

MANAGEMENT RESPONSE TO THE SPECIAL EVALUATION STUDY ON ASIAN DEVELOPMENT BANK VIII AND IX OPERATIONS

On 8 February 2008, the Officer-in-Charge, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

I. General Comments

1. We welcome OED's Special Evaluation Study (SES) on Asian Development Fund (ADF) VIII and IX Operations. We note the SES assessment that (i) increasing goal congestion under ADF VIII (2001–2004) may have temporarily stalled in the rising trend of project success over the years, and that (ii) the enhanced approach employed under ADF IX, started in 2005, is more likely to resume the upward trend of project success, although it is early to say.

2. We also note the SES finding that a number of reforms and business process changes¹ introduced in 2004–2006 have led to such improvements of ADF operations. This SES finding confirms the importance of consolidating our ongoing reforms and change initiatives under ADB's reform agenda. As observed in the SES, the reform agenda was our Management's response to the need for changes for ADB to remain relevant in a dynamic Asia and the Pacific region.

3. **Increase of ADF Size.** We agree with the SES recommendation to ADF donors that ADF's size should increase if it is to accelerate the achievement of the Millennium Development Goals (MDGs). We believe that a certain critical mass has to be deployed not only to achieve poverty reduction and address non-income MDGs, but also to ensure the leverage needed to achieve policy change and governance objectives.

4. **Usefulness of ADF Grants.** The SES casts doubts on the effectiveness of ADF grants. However, we believe that it is too early to make any judgment calls on the usefulness of ADF grant instrument, introduced only under ADF IX, on development outcomes. And given that grants are processed, disbursed and supervised in the same way as ADF loans, it is difficult to see how they would provide fewer opportunities for policy dialogue than loans. Finally, as the SES observes, our grants framework is closely aligned with that of the International Development Association, so that any changes would have to be embedded in a wider reassessment of grants as a development tool.

5. **Soundness of Performance-Based Allocation (PBA) System.** The SES questions the soundness of the PBA system introduced during ADF VIII. We maintain that the PBA system is the best practice available for achieving the highest level of development effectiveness with the limited resources we have. Like other multilateral development banks (MDBs), we acknowledge that it is not perfect, and we endeavor to fine-tune it as we go along (for example, for the Manila meeting, we plan to present donors with

¹ These include the Enhanced Poverty Reduction Strategy, Medium-Term Strategy II, the new Country Partnership Strategy process, the Resident Mission policy, the Public Communications Policy, and new financing instruments and modalities such as multitranches finance facility and local currency loan products, among others.

concrete proposals to attenuate some of the volatility and unpredictability of PBA outcomes).

II. Specific Recommendations

Recommendation: ADF X should avoid goal congestion in operations and in ADB as a whole.

6. We fully agree that ADB should avoid "goal congestion" in its ADF operations. This objective has already been anchored in the selectivity approach of the Medium-Term Strategy (MTS) II, and is also a crucial component of the Long-Term Strategic Framework (LTSF) 2008–2020 currently being finalized.

Recommendation: The ADF needs to be more selective in its support for sectors in many countries.

7. We fully agree with this recommendation. In the ongoing ADF X replenishment negotiations, donors have for their part supported the need for selectivity and the emerging consensus is that ADF should focus on what it has been doing best over the years, mainly infrastructure projects which will address poverty reduction in an indirect manner through economic growth and job opportunities, and increased access to markets and social services (health services, water and sanitation, and education).

Recommendation: Poverty reduction is an appropriate goal for ADF operations, and requires more than direct targeting of the poor in each country.

8. We agree with the SES recommendation that poverty reduction should be the main goal of ADF operations. We also support the SES finding that poverty reduction requires more than direct targeting of the poor in each country. As stated in the SES, we have already internalized this lesson of ADF VIII into our operations.

Recommendation: Aid harmonization and coordination remain necessary elements of the ADF approach.

9. We agree with the SES finding that donor harmonization and aid coordination is crucially important for aid effectiveness. We also agree that coordination of country programs among major donors to increase sector specialization should be a priority. However, as the implementation of the Paris Declaration should be, and in fact is, mostly country-driven, an effective division of labor between various actors depends significantly on country-specific circumstances.

Recommendation: An ADF geared to poverty reduction and governance is staff intensive and needs specialized skills.

10. We acknowledge this SES recommendation. As part of the Human Resources Strategy (HRS) adopted in October 2004, measures are being introduced to address to ADB's skills mix issues and skills gaps. We have also aligned our skills mix more closely with the priorities of MTS II. Subsequent to the staff engagement survey being undertaken in early 2008 and the adoption of

LTSF (2008–2020), we will review the HRS with the assistance of external experts and plan for appropriately increasing investment, if required. This review of the HRS will include the staffing issues to implement ADF operations and the specific requirements in resident missions.

Recommendation: Major governance issues should be primarily addressed through program lending, with agreed reforms being supported by advisory and capacity building technical assistance.

11. We believe this SES suggestion has to be qualified. The choice of lending modality should be determined on a case by case basis. We note that when a country's budget framework and financial management system is weak, provision of program loans could involve a significant degree of fiduciary risk. Also, one must recognize that governance efforts can also be effectively pursued by focusing efforts on the key sectors in which we deliver investment projects. Investment projects can also help strengthen institutions and capacity at the sector level, as highlighted by the Second Governance and Anticorruption Action Plan.

Recommendation: ADB should undertake a rigorous analysis to test the validity of the various country performance assessment (CPA) indicators.

12. We note the SES recommendation. However, although not perfect, the present CPA system is considered collectively by MDBs and donors as best practice presently available. It is not clear if alternative methods cited by the SES, like tying allocations to developing member countries' commitments to remove "binding constraints" for development would be less subjective and produce more comparable results across the range of ADF recipients.

Recommendation: ADB needs to pursue a varied approach to debt distress of ADF countries and not rely mainly on the institution of an ADF grant mechanism.

13. While the main purpose of the ADF grant framework is to promote debt sustainability, we agree with the SES observation that this instrument alone is insufficient. As the SES notes, countries must have a sound legal framework to monitor and manage public debt—in conjunction with sound macroeconomic management—to ensure that levels of public debt do not become burdensome. The Bretton Woods institutions are leading initiatives to strengthen debt management, and ADB will coordinate with them to ensure a consistent approach.