

**PROMOTING GOOD GOVERNANCE:
ADB'S MEDIUM-TERM AGENDA AND ACTION PLAN**

October 2000

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
APEC	–	Asia-Pacific Economic Cooperation
APG	–	Asia/Pacific Group on Money Laundering
CAP	–	country assistance plan
COS	–	country operational strategy
CSP	–	country strategy and program
DMC	–	developing member country
FATF	–	Financial Action Task Force
FMIS	–	farmer-managed irrigation schemes
IAS	–	International Accounting Standards
IMF	–	International Monetary Fund
IT	–	information technology
LGU	–	Local government unit
MDB	–	multilateral development bank
NGO	–	nongovernment organization
NIA	–	National Irrigation Administration
OEO	–	Operations Evaluation Office
OECD	–	Organization for Economic Cooperation and Development
OESD	–	Office of Environment and Social Development
OGA	–	Office of the General Auditor
OGC	–	Office of the General Counsel
PRC	–	People's Republic of China
SAI	–	Supreme Audit Institutions
SLO	–	State Law Office
SOE	–	state-owned enterprise
TA	–	technical assistance
WUA	–	water users' association

NOTE

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

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EXECUTIVE SUMMARY

The Asian Development Bank (ADB) has learned through decades of experience that sustainable development depends on the quality of decisions made toward development and reform, and, equally, on the manner in which these decisions are taken and carried out. In October 1995, ADB members reached a consensus to apply this fundamental lesson in a more systematic way in ADB's overall operations. Thus, ADB became the first multilateral development bank to have a board-approved policy on governance.

The governance policy became the basic building block for a cluster of good governance policies, which now includes policies on procurement, law and policy reform, participation of civil society, and anticorruption. Good governance has since also been established as one of the three pillars of ADB's Poverty Reduction Strategy. Without good governance, efforts at reducing poverty will not be effective. Therefore, ADB will introduce a performance-based allocation system, with particular emphasis on good governance, that enables ADB to effectively direct scarce Asian Development Fund (ADF) funds to countries in which they will have the greatest impact. With these additions, policy development in this field is now nearly complete, and ADB's cluster of good governance policies provides a sound basis for addressing most of the governance problems confronting ADB's developing member countries (DMCs). ADB will, of course, continue to review and, if needed, revise this policy cluster periodically based on experience.

Implementing ADB's Governance Policy. ADB has been involved in the full range of areas that constitute the governance field. Its work is becoming progressively more focused on analysis of governance issues in each DMC to identify the weaknesses impairing the effectiveness of development performance. Examples of ADB's activities across key governance themes include

- (i) public expenditure management to enhance budget preparation and expenditure management;
- (ii) public administration reforms;
- (iii) legal system reforms, especially developing legal information systems, enhancing DMC capacity to implement and administer laws, and supporting legal reforms for private sector development;
- (iv) institutional development and capacity building aimed at improving service delivery to consumers of government services, particularly the poor: this constitutes the largest segment of ADB's governance work, as most ADB projects include capacity-building components;
- (v) public accountability, through strong anticorruption measures in ADB's investments, improvement of audit standards and capacities in the DMCs, and activities to combat money laundering;
- (vi) improving governance at subnational levels by supporting devolution;
- (vii) improving the public-private interface by helping to improve (a) disclosure and transparency in the financial sectors of the DMCs; (b) effectiveness of regulatory frameworks; and (c) corporate governance of state-owned enterprises, and in the private sector, through improved laws and regulations; and
- (viii) strengthening participation, particularly in ADB's project work, and cooperating with nongovernment organizations, in ADB projects and to strengthen civil society.

In terms of the four elements of good governance, ADB has had some successes. The groundwork has been laid. While basic ground rules for improved governance have been established in many DMCs, the more difficult process of changing attitudes and behavior has also begun. Progress will be slow and difficult. It will depend largely on appreciation by leadership in the DMCs of the benefits of better governance and their support for the incentives required to bring about the necessary changes.

Lessons Learned. Many programs and projects in the governance area have tried to do too much in too short a time. In some cases, political realities were neglected at the design stage. Another important lesson is that without political commitment, improvements in governance are unlikely. Also, models that have worked well in developed nations are not necessarily successful when imported uncritically into a different political, cultural, and government environment. And capacity building must extend beyond training and introduction of information technology systems.

Medium-Term Governance Agenda and Action Plan 2000-2004

Objectives. ADB will take a lead role in promoting good governance in the Asian and Pacific Region. More specifically, ADB will aim to elevate governance issues to the top level of the development agenda in the Region; develop a consensus on regional benchmarks, codes of conduct, and best practices across the whole range of public and private sectors, and indicators of good governance; and enhance the quality of governance in individual DMCs. To achieve these objectives, ADB will

- (i) optimize the impact of its operations on poverty reduction by addressing key governance issues in DMCs in a systematic and focused manner;
- (ii) initiate a regional governance program to raise the profile of governance, and provide a regional focal point for governance issues;
- (iii) demonstrate to borrowing DMCs the cost of corruption and the value of eliminating it by setting an example of zero tolerance for it in ADB's own activities, and promote the spread of good internal financial and other control systems to DMCs by encouraging their use in all agencies involved in ADB related activities;
- (iv) actively seek to improve the coordination of governance activities by development agencies in the Asian and Pacific Region through enhanced cooperation and partnership;
- (v) strengthen ADB's capacity to effectively address governance issues; and
- (vi) provide regular and frequent feedback to all stakeholders on implementation of the action plan and the lessons learned.

Action Plan. The plan for implementing the medium-term governance agenda has six major areas of activity:

- (i) **enhancing governance quality in DMCs** by
 - (a) undertaking more rigorous and structured studies of governance issues in DMCs, and the risks the issues pose, as part of the process of preparing the country strategy and program (CSP);
 - (b) ensuring that the studies pay particular attention to the extent of transparency in budget preparation; level and trend of nonproductive government expenditures and spending on social sector programs;

- opportunities for and degree of participation in development processes (at national, sector, local, and project levels); prevalence of the rule of law; success in fighting corruption; existence of legal and bureaucratic factors promoting official secrecy and inhibiting public access to information; and the need to ensure that complex, large, and unusual patterns of financial transactions are monitored and reported;
- (c) formulating strategies and programs to address the key governance issues identified in the DMCs, together with relevant performance indicators;
 - (d) targeted capacity building focused on areas of weakness in governance identified in the CSP process;
 - (e) promoting participation in DMCs by ensuring that, in the design of projects and programs, attention is given to expanding opportunities for involvement by local representative assemblies and civil society, including women's groups; and
 - (f) developing indicators for the four elements of good governance, i.e., accountability, participation, predictability, and transparency, which will be used to identify the strengths and weaknesses in governance in individual DMCs, determine priority areas for ADB governance activities in the DMC concerned, and track the broad impact of governance interventions;
- (ii) **elevating good governance to the top of the development agenda** in the region by
- (a) developing a regional program of governance initiatives, focusing on the principles of accountability, participation, predictability, and transparency, with the aim of identifying and implementing effective methodologies, demonstrating the positive impact of good governance, and creating momentum for an expanded set of governance activities;
 - (b) establishing a regional partnership network on governance, comprising representatives from governments, civil society, private sector, and development agencies, to build a consensus on relevant benchmarks, best practices and codes of conduct, and indicators of good governance, and to review progress on achieving better governance in the region; and
 - (c) working with the ADB Institute to develop a program of workshops and training courses aimed at enhancing understanding of DMC politicians, officials, and leaders of civil society about the principles of good governance;
- (iii) **fighting corruption** by setting an example of zero tolerance, and promoting the spread of good financial and other internal control systems by
- (a) strengthening the control systems of executing agencies and identifying fraud and corruption through project procurement related audits;
 - (b) developing a training program to help ADB staff detect fraud and corruption in ADB-financed projects;
 - (c) introducing measures to strengthen borrowers' capacities to audit with appropriate independence;
 - (d) expanding assistance to supreme audit institutions in the DMCs for developing programs and training to strengthen their capability to detect corruption and fraud; and

- (e) preparing in consultation with other multilateral development banks (MDBs), master standard bidding documents with the aim of introducing standard terms and conditions for bidding and award of contract, as well as generally accepted international best practices, into ADB procurement procedures and practices;
- (iv) **coordinating governance activities** by working with the MDBs and aid agencies to actively promote unified approaches, and set up cooperative arrangements with the International Development Fund (IMF), World Bank, United Nations Development Programme (UNDP), and major bilateral aid agencies to carry out governance assessments and public expenditure reviews in the DMCs;
- (v) **strengthening ADB's capacity for governance operations** by
 - (a) providing governance specialist positions to all operational department and ensuring that ADB has sufficient staff for the effective implementation of the governance policy;
 - (b) providing resources to engage specialized experts to respond to the demand for governance reforms, as reflected in CSPs, through technical assistance or as staff consultants;
 - (c) developing governance and institutional databases on each DMC;
 - (d) elaborating the links between good governance and poverty reduction, and good governance and political and institutional frameworks; and
 - (e) providing managers and mission leaders with training and toolkits to effectively address governance issues in project design; and
- (vi) **monitoring implementation of the action plan** by providing an annual report to ADB's Board on implementation of the plan: the report will include information on actual achievements against the actions and targets in the annual work program, lessons learned, and a work program for the next year.

I. INTRODUCTION

1. As a regional development bank dedicated to sustainable development in its developing member countries (DMCs), the Asian Development Bank (ADB), in partnership with its member governments, has decades of experience in pursuing this objective. What ADB has learned in the process is that sustainable development depends on the quality of decisions made toward development and reform, and, equally, on the manner in which these decisions are taken and carried out. The development process has proved to be consistently more successful at bringing about desired results in environments of transparency in decision-making, a culture of accountability among government officials, and stakeholder participation in decision-making. Further, the manner in which development decisions are taken affects the quality of those decisions and their relevance and practicability.

2. In October 1995, ADB members reached a consensus to apply these fundamental lessons learned in a more systematic way in ADB's overall operations. Thus, ADB became the first multilateral development bank (MDB) to have a board-approved policy on governance.¹ This policy became the basic building block for a cluster of good governance policies, which now includes policies on procurement, law and policy reform,² participation of civil society,³ and anticorruption.⁴ Good governance has since also been established as one of the three pillars of ADB's Poverty Reduction Strategy.⁵ This is because, in the absence of good governance, efforts at reducing poverty will not be effective. Therefore, ADB will introduce a performance-based allocation system, with particular emphasis on good governance, that enables ADB to effectively direct scarce, especially Asian Development Fund (ADF) and Technical Assistance Special Fund (TASF), resources to countries in which they will have the greatest impact. With these additions, policy development in this field is now nearly complete, and ADB's cluster of good governance policies provides a sound basis for addressing most of the governance problems confronting DMCs. ADB will, of course, continue to review and, if needed, revise this policy cluster periodically based on experience learned.

3. It is timely therefore to take stock of ADB's governance activities and the impact they have achieved, and see how ADB's effectiveness in promoting good governance can be enhanced.

4. This paper (i) reviews the evolution of ADB's policy on governance, (ii) analyzes ADB's experience with governance activities, and (iii) proposes a medium-term agenda and action plan. It does not recommend amendments to ADB's existing policy on governance, which continues to be relevant, sound, and valid. This paper should be read in conjunction with the original governance policy (footnote 1).

II. ADB'S GOVERNANCE POLICY

5. The 1995 policy defined governance as "the manner in which power is exercised in the management of a country's social and economic resources for development." It then identified four elements of good governance: (i) accountability, (ii) participation, (iii) predictability, and (iv)

¹ R151-95: *Governance: Sound Development Management*, 17 August.

² IN 42-98: *A Review of the Law and Development Activities of the Asian Development Bank*, 18 February.

³ R54-98: *Cooperation between the Asian Development Bank and Nongovernment Organizations*, 27 March.

⁴ R89-98: *Anticorruption Policy*, 11 June.

⁵ R179-99: *Fighting Poverty in Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*, 19 October. The other two pillars are (i) pro-poor, sustainable economic growth; and (ii) social development.

transparency. In two important respects, ADB policy and practice since 1995 have extended this approach to governance and development.

6. First, the 1995 policy cited Article 36 (Prohibition of Political Activity) of the Charter and the legal opinion of the General Counsel on that Article. Based on Article 36 and the opinion, only economic—and not political—considerations will be relevant to ADB’s decisions. However, ADB is not prohibited from taking into account demonstrable and direct economic effects of noneconomic factors as part of the economic considerations on which it must base its decisions. The economic effects of such noneconomic factors must however, be clearly established before ADB finances programs focusing on such noneconomic factors.⁶

7. As discussed in detail in chapters III and IV, since 1995, in the process of implementing governance reforms in various sectors of its DMCs, ADB has gained a more comprehensive and in-depth understanding of what effective governance means. It has become increasingly clear that efforts to improve the quality of governance are more likely to succeed if the political realities underlying governance problems are taken into account. Indeed, the political and economic aspects of governance are often inseparable and the latter cannot be addressed in isolation. Thus, while political rights are outside the purview of its operations, ADB’s Poverty Reduction Strategy (of which good governance is a pillar) recognizes poverty as an unacceptable human condition. This implies an approach to development that recognizes the rights of people to decent living conditions.⁷ Similarly, ADB’s policies on nongovernment organizations (NGOs) and participation are implicitly linked with the rights of assembly, expression, and association. The transparency requirements of good governance are better met when there is freedom of access to information.

8. Second, the 1995 policy (para. 14) stipulates that “Given the role of government as economic development manager, policies that best suit these responsibilities need to be followed. Once these policy choices are made, however, good governance is required to make sure that implementation is effective and consistent.” This appeared to imply that in ADB’s policy, good governance was about processes that made the implementation of the policies and decisions effective and consistent, without regard to the content of those policies or decisions.

9. ADB has since learned that sometimes even good processes cannot be exempted from accountability for outcomes. A good example is the degree to which officials are made answerable for their decisions on the magnitude of unproductive expenditure. Policy mistakes and the economic inefficiencies associated with them are, indeed, capable of subverting sustainable development. As such, they may constitute part of the demonstrable and direct economic effects of noneconomic factors that ADB can take into account in making its decisions.

10. Thus, the 1995 policy, based in part on the General Counsel’s opinion on Article 36, has proven flexible enough to accommodate subsequent development of ADB policy and practice. In view of this, the issues that need to be considered in relation to ADB’s governance policy at this juncture concern implementation rather than substance. ADB has implemented its governance policy through a process of learning-by-doing and the next two chapters describe ADB’s governance activities under various categories and discuss the lessons learned.

⁶ R151-95, para. 46.

⁷ Amartya Sen. 1999. *Development as Freedom*, Knopf, New York and Oxford University Press, Oxford.

III. IMPLEMENTATION OF ADB'S GOVERNANCE POLICY

11. When the governance policy was approved, a concern of DMCs was that implementation should focus on development management and not become the basis for interference in a member country's political affairs. Sensitive to this concern, ADB's operations in governance focused on dialogue with the DMCs to identify governance areas most suitable for its interventions. In addition, activities were initiated to increase understanding of governance issues and to forge a broad constituency for good governance in the Asian and Pacific Region.

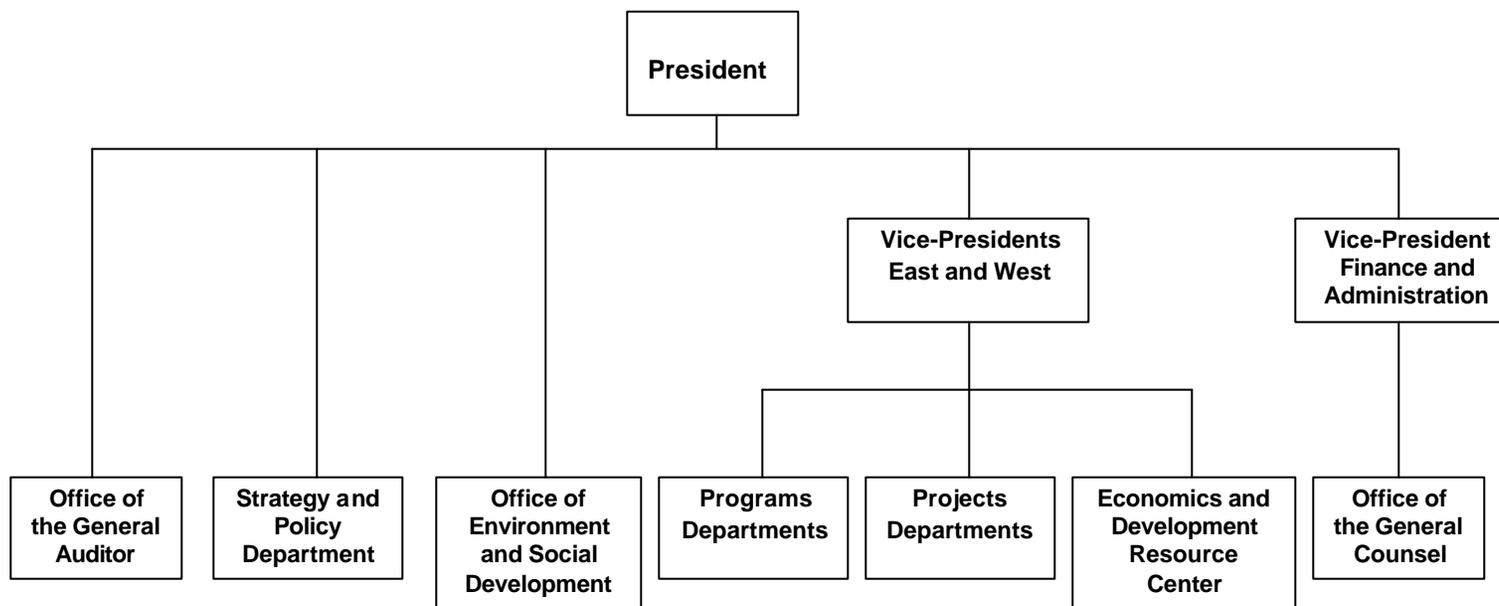
12. Approval of the policy also necessitated changes within ADB. Instructions were issued for staff to systematically identify, in consultation with the DMC concerned, opportunities to promote better governance in individual operations and procedures. Line departments were assigned this responsibility. These departments were already supporting capacity building and institutional development in many key areas, and broadening their role to include other aspects of governance was a natural extension. However, an internal force was needed to push governance initiatives, and in early 1997 the Resource Group on Governance was formed in the then Strategy and Policy Office. In 1998, governance specialists were placed in the programs departments, and in 1999 the Anticorruption Unit was established as part of the Office of the General Auditor (OGA). Thus, mainstreaming of the governance policy gathered momentum; governance activities now constitute a growing component of ADB operations.

