supporting activities to its DMCs. In 1994, ADB approved a policy that formalized its role as a catalyst for regional cooperation. ADB's Poverty Reduction Strategy and Long-Term Strategic Framework for 2001–2015 formally identified regional cooperation as a core component of its overarching goal to reduce poverty.

ADB's long association in the Asia and Pacific region allows it to play a constructive, often pivotal, role in promoting, developing, and supporting regional cooperation initiatives. Regional technical assistance projects have been financed to promote regional cooperation for many sectors. Below are some details on ADB's major regional programs in infrastructure integration. The deciding factor on the success of these initiatives is the political support from governments in the region. The Greater Mekong Subregion (GMS) economic cooperation program has been quite successful partly due to ADB's assistance in building trust and confidence among the subregion's governments. More work needs to be done with governments in other subregions to ensure successful outcomes.

Central Asian Regional Economic Cooperation (CAREC) Program

The CAREC Program includes Afghanistan, Azerbaijan, PRC (Xinjiang Uygur Autonomous Region), Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, and Uzbekistan. These countries are all landlocked, particularly Uzbekistan. Existing regional cooperation programs and initiatives in Central Asia include Economic Cooperation Organization, Central Asia Cooperation Organization, Commonwealth of Independent States, Eurasian Economic Community, Special Program for the Economies of Central Asia, Black Sea Economic Cooperation, and Shanghai Cooperation Organization.

The overall objective of the CAREC Program is to promote economic growth and raise living standards by encouraging economic cooperation in Central Asia. The program focuses on financing infrastructure projects and improving the policy environment to promote cross-border activities in four priority areas:

- transport (especially road transport);
- energy (including the water-energy nexus);
- trade policy; and
- trade facilitation (especially customs cooperation).

The main challenges in promoting regional cooperation are

- a perception of inequitable distribution of benefits from investments for regional projects;
- weak political will, and absence of mutual trust and ownership by governments;
- relatively poor government capacity for intraregional cooperation in most CAREC member countries; and
- sensitivity to national sovereignty and the pursuit of national self-reliance.

Concerted efforts are required to improve the incentives for cooperation. To create a conducive environment for effective regional cooperation, CAREC has supported initiatives to establish an efficient subregional transport infrastructure, rehabilitate energy networks, improve restoration of irrigation systems, establish seamless transit across the region, and develop regional markets. Joint action of the countries in the subregion is needed to realize gains and raise the living standards of the people.

Greater Mekong Subregion (GMS) Economic Cooperation Program

The GMS includes Cambodia, PRC (Guanxi and Yunnan Provinces), Lao People's Democratic Republic (Lao PDR), Myanmar, Thailand, and Viet Nam. A combination of rich natural and human resources make the GMS an area of enormous economic potential, yet about three fourths of its people remain poor. Of the 255 million people living in the region, about 35 million people—one in every seven—are undernourished. Many GMS countries are in transition from centrally planned to market economies, while Thailand lies in the other end of spectrum being a strong market economy. The greatest accomplishment of the GMS Program has been the confidence building and strengthening the sense of community among its member countries.

Since 1992, GMS countries have taken efforts to promote development by establishing closer linkages among themselves through both infrastructure development and multi-country agreements and reforms. The first GMS Summit, held in 2002, endorsed the Strategic Framework for the GMS, which consists of the following five thrusts:

- strengthen infrastructure linkages through a multi-sectoral approach;
- facilitate cross-border trade and investment;
- enhance private sector participation in development and improve its competitiveness;
- develop human resources and skill competencies; and
- protect the environment and promote sustainable use of the subregion's shared natural resources.

With ADB assistance, the GMS has emerged today as a subregional entity and a model of successful promotion of regional cooperation. Within a decade, the subregion has witnessed more integrated regional markets, growth of regional institutions, development of a sense of shared experience and community, and growing capacity for collective action for the common good. ADB has played a key role in these developments by providing financial and intellectual resources. The East-West Highway of GMS—linking the port of Da Nang in Viet Nam, through Lao PDR to Thailand's western border with Myanmar—is an example of core investment in cross-border connectivity. Similar cross-border links, including in power and gas transmission systems, may be found in other parts of the Asia and Pacific region.

