

**MANAGEMENT RESPONSE ON THE PROJECT PERFORMANCE AUDIT REPORT  
ON THE FINANCIAL SECTOR INTERMEDIATION LOAN IN PAKISTAN  
(Loan 1371-PAK)**

On 9 September 2005, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

1. Management finds the report well prepared. The report correctly questions a number of design features of the project, which mirrors the design of a parallel intervention of the World Bank. We agree that a program loan would have been the right instrument rather than a project loan based on a credit line with a program of policy actions addressing broad sector issues. Also, "shortage of funds" does not seem to correctly reflect the rationale for the loan project. It should have been the distortions in the financial system and the need of the economy for a resilient financial sector, as shown in the policy matrix. Such a shift in the articulation would have highlighted that a program loan would have been the right modality.

2. As stated in the report, the policy matrix was not backed by a loan releasing the loan amount based on the Government's performance and the credit line provided under the loan was disconnected to the more important policy reform agenda. While we agree that this constitutes a design weakness, we believe that the policy matrix sets out very important reform issues, which helped set the stage for the important and very successful financial sector reforms that Pakistan implemented since 1997 with the support of the IMF, World Bank, and ADB. The reform agenda set out under the policy matrix was highly relevant

(and not irrelevant as stated in the report) and was successfully implemented. Management also notes Operations Evaluation Mission's (OEM) confirmation that most of the loan's policy actions were complied (40 out of 45 fully complied, 3 partly complied).

3. We agree that the relevance of the credit line in this context was weak and that the credit line did not have a significant impact on financial intermediation and private sector activity. Factors such as (i) lacking mechanism to mitigate the foreign exchange risk and (ii) unattractive pricing of ADB's pool-based rate led to the low utilization of the credit line.

4. With regards to the report's two recommended follow-up actions directed to the Government (Ministry of Finance), ADB will have a course of dialogues with the Government through its Pakistan Resident Mission (PRM).