13. In retrospect, this incremental approach was appropriate, given the complexity of the issues, the state of knowledge at the time on the direct relationship between good governance and effective government, and DMCs' own pronounced views on the importance of governance. The approach allowed issues of governance to enter in the dialogue between the government officials and ADB staff, without threatening the quality of ADB's historical relationship with the DMCs, which has always been based on long-term mutual trust. A key event in the DMCs' realization of the importance of governance was the Asian crisis. It, together with vigorous efforts of the international financial institutions, including ADB and other development agencies, produced widespread recognition of the importance of good governance. Good governance's links with sustained economic and social development are now broadly understood and more generally accepted. The quality of governance is today the subject of a healthy debate in many DMCs. Consequently, ADB can now pursue a broader and more vigorous governance agenda in the region (Chapter V).

A. ADB's Governance Activities

14. Since governance covers a complex range of issues that are best integrated into sectoral work or overall country strategy, responsibility for specific governance activities has been delegated to individual ADB work units (Figure). The Strategy and Policy Department (previously the Strategy and Policy Office) is the focal point for review and implementation of the governance policy.

Organization of Governance Responsibilities Within ADB (As of the end of September 2000)



Functions

- | | | | | | | | |
|--|--|---|--|--|---|---|---|
| | <ul style="list-style-type: none"> ▪ Dealing with allegations of corruption in ADB-assisted projects and by ADB staff ▪ Strengthening audit capacity of supreme audit institutions | <ul style="list-style-type: none"> ▪ Providing policy development and coordination | <ul style="list-style-type: none"> ▪ Strengthening civil society ▪ Promoting participation | <ul style="list-style-type: none"> ▪ Developing governance review papers ▪ Developing governance improvement strategies ▪ Conducting policy dialogue with the developing member countries | <ul style="list-style-type: none"> ▪ Promoting institutional development ▪ Monitoring executing agency financial control ▪ Promoting participation ▪ Conducting policy dialogue on governance at the sector level | <ul style="list-style-type: none"> ▪ Assessing public-private sector accounting standards ▪ Monitoring financial governance of executing agencies | <ul style="list-style-type: none"> ▪ Overseeing of law and policy reform issues and developing law and policy reform initiatives |
|--|--|---|--|--|---|---|---|

Current Staff
(full-time on governance)

4	2	2	3	2 ^a	2	1
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^a 1 more position remains at recruitment stage, and 2 other positions are expected to start work in January 2001.

15. ADB has been active across a wide spectrum of governance activities (Appendix 1). An analysis of this large amount of work identifies a need to link governance interventions to more focused and coherent governance strategies for each borrowing DMC. ADB also needs to determine the areas in which it should develop its own competencies and what can be left to other agencies or to consultants. A coordinated and consistent approach to improving governance needs to be developed by all aid agencies engaged in such work in each DMC before governance can become a driving force for improved government performance and for a more balanced allocation of resources to programs in which the poor are able to enjoy a rightful priority.

16. The centerpiece of ADB's programming process in the DMCs is the country operational strategy (COS). Out of the COS flows the annual country assistance plan (CAP).¹ Initially, after adoption of the governance policy, there was little discussion of governance issues in the COS. As a result, prospective loans and technical assistance (TA) paid insufficient attention to governance considerations. This is now changing. Governance review papers are being prepared for each DMC, so that the COS can address pressing governance issues (including corruption) that are impairing the effectiveness of development assistance. Since 1998, six such papers have been produced.² The one for Thailand is on ADB's governance web site,³ and was used to develop a separate governance strategy paper for the country.

17. The following discussion of ADB's governance activities since 1995 is organized by key governance themes. Appendix 1 provides details of a select number of governance projects in each of these areas. Table 1 highlights some of ADB's performance during this period.

1. Core Government Functions and Public Sector Management

18. Country size is a limiting factor in ADB's capacity to address issues pertinent to all levels of government. Consequently, assistance has been mostly directed at smaller DMCs. ADB has processed six program loans for the Pacific DMCs and is developing two more to address governance issues that affect all government levels. Most of the programs were preceded by serious fiscal crises in the DMCs concerned. Therefore, the loans have major macroeconomic and governance objectives. They aim to (i) reduce public sector expenditures, (ii) privatize nonperforming state-owned enterprises (SOEs), and (iii) introduce performance orientation into public sector management. The programs were generally successful in meeting the first two objectives. Performance improvement has proved more intractable, possibly because there has been too great an emphasis on improving budgeting and not enough on improving the overall management of the agencies concerned. However, the groundwork for performance improvement has been laid, and it is now being more effectively addressed.

19. In 1999, ADB approved its first loan targeted exclusively at governance reform.⁴ The loan to Mongolia supports the pilot phase of a 10-year, Government-initiated public sector reform program, under which reforms will be implemented across three parts of the public sector (central budget, local governments, and SOEs) and will address budgetary processes and administrative aspects. The loan recognizes realistic timelines for the introduction of improved processes in public expenditure management and public administration.

¹ COSs and CAPs are to be replaced by the country strategy and program (CSP) in 2001.

² Cambodia, Lao People's Democratic Republic, Nepal, Pakistan, Thailand, and Viet Nam.

³ ADB. 1999. "Governance in Thailand: Challenges, Issues and Prospects", <http://www.adb.org/work/governance/govpub.asp>. and ADB, "The ADB's Strategy for Good Governance in Thailand", forthcoming in 2000.

⁴ Loan 1713-MON: *Governance Reform Program*, for \$25 million, approved on 2 December 1999.

Table 1: ADB and Governance Performance 1995-2000

Objectives ^a	Outputs/Outcomes
Strengthen governance in public sector management	<ul style="list-style-type: none"> ▪ Established an anticorruption commission in Indonesia and initiated a governance audit of the prosecuting agencies to strengthen capacity for prosecution of crimes, particularly corruption ▪ Strengthened national audit systems in the People's Republic of China (PRC), and the Lao People's Democratic Republic ▪ Continued training for members of supreme audit institutions throughout the region ▪ Held anticorruption seminars and workshops including a major workshop organized jointly with the Organization for Economic Co-operation and Development in Manila, with a second conference planned in Korea in December 2000
Improve public enterprise management and the public-private interface	<ul style="list-style-type: none"> ▪ Strengthened legal and regulatory frameworks for the financial sector in Indonesia and the Republic of Korea ▪ Improved transparency and accountability in the financial sector in Thailand ▪ Improved corporate governance in state-owned enterprises in India, Indonesia, Kyrgyz Republic, and Thailand ▪ Strengthened oversight and enforcement capacities of securities and stock exchange regulators in Bangladesh, India, Pakistan, and Philippines ▪ Improved natural environment regulatory systems in the PRC, Fiji Islands, and Philippines
Improve public expenditure management	<ul style="list-style-type: none"> ▪ Strengthened public expenditure management systems in India, Mongolia, the Pacific, and Sri Lanka
Support public administration reform	<ul style="list-style-type: none"> ▪ Revitalized public administrations in six Pacific developing member countries (DMCs) in which public sector reform programs have been undertaken ▪ Similar efforts begun in Mongolia and Nepal
Enhance participation	<ul style="list-style-type: none"> ▪ Required participation for all project design ▪ Set aside significant technical assistance funds (for example, \$6 million in Bangladesh and \$4 million in India) for participation programs in major projects ▪ Facilitated participation in project preparation throughout the region through direct funding of nongovernment organizations ▪ Established civil society forums to enhance public debate; the most successful has been the Cook Islands National Development Committee
Decentralize government services	<ul style="list-style-type: none"> ▪ Supported decentralization programs to local government units in the Philippines, and to the second and third tiers of government in Indonesia ▪ Improved service delivery at the municipal level including a regional level program introducing benchmarking of services to 10 municipalities throughout the region
Reform legal system	<ul style="list-style-type: none"> ▪ Supported the compilation and publication of laws in the PRC and Tajikistan ▪ Developed legal officers from lawyers to judges in Maldives, Mongolia, and Viet Nam ▪ Reformed the legal framework for private sector development and the related credit, security, and insolvency in DMCs, such as Indonesia, Kyrgyz Republic, Mongolia, and Viet Nam ▪ Completed diagnostic work for improving the judicial system for better enforcement of laws and greater access to justice

^a Extracted from the governance policy paper, R151-95: *Governance: Sound Development Management*, 17 August.

a. Public Expenditure Management

20. Many of the programs in the Pacific and the governance loan to Mongolia target public expenditure management as a critical dimension of public sector reform. Reducing expenditure and making government departments more cost conscious and output oriented are key drivers of change. Improvements to public expenditure management have also begun for Papua New Guinea and Sri Lanka. In part, the programs recognize the need for economists and accountants, using information technology, to produce forecasts to set a framework for budgets, to generate agreed estimates, and then to relate budgets to specified performance. In these projects, attention is also being paid to enhancing staff capacity to manage the systems.

b. Public Administration Reforms

21. Improving medium-term budget frameworks and public expenditure management requires changes in procedures and systems. In contrast, public administration reforms are more difficult to introduce because they can entail

- (i) making the civil service more merit-based and providing adequate legal protection to ensure they are independent, and thus less amenable to undue political influence and patronage;
- (ii) making the civil service more performance oriented, which may not fit in with the culture of tolerance and sociability;
- (iii) ensuring that civil service pay is competitive with the market (often this requires significant downsizing, which can be difficult politically and may involve serious front-end payments to retrenched civil servants);
- (iv) changing the machinery of government to make its operations more efficient (this usually requires reducing the number of ministries and departments, and therefore ministers); and
- (v) redefining the functions of ministries within a narrower range of core functions, which threatens existing spheres of influence.

22. Reforms of this nature are necessary preconditions for corruption to be reduced. They are also required to remove civil service inefficiencies, so that money appropriated for service delivery produces more and higher quality outputs. In this way, programs targeting poverty can produce better results.

23. There have been few opportunities for broad-based public administration reform in the region so far. Most of ADB's work in this field has been in the Pacific. There, the public sector reform program loans have involved general downsizing and, in some cases, a small reduction in the number of departments. However, downsizing has not yet been accompanied by a review of civil service pay. Hence, the civil service has difficulty retaining key professionals (e.g., lawyers, accountants, and information technology specialists) and competent officers if they are underpaid, and an effective public sector cannot afford to be deprived of its most talented people. In Mongolia, the Governance Reform Program does not envisage any further downsizing of the public sector; there, the reforms are directed at focusing the government on core functions, and putting in place a system of personnel management that rewards with proper incentives and discourages corruption through performance contracting and output-based systems. In Nepal, the government, with ADB support, has carried out a civil service census that will become the foundation for a computerized personnel information system that will be routinely updated and eventually linked to the payroll.

c. Legal System Reform

24. Law and policy reform is central to predictability, one of the four essential constituents of ADB's approach to governance. Legal and regulatory frameworks also ensure (i) participation (e.g., laws imposing notice periods before passage of secondary legislation or executive orders that affect communities); (ii) transparency (e.g., laws that require disclosure of information); and (iii) accountability (e.g., laws granting citizens the right to challenge administrative action before an ombudsman or the courts). ADB's law and policy reform activities have focused on four broad areas.

25. **Developing Legal Information Systems.** Creation of legal information systems that are readily accessible to citizens is an important pillar of the rule of law. Knowledge of the law is important to empower citizens and create a stable environment for economic transactions. Yet access to legal information faces major impediments in many DMCs. Laws are not necessarily compiled in one centralized place, and may not be published or readily available to the public. ADB has initiated work to compile and publish laws in the People's Republic of China (PRC) and Tajikistan.

26. ADB has also launched Project DIAL (Development of the Internet for Asian Law, an Internet subscription-based service for legislators and public officials in DMCs), and LAW-DEV,⁵ an Internet forum that provides a link for communication of ideas and information among more than 600 participants in 40 countries. Project DIAL, LAW-DEV, and *Bulletin on Law and Policy Reform*,⁶ provide important sources of information about DMC law reform activities and TA for law and policy reform.

27. **Creating the Capacity to Implement and Administer Laws.** Drafting of laws has long been a feature of ADB operations. However, passage of laws, though significant, is only one step in the process of law reform. Weak administration and enforcement of laws is common and threatens to undermine the legitimacy of many DMC public institutions. One important reason for this is the poor state of legal education and training. Midcareer training of government officials, judges, and lawyers has, therefore, been emphasized in ADB's law and policy reform activities. To strengthen capacity for law administration, ADB has supported training needs assessments in several DMCs.⁷ As a result, ADB is helping (i) retrain government legal officers in Viet Nam; (ii) establish an institute to provide continuing legal education for government lawyers, judges, prosecutors, and other legal professionals in Mongolia; and (iii) establish a law school and training in court administration and continuing education for judges in the Maldives.⁸

28. **Legal Reform for Private Sector Development.** Economic law reform, particularly development of business laws necessary for the functioning of a market economy, is another feature of ADB's law and policy reform activities. For example, ADB has helped Mongolia

⁵ On-line at <http://www.adb.org/Law/netforum.asp>

⁶ ADB. 1999. *Bulletin on Law and Policy Reform* (On-line at http://www.adb.org/Documents/Periodicals/Law_Bulletin/default.asp?p=lawdevt)

⁷ TA 5640-REG: *Institutionalizing Legal Training in Cambodia, the People's Republic of China, Mongolia, and Viet Nam*, for \$450,000, approved on 23 August 1995. India was later added.

⁸ TA 2853-VIE: *Retraining of Government Legal Officers*, for \$1.2 million, approved on 26 August 1997; TA 2967-MON: *Retraining of Legal Professionals in a Market Economy*, for \$1.0 million, approved on 23 December 1997; and TA 3389-MLD: *Strengthening Legal Education and Judicial Training*, for \$995,000, approved on 23 December 1999.

develop its legal framework and the Kyrgyz Republic develop a legal and regulatory framework for corporate governance.⁹

29. Laws relating to credit, security, and insolvency are essential for a well-functioning market economy. ADB has been active in developing insolvency laws and procedures to deal with state enterprise reorganization and liquidation in the PRC, introducing a collateral security registration system in Viet Nam, and establishing a new regulatory framework for secured transactions in Indonesia.¹⁰ ADB has also played a significant role in developing legal and regulatory frameworks for capital markets in a number of DMCs.

30. **Systemic Legal and Judicial Reform.** Protection of property and contract rights requires appropriate laws on the statute book, and more importantly, a set of institutions that can enforce such laws. Creating a functioning efficient legal and judicial system is perhaps the biggest challenge facing the DMCs. ADB is responsive to the need for systemic reform. For example, TA to Pakistan supported a thorough diagnosis of the legal and judicial sector,¹¹ and under a further TA¹² many of the recommendations from this diagnosis study will be pilot-tested as a prelude to a possible loan in 2001.

d. Enhancing Service Delivery

31. Most ADB projects aim to improve the availability and quality of public services. Concentrating only on investment in infrastructure is not sufficient; a focus on improving service delivery is crucial for getting the most out of budget appropriations and providing more and better services. It is also central to improving the prospects of the poor. Quality of public services, in turn, depends on institutional capacity and the incentive structure of the agency concerned. To address capacity, almost all ADB projects include a significant capacity-building component, usually provided through TA. The effectiveness of TAs was reviewed in 1997.¹³ It led to (i) the introduction of the cluster TA; (ii) improved policies, guidelines, and procedures; and (iii) improved design focusing on agency weaknesses that need to be addressed to improve service delivery. However, a key need, which has not received sufficient attention in ADB operations, is to transform the orientation of public services from inward-looking to customer-orientated to allow customers a greater say in the coverage and quality of services delivered. Where there is competition, as in the private sector, consumers can express their preferences by exercising choice. In the absence of competition, consumers need to have a forum to voice their opinions about the services provided which, in turn, requires government to provide such forums for opinions to be expressed and grievances to be dealt with.

e. Public Accountability

32. **Public Accountability Institutions.** In cooperation with the World Bank, ADB undertakes country financial accountability assessments. Seven such assessments have been

⁹ TA 1930-MON: *Developing Mongolia's Legal Framework*, for \$500,000, approved on 17 August 1993; and TA 2712-KGZ: *Preparation and Implementation of Guidelines in Best Practices in Corporate Governance*, for \$100,000, approved on 13 December 1996.

¹⁰ TA 2271-PRC: *State Enterprise Insolvency Reform*, for \$590,000, approved on 27 December 1994; and TA 2823-VIE: *Registration System for Secured Transactions*, for \$500,000, approved on 14 July 1997.

¹¹ TA 3015-PAK: *Legal and Judicial Reform*, for \$995,000, approved on 7 May 1998.

¹² TA 3433-PAK: *Strengthening of Institutional Capacity for Judicial and Legal Reform*, for \$2,900,000, approved on 27 April 2000.

¹³ R119-97: *Review of the Bank's Technical Assistance Operations*. 31 July.

undertaken in 2000.¹⁴ These analyze the degree to which a DMC's practices differ from internationally accepted standards, and the steps needed to rectify the divergences. In addition, ad hoc reviews are conducted in the context of individual projects. Other methods to improve audit standards are also being pilot tested. For example, in Indonesia international audit firms are required to submit reports through branches in Organization for Economic Cooperation and Development (OECD) countries to ensure that proper standards are followed.

33. **Anticorruption.** ADB has strengthened its procurement procedures by including anticorruption and transparency measures. A new anticorruption unit was established in ADB's OGA. The unit has experienced, externally recruited investigators. Staff guidelines were developed to review internal control procedures of executing agencies under ADB-financed projects. Officers now conduct a detailed examination of the internal controls and financial management rules of executing agencies as a formal component of loan approval. Inadequacies must be remedied as part of all loan programs. A rigorous review of compliance with covenants and assumptions is undertaken annually, and loans are suspended if audit reports are overdue by more than 12 months.

34. As of 15 September 2000, 96 cases had been investigated. Of these, 64 have been closed and 13 firms are now ineligible for ADB work for 2-7 years. In addition, 30 individuals are ineligible from two to an indefinite number of years. The number of firms and individuals who have been sanctioned is shown in ADB's web site, and their names are listed on ADB's "Sanctions" bulletin board.

35. ADB is also increasing support to the DMCs in their fight against corruption. A case in point is Indonesia. In May 1999, ADB adopted an anticorruption action plan for Indonesia. The plan was discussed at a workshop where key Government ministers and senior officials expressed support for its implementation. Since then, TA to establish an independent anticorruption commission was approved.¹⁵ A participatory process for developing TA proposals to support the Government's anticorruption efforts is under way. Work to strengthen the Attorney-General's Office in prosecuting white-collar crime was also initiated.