The approach to promote subregional cooperation in the GMS is also considered a best practice that can be replicated elsewhere in the Asia and Pacific region. The GMS's initial focus was on overcoming inadequate transport and communication linkages. Overcoming geographical barriers and integrating regional markets and promoting new economic opportunities have been key dimensions through which regional projects have complemented national assistance programs. Then, the need to harmonize the legal and regulatory frameworks and facilitate cross-border flows to allow the integration of markets for productions and services has become another focus of the GMS program. This is an example of proper sequencing of interventions.

<u>The Pacific</u>

The 14 Pacific DMCs of ADB context are widely dispersed over a large geographical area and differ significantly in size, population, endowments, opportunities, and development constraints. Total population of the Pacific DMCs is 8.9 million. The total exclusive economic zone is 19.1 million square kilometers, or 36 times larger than their total landmass of about 544,000 square kilometers. Due to the low level of economic integration and high geographical dispersion, the nature and scope of regional cooperation in the Pacific vastly differ from regional cooperation elsewhere. Because of the geographical dispersion, the scope for cooperation among Pacific DMCs in physical investment or infrastructure at the regional level is limited. One of the most critically needed regional public goods for the Pacific is appropriate knowledge and technology related to the specialized but common needs of these countries. It is also important to build related regional institutional capacity to obtain the benefits of economies of scale and improve the availability of skills in the Pacific.

ADB's regional cooperation strategy in Pacific DMCs seeks to build and/or strengthen regional consensus and the local pool of expertise. To ensure shared interest, ownership, and participation of Pacific DMCs, the regional cooperation strategy will respond to the differences across the Pacific by varying emphasis and approach for different groups of countries in the region. ADB will also seek greater consultation and partnership with regional organizations and focus on enhanced participation of local officials and experts.

South Asia

Regional cooperation in South Asia was initiated in 1985 with the establishment of the South Asian Association for Regional Cooperation (SAARC). At that time, Afghanistan was not included in the grouping. The 13th SAARC Summit, held in Dhaka on 12–13 November 2005, agreed to include Afghanistan as a SAARC member. To complement the SAARC initiative—at the request of Bangladesh, Bhutan, India, and Nepal—ADB is supporting project/program-based subregional cooperation among the four countries through South Asia Subregional Economic Cooperation since 2001. To respond to South Asian countries' interest in establishing closer links with neighboring regions, a new Subregional Economic Cooperation in South and Central Asia/Central and South Asia Trade and Transport Forum was launched to facilitate trade and transit between the landlocked Central Asia and South Asia having deep seaports by improving infrastructure and policies/procedures. Similarly, ADB's support is being explored to improve connectivity between South Asia and Southeast Asia through assistance to the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, comprising Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, and Thailand.

Given that regional or subregional cooperation is relatively new in South Asia, the main focus of ADB's support for the regional/subregional cooperation programs is being placed on infrastructure connectivity and trade promotion at both regional/subregional and cross-regional levels. Furthermore, to help create an environment for trust and confidence toward regional/subregional cooperation, ADB will support identifying and implementing cooperation projects which produce tangible or visible benefits in a relatively short time horizon.

Southeast Asia

In ADB's context, Southeast Asia covers Indonesia, Malaysia, Philippines, and Singapore—four of the five founding members of Association of South East Asian Nations (ASEAN). The nations of Southeast Asia are linked by a distinct geography and by a dramatic economic history, including the 1997 Asian financial crisis which wiped out much of the miracle achievements of the newly emerged tiger economies in the subregion. The greatest obstacle to competitiveness in the region is the fragmentation of the subregional market, which sharply increases the cost of doing business and deters foreign direct investment. The countries in the subregion have to surmount several challenges, especially the infrastructure obstacle caused by its archipelagic geography. This unusual landscape requires integrated planning of transport and energy infrastructure, as many areas are far more easily linked to other nations than they are to their own national centers. Infrastructure issues are especially serious barriers to development in the poorer, border islands of Indonesia and the Philippines, and in Sarawak and Sabah in Malaysia.

