OPERATIONS MANUAL
BANK POLICIES (BP)

These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

SECTOR DEVELOPMENT PROGRAMS

A. Introduction

1. A sector development program (SDP) is a combination of an investment (project or sector) component and a policy-based (program) component as well as, where appropriate, attached technical assistance (TA), with a view to meeting sector needs in a comprehensive and integrated fashion. The SDP is not a separate lending modality, but represents a combination, under appropriate circumstances, of policy and investment-based assistance.[1]

B. Definition

2. The term "sector" in the context of an SDP is to be understood in the broad sense of the word. In addition to the traditional concept of a sector, it may include subsectors of more limited scope, or relate to broad cross-sectoral themes of a macroeconomic nature.

C. The Policy

3. The policies and procedures applicable to each component of an SDP must apply in the context of the whole SDP.[2]

D. Scope of the Policy

4. An SDP is considered when a sector requires both an investment component and a policy reform component, and where the former is unlikely to be accomplished in full and on time without the support of a policy-based lending component. This may be especially relevant where policy reform results in substantial economic, financial, or social costs. The SDP fosters an integrated, and generally long-term, approach to sector needs and enhances ADB's leverage for promoting policy and institutional reform.

5. Strong commitment to sector reform by the government is essential for the success of the SDP modality of lending. Implementation experience with past program loans and SDPs and with policy conditions attached to project and sector loans in the developing member country (DMC) and sector concerned is an important factor for determining eligibility for SDP assistance.

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[1] A combination of a policy-based program loan and a technical assistance loan for capacity building will be processed as a program loan.
[2] See OM Section D11(Processing Loan Proposals), OM Section D4 (Program Lending) and, where applicable, OM Section D3 (Sector Lending), and OM Section D12 (Technical Assistance).

6. The investment component of an SDP involves primarily public sector investments. Where appropriate, SDPs could also include a private sector investment fund, channeled through competent financial intermediaries, to stimulate a private sector supply response to a sector reform program.

1. Sector Analysis

7. A comprehensive sector study must be undertaken prior to considering an SDP. In addition to policy issues, the sector study must address the relative roles of the public and private sectors, social and environmental issues, and institutional development needs in the sector. An advisory TA may be processed with the SDP to study further any unresolved policy issues or to strengthen the capacity of key sector institutions.

8. An assessment of the impact of proposed sector reforms on the poor and other vulnerable groups must be carried out. If adverse short-term impacts are expected on the poor and such groups, the SDP seeks to include mitigating or offsetting measures. When applicable, specific project components or counterpart funds may be used for this purpose.

9. The investment component of an SDP should be prepared in accordance with usual ADB procedures and standards, including preparation of a feasibility study in the case of a project loan and formulation of subproject selection criteria and evaluation methodology in the case of a sector loan.

2. Macroeconomic Linkage and Aid Coordination

10. SDPs must take into account the linkage between the proposed sector program and the macroeconomic conditions in the DMC. In particular, general macroeconomic conditions and the direction of macroeconomic policies must be deemed satisfactory for an SDP to be considered. Also, the effect of untied capital inflows from the program-lending component on money supply and the exchange rate must be considered.

11. ADB is to consult and closely coordinate with the International Monetary Fund, the World Bank and, where applicable, other multilateral development banks and major bilateral agencies in formulating and implementing SDPs. Aid coordination must in particular address the interface of the policy and investment program supported by the SDP with the macroeconomic aspects.

3. Tranching

12. The program-lending component of an SDP may be divided into tranches if major elements of the sector policy reforms are to be introduced after the loan becomes effective. The program-lending period and number of tranches are determined case by case. Tranching conditions must be formulated with due regard for the proper timing and sequencing of reform measures.

13. With regard to the investment component, tranching is generally not feasible or advisable for a project loan.[3] However, in the case of a sector loan, loan commitments for new subprojects in each successive time period could, where necessary, be made contingent on the timely and effective implementation of agreed upon reforms.

14. Comprehensive and far-reaching policy reform is normally required in an SDP. However, in view of the dislocations often caused by drastic policy changes, and the sometimes adverse short-term impact of policy reform on specific groups, ADB can, where justified, support an incremental pace of reform. This may be accomplished through a succession of program loans or SDPs in a sector, or through the adoption of a longer time frame for a single program loan or SDP.