36. Money laundering—a symptom of corruption—poses risks to the stability of the region's economies, particularly the small, vulnerable Pacific DMCs. ADB, therefore, maintains a close liaison with the Asia/Pacific Group on Money Laundering, which works closely with the Financial Action Task Force (FATF) and promotes the FATF 40 recommendations. In 1999, ADB hosted the second annual meeting of the Asia/Pacific Group on Money Laundering. In advising Vanuatu on amendments to its Offshore Finance Center Act,¹⁶ ADB sought to strike a balance between the country's needs to attract genuine investment and to avoid becoming a haven for money laundering. ADB also seeks to inhibit money laundering through its programs of financial sector reforms. For example, one of the requirements of the Financial Governance Reform Program loan to Indonesia¹⁷ is enactment of legislation to prevent money laundering. The preparation of similar legislation was covenanted under the Financial Sector Program loan to Samoa.¹⁸

¹⁴ TA 5877-REG: *Strengthening Financial Management and Governance in Selected DMCs*, for \$400,000, approved on 14 December 1999. The countries to be covered are Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam.

¹⁵ TA 3381-INO: *Establishment of an Anticorruption Commission*, for \$1.0 million, approved on 28 December 1999.

¹⁶ Loan 1624-VAN(SF): *Comprehensive Reform Program*, for \$20.0 million, approved on 16 July 1998.

¹⁷ Loan 1618-INO: *Financial Governance Reforms: Sector Development Program*, for \$1.4 billion, approved on 25 June 1998.

¹⁸ Loan 1608-SAM: *Financial Sector Program*, for \$7.5 million, approved on 19 February 1998.

2. Improving Governance at Subnational Levels of Government

37. Moving decision making as close as possible to affected citizens increases the likelihood of more efficient and responsive government. Physical proximity also makes it easier for citizens to hold local officials accountable for performance. However, making such changes happen is often difficult because they impinge on power relationships within a government. Nevertheless, in the Philippines, ADB has contributed to this process. Reforms supported in the Philippines devolve administrative and financial management from central to provincial and municipal governments.¹⁹ In parallel, other interventions help strengthen the capacity of local governments in planning, financial management, and implementation of development activities and projects.

38. In Indonesia a number of activities toward decentralization have proceeded.²⁰ These will devolve administrative and fiscal authority from central to district governments; build capacity at the district government level, particularly emphasizing efforts on poverty reduction; and give autonomy and responsibility to local schools and health services through village and district communities, to better meet local needs. These interventions have been designed to also provide incentives for local decision makers to direct their efforts toward poverty reductions to the extent possible.

39. ADB has also provided support for strengthening financial management, legal structures, and service delivery at subnational levels to improve fiscal management, achieve a more cost effective and sustainable service delivery, and drive change in urban local governments in a number of DMCs. These efforts have had a strong capacity-building component, as exchange of information with and learning from peers have proven to be potent means for effective reforms at subnational levels.

3. Public-Private Interface

40. Good public governance is important to encourage the development of the private sector, and has a vital role in improving governance in the private sector. The Asian crisis highlighted the need for DMC governments to address the weaknesses in the legal and regulatory frameworks within which the financial sector and private corporations function. In this crucial area, ADB has undertaken a number of activities.

a. Financial Governance

41. In the aftermath of the Asian crisis in 1997, corporate governance and financial sector reforms became central to the debate among policymakers and aid agencies. Weak enforcement of the principles of corporate governance was identified as a major contributing factor to the crisis. ADB assistance to the countries worst hit by the crisis—Indonesia, Republic

¹⁹ Loan 1729-PHI: *LGU Private Infrastructure and Project Development Facility*, for \$3 million, approved on 20 December 1999.

²⁰ Loan 1677-INO: *Community and Local Government Support: Sector Development Program*, for \$200 million, approved on 25 March 1999; TA 3177-INO: *Capacity Building to Support for Decentralized Administrative Systems*, for \$500,000, approved on 25 March 1999; TA 3178-INO: *Capacity Building for Setting Up District Level Financial and Budgetary Systems*, for \$460,000, approved on 25 March 1999; TA 3179-INO: *Capacity Building for Participation, Monitoring, and Evaluation*, for \$1.54 million, approved on 25 March 1999; Loan 1678-INO: *Community and Local Government Support: Sector Development Program – Project Loan*, for \$120 million, approved on 25 March 1999; Loan 1622-INO: *Social Protection Sector Development Program*, for \$100 million, approved on 9 July 1998, and Loan 1675-INO: *Health and Nutrition Sector Development Program*, for \$100 million, approved on 25 March 1999.

of Korea, and Thailand—has had a focus on financial and corporate governance. In Indonesia, such assistance aims to improve resource allocation in the financial and public sectors (through adoption of good practice in financial governance); increase disclosure and transparency of financial information; and strengthen legal and regulatory frameworks of the financial sector. In the Republic of Korea, ADB emphasizes restructuring of financial institutions, strengthening of regulation and supervision, and introduction of measures to liberalize and further develop the capital market. In Thailand, the focus is on fundamental reforms for transparency and accountability in the financial sector. Under TAs in insolvency and secured transactions law reform, ADB has highlighted the importance of efficient and well-functioning legal frameworks for insolvency and secured transactions for the financial system.²¹ ADB has also pioneered an integrated approach to insolvency and secured transactions law reform, which is now being applied in Nepal. Continuation of the financial and corporate governance reforms is critical to sustain the ongoing economic recovery in the crisis-affected DMCs.

b. Corporate Governance

42. ADB views corporate governance more broadly than just the internal governance of private corporations. As a development institution, ADB is also concerned with the broader regulatory framework (as it pertains to the private sector and SOEs), the policy framework to ensure competition and contestability, and the responsibility of firms as good corporate citizens (including implications for pursuing sound environmental policies).

43. A number of loans and TAs have been provided to improve corporate governance in ADB member countries. Recipient DMCs include India, Indonesia, Kyrgyz Republic, and Thailand. Much of this work is focusing on improving corporate governance of SOEs and involves adjustments to the legal framework and strengthening of insolvency procedures.

44. In its private sector operations, ADB places paramount emphasis on good corporate governance and has had some recent successes in efforts to improve corporate governance practices in the region. For example, the fund manager of the THAI SME Fund (involving a \$25 million equity investment by ADB) has agreed to require each investee company to comply with the best corporate governance practices. Also, the Global Trust Bank in India has accepted most of the principles of corporate governance enunciated by ADB and is one of the few banks in Asia to announce its written and transparent corporate governance code. ADB is discussing a similar approach with other banks in India.

45. In addition to its operational work, ADB has been actively supporting Asia-Pacific Economic Cooperation (APEC) initiatives on corporate governance. ADB was part of the core group for the 1998 Initiative on Corporate Governance that examined the leading issues in Asian corporate governance. In addition to country studies on the PRC, Indonesia, Republic of Korea, and Philippines, ADB took the lead in preparing the report to the APEC finance ministers at their May 1999 meeting outlining key issues and providing a practical guide for strengthening governance in the region. ADB has also been collaborating with OECD, and joined with it and the World Bank in organizing the Asian Corporate Governance Roundtable in Hong Kong, China in May 2000.

²¹ ADB has also supported strengthening the legal environment for dealing with the economic crisis through TA 5795-REG: *Insolvency Law Reform*, for \$550,000, approved on 13 July 1998; and TA 5773-REG: *Secured Transactions Law Reform*, for \$300,000, approved on 6 January 1998.

c. Regulatory Frameworks

46. ADB has an established track record in helping DMCs improve regulatory frameworks, particularly in energy, banking and capital markets, and bankruptcy and liquidation. For example, ADB-financed capital market program loans to Bangladesh, India, Pakistan, and Philippines have promoted legal reforms to strengthen the oversight and enforcement capabilities of securities and stock exchange regulators.²²

47. ADB has also been active in improving regulatory systems affecting the natural environment. Civil society, and particularly the poor, are often the victims of weak environmental management. ADB has tried to address their concerns. As a result, critical environmental legislation has been passed in one case, the urban poor have determined the improvements required in urban services and environmental quality in another, and industries have introduced clean technologies in a third. A less successful aspect of these initiatives was the attempt to get the DMCs to adopt environmental accounting practices.

4. Civil Society

48. There is often a close relationship between strengthening of civil society and good governance. Strengthening of civil society is a key to creating the momentum for reform where support for improved governance may be weak. ADB, especially in the Pacific, has been pilot testing mechanisms to provide civil society with a voice in the political process, at the national and subsidiary levels of government. Such mechanisms are promising, but more work needs to be done to develop and sustain civil society forums and other mechanisms in the interests of good governance. One such example has been the Cook Islands Public Sector Reform Program, in which two forums were established for civil society's involvement. One was the National Development Committee, an advisory body and think tank for the Government. The committee's principal duty is to comment publicly on the budget. The other is the Public Expenditure Review Committee, which investigates issues of abuse and other matters referred to it by citizens.

49. ADB recognizes the importance of NGOs as a key component of civil society. While ADB's financing instruments do not yet include direct assistance to NGOs, ADB cooperates with them in several other ways, e.g., as consultants to design or supervise ADB projects. Bilateral aid agencies usually have better instruments than does ADB to work with NGOs. In the future, ADB will focus more on working cooperatively with bilateral aid agencies to strengthen civil society and the part that NGOs play in civil society, both directly and as a conduit to other institutions that influence public opinion.

50. ADB's 1998 paper, *Cooperation between the Asian Development Bank and Nongovernment Organizations*,²³ recommended expanded cooperation with NGOs in project activities, in programming and country-level work, and in policy cooperation. The main objective is to integrate NGO experience, knowledge, and expertise into ADB operations, such that these more effectively address ADB's development agenda. At the same time, the role of NGOs as increasingly significant participants in development processes will be recognized. To enhance

²² Loan 1576-PAK: *Capital Market Development Program Loan*, for \$250.0 million, approved on 6 November 1997; Loan 1408-IND: *Capital Market Development Program*, for \$250.0 million, approved on 28 November 1997; and Loan 1363-PHI: *Capital Market Development Program*, for \$150.0 million, approved on 22 November 1995.

²³ R54-98: *Cooperation between the Asian Development Bank and Nongovernment Organizations*, 27 March.

ADB's cooperation with NGOs, a high-level committee and a Task Force on ADB's Institutional Arrangements for Cooperation with NGOs have been established. The latter has suggested the establishment of an NGO center and a network within ADB.

51. In 1996 a pilot fund was established using TA²⁴ to encourage participatory processes in ADB projects and programs. Under this initiative, 15 operational activities received support involving 11 DMCs, 11 subsectors, and different phases of ADB's operations. ADB staff identified stakeholders, built alliances within the DMCs, and designed workshops and other participatory events, thus contributing to greater participation and ownership by DMCs in the small number of projects involved. A second phase of the TA began in January 2000. Under this phase, ADB is assessing participation needs on a case-by-case basis, committing significant funds where appropriate. For example, \$6.8 million has been allocated to mainstream local participation in irrigation design in Bangladesh²⁵ and \$4.0 million to support participation in urban development in Rajasthan, India.²⁶ To support the latter, ADB is undertaking a TA²⁷ to develop a model for participation in projects. An important aspect of participatory processes is the need to inform beneficiaries of their rights under various legal and regulatory frameworks (e.g., water user associations) supported under ADB projects and how to avail themselves of these rights. The ongoing work under a regional TA²⁸ will assist ADB in mainstreaming lessons learned in legal literacy into its project designs.

B. Assessing the Impact on the Four Elements of Good Governance

52. Impacts of ADB's governance reform interventions are seldom restricted to one area. For example, greater public participation in development processes can lead to improved accountability and transparency, and improved regulatory frameworks, which require better systems of accountability and transparency, can lead to greater public participation in decisions that affect them. Hence, it is not easy to accurately assess the contribution of ADB's governance initiatives to each of the four constituent elements. Nevertheless, an attempt to do so may be instructive.

53. A preliminary observation is that ADB's efforts and the efforts of other aid agencies have prepared the ground for better governance where it has been weak. In most DMCs, the situation has improved in terms of actions taken; however, change in attitudes and behavior of officials proceeds more slowly.

1. Accountability

54. For ADB, accountability is the imperative to make public officials (i) answerable for their performance and behavior, and (ii) subject to the institution from which they derive their authority. What ADB is directly concerned with is executive accountability. This has been addressed through projects that aim to

²⁴ TA 5692-REG: *Facilitating Capacity Building and Participatory Activities*, for \$300,000, approved on 19 July 1996.

²⁵ Loan 1381-BAN: *Small Scale Water Resources*, for \$32.0 million, approved on 26 September 1995; and TA 2564-BAN: *Beneficiary Participation and Project Management*, for \$6.8 million, approved on 2 May 1996.

²⁶ Loan 1647-IND: *Rajasthan Urban Infrastructure Development Project*, for \$250 million, approved on 3 December 1998.

²⁷ SSTA 3324: *Community Participation in Urban Environment Improvement*, for \$150,000, approved on 3 December 1999.

²⁸ TA 5856-REG: *Legal Literacy for Supporting Governance*, for \$500,000, approved on 24 August 1999.

- (i) improve budget and expenditure management by focusing on agreed outputs and their consequence, better performance management;
- (ii) make delivery of public services more responsive to customers (reforms at the local government level have focused on benchmarking and relating performance indicators to customer satisfaction); and
- (iii) strengthen the capacity of supreme audit institutions and encourage prompt action by the executive branch of the government on audit findings and recommendations by supreme audit institutions; the next stage is to extend this work to the review bodies (e.g., public accounts committees, as is envisaged in Sri Lanka) to help them review individual agency responsibility.

55. ADB has had some success in improving formats, such as the budget processes. Using the budget as a performance management tool, however, has been less successful. A major constraint is often the quality of accounting staff and their capacity to relate, for managers, the link between expenditure and output. Audit improvements have tended to be in compliance and not in effectiveness. Also, there is still a long way to go in relating public sector performance to customer needs, improving public service productivity, and introducing appropriate incentives and sanctions.

2. Participation

56. For ADB, the principle of participation is derived from the fact that people are not only the ultimate beneficiaries of development, but also agents of development. Participation has been promoted through

- (i) involvement of beneficiaries and affected groups in design and implementation of public programs and projects,
- (ii) decentralization and empowerment of local governments, and
- (iii) cooperation with NGOs.

57. ADB has sought to integrate participation into its operations by establishing a framework to formalize participation at two levels: (i) establishing civil society forums of advice and review, and (ii) ensuring that beneficiaries have a central role in the design of projects. Staff instructions issued by ADB's President (and later disseminated to the public) demonstrate how participatory development processes fit into ADB's business practices, to instill a wider sense of ownership in the development activities that ADB supports. The introduction of such processes into ADB operations will lead to their being absorbed by governments in development management generally at the project, sector, and national levels.

58. Significant strides have been taken to ensure participation in ADB-supported projects. There is now

- (i) much more participation of stakeholders in project design and implementation; and
- (ii) greater involvement of NGOs in project design and implementation.²⁹

²⁹ The 1999 Operations Evaluations Office report on the Role of Nongovernment Organizations and Community-Based Organizations in ADB Projects found that while ADB has been successful in increasingly involving NGOs as partners in its development assistance programs, NGO involvement varied significantly in its scope, quality, and effectiveness. The study concludes that future ADB support for NGO involvement should be selective, taking into account the country and sector environments in which a project will be implemented, and the knowledge, expertise, and capability of NGOs to effectively contribute to the specific project and location in question.

59. However, the extent to which such participatory processes have spread to other (non-ADB-funded) operations of executing agencies, and to other public service providers, is not known. A key test would be customer surveys assessing the satisfaction level of local populations.

60. Strengthening civil society and improving parliamentary processes, however, are more difficult. Both are often deeply embedded in tradition and ADB can do little more than add its voice to others through the policy dialogue. ADB has a greater opportunity of influencing civil society in small DMCs than in large ones. In small DMCs like the Cook Islands and other Pacific DMCs, ADB has successfully promoted forums for representatives of different sectors of society to discuss the reform programs to be introduced to address the economic crises faced by them.

Predictability

61. Predictability refers to the existence of laws, regulations, policies, and procedures with which to regulate society and govern certain kinds of government action; and their fair and consistent application. ADB has promoted this principle by

- (i) assisting DMCs to develop their legal systems, including commercial law in transition economies;
- (ii) developing and training the professional groups needed to make legal systems work effectively;
- (iii) strengthening regulatory frameworks that govern infrastructure and public service providers (e.g., energy and telecommunications), capital markets, and the natural environment; and
- (iv) supporting access to legal information and increasing legal literacy in the DMCs, and improving the quality of the judicial process by training judges and magistrates.

62. ADB has done substantial work in the field of law and policy reform. It will continue to be a major focus of efforts to improve governance quality in the DMCs. However, putting laws and regulations in place is one thing and having them applied and enforced in practice is another.

3. Transparency

63. Transparency concerns the disclosure of information regarding government rules, regulations, and decisions. It enables interested parties to assure themselves that official processes and procedures have been followed in a predictable way to a fair conclusion.

64. Government procurement is an area where transparency is particularly important. ADB ensures that ADB-financed procurement is undertaken in an open, fair, and competitive environment. Accordingly, ADB has

- (i) encouraged competition through post- rather than prequalification criteria,
- (ii) provided TA to several DMCs to improve laws and accounting procedures relating to procurement,
- (iii) provided training in newly introduced procurement procedures,
- (iv) helped some DMCs improve the capacity of their tender boards, and

- (v) encouraged third party monitoring of ADB investment projects through international and local NGOs.

65. Aside from the focus on public procurement and anticorruption, ADB has made modest efforts in directly targeting transparency. As part of ADB's ongoing dialogue with the Government of Pakistan for judicial and legal reforms, ADB canvassed the need for a freedom of information law. As a result, the Government of Pakistan recently issued the Freedom of Information Bill for comments by the public. Similarly, the need for a freedom of information law has also been included in ADB's dialogue with the Government of Nepal in the context of civil service reform. In its ongoing work on governance, ADB will increasingly address broader issues of freedom of information and transparency in government decision-making and public policy implementation.

66. In terms of the four elements of good governance, therefore, ADB can claim some successes. Certainly, the groundwork has been laid, and basic ground rules for improved governance have been established in many DMCs. Intensive dialogue is under way in most areas, and champions of change are more easily found than before. However, this phase is not an end, but a means to the more difficult process of changing attitudes and behavior which, admittedly, proceeds much more slowly. The pace of change will depend largely on the appreciation by DMC leaders of the benefits of better governance and their support for the incentives required to bring about necessary improvements.

C. Addressing Governance Issues—ADB's Instruments

67. ADB has addressed governance issues within its lending modalities and grant-funded TA. With the increased pace of assistance for governance reforms in recent years, the mismatch between the instruments and the assistance requirements for good governance and capacity building became obvious. Capacity building usually entails long-term attention, while ADB's instruments, particularly policy-based loans and conventional TA, tend to be for the short to medium term. However, ADB's new modalities now allow longer commitment periods (e.g., the TA cluster approach and slow-disbursing program loans). Also ADB has pilot tested an approach to phasing of reforms to suit overlapping or sequential lending programs.³⁰ These changes in modalities will go a long way to resolving the mismatch.