The regional cooperation strategy for Southeast Asia is, therefore, focusing on efforts to review and selectively build on, streamline, and integrate past and ongoing assistance activities in the region, including investments in infrastructure development and technical assistance activities in support of the Brunei Darussalam, Indonesia, Malaysia, and Philippines East ASEAN Growth Area.

9. Integrating ADB's Approach with Local Stakeholders, DMC Governments, and Donor Coordination Issues

a. Integrating ADB's Approach with Local Stakeholders and DMC Governments

The key to ultimate success is always generating support or "buy-in" from the top officials in the national governments, local governments, and other key stakeholders, such as businesses, farmers, consumers, and labor in the region. Generating this type of "buy-in" before designing and implementing a regional growth strategy is necessary, but not always possible. Since the benefits of regional integration are not immediately obvious to the governments involved, ADB, as a premier development institution in the Asia and Pacific region, can help in catalyzing the "buy-in" process. After showing the benefits of such regional projects, ADB can obtain the support needed for DMC government and stakeholder support for more regional projects that will help promote economic and social growth and reduce poverty.

b. Donor Coordination Issues: Differing Philosophies and How to Merge Them

Since the goal of meeting the MDGs has become accepted internationally, cooperation and coordination have become central to all donors, international organizations, and nongovernment organization (NGOs) involved in development projects. With the publication of *Connecting Asia: A New Framework for Infrastructure*, by ADB, World Bank, and JBIC, a general consensus has been reached by the three major development institutions. The approaches jointly adopted by these institutions should appeal to other development partners.

The next step in donor coordination is a major challenge. Each of the major development institutions designs its own programs for each country. However, there may be a building consensus on donor coordination. The Paris Declaration on Aid Effectiveness was held in early 2005 to address ownership, harmonization, alignment, results, and mutual accountability. At the forum, the ministers were encouraged that many donors and partner countries are making aid effectiveness a high priority, and they reaffirmed their commitment to accelerate progress in implementation, especially in the following areas:

- strengthening partner countries' national development strategies and associated operational frameworks (e.g., planning, budget, and performance assessment frameworks);
- increasing alignment of aid with partner countries' priorities, systems, and procedures, and helping to strengthen their capacities;

- enhancing donors' and partner countries' respective accountability to their citizens and parliaments for their development policies, strategies, and performance;
- eliminating duplication of efforts and rationalizing donor activities to make them as cost-effective as possible;
- reforming and simplifying donor policies and procedures to encourage collaborative behavior and progressive alignment with partner countries' priorities, systems and procedures; and
- defining measures and standards of performance and accountability of partner country systems in public financial management, procurement, fiduciary safeguards and environmental assessments, in line with broadly accepted good practices and their quick and widespread application.

The ministers involved in the forum set targets to be reached by all member countries by 2010. Targets were established for all five commitments under the Declaration (ownership, harmonization, alignment, results, and mutual accountability). The following 12 indicators of progress were established.

- Partners have operational development strategies—Number of countries with national development strategies (including PRSs) that have clear strategic priorities linked to a medium-term expenditure framework and reflected in annual budgets;
- Reliable country systems—Number of partner countries that have procurement and public financial management systems that either (i) adhere to broadly accepted good practices, or (ii) have a reform program in place to achieve these;
- Aid flows are aligned on national priorities—Percent of aid flows to the government sector that is reported on partners' national budgets;
- Strengthen capacity by coordinated support—Percent of donor capacity-development support provided through coordinated programs consistent with partners' national development strategies;
- Use of country procurement systems—Percent of donors and of aid flows that use partner country procurement systems which either (i) adhere to broadly accepted good practices, or (ii) have a reform program in place to achieve these;
- Strengthen capacity by avoiding parallel implementation structures—Number of parallel project implementation units per country;
- Aid is more predictable—Percent of aid disbursements released according to agreed schedules in annual or multi-year frameworks;
- Aid is untied—Percent of bilateral aid that is untied;
- Use of common arrangements or procedures—Percent of aid provided as program-based approaches;
- Encourage shared analysis—Percent of (i) field missions, and/or (ii) country analytic work, including diagnostic reviews that are joint;

- Results-oriented frameworks—Number of countries with transparent and performance assessment frameworks that can be monitored to assess progress against (i) the national development strategies, and (ii) sector programs; and
- Mutual accountability—Number of partner countries that undertake mutual assessments of progress in implementing agreed commitments on aid effectiveness including those in this Declaration.