4. State- or Provincial-Level SDPs

15. SDPs at the state or provincial level may be considered in DMCs and sectors where sufficient autonomy for policy exists at these levels of government, and where there are no legal or administrative impediments to such loans. The ability of these levels of government to address all relevant sector issues, and the full concurrence of the national government and the state or provincial level government, are required for this approach.

5. Loan Amounts

16. A relatively large amount of resources may be required in an SDP to enable ADB to meet underlying sector needs in a comprehensive manner. The total size of an SDP depends on ADB's overall lending program to the DMC, sectoral investment needs, availability of alternative sources of financing, the strength and costs of the policy reform program, and intersectoral priorities.

6. Ceilings

17. The program-lending components of SDPs are added to the free-standing program loans when considering the ADB-wide ceiling for program lending.

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[3] Where appropriate, front-loading of key policy conditionalities could be required where severe sector distortions are in evidence.

Basis: This OM section is based on:

ADB. 1996. Doc. R143-96, *Review of the Bank's Program-Lending Policies,* 3 July. Manila.

This OM section is to be read with OM Section D5/OP.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Director; Strategic Planning, Policy and Interagency Relations Division; Strategy and Policy Department.

OPERATIONS MANUAL
OPERATIONAL PROCEDURES (OP)

These procedures were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

SECTOR DEVELOPMENT PROGRAMS

A. Introduction

1. The operational policies and procedures applicable to project or sector loans and to program loans apply *ipso facto* to the investment and policy-based components of a sector development programs (SDP), respectively.[1] In addition, for SDPs, the policy and investment components as well as, where applicable, the attached technical assistance (TA), are processed, approved, and administered jointly.

B. Application of the Policy

1. Processing

2. The SDP loan follows the same processing stages as those of a program loan; however, a single report and recommendation of the President (RRP) is prepared and Board approval is sought for the entire assistance package. The SDP approach is appropriate where there is a clear benefit in adding a policy-based lending component, in terms of significantly enhancing the prospects for policy reform. The SDP approach is useful where a sector requires both large-scale investment lending and substantive policy reform, and where the latter cannot readily be accomplished without the support of an additional lending component. ADB therefore normally requires for particularly difficult or costly reform measures to justify the program lending component.

2. Procurement and Disbursement

3. Current ADB policies and procedures with regard to procurement and disbursement apply to each of the SDP components.

3. Implementation and Monitoring

4. Although the impact of an SDP on sector performance and development objectives is to be considered and monitored as a whole, administration of the investment and policy-based components may to some extent be separated. In particular, the investment component generally follows different procurement and disbursement procedures, has a distinct timetable and implementation arrangements, and may be subject to separate or specific review missions. However, particular attention must be paid to ensure that when the program loan component of the SDP is reviewed, its linkage to the investment component is kept in the perspective, and vice versa.

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[1] See OM Section D11 (Processing Loan Proposals), OM Section D3 (Sector Lending), and OM Section D4 (Program Lending).

4. Technical Assistance

5. If TAs are attached to policy components of an SDP, they must be carefully targeted to meet key capacity-building needs in the sector and/or address major policy issues having a bearing on future strategy decisions. The number and design of attached TAs must be geared to the absorptive capacity of the executing agencies involved. Close supervision of TA execution by ADB, and incorporation of their findings in ongoing policy dialogue, are an essential part of SDP administration.

5. Counterpart Funds

6. SDPs must include a broad review of budgetary allocations to and within the sector, with a view to ensuring that essential expenditures are met. Where shortfalls in the allocation of development or operating expenditures to the sector are identified, the SDP must seek to correct these, to the extent feasible, by obtaining matching expenditure commitments from the borrowing government in exchange for the counterpart funds generated. Such matching expenditure commitments may, where applicable, take the form of policy covenants, and be documented in the loan agreement and indicated in the policy matrix. In all cases, agreement on the appropriate use of the additional budgetary resources generated by a policy component of the SDP must be reached during loan negotiations, and be specified as counterpart funds and explained in the RRP.

Basis: This OM section is based on OM Section D5/BP and the documents cited therein.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Director; Strategic Planning, Policy and Interagency Relations Division; Strategy and Policy Department.