68. In 1997, ADB launched an important TA instrument—the TA cluster. Recognizing that a single TA intervention is often not sufficient to address a set of related issues or problems, the cluster approach is especially suitable for governance initiatives, which often need to handle unpredictability and provide for flexibility. In some cases, a series of interventions over time is called for. In others, a range of interventions may be required, involving a number of agencies. Power Sector Restructuring in Gujarat is an example of TA cluster. The objective of this TA cluster was to increase the reliability, efficiency, and commercial orientation of the Gujarat power sector through gradual, comprehensive, and systematic restructuring along functional lines. Five related TAs³¹ were designed to help the state government design and implement key reform measures such as unbundling of generation, transmission, and distribution;

³⁰ For example, the Governance Reform Program Loan to Mongolia (1713 MON, approved 2 December 1999) was the pilot phase of a 10-year program of public sector reforms designed and initiated by the government.

³¹ TA 2738-IND: *Preparation of a Power System Master Plan for the State of Gujarat*, for \$600,000, approved on 17 December 1996; TA 2739-IND: *Development of a Framework for Electricity Tariffs in Gujarat*, for \$300,000, approved on 17 December 1996; TA 2741-IND: *Financial Management Support to Kheda and Rajkot Distribution Centers of the Gujarat Electricity Board*, for \$580,000, approved on 17 December 1996; TA 2740-IND: *Review of Electricity Legislation and Regulations in Gujarat*, for \$235,000, approved on 17 December 1996; and TA 2742-IND: *Solicitation of Private Sector Implementation of the Chhara Combined Cycle Power*, for \$375,000, approved on 17 December 1996

commercialization of generation and distribution; separation of sector regulation from ownership of assets; and private sector participation in generation and distribution. These initiatives were closely interrelated and paved the way for possible lending and investment operations by ADB and other agencies to the power sector in Gujarat.

69. Regional TA, although generally short term and limited in size, is another flexible instrument to bring DMCs together and compare experiences in addressing governance issues. For example, such TAs have (i) provided a forum for municipal governments to develop capacity for benchmarking and continuous improvement, and learn from each other in the process;³² (ii) supported activities to assess the merits of different approaches to fighting corruption in DMCs; (iii) enabled information on subjects like public expenditure management and public administration to be produced and disseminated;³³ and (iv) helped raise awareness of regulatory and governance issues among policymakers, investors, and civil society.³⁴

D. Developing ADB's Capacity to Address Governance Issues

70. Initially, to promote knowledge and interest among staff on governance issues, training workshops were organized for managers (August 1996) and mission leaders (January 1997). In April 1997, a learning group was set up to meet on a regular basis. Through lectures and seminars, the group was exposed to good practices in different areas of governance. In 1998, ADB started a systematic training program on governance and anticorruption. Training sessions on fraud detection and anticorruption have been conducted for directors, managers, and other staff. Two other training courses have been developed to run on a continuing basis: one, on public expenditure management and public administration, and the other on decentralization and local government. A feature of many of these training events has been close collaboration between ADB and MDBs to share efforts and experience to educate their staff on governance.

71. ADB staff also require better conceptual and operational tools and protocols to fully integrate governance considerations into their activities. As a starting point in its action plan for 2000-2004 (Chapter V), ADB has started to develop (i) toolkits for some main areas of governance, and for overall governance assessment for individual DMCs; (ii) indicators of governance, to monitor progress made by individual countries over time; and (iii) in-depth studies of the interlinkages between governance and poverty reduction efforts. These activities are designed to enhance staff members' abilities to mainstream governance issues within ADB's general lending activities.

72. By the end of 1999, ADB had three general governance specialists in the programs departments, and two in the Strategy and Policy Department, the head of the Law and Policy Reform Special Practice Group in the Office of the General Counsel, and three positions focusing on anticorruption in OGA. In addition, there were two specialists in the Office of Environment and Social Development focusing on civil society and participation. In 2000, nine new positions were added in the area of governance—six financial specialists, mostly assigned to project departments, to assess financial systems in executing agencies; one anticorruption specialist in OGA, and two positions for law and policy reform in the Office of the General

³² TA 5764-REG: *Enhancing Municipal Service Delivery Capability in Selected DMCs*, for \$550,000, approved on 24 December 1997.

³³ TA 5813-REG: *Public Expenditure Management and Public Administration*, for \$500,000, approved on 27 October 1998; and TA 5829-REG: *Accountability Mechanisms for the Asian and Pacific Region*, for \$500,000, approved on 31 December 1998.

³⁴ TA 5758-REG: *Governance and Regulatory Regimes for Private Infrastructure Development*, for \$150,000, approved on 30 October 1997.

Counsel. Over the next four years, 2001-2004, ADB will enhance its governance operations by providing more staff resources, new and redeployed, to operations departments to ensure effective mainstreaming of governance policy into ADB operations. In this regard, several new positions may be added in 2001. Future resource requirements will depend largely on the annual assessment on the progress of implementing the governance action plan.

IV. LESSONS LEARNED

73. ADB has learned several important lessons from the implementation of projects with governance objectives, reviews of ongoing projects, and special evaluation studies by the Operations Evaluations Office.³⁵ Evaluations of earlier capacity building and governance interventions also provide useful information.

A. Accounting for DMCs' Political Realities

74. Reform of the public sector may require measures that have negative social impacts in the short term (e.g., dealing with overstaffing, privatizing SOEs, or reducing service levels) before long-term benefits can be realized. In a democracy, even where there is a champion for a set of proposed reforms, the political costs of public sector reform need to be addressed through effective planning and public relations. However, reluctant officials should not be allowed to use the political difficulty of these reforms as an excuse for inaction.

75. Governance reforms can provoke political sensitivity even when their social impact is not necessarily negative. Some issues, for example, official secrecy and freedom of information, unproductive expenditure, and money laundering, must be addressed decisively, while avoiding unnecessary confrontation.

B. Making Reform Programs Realistic

76. In developing reform programs, attention needs to be paid to the implementation capacity of the country and, where possible, efforts should be devoted to enhance that capacity. Setting overambitious targets should be avoided because it can stretch the capabilities of the public officials and the public sector machinery, and cause disruptions in the smooth functioning of the government or result in compromised quality of output. On the other hand, targets that are not ambitious enough can lower the quality or delay the results of reforms and lead to public disillusionment. Therefore, in designing reform measures, staff should base their reform recommendations on a thorough assessment and study of needs and available capacity.

C. Improving Governance Requires Commitment

77. The greater the commitment of a country's leadership to governance reform, the more likely it is that reforms will take root. Where commitment is absent, ADB's best response is to strengthen and reinforce constituencies for reform and maintain policy dialogue. Only when

³⁵ SS23: Special Study: *Assessment of the Effectiveness of Bank Assistance in Capacity Building to Western Samoa*, December 1995; SS25: Special Study: *Assessment of the Effectiveness of Technical Assistance for Capacity Building in Indonesia*, December 1996; SST: REG 99025: *Special Evaluation Study of Effectiveness and Impact of ADB Assistance to the Reform of Public Expenditure Management in Bhutan, India, Kiribati, and Lao People's Democratic Republic*, December 1999; and TPA: BHU 98031: *Institutional Strengthening of the National Budget and Aid Coordination Division of the Ministry of Finance*, December 1998.

there is a critical mass of support for reform will ADB's financial support bear fruit. More than any other form of policy reform, governance reforms require shared commitments across the political spectrum, including the opposition and the individual parliamentarians. However, at times, lack of commitment results from a lack of awareness about the issues, rather than an unwillingness to address them. Therefore, efforts at raising awareness can have an important role in strengthening commitment.

D. Improving Governance Systems Requires Resources

78. Public sector reform involves a complex set of activities. Momentum, once gained, needs to be sustained. Because agencies have only a limited number of competent staff, these are usually assigned to areas critical to day-to-day operations. Governments find it difficult to release staff from short-term crisis management to areas where benefits are slow to materialize. In the absence of competent local staff assigned full time to the process, reforms will suffer. Where management cadres are weak, great emphasis needs to be directed at building capacity.

E. Importing Recommended Practices Should Be Done Cautiously

79. Policy reforms and technical improvements in the functions of the government, even when proven to be successful in one environment, should not be blindly duplicated in another. For example, budgetary practices requiring trained accountants and a culture of absence of corruption cannot be directly introduced in financial environments where there are few trained accountants, embedded traditions of corruption, and the government has difficulty even managing expenditures on an input basis. In a similar vein, enhancing business transactions between the public and private sectors (outsourcing public activities, and partial privatization of SOEs and public utilities) should be followed cautiously when principles of avoiding conflict of interest are unknown or new to the public officials.

80. Several variables act as constraints in such cases. Organizational culture, management style, staff and systems' capacities, internal processes, and external linkages all require careful analysis before embarking on radical redesign of an operating environment. A number of ADB studies have stressed the importance of prior diagnostic analysis. Effective reform also requires careful, incremental sequencing of steps.

F. Capacity Building Requires Broad-Based Interventions

81. Effective capacity building requires more than training and introduction of information technology systems. The general government environment affects the capacity of an agency to perform and is often a significant barrier to change at the agency level. Hence, a diagnostic study needs to extend beyond the confines of a particular agency. Interventions must also address the total system from an agency perspective, if they are to be effective.

G. Collating Governance Experience

82. ADB's studies of capacity building have found little systematic collation of material, partly because staff time is fully committed elsewhere. Development of databases on governance and institutional environments of the DMCs needs to be incorporated into the business process. Additionally, the impact of individual reform programs must be monitored more systematically. ADB has increased the use of project performance monitoring systems to develop the indicators needed for monitoring progress under each program and the impact of reforms. This increased

attention to monitoring of impacts and outputs is a basic change in ADB's focus, away from an input-based approach to one based on outcomes achieved.

V. MEDIUM-TERM GOVERNANCE AGENDA AND ACTION PLAN 2000-2004³⁶

A. Objectives

83. ADB will play a lead role in promoting good governance in the Asian and Pacific Region. More specifically, ADB will aim to (i) elevate governance issues to the top level of the development agenda in the Region; (ii) develop a consensus on regional benchmarks, codes of conduct and best practices across the whole range of public and private sectors, and indicators of good governance; and (iii) enhance the quality of governance in individual DMCs.

84. To achieve these objectives, ADB will

- (i) optimize the impact of its operations on poverty reduction by addressing key governance issues in DMCs in a systematic and focused manner;
- (ii) initiate a regional governance program to raise the profile of governance, and provide a regional focal point for governance issues;
- (iii) demonstrate to borrowing DMCs the cost of corruption and the value of eliminating it by setting an example of zero tolerance for it in ADB's own activities, and promote the spread of good financial and other internal control systems to DMCs by encouraging their use in all agencies involved in ADB related activities;
- (iv) actively seek to improve the coordination of governance activities by development agencies in the Region through enhanced cooperation and partnership;
- (v) strengthen ADB's capacity to effectively address governance issues; and
- (vi) provide regular and frequent feedback to all stakeholders on implementation of the action plan and the lessons learned.

B. Approach

85. A principal lesson learned from five years of designing and implementing governance reforms in the DMCs is the need for the commitment of the government or agency concerned if the improvements introduced are to be "owned" by them and sustained. Where commitment to improving governance is weak, ADB will aim to enhance it through dialogue, advocacy, promotion, and support to sympathetic stakeholders. If such commitment is lacking or poor, governance reforms will not succeed and poverty reduction will suffer as a consequence. Therefore, ADB will introduce a performance-based allocation system, with governance as a central criterion of the performance rating, so that scarce ADF funds can be directed to DMCs where they will have the greatest impact.

³⁶ The loans and TA focusing on governance each year will be identified in the three-year rolling work program and budget framework document.

86. ADB will develop/reinforce strengths in selected key governance areas. The approach will be focused, selective, and strategic. The areas of specialization will be determined in relation to ADB's overarching goal of poverty reduction and the priorities of the DMC.³⁷

87. Other important elements of the proposed approach include

- (i) consensually developing realistic and progressive long-term programs of governance reform for individual DMCs and reporting on progress;
- (ii) focusing on governance issues that militate against effective and efficient service delivery in poverty reduction programs and projects, particularly in DMCs with weak governance;
- (iii) addressing weak governance and institutional capacity concurrently;
- (iv) promoting good governance on a regional basis and supporting champions of change to learn from one another and to promote the message to other DMCs;
- (v) using TA strategically to test a DMC's commitment to change and as an incentive for public sector reform; and
- (vi) working with the ADB Institute to augment ADB's governance efforts with a focused program of seminars, workshops, and training courses.

C. Action Plan (summarized in Appendix 2)

88. The plan has six major activities

1. Enhancing Quality of Governance in DMCs

- (a) Beginning in 2001, as part of the country strategy and program (CSP) process, more rigorous and structured studies will be undertaken to analyze governance issues in individual DMCs and the risks they pose.³⁸ In addition, public expenditure reviews for all DMCs will be undertaken in collaboration with the World Bank, International Monetary Fund (IMF), and other development agencies
- (b) This analysis will pay particular attention to the extent of transparency in budget preparation; level and trend of nonproductive government expenditures and spending on social sector programs; opportunities for and degree of participation in development processes (at national, sector, local, and project levels); prevalence of the rule of law; success in fighting corruption; existence of legal and bureaucratic factors promoting official secrecy and inhibiting public access to information; and the need to ensure that complex, large, and unusual patterns of financial transactions are monitored and reported.
- (c) Based on this analysis, the CSPs will formulate strategies and programs to address the key governance issues, including noneconomic factors that have demonstrable and direct economic effects that have been identified.³⁹ The CSPs will also specify relevant performance indicators

³⁷ If DMCs seek ADB's assistance outside the areas of specialization chosen, the advice to be given will be outsourced.

³⁸ Preparation of governance review papers has started as part of the present COS-CAP process (para 13).

³⁹ The governance strategy for a country will be formulated as an integral part of the process for preparation of the CSP outlined under the ADB's Poverty Reduction Strategy, including full consultation of all stakeholders.

(future CSPs will assess the effectiveness of these programs and identify successes and failures).⁴⁰ Governance assessments and progress in improving the quality of governance will inform both the level and sectoral composition of ADB assistance to a DMC.

- (d) Targeted capacity building will be a major part of ADB's efforts in improving governance in DMCs. In this regard, ADB will focus on areas of weakness in governance identified in the CSP process.⁴¹ Such activities will include strengthening the capacity of the public sector to monitor and evaluate government performance, and of civil society (particularly NGOs and other groups that represent vulnerable segments of the population), to maintain the debate about improvements in governance.
- (e) Enhancing participation in development decision-making is another area of importance for ADB. Therefore, ADB will promote participation in DMCs by ensuring that, in the design of projects and programs, attention is given to expanding opportunities for involvement by local representative assemblies and civil society, including women's groups, and creating a favorable environment for citizens to have meaningful input into development decisions.
- (f) By 2001, ADB will develop indicators for the four elements of good governance, i.e., accountability, participation, predictability and transparency, for all DMCs. These indicators will be used to identify the strengths and weaknesses in governance in individual DMCs, determine priority areas for ADB governance activities in the DMC concerned, and track the broad impact of governance interventions. The indicators will be implemented on the basis of rigorous studies undertaken as part of the CSP process and revised annually in the context of the CSP updates.

2. Elevating Good Governance to the Top Level of the Development Agenda in the Region:

- (a) Focusing on the principles of accountability, participation, predictability, and transparency, ADB will develop a regional program of governance initiatives. This program will begin in 2001 and will directly promote good governance principles in the DMCs' antipoverty programs.⁴² The aim is to identify and implement effective methodologies that could be applied in all or most DMCs, demonstrate the positive impact of good governance, and create momentum for an expanded set of governance activities. (Possible initiatives under consideration are listed in Appendix 3.)
- (b) By 2001, ADB will promote a regional partnership network on governance, comprising representatives from governments, civil society,

⁴⁰ The quality assurance panel (proposed under the business process redesign) will include a governance specialist to ensure that projects with major institutional development components are consistent with ADB's governance policy and priorities, as well as project quality.

⁴¹ The ongoing country financial accountability assessments will also identify weaknesses in the accounting and auditing professions, and ADB will provide assistance to remedy the deficiencies identified.

⁴² This proposal and the proposal for a regional partnership network will require a reassessment of regional TA priorities.

the private sector, and development agencies, to build a consensus on relevant benchmarks, best practices and codes of conduct, and indicators of good governance, and review progress in achieving better governance in the region. The network will also be a venue for successful “champions of change” to promote the value of good governance. ADB will provide a web site to support this partnership network.

- (c) ADB will work with the ADB Institute to develop a program of workshops and training courses to enhance understanding of DMC politicians, officials, and leaders of civil society about the value and principles of good governance. The workshops and courses will be demand driven, reflecting the impact of the dialogue and other ADB initiatives .
- (d) ADB will actively lead a continuing public debate on the importance of governance issues by commissioning studies and publishing their results and through other public affairs’ initiatives.

3. Fighting Corruption by Setting an Example of Zero-Tolerance, and by Promoting the Spread of Good Financial and Other Internal Control Systems:⁴³

- (a) Through project procurement related audits, ADB will assist DMCs to strengthen the control systems of executing agencies and identify fraud and corruption. Whenever, pursuant to ADB guidelines, fraud or corruption is identified, appropriate steps will be taken, including sanctions against the contractor and cancellation of the loan.
- (b) Beginning in 2000, ADB will develop a program to train ADB staff to detect fraud and corruption in ADB-financed projects.
- (c) By 2001, ADB will introduce measures to strengthen borrowers’ capacities to carry out audits with appropriate independence. Attention will also be paid to professional accountancy bodies and the way they manage their own ethical standards. This focus will also produce benefits in corporate governance.
- (d) ADB will expand its assistance to supreme audit institutions (SAIs) in the DMCs for developing programs and training to strengthen their capability to detect corruption and fraud. ADB continues to support the Asian Organization of Supreme Audit Institutions (ASOSAI) and South Pacific Association of Supreme Audit Institutions (SPASAI)⁴⁵ to strengthen SAIs in the region. Attention will also be paid to benchmarking the performance of supreme audit institutions.

⁴³ This is in addition to country specific anticorruption projects and programs that will form part of the CSP for the DMC concerned.

⁴⁴ Such a focus would also produce benefits in the corporate governance field.

⁴⁵ TA 5872-REG: *Regional Long-Term Audit Training Program for Members of the ASOSAI, Phase II*, for \$300,000, approved on 03 December 1999 and TA 5910-REG: *Long-Term Regional Training Program for Members of SPASAI, Phase II*, for \$200,000, approved on 6 April 2000.

- (e) ADB will prepare, in consultation with other MDBs, master standard bidding documents to introduce standard terms and conditions for bidding and award of contracts, as well as generally accepted international best practices, into ADB procurement procedures and practices.

4. Coordinating Governance Work of MDBs and Other Development Agencies:

- (a) The MDB Working Group on Governance, Anticorruption, and Capacity Building has set up four subgroups to actively promote unified approaches and cooperation in key areas.⁴⁶ The working group will complete the first phase of work to develop understandings on major issues by 2001.
- (b) ADB will set up cooperative arrangements with the IMF, World Bank, United Nations Development Programme (UNDP), and major bilateral aid agencies to carry out governance assessments and public expenditure reviews in the DMCs.