10. Key Crosscutting Themes: Governance, Capacity Building, and Inclusiveness

a. Good Governance—Critical to all Success

Improving governance and combating corruption are critical to poverty reduction, which is the overarching goal of ADB. Poor governance and corruption deter investment, waste resources, and distort their allocation, undermine the credibility of public authorities, and increase insecurity. Moreover, the poor suffer most from the consequences of weak governance and corruption. In 1995, ADB became the first MDB to adopt a governance policy, which was to be integrated into all ADB's operations. The policy, Governance: Sound Development Management, defines governance as "…the manner in which power is exercised in the management of a country's economic and social resources for development." It identified four of the basic elements of good governance as accountability, predictability, participation, and transparency; stressed the importance of flexible approaches specific to each country; and proposed an increase in ADB resources for governance, such as redeploying staff and enhancing expertise in governance and institutional development.

Combating corruption is a vital element of improving governance. Corruption reduces the impact of investments in DMCs by creating unproductive debt and corroding confidence. In addition, ADB is required to follow sound banking principles, which include ensuring that loans are used only for their agreed purpose. ADB's 1998 Anticorruption Policy has four objectives:

- support competitive markets and efficient, effective, accountable, and transparent public administration as part of ADB's general work on governance and capacity building;
- support promising anti-corruption work on a case-by-case basis;
- improve ADB's dialogue with DMCs on governance issues, including corruption; and
- ensure that ADB staff adheres to the highest ethical standards.

b. Capacity Building

On-the-job training of the public sector employees is critical to any capacity building exercise. While restructuring the legal and regulatory environment is required, having the individuals who will operate in this new environment, understand the new rules of the game and the ability to apply them is a crucial factor to the success of the reform process. Also for this reason, long-term investment in education is absolutely critical to economic development and to building institutions and regulatory systems that are sophisticated enough to deal with the problems of the modern world.

c. Inclusiveness

Complex issues surround how infrastructure will continue to serve the goals of inclusive development. A number of projects throughout the region seek to coordinate regional infrastructure but development challenges exist around the design and implementation of these projects. Integration among and within countries has fostered high economic growth overall and the fruits have been shared. The theme of integration and regional cooperation needs to be encouraged and promoted. Inclusive development brings about political cohesion and social stability through mutual interdependence. Infrastructure has underpinned that interdependence, and has played an essential role in making development inclusive. On the country level, project selection needs to incorporate the goals of inclusive development that benefit all members of society. Selecting projects, targeting beneficiaries, and identifying the costs and benefits are essential to inclusive development to dissolve income disparities that have developed throughout the region.

ANNEX: CLEAN ENERGY AND THE USE OF EMISSION TRADING MECHANISMS

Energy use in DMCs is increasing substantially to support economic growth necessary to increase living standards, and is primarily powered by fossil fuels. The current energy path—focused on expanding fossil fuel supplies—is neither environmentally nor economically sustainable. Increasing the use of energy efficiency (EE) to bring more service value from each primary energy unit consumed has large environmental and economic benefits. EE is essential to reduce global emission of greenhouse gases (GHGs), ease growth in fossil energy demand and the upward pressure on energy prices, and improve energy security.

