

**MANAGEMENT RESPONSE TO THE SPECIAL EVALUATION STUDY
ON THE SPECIAL EVALUATION STUDY ON ADB ASSISTANCE FOR DOMESTIC
CAPITAL MARKET DEVELOPMENT**

On 2 October 2008, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

I. General Comments

1. We welcome the Special Evaluation Study (SES) on ADB Assistance for Domestic Capital Market Development. The SES provides an overview of ADB assistance for domestic capital market development and contains a number of useful suggestions for our consideration.

2. We would like to highlight a few general points relating to SES for your consideration. First, capital market development is a long-term process and requires a great deal of time and resources for a developing member country (DMC) to address a range of complex factors, many times beyond the scope of the reform programs, to successfully develop a capital market. Such factors could include the level of national savings in the economy, the strength of the country's economic fundamentals, the business climate, and its growth potential. As such, SES should evaluate ADB assistance for domestic capital market development taking into account these factors.

3. Second, SES suggests that the use of ADB resources might have been less-efficient based on its observation that (i) resource transfers under the program lending modality generally exceeded actual adjustment and investment cost associated with the supported reform programs, and (ii) sector impact is not closely related to the level of resources transferred. We disagree with these observations. Firstly, we believe that the real adjustment costs of a reform program are underestimated as they only take into account the direct costs, rather than the indirect costs of adopting the reform program. The indirect costs could include those costs arising from the Government's efforts in building consensus among policy makers and stakeholders to support the reforms. Secondly, the quantification of the impact is generally underestimated especially considering the significant opportunity costs of not developing or delaying the support for the capital market development.

4. Third, SES states that ADB provided little assistance for enhancing skill levels of market participants. We would like to stress that market participants are from the private sector whose business can generate significant revenues. For this reason, we believe that our limited capacity development technical assistance (TA) resource would be best used by targeting capacity building of DMC officials, rather than market participants. DMC officials tend to have little resource to build capacity required to undertake their responsibilities.

5. Fourth, we believe that the discussion with all mission leaders for the programs/projects under evaluation is essential to help SES gain a better understanding of issues confronted by the processing teams and how they formulated the reform programs to address selected issues. However, it is our

understanding that SES held discussion with selected mission leaders as SES viewed appropriate. Unless SES has complete information on program/project formulation, it would be difficult to appreciate the context on how the reform programs were put together and fully assess them.

II. Specific Comments on the Recommendations

6. **Improve the Strategic Focus of ADB Sector Operations.** In general, we agree with the recommendations under 1.i and 1.ii of this section, and have already taken steps to implement most of these recommendations. ADB has already undertaken the financial sector review. As a step forward, we will begin our work on a financial sector strategy in 2009. A results framework and a set of monitorable indicators have long been developed for ADB assistance to support capital market development. SES recommendation that a similar results framework for the financial sector strategy will be considered as appropriate.

7. As recommended by SES, we will review whether ADB should participate in the preparation of reports on the observance of International Organization of Securities Commissions' core principles for securities regulation in sector focus countries (under the Financial Sector Assessment Program) with the IMF and the World Bank. Nevertheless, our participation will be subject to invitation by the two institutions. We would like to stress that we strongly coordinate with these institutions and other relevant stakeholders in developing reform programs to support the development of the capital market. Furthermore, in most countries in Asia, ADB takes the lead in capital market development.

8. We also note that Management has already taken steps to ensure that PSOD has significantly increased its involvement in the preparation of sector assistance strategies in focus countries.

9. **To strengthen delivery of ADB assistance.** We also generally agree with recommendations under 2.i to 2.iii and have implemented most of these recommendations. With respect to recommendation 2.i on adherence to international standards and principles as indicators in design and monitoring frameworks pertaining to assistance for securities market regulation and infrastructure, ADB has long promoted the adoption of international standards and principles by its member countries, not only with its policy-based loans but also with its TA projects for its DMCs. Where there are shortcomings, Management will continue to work with regional departments to address them.

10. Lastly, we have already adopted the recommendations that (i) the costs and benefits of capital market development measures be carefully considered, and (ii) relevant private and public stakeholders be involved in the formulation of the reform programs and any capital market reforms involving changes affecting market participants be discussed in public hearings or workshops. Recommendations that ADB develop and promote cost-efficient approaches to capital market development, for small DMCs, will be reviewed and considered as appropriate.