5. Strengthening ADB's Governance Capacity

- (a) ADB will provide governance specialist positions to all operational departments and ensure that a minimum critical mass is built up for the effective implementation of the governance policy. In addition, resources will be provided to engage specialized experts to respond to the demand for governance reforms, as reflected in CSPs, through TAs or as staff consultants.
- (b) ADB will develop governance and institutional databases on each DMC.⁴⁷ The latter will include information about the strengths and weaknesses of key executing agencies in the priority sectors assisted by ADB. ADB will also enhance its project performance reports so that information is collected about the contribution that projects are making to improved governance.
- (c) ADB will elaborate the links between good governance and poverty reduction, private sector development, and political and institutional frameworks, and ensure that the links are recognized in project designs and in promotional material prepared by ADB.
- (d) Managers and mission leaders will be appropriately trained and provided with toolkits for effectively addressing governance issues in project design. The training will encompass case studies illustrating key lessons learned about governance and the case studies will be updated regularly as more information becomes available.

⁴⁶ The four subgroups cover (i) incorporating improvements in performance-based allocation systems; (ii) improved DMC governance environment; (iii) improved project management; and (iv) improved anticorruption work.

⁴⁷ To avoid duplication of effort, work on establishment of databases will be coordinated with the World Bank and other concerned development agencies.

6. Monitoring Implementation of the Action Plan

- (a) In the first quarter of 2001, based on the approved action plan, ADB will present to its Board a work program on governance. The program will include measurable and monitorable actions and targets for 2001.
- (b) Beginning 2002, ADB will provide an annual report to its Board on implementation of the action plan. The report will include information on actual achievements against the actions and targets in the annual work program, lessons learned, and a work program for the next year.

VI. CONCLUSIONS AND RECOMMENDATIONS

89. The following general conclusions emerge from this review of the evolution of ADB's policy on governance and experience with governance activities since 1995.

- (i) The 1995 policy, including the General Counsel's opinion on Article 36, has proven flexible enough to accommodate subsequent development of ADB policy and practice.
- (ii) The 1995 policy, together with subsequent policies on procurement, law and development, participation of civil society and anticorruption, the poverty reduction strategy, and the planned performance-based allocation system constitute a cluster of good governance policies that provides ADB with a sound basis for addressing most of the governance problems confronting DMCs.
- (iii) During the last five years, ADB has been active across a wide spectrum of governance areas and has implemented a large number of projects aimed at improving governance in DMCs.
- (iv) The quality of governance is today the subject of a healthy debate in many DMCs. Consequently, ADB can now pursue a focused, selective, and strategic approach to address a broad and vigorous governance agenda in the region.

90. Based on an overall assessment of ADB's governance operations and the lessons learned from implementing projects with governance objectives, ADB has formulated a medium-term governance agenda and action plan for the period 2000-2004. The objective of the agenda and action plan is for ADB to take a lead role in promoting good governance in the Asian and Pacific Region. More specifically, it aims to elevate governance issues to the top level of the development agenda in the region; build consensus on regional benchmarks, codes of conduct, and indicators of good governance; and enhance the quality of governance in individual DMCs.

91. The Boards' approval is sought for the medium-term governance agenda and action plan presented in Chapter V.

APPENDIXES

Number	Title	Page	Cited on (page, para.)
1	Selected ADB Projects with a Major Governance Focus	28	5, 15
2	Governance Action Plan 2000-2004	52	22, Section V.C
3	Regional Program for Good Governance	56	23, Section V.C 2(a)

SELECTED ADB PROJECTS WITH A MAJOR GOVERNANCE FOCUS

A Core Government Functions and Public Sector Management

1. Core Government Functions

a. Public Sector Reforms in the Pacific

1. The Office of Pacific Operations has played the biggest role in supporting whole government reforms. The Office has processed and reviewed seven such loans (to Cook Islands, Marshall Islands, Federated States of Micronesia, Nauru, Samoa, Solomon Islands, and Vanuatu).¹ The findings of these loans is as follows.

“...The reform initiatives have been substantially internally generated, and committed political effort has gone into maintaining the reform momentum. The funding agencies have responded appropriately, with the Asian Development Bank (ADB) generally taking the lead in developing the reform framework as a basis for external assistance. Some reform programs have been overly ambitious. On the other hand, in retrospect, the reform programs have usefully capitalized on initial enthusiasm, and have generated substantive policy, legal, and institutional gains even in those cases where the momentum is now slowing. Results achieved to date have justified the Bank’s change of strategic focus in the Pacific.

The reform programs in the Pacific have only recently begun. Being change processes, they are long-term in nature. Sustainable change must be evolutionary change, allowing time for internalization and institutionalization of new modes of behavior and operation. The programs must also be and remain continuous learning processes. There are no ready formulae, recipes, or models that have all the answers and which can assure success. There are, however, important principles that must be respected and used in designing and implementing these reform processes...”

b. Governance Reform Program Loan: Mongolia

2. Mongolia’s Governance Reform Program is a pilot phase of a 10-year Government initiative to address governance issues in the public sector and how they impact on the whole economy.² Under this Program, in parallel with the administrative reforms, which will be pursued in a phased manner across three layers of central Government, local government, and state-owned enterprises (SOEs), output-oriented budgetary reforms will be introduced at both the central and local government levels. An outcomes-based public expenditure management system will be established within the Ministry of Finance, and through the administrative reforms, agency and local government budgeting will be linked systematically with this system. Table A1 summarizes the reforms.

¹ Loan 1466-COO: *Economic Restructuring Program*, for \$5 million, approved on 26 September 1996; Loan 1513-RMI: *Public Sector Reform*, for \$12 million, approved on 30 January 1997; Loan 1520-FSM: *Public Sector Reform*, for \$18 million, approved on 29 April 1997; Loan 1608-SAM: *Financial Sector Program Loan*, for \$7.5 million, approved on 19 February 1998; Loan 1627-SOL: *Public Sector Reform Program*, for \$25 million, approved on 27 August 1998; and Loan 1624-VAN: *Comprehensive Reform Program*, for \$20 million, approved on 16 July 1998.

² Loan 1713-MON: *Governance Reform Program*, for \$25 million, approved on 2 December 1999.

Table A1: Spectrum of the Public Sector Governance Reforms in Mongolia, 1999-2009

Central Government	Local Governments	State-Owned Enterprises
Implement initial requirements of the reforms (PP) <ol style="list-style-type: none"> 1. Budgetary reforms : <ul style="list-style-type: none"> · Improve strategic prioritization and resource allocation · Stabilize public sector finances · Improve budget execution 2. Establish standards for public sector personnel management 3. Strengthen financial policy coordination 4. Improve banking, cash flow, debt, and investment management 	Design an implementation strategy (PP) Formalize division of responsibilities between central and local governments Introduce output contracting	Privatization Management reform (PP) Transparency Improve financial governance
Strengthen strategic focus at portfolio level <ul style="list-style-type: none"> · Bunch 1 (PP) · Bunch 2 (EPP) · Bunch 3 · Three pilot portfolio ministries (EPP) · Other ministries 	Increase focus on core functions 20 local budgetary bodies (EPP)	
Administrative reforms (performance contracting) <ul style="list-style-type: none"> · Bunch 1 (PP) · Bunch 2 (EPP) · Bunch 3 	Administrative reforms <ul style="list-style-type: none"> · One or two pilot provincial government's bunch 1 (PP) · Other provincial governments 	

Bunch: Public sector agencies are divided into small groups for implementing the administrative reforms;
 EPP: Will begin to implement reforms during the pilot program, but only after review of earlier experience;
 PP: Will be implemented under the pilot program (1999-2002).

c. Public Resource Management Program: India

3. The Program supports reforms to improve public finances in India's largest state, Madhya Pradesh, including raising tax revenues, cutting subsidies, and channeling funds raised from these actions into more social services urgently needed by the poor.³

4. In this Program, governance activities include (i) improving the capacity of government agencies in financial and fiscal management; (ii) reforming the tax system and cutting subsidies to increase state revenues and reduce state expenditure; (iii) reforming the public enterprise sector, including shutting down some of them; (iv) establishing and strengthening the policy, regulatory, and institutional frameworks governing private sector participation; and (v) directing increased revenues and other savings to vital social services, such as basic health and primary education to support human development.

d. Strengthening the State Law Office and Law Reform and Capacity Building: Vanuatu

5. The first technical assistance (TA)⁴ supports the Government to strengthen the State Law Office (SLO), improve the quality of legislation, and improve the advice on reform measures. (i) During 1999, all the experienced legal staff except the Attorney General left SLO for the private sector. Through the TA, four fresh graduates were recruited, trained in litigation and legal negotiation, and guided in the requirements of drafting legislation, statutory interpretation, and compliance issues. Major attention was paid to the problems of money laundering and property checking in the offshore banking centre. (ii) The TA helped to improve the quality of legislation, focusing on ensuring appropriate links between reform measures—a patents act, copyright act, trade marks act, e-commerce act, forest harvest act, and interactive gaming act have been drafted. The TA is drawing up amendments to the Financial Institutions Act and the Banking Act to ensure that anti-money laundering conditions are met, and a new set of Rules for the Supreme Court of Vanuatu. (iii) The TA is helping to improve the quality and timeliness of advice provided to Government ministries on the legal implications of reform measures. The reform was principally addressed by reorganizing SLO processes and the way in which they stored and filed information.

6. The second TA⁵ directly supports the Program's objectives by ensuring there is due process in the operations of SLO and central Government institutions.

e. Governance and Public Sector Reform Program: Papua New Guinea

7. The TA supports the Government's public sector reform program by maintaining full collaboration with all other reform and structural improvement efforts.⁶ The TA has supported the forum set up to drive the reform program, the Central Agencies Committee. It outlined the set of issues that need to be addressed and could be used as a basis to prioritize a reform plan. It also proposed some ideas about measures that could be taken to address the disappointing level of service delivery currently experienced in Papua New Guinea. The main present

³ Loan 1717-IND: *Madhya Pradesh Public Resource Management Program*, for \$250 million, approved on 14 December 1999.

⁴ TA 3197-VAN: *Strengthening the State Law Office*, for \$150,000, approved on 29 May 1999.

⁵ TA 3366-VAN: *Law Reform and Capacity Building*, for \$300,000, approved on 23 December 1999.

⁶ TA 3280-PNG: *Governance and Public Sector Reform Program*, for \$600,000, approved on 16 October 1999.

concern of the Committee is a public expenditure review that is being supported by the World Bank.

f. Economic Policy Reform and Management: Federated States of Micronesia

8. The TA supports the Government in establishing far-reaching structural adjustment policies to prepare the country for the post-Compact era.⁷ A project management unit is assisting the federal and state governments to implement the agreed reform measures and producing economic information to help the government monitor impacts. State public services have been reduced by up to 37 percent, though this has had serious repercussions on the local economies and little impact on productivity. Privatization has tended to be sluggish.

g. Institutional Support to Central Agencies for the Comprehensive Reform Program (Phases 1 and 2): Vanuatu

9. The TAs support the Department of Strategic Management and help strengthen financial and economic management of the central agencies for program implementation.⁸

h. National Reform Program: Nauru

10. The TA is supporting the Government formulate a national reform program by identifying policy and strategic options.⁹ A policy options paper led to an awareness of the need for reforms, but was not acted upon as the reform government lost its majority. It did, however, result in a program loan incorporating several reform measures. These included downsizing the public service, which has reduced the payroll by 30 percent, and transparency in budget preparation. An independent audit and valuation of the Trust Fund Assets, which is key to the reform program, has only recently been addressed. The value of the fund has been established. Progress has been hampered by frequent changes of government.

i. Workshop on Key Themes and Priorities for Governance and Capacity Building in the Asian and Pacific Region

11. This regional TA financed a workshop in Manila that developed the definition of ADB's main areas of concern in governance and public management.¹⁰ The workshop brought together experts on all the major governance areas, as well as leading developing member country (DMC) policymakers, to discuss the technical soundness and operational viability of current and proposed ADB governance and capacity-building work.

⁷ TA 3024-FSM: *Economic Policy Reform and Management*, for \$1.377 million, approved on 2 June 1998.

⁸ TA 2984-VAN: *Institutional Support to Central Agencies for the Comprehensive Reform Program (Phase 1)*, for \$630,000, approved on 23 January 1998, and TA 3046-VAN: *Institutional Support to Central Agencies for the Comprehensive Reform Program, (Phase 2)*, for \$1.2 million, approved on 16 July 1998.

⁹ TA 2617-NAU: *National Reform Program*, for \$100,000, approved on 25 July 1996.

¹⁰ TA 5768-REG: *Workshop on Key Themes and Priorities for Governance and Capacity Building in the Asian and Pacific Region*, for \$190,000, approved on 31 December 1997.

2. Public Expenditure Management

a. Financial Management: Papua New Guinea

12. The Project¹¹ will improve planning and budgeting systems, and budget execution and accounting systems, and link them up in a more integrated information technology system. The Project, cofinanced by Australia, has a major focus on human resource development and accounts personnel. Better public sector financial management will underpin future programs of public sector, economic, and governance reforms. Overspending, waste, and corruption will be reduced, allowing more resources to be channeled into poverty reduction and social sector programs.

b. Economic Restructuring Program: Cook Islands

13. The Cook Islands' Economic Restructuring Program,¹² has produced (i) the revised Ministry of Finance and Economic Management Act requiring the Government to maintain operating expenses within the limits of the Government's internally generated revenues and to publish statements of its fiscal and economic strategy before its budgets are drawn up; (ii) the Public Expenditure Review Committee Audit Act, which created an independent committee with wide powers to review all aspects of public finance so as to ensure transparency of national and local bodies, and provides for the adoption of generally accepted international accounting principles throughout the Government; and (iii) the Public Service Act which gives heads of ministries the power and responsibility to staff and manage their departments according to good employment principles to achieve defined outputs required by their own performance contracts.

c. Public Expenditure Management and the Implications of Decentralization: Indonesia

14. This TA is to develop internal Government capacity to initiate and guide performance-oriented reforms in public expenditure management.¹³ This TA is a component of the Anticorruption Action Plan for Indonesia prepared by ADB at the request of and with the support of the Government.

d. Strengthening Public Expenditure Management Systems: Sri Lanka

15. A long-term program of public expenditure management reform was started in 1993 with the Financial Management Training Project.¹⁴ The Project was to computerize public accounting systems throughout the public service; however most agencies had no experience with information technology systems. A low-level system was developed to familiarize personnel with computerized accounting. The Project introduced scores of accounting personnel to computerized systems and trained them in their use, accelerated the production of monthly financial statements to the Ministry of Finance and Planning, and strengthened the Office of the Auditor General. A second stage has been initiated through a cluster TA¹⁵ to help the Ministry of Finance and Planning design a public expenditure information and management system,

¹¹ Loan 1703-PNG: *Financial Management*, for \$25.8 million, approved on 21 October 1999.

¹² Loan 1466-COO: *Economic Restructuring Program*, for \$5 million, approved on 26 September 1996.

¹³ TA 3394-INO: *Public Expenditure Management and the Implications of Decentralization*, for \$225,000, approved on 25 January 2000.

¹⁴ Loan 1275-SRI: *Financial Management Training Project*, for \$13 million, approved on 29 November 1993.

¹⁵ TA 3301-SRI: *Strengthening Public Expenditure Management Systems*, for \$3 million, approved on 16 November 1999.

develop a medium-term expenditure framework, and support these changes by revising the Finance Act and improving the internal audit function throughout the service.

e. Workshop on Public Expenditure Management in the World Conference on Governance 1999

16. This regional TA financed the public financial and accountability component of the World Conference on Governance in Manila in May-June 1999.¹⁶

f. Public Expenditure Management and Public Administration

17. This regional TA¹⁷ financed the writing of two major ADB publications, *Managing Government Expenditure* (published in April 1999) and *To Serve and Preserve: Improving Public Administration* (forthcoming in October 2000). It is also financing a series of in-country workshops on the programming and management of public expenditure. A first series, with assistance and financing by the ADB Institute, took place in Cambodia and Viet Nam in September-October 1999. The second workshop was held in March 2000 in India for Ministry of Finance officials. Others will be organized as requests are made by the countries concerned.

3. Public Administration Reforms

a. Public Sector Reform Program: Solomon Islands

18. The Program's main objectives are to (i) support macroeconomic and fiscal policy reforms; (ii) support public sector management reforms, reorientation of the public sector, and movement toward performance-based management; (iii) support reform of public enterprises; and (iv) strengthen governance institutions to improve accountability and transparency in the Government.¹⁸ Medium-term targets included (i) cutting the payroll cost by about 9 percent, which was done within 12 months; (ii) balancing the budget, which, under current economic conditions, is more difficult than earlier but there is now much tighter control of public expenditure; (iii) linking the medium-term budget framework to the medium-term development strategy, which has been completed; (iv) placing tight centralized controls on Government finances, which has been done by revitalizing the warrant system; (v) forming within the Prime Minister's Office an institutional strengthening unit, which has been operating; (vi) placing ministry secretaries on performance contracts with specific deliverables, which is now operational after a series of workshops and practical assistance; (vii) implementing for senior officers and managers an executive development program, which is now operational; (viii) setting measurable output targets in ministry budget submissions, which is being pilot tested in four ministries; (ix) streamlining/simplifying public service employment laws and procedures, which will be addressed in a new Public Service Act; (x) reengineering work processes and structures in key ministries, which is being done in a continuous improvement program; and (xi) eliminating the backlog of national Government accounts and audits, which is being progressively addressed with audits having been completed to 1997 (there had been none since 1985). The current political crisis in the country is a significant setback for the program, which will need to be reviewed and reformulated upon the return to normalcy.

¹⁶ TA 5833-REG: *Workshop on Public Expenditure Management in the World Conference on Governance 1999*, for \$75,000, approved on 12 February 1999.

¹⁷ TA 5813-REG: *Public Expenditure Management and Public Administration*, for \$500,000, approved on 27 October 1998.

