

## **OPERATIONS MANUAL POLICIES AND PROCEDURES**

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These policies and procedures were prepared for use by ADB staff and are not necessarily a complete treatment of the subject. This *Operations Manual* was prepared and issued by the Strategy, Policy, and Partnerships Department (SPD) with the approval of the President. Questions may be directed to the director of the Strategy, Policy, and Business Process Division of SPD.

### **SECTOR LENDING**

#### **A. Purpose and Key Features**

1. Sector lending is a form of Asian Development Bank (ADB) assistance to a developing member country (DMC) for project-related investments based on considerations relating to a sector or subsector of the DMC. The purpose of a sector loan is to assist in the development of a specific sector or subsector by financing a part of the investment in the sector planned by the DMC. Such lending is particularly appropriate when many subprojects<sup>1</sup> in the sector or subsector are to be financed. A sector loan is expected to improve sector policies and strengthen institutional capacity.<sup>2</sup>

#### **B. The Policy**

##### **1. Eligibility Criteria**

2. The following criteria need to be satisfied to meet ADB's policy on sector lending:

- (i) the borrowing DMC has a sector development plan to meet the priority development needs of the sector;
- (ii) the borrowing DMC has the institutional capacity to implement the sector development plan; and
- (iii) the policies applicable to the sector are appropriate and will be improved, if warranted.

3. If these criteria are not met adequately, technical assistance (TA) may be given for project preparation, sector analysis, and capacity building before or together with the provision of a sector loan.

4. Sector lending is expected to achieve a greater impact on a sector than stand-alone project lending by enabling an integrated focus on sector policies, sector development perspectives, and sector development plans, and on the adequacy of institutions to formulate and manage such plans for the sector. Sector lending assists a DMC in achieving economic and social progress in a sector or subsector through project-related investments in a geographic area

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<sup>1</sup> "Subprojects" refers to projects that make up a sector loan.

<sup>2</sup> "Capacity" refers to the broad institutional framework within a DMC that is responsible for the direction, management, and sustenance of the development process in a sector or in the economy. Capacity dictates a country's receptivity to policy reform and adjustment; its ability to raise and manage domestic resources; its efficiencies and effectiveness in creating necessary infrastructure, maintaining it, and delivering required services; and its openness and skill in catalyzing participation.

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(area slice), over a period of time (time slice), or both, based on considerations relating to the sector as a whole.

### **2. Sector Analysis**

5. Sector projects need to be supported by a comprehensive sector analysis that covers the factors that affect performance, including the policy, institutional, legal, and regulatory frameworks; recent trends in current and capital expenditures; the type and composition of the expenditures; the respective roles of the public and private sectors and their relationships; pricing policy; the sustainability of investments; and the possibility of intrasectoral resource allocation. Such analysis also needs to address social dimensions, environmental considerations, and issues of good governance in sector management. Where feasible, the analysis needs to establish well-defined indicators and benchmarks of sector performance that can be monitored throughout implementation of the sector project and serve as a basis for assessing performance and also for evaluating operations. Where the necessary analysis and information are available and of good quality, these also serve as a basis for the formulation of sector projects.

### **3. Institutional Analysis and Capacity Building**

6. The success of sector lending depends upon the capacity of the executing agency in terms of investment planning, coordination, and implementation; post- investment operation and maintenance; and the involvement of private, voluntary, and community institutions. Assessment of institutional capacity is therefore a prerequisite for sector lending, to identify institutional shortcomings and their causes, leading to the selection of suitable advisory TA to remedy the constraints and enhance the capacity of institutions and their performance.

7. In the context of sector lending, institutional analysis is to be carried out before the provision of the sector loan to assess levels of efficiencies and effectiveness in the executing agency and to plan capacity-building measures as required. While the assessment of institutional capacity remains a value judgment for ADB, three broad conditions underpin a decision to proceed with sector lending without capacity building. The overall assessment of institutional capacity must be positive (i.e., the executing agency is willing and able to take the lead). There must also be acceptable levels of capacity in project management, especially in terms of procurement and financial management (including disbursement, accounting, and internal control systems), as well as in environmental impact assessment and social analysis. There must also be reasonably well-developed and articulated strategies for the sector because a sector loan project cannot exist in a policy vacuum and cannot be just the sum of all existing or intended expenditure programs.

### **4. Lending Terms**

8. ADB lending terms are the same for a sector loan as for a project loan sourced from ordinary capital resources on regular or concessional terms, as applicable. The terms of a sector loan from ordinary capital resources depend on the average life of the subprojects and the typical implementation period.

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### 5. Use of Loan Proceeds

9. Sector loan proceeds are used in accordance with ADB's relevant policies.<sup>3</sup>

### 6. Cost Recovery

10. In revenue-earning subprojects of a sector loan, full cost recovery (including depreciation and debt service) will be sought to the extent feasible. When benefits<sup>4</sup> are difficult to quantify (e.g., public health, population, education), the need for the subprojects should be evaluated and the least-cost option established.

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### Bases

- i ADB. 1999. *Review of the Bank's Sector Lending Policies*. Manila (IN181-99).
- ii ADB. 1984. *A Review of Sector Lending Operations*. Manila (R186-84).
- iii ADB. 1980. *Sector Lending*. Manila (R52-80).

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<sup>3</sup> ADB. 2023. Cost Sharing and Eligibility of Expenditures. *Operations Manual*. OM H3. Manila.

<sup>4</sup> ADB. 2023. Economic Analysis of Projects. *Operations Manual*. OM G1. Manila.