> ***A "'win-win" for all:*** *The Clean Development Mechanism (CDM) is an innovative financing instrument established by the Kyoto Protocol. It provides additional financial resources for developing countries to implement projects that achieve both sustainable development and greenhouse gas reduction, such as clean energy and urban sanitation projects. In return it will provide "carbon credits" to investors bound under the Kyoto Protocol targets, which can be used to offset their own emissions at lower costs.*

ADB has implemented several lending and non-lending assistance in EE but much more and deeper action is required. It seeks a strategy, and associated investment and action plan, to assist its DMCs to achieve significant measurable change in their energy patterns and secure a low-carbon sustainable energy future. To this end, ADB established the energy efficiency initiative (EEI) on 29 July 2005 and constituted a task force and a steering committee to prepare the EEI report.[1] EE and renewable energy contribute to reducing poverty and meeting the MDG's because they are often the least cost means for delivering energy services in rural and off-grid communities. Access to energy services improves living standards, increases productivity, offers livelihood and opportunity for starting small enterprise, improves access to better education and health services, and brings information technologies and e-governance to remote communities. Empirical evidence from pilot projects is available but methods are needed to scale up these activities. Making rural regions economically viable can stem the rural-to-urban migration, allow the rural people to enjoy a high quality of life with overall lower levels of primary resource consumption, that is a key to long-term sustainability.[2]

ADB is also focusing on assisting DMCs to utilize the emerging "carbon market" to promote clean energy and other projects that reduce emissions of greenhouse gases. The Clean Development Mechanism Facility (CDMF) was set up in 2003 to provide technical and administrative assistance in parallel to ADB loans for projects that may qualify as CDM. Three ADB-financed projects have already contracted credit buyers (including the World Bank's Prototype Carbon Fund), and several more projects are coming up in the near-term portfolio.

The mandate of the CDMF is to bring value added to projects in ADB's portfolio by identifying CDM components in projects and providing CDM support throughout the project cycle. This

[1] Report of the Energy Efficiency Initiative Task Force, Preliminary Draft for Review of The Steering Committee, 22 December 2005.
[2] A June 2005 article titled "Sustainable, Efficient Electricity Service for One Billion People," by Fulkerson, Levine, Sinton, and Gupta argues that new technologies that would need to be developed to extend the services to one billion people in the remote regions will accelerate commercialization, and so also benefit people in industrialized countries.

includes development of CDM-specific documentation, arranging verification by third party "audit" firms, and assistance to receive host country approval and successful CDM registration. These steps are completely synchronized with ADB's loan/technical assistance processing so that incremental costs and time requirements are minimized to the extent possible. Upon completion of the project development cycle, the CDMF assists DMC developers market the carbon credits and facilitate agreements between buyers.

While many countries and institutions have launched so called carbon funds to purchase carbon credits on payment-on-delivery terms from projects, there are still very few vehicles that make funds available to cofinance projects that promote development and GHG reduction. A critical lack of base project financing exists, and many (e.g., DMC officials, private sector, and climate change advocacy groups) have suggested that industrialized countries and MDBs should play a greater role in stimulating investment in such projects, rather than just focusing on back-end procurement of carbon credits from projects that are already happening.

In this context, ADB recently proposed the Carbon Market Initiative (CMI), which will expand existing services under the CDMF, and offer greater value-added to DMCs by enabling upfront cofinancing for eligible projects. The CMI is intended to explore the following three interrelated activities:

- establish a special cofinancing facility, focusing on the implementation phase of projects;
- provide marketing/brokerage support to developers and sponsors with projects with carbon credit content; and
- provide technical services to operations departments, covering work at the country programming, project processing, and implementation level.

The proposed ADB initiative offers major advantages to both carbon buying and supplying countries. Buyers (and thus potential fund investor countries) will be able to secure carbon credits early in the credit generation process, while benefiting from the underlying project finance and direct implementation support provided by ADB during the project cycle thereafter. Supplier countries will obtain more attractive financing upfront at the start of the project cycle (from the cofinancing vehicle), but later also benefit from ADB's direct marketing or brokerage support in relation to the residual or non-committed credits. ADB, as a service to DMCs to improve the financial viability of projects, has been successful in securing several times higher prices than the standard rates offered by existing credit procurement funds in the market.

As a premier project developer and financier in Asia, ADB aims to utilize emerging environmental markets to support DMCs expand its portfolio of projects that promote sustainable growth, social development, and environmental management. The ultimate goal is to catalyze a real change in investment patterns that will shape the infrastructure of developing economies for the decades to come.