¹⁸ Loan 1627-SOL: *Public Sector Reform Program Loan*, for \$25 million, approved on 27 August 1998.

b. Comprehensive Reform Program: Vanuatu

19. The loan supports the Comprehensive Reform Program, which addresses key governance, public sector, and financial and economic reform issues.¹⁹ Under the Program, major legislative, policy, institutional, and structural reforms are being effected to restore stability and confidence in, and to revitalize, the economy. A key element of the reforms was the enactment of new legislation to redefine and separate the boundaries between the political leadership and the public sector. The legislation, however, is now being reviewed by the new Government. Other intended reforms included establishing more transparent and accountable financial management and regulatory regimes, and creating a smaller and more efficient public service, which, as yet, have not been addressed satisfactorily. In restructuring the economy, the program has (i) created a broader tax base with the introduction of a value added tax (VAT) and through a lower and more uniform tariff structure; (ii) sought to increase spending on social programs, especially health and education; and (iii) tried to open the economy to attract direct foreign investment through the Foreign Investment Act, which has been subsequently amended against the spirit of the reform program.

c. Social Sector Reform Program: Thailand

20. The Social Sector Program was developed by the Thai Government with the assistance of ADB in cooperation with a number of aid agencies.²⁰ The Program will support activities and policy reforms in the labor, health and social welfare, and education sectors, and the administrative decentralization of health and education services. The higher education project, for example, contains provisions to promote increased accountability and autonomy of higher education institutions, and improve teacher incentives through merit-based promotion and a competitive salary structure. A key reform at the central level is to improve the targeting of poverty spending through the Bureau of Budget allocating budgets based on incidence of poverty. It is too early to measure the impacts. Also the government has simplified procedures for private enterprises to obtain tax deductions for training, but their impact is only just beginning to be measured. In the education sector, an independent school inspection body has been established to improve performance-based school management. The Ministry of Education is to reduce its headquarters' staff by 25 percent and has started the process. The Ministry of Health has agreed to deploy more personnel to rural areas to improve service delivery to the poor, but numbers are not yet available. The Government also agreed to start corporatizing (restructuring as a corporation) one rural hospital by delegating sufficient authority over administrative, financial, and personnel matters.

d. Formulating an Action Plan for Civil Service Reform: Nepal

21. The TA²¹ supports preparatory activities for developing a civil service reform project by reviewing legislation and rules relating to the public service and developing a set of recommendations to incrementally introduce the best-known practices to its public service.

¹⁹ Loan 1624-VAN: *Comprehensive Reform Program*, for \$20 million, approved on 16 July 1998.

²⁰ Loan 1611-THA: *Social Sector Reform Program*, for \$500 million, approved on 12 March 1998.

²¹ TA 3117-NEP: *Formulating an Action Plan for Civil Service Reform*, for \$630,000, approved on 14 December 1998.

e. Strengthening Capacity for Public Administration Reform: Viet Nam

22. The TA is helping formulate a public administration reform strategy, inclusive of a medium-term action plan, centered on achieving more effective coordination of ministries at the center, and stronger linkages between the center and the provinces.²²

f. Public Sector Management Reforms, Strengthening of Public Sector Management: Solomon Islands

23. These TAs are to help the Government prepare and implement a strategy and action plan to introduce results-based management in the public sector²³ and strengthen the capacity of the Privatization Unit of the Ministry of Finance to implement the Government's Privatization Policy.²⁴ While it is too early to introduce results-based management linked to the budget, but, through the continuous improvement program, results-based targets have been introduced at the service delivery level. The main target for privatization was the Solomon Islands Plantations. The current insurgency has complicated the timing of privatization.

g. Public Service Reform Program: The Marshall Islands

24. The TA is providing guidance on the implementation of public service reforms as part of the Public Sector Reform Program loan (footnote 1), and is designing training and counseling programs for retrenched civil servants.²⁵ Progress has suffered as the political and economic situation has fluctuated. A target for the public service to have 1,484 officers was met, with over 600 public servants retrenched.

4. Legal System Reform

a. Development of Economic Laws: People's Republic of China

25. In support of the Government's economic reform policy, one of the objectives of the legislative program of the People's Republic of China (PRC) is to establish a legal and regulatory framework appropriate for a market economy. To support this, Appendix 1, page 16 prepare seven key economic laws and regulations that have been given priority since 1999–2001. ADB will help the PRC (i) amend the Company Law, (ii) enact a new bankruptcy law, (iii) complete a trust law, (iv) provide for laws on closure and restructure of financial institutions, (v) develop a social security law, (vi) draft a new law on registration of commercial and industrial organizations, and (vii) develop an administrative licensing law.²⁶

26. This law reform program will result in a legal and regulatory framework conducive to economic reform, effective administration of corporations, improvement of corporate governance, and creation of conditions of fair competition for different types of enterprises. The new bankruptcy law and law on closure and restructuring of financial institutions will be essential to ensure the efficient and productive use of resources. The trust law will enable the emergence

²² TA 3023-VIE: *Strengthening Capacity for Public Administration Reform Phase II*, for \$995,000, approved on 28 May 1998.

²³ TA 3009-SOL: *Public Sector Management Reforms*, for \$150,000, approved on 20 April 1998.

²⁴ TA 3061-SOL: *Strengthening of Public Sector Management*, for \$600,000, approved on 27 August 1998.

²⁵ Loan No. 1515-RMI: *Public Sector Reform Program*, for \$12,000,000, approved on 30 January 1997.

²⁶ TA 3279-PRC: *Development of Economic Laws*, for \$1.4 million, approved on 19 October 1999.

of new vehicles for financial investment and asset management in the form of pension funds, mutual funds, housing assistance funds, and financial asset management companies. The new social security law—covering unemployment benefits, accidental injury and death, and pensions—is an essential part of the PRC's transformation from a centrally planned to a market economy. TA implementation will put in place a legal and regulatory framework that will reduce the risk of a financial crisis.

b. Dissemination of Laws and Strengthening of the Legal Information System: Tajikistan

27. The TA helped establish the Law Reform Commission, disseminate laws of Tajikistan, and train Tajik lawyers.²⁷ It is too early to ascertain the impact of the Law Reform Commission.

c. Provincial Legislation for Environmental Protection and Natural Resources Conservation: People's Republic of China

28. One of the most pressing areas for policy reform in the PRC is land administration. The improper pricing of landed natural resources has contributed to extensive soil erosion, deforestation (accompanied by silting of rivers), and (most importantly) high rates of conversion of farmland to industrial and residential uses. Under a previous TA, a team of environmental law specialists from the University of Peking Law School and New York University School of Law worked with the Environmental and Natural Resources Protection Conservation Committee (EPNRCC) of the National People's Congress to draft a national land administration law. It contains important and innovative mechanisms to more appropriately price farmland upon conversion, and to compensate farmers whose land is taken for development purposes. Because provinces have considerable autonomy in the PRC, national laws usually need to be supplemented by provincial implementing legislation. In this TA,²⁸ a team of law specialists from the two universities worked with the EPNRCC of the Sichuan People's Provincial Congress to draft and implement a provincial land administration law to implement the National Land Administration Law. In December 1999, the Sichuan People's Congress adopted the Implementation Measures of Sichuan Province on the Land Administration Law of the PRC. This adopts the most important farmland protection mechanisms of the national Land Administration Law. Representatives of all of the PRC's provinces will receive training based on the achievements of the Sichuan People's Congress.

d. Legal and Judicial Reform Project: Pakistan

29. TA for legal and judicial reform supported a diagnostic study of the legal system in Pakistan to identify the systemic causes of inefficient legal and judicial institutions, infrastructure, and procedures that are inimical to enterprise and economic development.²⁹ The study recommended ways to address the need for good governance measures, such as a freedom of information act and an administrative grievance mechanism; the internal governance of legal institutions, including establishing a national policy-making body and appointing provincial judicial ombudspersons; changes in incentives and reporting structures that will

²⁷ TA 3238-TAJ: *Dissemination of Laws and Strengthening of the Legal Information System*, for \$380,000, approved on 9 August 1999.

²⁸ TA 3123-PRC: *Provincial Legislation for Environmental Protection and Natural Resources Conservation*, for \$300,000, approved on 15 December 1998.

²⁹ TA 3015-PAK: *Legal and Judicial Reform*, for \$995,000, approved on 7 May 1998. This TA was in continuation of TA 2979-PAK: *Strengthening of Government Legal Services and the Subordinate Judiciary*, for \$150,000, approved on 31 December 1997.

improve judicial performance and accountability; delays and human resource constraints; and the financing of the judiciary to improve salary structures and judicial facilities. The recommendations are a deliberate effort to make strategic choices about reform activities and to structure credible institutions. This was followed by another TA,³⁰ which will provide the basis for a legal and judicial reform loan to Pakistan, which is slated for consideration in 2001.

5. Enhancing Service Delivery

a. Irrigation Sector: Philippines

30. The Project components include construction and rehabilitation of irrigation systems, and protection of water resources.³¹ Implementation and financial arrangements were designed to enhance the participatory, transparency, and accountability aspects of the National Irrigation Administration (NIA), a government-owned corporation and the project's executing agency. Under the Project, NIA is obligated to adopt client-oriented approaches that entail closer consultations with project clients (i.e., farmers and local governments), obtain informed consents of clients on subproject designs and cost-sharing arrangements, and conduct transparent discussions on accountability for the performance of irrigation systems built. In parallel with project implementation, the TA, *Review of Cost Recovery Mechanisms for National Irrigation Systems*,³² provides assistance in strengthening NIA's financial accountability to its shareholder—the Philippine Government.

b. Power Sector Restructuring Program: Philippines

31. The Program prepares the Philippine power industry for privatization. Currently, virtually all power generation is arranged through the financially strapped Government-owned National Power Corporation.³³ Privatization will shift the heavy financial burden of power sector development from the public to the private sector. Moving it to the competitive world of private business will lead to efficiencies in generation and distribution, and eventually lower electricity charges for consumers. Enabling legislation for industry restructuring has been passed in both houses of congress and the overall legislation is expected to be passed in September 2000. Implementing rules and regulations issued under the enabling legislation to support industry restructuring are expected to be approved by mid-2001.

c. Health Sector Development Program: Mongolia

32. The program loan³⁴ is supporting reforms to develop a more efficient health system that is sustainable in a market economy and to encourage private sector participation. The investment loan³⁵ is helping to improve the health system's management and infrastructure, as well as health service quality. Due to the time lag between a change and the results of the change being evident in the statistics, it is too early to verify the extent of the improvements. The reforms include strengthening and improving the quality of primary health care, developing

³⁰ TA 3433-PAK: *Strengthening of Institutional Capacity for Judicial and Legal Reform*, for \$2,900,000, approved on 27 April 2000.

³¹ Loan 1668-PHI: *Southern Philippines Irrigation Sector*, for \$60 million, approved on 18 December 1998.

³² TA 3235-PHI: *Review of Cost Recovery Mechanisms for National Irrigation Systems*, for \$300,000, approved on 4 August 1999.

³³ Loan 1662-PHI: *Power Sector Restructuring Program*, for \$300,000, approved on 16 December 1998.

³⁴ Loan 1568-MON: *Health Sector Development Program*, for \$4 million, approved on 4 November 1997.

³⁵ Loan 1569-MON: *Health Sector Development Project*, for \$11.92 million, approved on 4 November 1997.

an effective referral system for quality services, and introducing mechanisms to maximize private sector entrepreneurship in health service delivery. In the provinces, autonomous health boards with representatives from civil society and local government have established performance contracts with quantitative targets for the provincial and district hospitals. A new agency for licensing and accreditation of health personnel and health facilities has been established. In Ulaanbataar and the provinces, private medical practices provide primary health care under contracts including incentives to ensure that they deliver them to vulnerable and poor groups.

d. Education Sector Development: Kyrgyz Republic

33. The first loan provides program support for key government reforms in the policy areas of sector sustainability and efficiency, quality and relevance of basic education, and access to and equity in preschool and basic education.³⁶ Major reforms include the rationalization of the user-charge system for basic education, the state funding system for schools, and education sector staffing. The second loan was earmarked to help the Government with curriculum and textbook reform, teacher development, improvement of education delivery, and capacity building and resource mobilization.³⁷ At this early stage in project implementation, statistical information is not showing any discernible trends.

e. Health Sector Development Program: Papua New Guinea

34. The Program focuses on the provision of priority health services for women and children in rural areas, and supports improvements in the management and efficiency of the health systems.³⁸ Policy initiatives include shifting emphasis from urban to rural areas and from curative to preventive health care. Financial reforms aim at stable funding; better financial planning; greater reliance on user fees; and increased allocation of resources for drugs, supplies, and medical services. The Program, as part of the Government's strategy to decentralize authority to provincial and local level governments, emphasizes capacity-building in the nation's health care agencies, health centers, and posts; and closer collaboration with churches, nongovernment organizations (NGOs), and private health services. The principal achievement has been the collection of morbidity and other statistics across the country, which has increased the transparency of the effectiveness of the public health system throughout Papua New Guinea.

f. Fourth Rural Water and Sanitation Sector Project: Nepal

35. The Project addresses potable water supply and sanitation deficiencies in some of Nepal's most disadvantaged rural areas.³⁹ The sector loan aims to transform the Department of Water Supply and Sewerage from a project implementer to a facilitator, and adopts a community-based, user-responsive approach for subproject formulation, implementation, and operation and maintenance.

³⁶ Loan 1554-KGZ: *Education Sector Development Program*, for \$19 million, approved on 29 September 1997.

³⁷ Loan 1555-KGZ: *Education Sector Development Project*, for \$13.7 million, approved on 29 September 1997.

³⁸ Loan 1516-PNG: *Health Sector Development Program*, for \$45 million, approved on 20 March 1997.

³⁹ Loan 1464-NEP: *Fourth Rural Water and Sanitation Sector Project*, for \$20 million, approved on 24 September 1996.

g. Capacity Building for Public Enterprise Reform and Social Safety Net in Madhya Pradesh: India

36. The TA is supporting the government of Madhya Pradesh's efforts to develop and implement a comprehensive and socially sustainable program of public enterprise reforms and to strengthen institutional capacity.⁴⁰

h. Restructuring State Level Housing Institutions: India

37. The objective of the TA is to facilitate the transformation of the state housing boards, which have been the main provider of low cost housing with state subsidized funds, from government-owned housing agencies to market-based, demand-driven housing institutions.⁴¹ The TA will improve the accountability of the management of the state housing boards by introducing commercial accounting and management information systems. The changes will be the first step in moving the housing boards toward corporatization. Over the long run, the changes are expected to enable the housing boards to improve their service delivery efficiency and capability.

6. Public Accountability

a. Establishment of an Anticorruption Commission: Indonesia

38. The TA is helping to establish an independent anticorruption commission. An important component of this TA will be vigorous public dissemination and consultations on the purposes of the commission and related anticorruption legislation.⁴² The TA will provide contextualized best international and regional practices in establishing and successfully operating an independent anticorruption commission.

b. Strengthening the Government Auditing System: PRC

39. The TA is assisting the PRC's National Audit Office to formulate and implement Government auditing standards and procedures aligned with international auditing standards.⁴³ The TA is helping improve the efficiency and effectiveness of Government audits, thus enhancing transparency and public accountability. It will also help reduce waste and abuse of public funds, thus contributing to combating corruption in the PRC, and ensuring funds directed at poverty reduction programs are more likely to reach their destination.

c. Establishing the National Audit Office: Lao People's Democratic Republic

40. The TA is helping set up the National Audit Office, draft a five-year operational plan, carry out a training program, prepare an audit manual, implement guidelines for audits, and conduct four pilot audits.⁴⁴

⁴⁰ TA 3338-IND: *Capacity Building for Public Enterprise Reform and Social Safety Net in Madhya Pradesh*, for \$600,000, approved on 14 December 1999.

⁴¹ TA 3067-IND: *Restructuring State Level Housing Institutions*, for \$500,000, approved on 11 September 1998.

⁴² TA 3381-INO: *Establishment of an Anticorruption Commission*, for \$1 million, approved on 28 December 1999.

⁴³ TA 3103-PRC: *Strengthening the Government Auditing System*, for \$700,000, approved on 27 November 1998.

⁴⁴ TA 2987-LAO: *Establishing the National Audit Office*, for \$400,000, approved on 9 February 1998.

d. Long-Term Training Program for Members of Supreme Audit Institutions, Phase I and Phase II; Long-Term Regional Training Program for Members of the South Pacific Association of Supreme Audit Institutions

41. The two regional TAs have contributed to continuous training of government auditors by creating a pool of qualified trainers available at the regional and local levels. With the supreme audit institutions' crucial role in strengthening accountability in public sector management, audit training programs promote good governance and increase the level of fraud awareness among government auditors.⁴⁵

e. Accountability Mechanisms in the Asian and Pacific Region

42. This regional TA financed a major workshop on anticorruption organized jointly with the Organization for Economic Cooperation and Development (OECD) at ADB's request. The workshop was held in Manila in September 1999. The scope of the TA has been changed to include financing of a follow-up workshop on anticorruption in Seoul, Korea in December 2000 and reorientation of the case studies and surveys from accountability institutions toward urban local governments. The latter will involve pilot testing report card surveys in the 11 cities of Metro Manila and institutionalizing the survey as a means of promoting greater accountability and better delivery of local public services. The TA is also intended to support the establishment of a "whistleblower" protection scheme for people who report on corruption in Bangladesh.⁴⁶

B. Improving Governance at Subnational Levels

1. LGU Private Infrastructure and Project Development Facility: Philippines

43. Local government units (LGUs) currently lack capacity and resources to prepare projects and solicit private sector participation. They instead depend on private firms approaching them, and preparing and developing project proposals. Unsolicited project proposals do not always provide the best value for money nor fully conform with the communities' needs. Now LGUs have access to the LGU Private Infrastructure Development Facility, for which a \$3 million TA loan was approved by ADB.⁴⁷ This gives them more control over their projects, and provides more equal competition among bidders, which ultimately will benefit the local community.

⁴⁵ TA 5688-REG: *Regional Long-Term Audit Training Program for Members of the Asian Organization of Supreme Audit Institutions, Phase I*, for \$1 million, approved on 13 June 1996; TA 5872-REG: *Regional Long-Term Audit Training Program for Members of the Asian Organization of Supreme Audit Institutions, Phase II*, for \$300,000, approved on 3 December 1999; and TA 5830-REG: *Long-Term Regional Training Program for Members of the South Pacific Association of Supreme Audit Institutions*, for \$700,000, approved on 3 February 1999.

⁴⁶ TA 5829-REG: *Accountability Mechanisms in the Asian and Pacific Region*, for \$500,000, approved on 31 December 1998.

⁴⁷ Loan 1729-PHI: *LGU Private Infrastructure and Project Development Facility*, for \$3 million, approved on 20 December 1999.

2. Karnataka Urban Development and Coastal Environmental Management: India

44. The Project provides essential urban infrastructure and municipal services that will improve the lives of a million people.⁴⁸ Services include urgent improvements in water supply and sanitation facilities, solid waste and wastewater management, and roads and traffic management. Significantly, the Project is part of a Government strategy to shift the responsibility for municipal management from states to cities. Capacity building is provided at state and local levels to support this. Community participation plays a major role in the design and implementation of subprojects.

3. Community and Local Government Support: Sector Development Program: Indonesia

45. With increasing public awareness of governance-related issues, the Government of Indonesia is striving to improve transparency, accountability, and public participation. Heightened emphasis is being placed on the responsiveness and efficiency of basic services, particularly for the poor. A regional government law and a law on intergovernmental fiscal relations, which are under consideration by Parliament, will strengthen the policy framework for decentralization and increase the responsiveness of local governments and communities to address the needs of the poor. A \$200 million policy loan component supports a set of reforms under the Government's decentralization program to devolve administrative and fiscal authority from central to district governments.⁴⁹ Three TAs are attached to the program loan to support decentralized administrative systems;⁵⁰ set up district-level financial and budgetary systems;⁵¹ and implement participatory planning, monitoring, and evaluation.⁵² A second ADB loan, for \$120 million, will fund a project aimed at both capacity building at the district government level and poverty reduction.⁵³

4. Social Protection Sector Development Program, Health and Nutrition Sector Development Program: Indonesia

46. Policy reforms implemented under the two loans strengthened decentralization, giving autonomy and responsibility to local schools and health services through village and district committees to better meet local needs. The management structure is highly decentralized to allow local decision making and beneficiary targeting.⁵⁴ The programs incorporate measures to support efficient, effective, accountable, and transparent public administration. Effective external

⁴⁸ Loan 1704-IND: *Karnataka Urban Development and Coastal Environmental Management*, for \$175 million, approved on 26 October 1999.

⁴⁹ Loan 1677-INO: *Community and Local Government Support: Sector Development Program*, for \$200 million, approved on 25 March 1999.

⁵⁰ TA 3177-INO: *Capacity Building to Support for Decentralized Administrative Systems*, for \$500,000, approved on 25 March 1999.

⁵¹ TA 3178-INO: *Capacity Building for Setting Up District Level Financial and Budgetary Systems*, for \$460,000, approved on 25 March 1999.

⁵² TA 3179-INO: *Capacity Building for Participation, Monitoring, and Evaluation*, for \$1.54 million, approved on 25 March 1999.

⁵³ Loan 1678-INO: *Community and Local Government Support: Sector Development Program – Project Loan*, for \$120 million, approved on 25 March 1999.

⁵⁴ Loan 1622-INO: *Social Protection Sector Development Program*, for \$100 million, approved on 9 July 1998, and Loan 1675-INO: *Health and Nutrition Sector Development Program*, for \$100 million, approved on 25 March 1999.

monitoring and oversight mechanisms are in place, while internal capacity to manage, and monitor (and audit) expenditures is being developed.

47. The Programs are introducing a system of block grants to public and private schools and health centers, giving these units the authority to plan and manage their resources, and introducing a formula linking resource allocation to the district poverty index. Adoption of an objective (pro-poor) formula for resource allocation minimizes inappropriate or inefficient distribution of resources based on national norms, subjective decisions, and rent-seeking during the budgeting process. The block grant mechanism bypasses ordinary bureaucratic systems—the post office system is the conduit to move program funds directly to districts—to ensure direct, timely, and predictable support to providers and beneficiaries. The block grant approach has since been adopted as the Government's primary mechanism to channel budgetary support for the education and health sectors. It is a major step in decentralization and greatly simplifies fund flow mechanisms. Attached to the Social Protection Program was a \$2.5 million grant provided by the Government of Australia to monitor scholarships and block grants. The grant has contributed significantly to good governance by collecting data on scholarship and block grant targeting and utilization and establishing a complaints resolution mechanism. 7,600 junior secondary schools and 44,000 primary schools have established functioning committees. The names of scholarship holders are publicly posted. Student perceptions have been surveyed. 82 percent believe that scholarships have successfully targeted the poor and very poor. In the context of block grants, 95.2 percent have been applied for purposes specified in the guidelines. A number of complaints have been verified and the officials concerned have been transferred or demoted, but the numbers have been small, partly because the bureaucratic requirements for investigation are tedious, but largely because the system is working well. The monitoring system can be considered a model for monitoring of subsequent programs funded by ADB.

5. Gujarat Public Sector Resource Management Program: India

48. The state of Gujarat in India faces wide-ranging structural challenges in the public finance area because of stagnation in resource mobilization, weak fiscal management, growing inefficiency of SOEs, and lack of support for efficient infrastructure. ADB's program loan of \$250 million, for the first subnational operation in India, supports the Gujarat government in augmenting domestic resource mobilization, improving the allocation and efficiency of public resources, and reducing the government's role in commercial activities, while promoting market-oriented policies to enhance private sector participation in physical infrastructure.⁵⁵ To support the program loan, ADB provided TA to strengthen institutional capacities for budget policy, planning, and modernizing tax administration to improve transparency and accountability.⁵⁶ An additional TA to develop a restructuring program for SOEs aims to strengthen the technical secretariat charged with the responsibility for the restructuring.⁵⁷ The construction of a core investment plan has enabled state expenditures to be prioritized and rationalized and protected expenditures for social and economic development from ad hoc budgetary cuts. As a result, Gujarat has not reduced its expenditure for social and economic development despite the fiscal pressures it is experiencing. Subsidies to state-owned utilities are now stated. Proposed tariff changes in the power sector are subject to review by the Gujarat Electricity Regulatory Commission according to a transparent process of public hearings. Such hearings were held in

⁵⁵ Loan No.1506-IND:Gujarat Public Sector Resource Management Program, for \$250 million, approved on 18 December 1996.

⁵⁶ TA 2668-IND: Gujarat's Reform of Public Finances, for \$600,000, approved on 23 October 1996.

⁵⁷ TA 2552-IND: Restructuring Program for State-Owned Enterprises in Gujarat, for \$500,000, approved on 2 April 1996.

February 2000 and should lead to Gujarat being the first Indian state to revise tariffs on the basis of operational and financial information analyzed by an independent regulatory authority.

6. Review of Provincial Government: Solomon Islands

49. The TA facilitates a revision of provincial government legal and institutional arrangements to achieve a more cost-effective, reliable, and sustainable delivery of essential services at provincial and subprovincial levels.⁵⁸

7. Study of Extrabudgetary Expenditures and Revenues: PRC

50. The TA helps the Government identify the responsibilities that various levels of government will assume under the fiscal reform program, redefine the concept and scope of the extrabudgetary funds and self-raised funds, and reinforce the management and distribution of these resources to ensure that authorities are adequately funded and a stated level of service delivery prevails across the various levels of government.⁵⁹

8. Enhancing Municipal Service Delivery Capability in Selected DMCs

51. The regional TA aims to pilot test the techniques of benchmarking and continuous improvement as a means to drive change in urban local governments. In a parallel activity, the ADB Institute supported the organization of the Asian Mayors' Forums in Cebu (1998), Colombo (1999), and Shanghai (2000) to exchange information on innovations and good practice in municipal management.⁶⁰ The pilot project has proven that the techniques are relevant and useful for promoting change, increasing customer satisfaction, improving quality and coverage of service delivery, and enhancing revenues at the municipal level. For example, customer complaint handling has dramatically improved through setting up a public assistance center in the municipal building, installing telephone hotlines, training customer complaint staff, broadcasting daily radio programs for airing of complaints and providing feedback, and monitoring complaints all the way through their resolution. In solid waste education and enforcement many innovative practices were adopted, including development of education programs for school children, waste separation by residents, and deputization of individuals and community-based organizations to issue citation tickets and impose on-the-spot fines in offenders. Also, significant opportunities for increasing revenues from property tax have emerged, and some municipalities have started to use vacant lots as paid parking, erected new parking signs to ease the flow of traffic, and revised parking regulations.

9. Governance and Development in South Asia and other DMCs

52. This regional TA focused on the needs of South Asian DMCs to identify what they can learn from other countries in the region. Activities included a regional seminar on Municipal Management Reforms held in Lahore in October 1997.⁶¹ An additional contribution toward

⁵⁸ TA 3171-SOL: *Review of Provincial Government*, for \$150,000, approved on 16 March 1999.

⁵⁹ TA 2743-PRC: *A Study of Extrabudgetary Expenditures and Revenues*, for \$600,000, approved on 31 December 1996.

⁶⁰ TA 5764-REG: *Enhancing Municipal Service Delivery Capability in Selected DMCs*, for \$550,000, approved on 24 December 1997.

⁶¹ TA 5664-REG: *Governance and Development in South Asia and other DMCs*, for \$350,000, approved on 22 December 1995.

sharing best practices in municipal governance was made through a workshop in Tokyo in February 1998, in collaboration with the ADB Institute.

C. Public-Private Interface

1. Financial Governance

a. Financial Governance Reforms: Indonesia; Financial Sector Program: Republic of Korea; Financial Markets Reform Program: Thailand

53. ADB assistance to the countries worst hit by the Asian crisis—Indonesia, Republic of Korea, and Thailand—has focused on financial governance. In Indonesia, the centerpiece of ADB assistance is the Financial Governance Reforms: Sector Development Program Loan.⁶² Its overall objective is to improve resource allocation in the financial and public sectors by adopting good practices in financial governance; increasing disclosure and transparency of financial information; and strengthening legal and regulatory frameworks for the financial sector. A key change has been the enactment of a new Central Bank Law that provides the bank with *de jure* independence that has progressively enabled it to assert more effective authority in the banking sector.

54. In the Republic of Korea, ADB contributed the \$4 billion Financial Sector Program loan⁶³ to the multilateral assistance package led by the International Monetary Fund (IMF). The loan supports the restructuring of financial institutions, combined with strengthening of regulation and supervision, as well as measures to liberalize and develop the capital market. There is now a central supervisory agency for the financial sector and the central bank is exercising greater oversight of monetary policy.

55. In Thailand, the Financial Markets Reform Program loan for \$300 million underpinned fundamental reforms for transparency and accountability in the financial sector.⁶⁴

b. Secured Transactions Law Reform and Insolvency Law Reform

56. In 1999, ADB held a two-part symposium, Secured Transactions Law Reform and Insolvency Law Reform, under two TA grants approved in 1998.⁶⁵ More than 150 senior judicial officers; government policymakers; central bank and private sector representatives; participants from the World Bank, IMF, and United Nations Commission on International Trade Law; and others attended the symposium.

57. The Asian financial crisis has illuminated the lack of frameworks in many DMCs for the systematic restructuring of debt and the efficient liquidation of businesses incapable of being restructured. As a first step to facilitate developing sound legal frameworks to address these problems, ADB studied the insolvency regimes in 11 Asian economies. The studies are published on the internet at www.insolvencyasia.com.

⁶² Loan 1618-INO: *Financial Governance Reforms: Sector Development Program Loan*, for \$1.4 billion, approved on 25 June 1998.

⁶³ Loan 1601-KOR: *Financial Sector Program*, for \$4 billion, approved on 19 December 1997.

⁶⁴ Loan 1600-THA: *Financial Markets Reform Program*, for \$300 million, approved on 19 December 1997.

⁶⁵ TA 5773-REG: *Secured Transactions Law Reform*, for \$300,000, approved on 6 January 1998, and TA 5795-REG: *Insolvency Law Reform*, for \$550,000, approved on 13 July 1998.

2. Corporate Governance

a. State-Owned Enterprise Reform and Corporate Governance Program: Viet Nam

58. Viet Nam is accelerating reform of its SOEs, especially removing policies and practices that favor SOEs over private enterprises, and making renewed efforts to attract foreign investors. The program's key aims are to strengthen the SOEs' institutional and policy framework, enhance corporate governance, and increase labor mobility.⁶⁶ As called for by the reform program supported by the loan, the Government has established the National Enterprise Reform Committee as a clearinghouse to identify priorities and sequencing of reforms, initiate pilot experiments, fine-tune strategy, and monitor and evaluate progress. In addition, the Government will corporatize 60 percent of all medium and large industrial SOEs, and will develop guidelines for corporate governance to be adopted by all firms to be listed in the stock exchange under the program. The Government will also strengthen its bankruptcy laws, and adopt international accounting and auditing standards. To facilitate SOE restructuring, a more flexible social insurance system will be introduced to allow great labor mobility.

b. Corporate Governance and Enterprise Reform Program and Capacity Building in Corporate Governance and Insolvency Procedures, the Kyrgyz Republic

59. The program loan's focus was on (i) strengthening internal governance structures of both private and state-owned companies; (ii) increasing competition, both external and domestic; (iii) implementing hard budget constraints including phasing down of subsidies to companies; (iv) strengthening insolvency procedures by introducing new law; and (v) introducing and adopting improved accounting standards.⁶⁷ As part of the program loan, legislative amendments have been enacted in the Law on Bankruptcy, the Civil Code, and the Law on Economic Societies and Partnerships. In addition, the Government also passed an important resolution stipulating that all joint-stock companies adhere to the Model Company Charter and the principles of corporate governance outlined in the *Handbook on Corporate Governance*, both prepared as a part of the program loan.

60. With regard to the hard budget constraints, significant and rapid progress has been made. As a first step, budgetary loans to SOEs in arrears were completely cut off in 1997. Subsequently, budgetary loans were to be halved every year from their initial level of Som320 million (\$7.4 million) in 1997 under the program loan. The actual phase-out has been even faster. In 1998, budgetary loans to enterprises fell sharply to Som73.7 million (\$1.7 million). In the 1999 budget, the Government allocated and extended only Som25.0 million for such loans. The loans are to be fully phased out as per the year 2000 budget.

61. Recognizing the importance of internationally accepted accounting standards (IAAS), the program has supported the development and promotion of accounting standards that conform to them. To this end, the Ministry of Finance established a department to develop and approve accounting methodology and standards, promulgate instructions, provide training, and license professional accounting and auditing activities. The Ministry of Finance has established the regulatory and technical basis for IAAS, including adoption of the core standards, a fully reformed chart of accounts, conversion and maintenance of new accounts and tax reconciliation

⁶⁶ Loan 1734-VIE: *State-Owned Enterprise Reform and Corporate Governance Program*, for \$40 million, approved on 21 December 1999.

⁶⁷ Loan 1546-KGZ: *Corporate Governance and Enterprise Reform Program*, for \$40 million, approved on 25 September 1997.

forms. IAAS have been introduced in a number of small and medium enterprises under the Accounting Reform Project financed by the United States Agency for International Development (USAID). About 1,100 joint stock companies (of 4,500 total registered enterprises) have converted to the new Kyrgyz Accounting Standards, modeled after IAAS, and over 3,000 individual accountants have been trained.

62. The amendments introduced to the Law on Bankruptcy and the Implementation Guidelines are considered to be sound in relation to the legal framework prevailing in other countries in central Asia. Just under 200 bankruptcy-related cases were registered in 1999, representing a more than 100 percent increase over the number of such cases in 1997 and 1998. However, the actual implementation has not been without hurdles, with significant problems noted in the following areas: (i) circuitous nature of the appeals process, leading to considerable delays in final judgements; (ii) lack of transparency in rulings; and (iii) political interference in the judicial decision-making process.

63. Against this backdrop, the protection for equity investors and creditors was strengthened through a program to institutionalize best practice in corporate governance. This was achieved through a handbook on best practice, which includes a model company charter. According to most recent data, around 520 joint stock companies have registered revised charters, prepared in accordance with the newly established codes of best practice. All the state-owned and majority state-owned enterprises have adopted the revised charter. The capacity-building loan complemented this through (i) support for the judiciary in insolvency proceedings, (ii) training in management for managers from the state and private sectors, (iii) a campaign for increasing public awareness of governance issues, and (iv) establishment of a corporate development center to improve understanding of the concept of corporate governance and advise enterprises on how they can comply with the new legal provisions for corporate governance.⁶⁸ The corporate development center has organized close to 50 seminars in corporate management and governance-related areas, and intensive training sessions on bankruptcy, which have attracted more than 1,400 trainees from different regions of the country. In total, 200 Government officials, 400 enterprise managers, and 800 students have been trained under the management development training program. About 60 enterprises have been provided with intensive consulting and advisory support on matters relating to the above four major areas. All the 50 arbitration court judges in the country have received classroom training on corporate, financial, and insolvency concepts; valuation of assets; basic accounting techniques; and interpreting corporate balance sheets. The judges were also taken on field visits to enterprises and to courts dealing with bankruptcy cases for practical training. Only anecdotal information is available with regard to the positive impact of the judicial training program on performance.

c. Second Industrial Energy Efficiency and Environment Improvement: PRC

64. The Project will improve the Government's energy efficiency programs by strengthening energy conservation management, while continuing market-based reforms in energy pricing. Enterprises will be encouraged to implement corporate governance reforms to enhance performance, efficiency, and environmental protection.⁶⁹ During the processing of the Projects, it was agreed that only SOEs that had implemented significant enterprise restructuring measures would be eligible for support. All the five selected enterprises have autonomy in

⁶⁸ Loan 1547-KGZ: *Capacity Building in Corporate Governance and Insolvency Procedures*, for \$4 million, approved on 25 September 1997.

⁶⁹ Loan 1436-PRC: *Second Industrial Energy Efficiency and Environment Improvement*, for \$178 million, approved on 9 May 1996.

financial management, production, marketing, pricing, investment, technical development, employment, and salary levels. Two of the five enterprises have been incorporated as limited companies. The assisted enterprises will be encouraged to issue shares to diversify ownership and mobilize resources to finance part of the costs of the subprojects. The primary focus of the subprojects is on increasing the efficiency of energy use. This will be achieved by improving efficiency of energy-intensive production processes, recovering and using waste heat, introducing new technologies for production processes and facilities to improve the efficiency of the production system, enhancing energy management, and undertaking programs for energy conservation. The energy-efficiency modifications will result in an annual saving in energy of about 110,000 tons of coal equivalent worth about \$12.04 million a year.

d. Corporate Governance and Enterprise Restructuring: Indonesia

64. The advisory TA supports improvement of corporate governance policy and mechanisms in the SOEs in Indonesia⁷⁰ and it facilitates their effective restructuring and divestment/privatization within this framework. The TA supports development and implementation of corporate governance mechanisms and has produced a corporate governance framework that is being pilot tested in seven SOEs, lifting disclosure standards for all SOEs to the level applying to listed companies. All commissioners and directors are given management contracts and SOEs are required to issue statements of corporate intent. The TA also supports (i) development of a time-bound implementation plan to launch corporate restructuring/divestment; (ii) adjustments in the legal framework, which has produced a draft Privatization Law and a draft SOE Law to be submitted to the National Assembly in 2000; and (iii) capacity building of key Government agencies concerned with managing the SOE reform/restructuring process, including an analytical framework for financial and corporate analysis of SOEs to determine privatization suitability and liquidation plans. This framework has enabled 84 SOEs to be analyzed financially and could result in recommendations for 42 privatizations, 34 corporate restructurings, and 8 liquidations.

e. A Study of Corporate Governance and Financing for Selected DMCs and Workshop on Corporate Governance and Financing for Selected DMCs

65. Under the regional TA, an in-depth study of key issues relating to corporate governance and financing in selected DMCs was completed.⁷¹ A follow-up workshop to disseminate the major findings of the TA was attended by 18 DMC officials as well as representatives from Association of Southeast Asian Nations Secretariat, OECD, World Bank, and ADB Institute.⁷²

3. Regulatory Frameworks

a. Power Sector Restructuring Program: Indonesia

66. The Program, a major step toward restructuring the power sector in Indonesia, is part of ADB's overall efforts to help the country implement major structural adjustment and mitigate

⁷⁰ TA 3149-INO: *Corporate Governance and Enterprise Reform*, for \$2.47 million, approved on 29 December 1998.

⁷¹ TA 5802-REG: *A Study of Corporate Governance and Financing for Selected DMCs*, for \$250,000, approved on 7 August 1998.

⁷² TA 5864-REG: *Workshop on Corporate Governance and Financing for Selected DMCs*, for \$70,000, approved on 20 September 1999.

social distress caused by the Asian financial crisis.⁷³ Successful restructuring of the power sector is critical for governance of power generation capacity additions in Indonesia and for the economic recovery. The restructuring program aims to establish a competitive market for electricity in Java-Bali, which will increase economic efficiency of the power sector in the region. The Program includes a separate TA loan for building capacity to establish a competitive electricity market. Implementation suffered delays as a result of the change of government in 1999. Commitment remains for the objectives of this loan. Tariffs were raised by 29 percent in April 2000 and a law facilitating the establishment of a competitive electricity market has been drafted that will also introduce an independent regulator.

b. Financial Sector Program: Viet Nam

67. The objectives of the Program are to strengthen the capacity of the financial system in Viet Nam to mobilize savings and to use such savings more efficiently.⁷⁴ The Program has four components: (i) establish the essential market infrastructure to facilitate private sector participation, (ii) commercialize and modernize domestic banking operations, (iii) promote competition, and (iv) initiate the development of a capital market. To enhance the country's financial market infrastructure, the Program calls for strengthening the legal and regulatory framework, establishing uniform accounting and audit systems in conformity with international standards, meeting full disclosure requirements for financial statements and publicly listed securities, and adopting measures to protect investors. To develop the capital market, a regulatory agency will be set up and securities legislation developed. The Government will subsequently initiate the establishment of an organized market in securities. Anticipated reforms within the financial sector include reorganization of the state-operated commercial banks along commercial lines to provide greater operational autonomy. Many of the required changes to legislation were only made after late 1998, including the issuance of a decree on negotiability and transferability of financial instruments and decrees on secured transactions, the new Law on the State Bank of Viet Nam, the Law on Banks and Nonbank Financial Institutions, accounting and audit policy, disclosure requirements, and deposit insurance. Consequently, it is too early to demonstrate the impacts the changes will have on the sector. Similarly, the development of a domestic capital market has resulted in establishing the necessary legal and regulatory frameworks, a regulatory authority, and a trading system and centers. The computer system supporting operations has not been installed; thus it is too early to see any impact.

c. Support for an Energy Regulatory Authority: Bangladesh

68. To streamline the legislative basis for the power sector's restructuring and regulation, and to enable the establishment of an independent regulatory authority, the Government is drafting a new Electricity Reform Act and is expected to introduce it in Parliament by December 2000. The TA will help draft for the power sector the regulations that will be administered by the new regulatory authority.⁷⁵ This will further depoliticize tariff setting and licensing procedures, making the sector's operations more transparent. The regulatory authority will conduct open hearings, and take into consideration all objections to proposals for tariff increases from interested parties before announcing its award. It will also force disclosure of information on a consistent basis from the sector entities, thus enabling interagency comparisons. Both these actions will greatly increase transparency in the sector. The first phase of the TA will be completed in September 2000. So far, a mission statement for the energy authority has been completed, and is a necessary first step to focus management on developing appropriate

⁷³ Loan 1673-INO: *Power Sector Restructuring Program*, for \$380 million, approved on 23 March 1999.

⁷⁴ Loan 1485-VIE: *Financial Sector Program*, for \$90 million, approved on 19 November 1996.

⁷⁵ TA 3129-BAN: *Support for an Energy Regulatory Authority*, for \$900,000, approved on 16 December 1998.

strategic directions for the authority. Consensus has also been reached among the stakeholders about the functions to be carried out by the regulator and the key elements of its role.

A. Promoting Participation and Strengthening Civil Society

1. Coastal Community Development and Fishery Resource Management: Indonesia; Low Income Upland Communities, Second Irrigation Systems Improvement, and Cordillera Highland Agricultural Resource Management: Philippines

69. These projects espouse a strong participatory and consultative approach with beneficiaries.⁷⁶ Community consultations are undertaken through NGOs. These are intended to shape the final scope and design of activities undertaken under the projects.

70. Due to the political uncertainties in Indonesia, implementation of the Coastal Community Development and Fishery Project was delayed. The Project has commenced and initial signs are promising that institutional strengthening will result in solid achievements.

71. In the Philippine Upland Communities' Project, 98 local organizations have been established in the seven project watersheds and these have been instrumental in empowering the participation of the communities in afforestation, agroforestry, income-diversification, and infrastructure planning and works. As a result of the positive response from the communities, local governments have also adopted a more transparent and consultative approach to planning and program implementation. In the Second Irrigation Systems Improvement Project, interventions have been successful improving irrigation efficiencies and facilitating equitable distribution of water through implementation of the rotational irrigation method. The Project has facilitated improvements and sustainability of operation and maintenance by turning over the management of the systems to the beneficiary organizations after they were properly organized, trained, and equipped. In addition, the Project has given the beneficiaries control over procurement of inputs and marketing of produce by providing them with adequate storage and postharvest facilities. In the Cordillera Highlands Project, the beneficiaries and local governments have been enthusiastic in assuming greater responsibilities over project decision making and resources, which has also resulted in greater accountability for their choices. Under the Project, the screening of activities for financing (investment works and training) is undertaken mainly by at the local government level (i.e., province and municipalities). The NGOs engaged under the Project have made the target communities aware of this fact and provided the results of the screening process to the communities. Therefore, the communities are aware that the local governments are accountable for the investment decisions made under the Project.

2. Second Irrigation Sector: Nepal

72. The Project is designed to help the Government improve the performance of farmer-managed irrigation schemes (FMISs) in the Central and Eastern regions of Nepal.⁷⁷ The schemes are owned and managed by farmers through their water users' associations (WUAs). The scope of the Project consists of strengthening about 180 WUAs to enable the farmers to

⁷⁶ Loan 1570-INO: *Coastal Community Development and Fishery*, for \$26 million, approved on 4 November 1997; Loan 999-PHI: *Low Income Upland Communities*, for \$32 million, approved on 14 December 1989; Loan 1365-PHI: *Second Irrigation Systems Improvement*, for \$15 million, approved on 30 August 1995; and Loan 1421-PHI: *Cordillera Highland Agricultural Resource Management*, for \$9.5 million, approved on 11 January 1996.

⁷⁷ Loan 1437-NEP: *Second Irrigation Sector*, for \$25 million, approved on 16 May 1996.

participate actively in planning, designing, implementing, and operating their FMISs; improving and constructing about 180 FMISs to increase agricultural productivity and water use efficiency; providing service vehicles, equipment, and training to enable the Department of Irrigation to assist the FMISs and WUAs; and providing agricultural extension to ensure that increased availability of water under the Project will result in increased crop production and incomes. The Project will serve as a model for a bottom-up and integrated approach in irrigation development. Most of the subprojects have been completed to an acceptable standard and are sustainable due to active participation of the beneficiaries in these activities. Revised implementation arrangements have improved the selection criteria for subprojects and transparency of their implementation process. Special training programs for beneficiaries and staff of the executing agency have been proceeding well.

3. Forestry Sector Project: Pakistan

73. The Project promotes participation of beneficiaries in designing, planning, and implementing project-related activities; enhances the capability of the concerned institutions, including NGOs and community-based organizations; and seeks refinement of forestry sector policies and legislation, and improvement of the institutional framework in response to the revised policies.⁷⁸ A comprehensive capacity building program has been designed and will begin implementation in 2000. The numerous changes in the Forestry Department have resulted very noticeable changes to the attitude of staff who now embrace the participatory approach required for successful social forestry.

4. Second Institutional Strengthening of Government-NGO Cooperation: Bangladesh

74. The TA is helping strengthen government-NGO cooperation at the local government level, revise the regulatory framework, and draft proposed new modalities for NGO funding.⁷⁹

5. Facilitating Capacity Building and Participation Activities

75. The regional TA established a pilot fund of \$300,000 under which incentives could be offered to projects and programs departments to support participatory and capacity-building initiatives.⁸⁰

6. A Survey of Nongovernment Government Organization Capacity Building Needs in South Pacific DMCs; and Capacity Building Support to NGOs for Financial Resource Mobilization and Management

⁷⁸ Loan 1403-PAK: *Forestry Sector Project*, for \$42.6 million, approved on 9 November 1995.

⁷⁹ TA 2848-BAN: *Second Institutional Strengthening of Government-NGO Cooperation*, for \$400,000, approved on 25 August 1997.

⁸⁰ TA 5692-REG: *Facilitating Capacity Building and Participation Activities*, for \$300,000, approved on 19 July 1996.

76. The regional TAs support a survey of capacity-building needs for NGOs; examine the current circumstances of NGOs in the selected DMCs and their respective contributions to governance, poverty reduction, and development; and support institutional capacity building for NGOs.⁸¹

⁸¹ TA-5884-REG: *A Survey of Nongovernment Government Organization Capacity Building Needs in South Pacific DMCs*, for \$150,000, approved on 22 December 1999 and TA 5873-REG: *Capacity Building Support to Nongovernment NGOs for Financial Resource Mobilization and Management*, for \$300,000, approved on 3 December 1999.

Governance Action Plan 2000-2004

Objective	Actions	Targeted Date	Outcomes
To optimize the impacts of Asian Development Bank (ADB) operations on poverty reduction by addressing key governance issues in developing member countries (DMCs) in a systematic and focused manner	Undertake rigorous and structured studies to analyze governance issues in individual DMCs and the risks they pose. In addition, public expenditure reviews for all DMCs will be undertaken in collaboration with the World Bank, International Monetary Fund (IMF), and other development agencies.	Beginning in 2001	<ul style="list-style-type: none"> ▪ Key DMC weaknesses addressed effectively ▪ Public expenditure prioritization with regard to poverty reduction improved ▪ Consistent application of the law ▪ Reduced corruption
	This analysis will pay particular attention to the extent of transparency in budget preparation; level and trend of nonproductive government expenditures and spending on social sector programs; opportunities for and degree of participation in development processes (at national, sector, local, and project levels); prevalence of the rule of law, success in fighting corruption; existence of legal and bureaucratic factors promoting official secrecy and inhibiting public access to information; and the need to ensure that complex, large, and unusual patterns of financial transactions are monitored and reported.		
	Formulate strategies and programs to address the key governance issues, including noneconomic factors that have demonstrable and direct economic effects, that have been identified, and that specify relevant performance indicators (future country strategies and programs [CSPs] will assess the effectiveness of these programs and identify successes and failures). Governance assessments and progress in improving the quality of governance will be used to inform both the level and sectoral composition of ADB assistance to a DMC.	Beginning in 2001	<ul style="list-style-type: none"> ▪ Elimination of factors contributing to weak governance ▪ Increased effectiveness and impact of ADB's governance activities ▪ Civil society empowered
	Targeted capacity building will be a major part of ADB's efforts in improving governance in DMCs. In this regard, ADB will focus on areas of weakness in governance identified in the CSP process. Such activities will include strengthening capacity of the public sector to monitor and evaluate government performance, and of civil society, particularly nongovernment organizations and other groups that represent vulnerable segments of the population, to maintain the debate about improvements in governance.		

Objective	Actions	Targeted Date	Outcomes
	Promote participation in DMCs by ensuring that, in the design of projects and programs, attention is given to expanding opportunities for involvement by local representative assemblies and civil society, including women's groups, and creating a favorable environment for citizens to have a meaningful input into development decisions.		
	Develop indicators for the four elements of good governance, i.e., accountability, participation, predictability and transparency, for all DMCs. The indicators will be implemented on the basis of rigorous studies undertaken as part of the CSP process and revised annually in the context of the CSP updates.	By 2001	<ul style="list-style-type: none"> ▪ Strengths and weaknesses in governance in individual DMCs identified ▪ Priority areas for ADB governance activities in each DMC determined ▪ Broad impact of governance interventions tracked
To elevate good governance to the top level of the development agenda in the region	Develop a regional program to improve application of good governance principles in the DMCs' poverty programs. (Appendix 3 provides examples .)	Beginning in 2001	<ul style="list-style-type: none"> ▪ Enhanced public scrutiny of government performance ▪ Improved voice of beneficiaries in quality of government services ▪ Consistent application of government regulations ▪ Effective methodologies identified ▪ Demonstration effect of positive impact of good governance ▪ Expanded set of governance activities
	<p>Establish a regional partnership network on governance comprising representatives from governments, civil society, private sector, and development agencies.</p> <p>Build a regional consensus on relevant benchmarks, best practices, codes of conduct, and indicators of good governance and review progress in achieving better governance in the region. ADB will provide a web site to support the network.</p> <p>Commission and publish studies on important governance issues and concerns.</p>		<ul style="list-style-type: none"> ▪ Wider acceptance of good governance principles in the DMCs, including benchmarks, codes of conduct and indicators of good governance and of the need to improve their application ▪ Commitment to governance reforms enhanced ▪ Regional consensus on the attributes of good governance in the Asian and Pacific Region
	Develop a program with the ADB Institute to run work workshops and training courses directed at enhancing the understanding of DMC politicians, officials, and leaders of civil society on the value and principles of good governance.	Continuous	<ul style="list-style-type: none"> • Expanding constituency in favor of programs of institutional change

Objective	Actions	Targeted Date	Outcomes
To fight corruption by setting an example and by promoting the spread of good financial and other internal control systems	Through project procurement related audits, assist DMCs to strengthen the control systems of executing agencies and identifying fraud and corruption. Whenever, pursuant to ADB guidelines, fraud or corruption is identified, appropriate steps will be taken including sanctions against the contractor and cancellation of the loan. Develop a training program to assist ADB staff in detecting fraud and corruption in ADB-financed projects.	Starting 2001	<ul style="list-style-type: none"> ▪ Gradual elimination of corrupt practices associated with ADB projects; ▪ Corrupt businesses put out of business • Spread of good financial and other internal control systems in the DMCs
	Introduce measures to strengthen borrowers' capacities to carry out audits with appropriate independence.	2001	<ul style="list-style-type: none"> ▪ Effective project audits
	Expand assistance to supreme audit institutions in the DMCs for developing programs and training to strengthen their capability to detect corruption and fraud.	Continuous	<ul style="list-style-type: none"> ▪ Effective supreme audit institutions in DMCs
	Prepare, in consultation with other multilateral development banks (MDBs), master standard bidding documents with the aim of introducing standard terms and conditions for bidding and award of contract, as well as generally accepted international best practices, into ADB procurement procedures and practices.	2001	<ul style="list-style-type: none"> ▪ Standard bidding documents used for all international and domestic procurement
To coordinate governance initiatives with development agencies in the Asian and Pacific Region	Develop key understandings on major governance issues within the MDB Working Group on Governance, Anticorruption and Capacity Building.	2001	<ul style="list-style-type: none"> ▪ Consistent treatment of governance issues on the part of the MDBs
	Formalize arrangements with the International Monetary Fund (IMF), World Bank, United Nations Development Programme (UNDP) and major bilateral agencies for cooperation in carrying out governance assessments and public expenditure reviews in the DMCs.	2001	<ul style="list-style-type: none"> ▪ Cooperative governance programs conducted by ADB and other development agencies
To strengthen ADB's capacity for governance operations	Establish a critical mass of general governance specialists.	2001	<ul style="list-style-type: none"> ▪ Leadership of ADB in governance ▪ Improved governance interventions in project and sector operations
	Establish governance and institutional databases to ensure that information about the strengths and weaknesses of key executing agencies is stored and updated systematically.	Beginning 2001	<ul style="list-style-type: none"> ▪ Improved project designs producing institutional sustainability
	Elaborate the links between good governance-poverty reduction, private sector development, and institutional frameworks.	ongoing	<ul style="list-style-type: none"> ▪ Better understanding of links ▪ Improved service delivery efficiency in the DMCs

Objective	Actions	Targeted Date	Outcomes
	Develop protocols/toolkits for use by mission leaders and managers to ensure that governance issues are addressed effectively in all project designs.	2001	<ul style="list-style-type: none"> ▪ Improved project design ▪ Enhanced focus on key governance constraints
	Develop a program of courses on governance targeted at mission leaders and senior staff.	2000	<ul style="list-style-type: none"> ▪ Enhanced understanding of ADB staff of governance issues
To provide quick feedback to all stakeholders of progress in implementing the action plan and the lessons learned.	<p>Present to the Board a work program on governance, which will include measurable and monitorable actions and targets for 2001.</p> <p>Provide an annual report to ADB's Board on the implementation of the action plan. The report will include information on achievements against the actions and targets in the annual work program, lessons learned, and a work program for the next year.</p>	<p>1st quarter 2001</p> <p>Beginning 2002</p>	<ul style="list-style-type: none"> ▪ Effective ADB performance and scrutiny by the Board

REGIONAL PROGRAM FOR GOOD GOVERNANCE

1. The regional program for good governance is additional to specific programs to be developed for individual developing member countries (DMCs) in the CSP process. This program will concentrate on governance issues that are common to the whole region or to groups of DMCs. The program is in the concept development phase. Its objective is to test ideas that will promote improvements in the four elements of good governance—accountability, participation, predictability, and transparency—as they directly influence poverty reduction. For each two-year program, three or four initiatives will be selected for implementation across the maximum number of DMCs possible. The high degree of visibility of the initiatives is expected to prompt the DMCs to adopt the successes.

2. The 2001-2002 program could include initiatives such as

- (i) establishing annual regional awards for good governance, focusing primarily on change and innovation, and including awards in corporate governance;
- (ii) launching a DMC-wide intervention, in partnership with local non-government organizations (NGOs) and other aid agencies, to extend legal literacy to the excluded and, in particular, to women;
- (iii) developing annual perception surveys of key state institutions, in partnership with regional, international, and/or local NGOs, to determine how well they are perceived by different segments of a population;
- (iv) developing customer surveys and scorecards as a way to enhance accountability for service delivery and increase participation of the poor in the quality of a service;
- (v) supporting constituencies for the poor to lobby the government to improve service delivery or other areas of government activity that impact on the poor; an example of constituencies that have proved effective in improving the quality of primary education in some countries in Africa is the primary teachers associations;
- (vi) developing initiatives with the private sector to act as good corporate citizens by promoting a service of value to the poor that reflects an aspect of good governance;
- (vii) testing performance-based service delivery targeting the poor in which contractors tender a fixed price to deliver a service or product and payment is based on an independent audit/inspection confirming delivery of the service or product: products of inferior quality will be returned to the supplier, and services below the quality tendered would not be paid; and
- (viii) enhancing the work of standing committees of national assemblies, particularly as they relate to the accountability of government departments and agencies.