

OPERATIONS MANUAL POLICIES AND PROCEDURES

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 and is subject to compliance review. Questions may be directed to the director of the Strategy, Policy, and Business Process Division of SPD.

SECTOR DEVELOPMENT PROGRAMS

A. Scope

1. A sector development program (SDP) is a combination of an investment (project loan, sector loan, or financial intermediation loan) component and a policy-based loan (PBL) component as well as, where appropriate, attached technical assistance, 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

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.

3. SDPs at the state or provincial level may be considered in developing member countries (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.

B. Applicability of Policies and Procedures

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

C. Considerations for Sector Development Program

5. An SDP is considered when a sector requires both an investment component and a PBL component, and where the former is unlikely to be accomplished in full and on time without the support of a PBL 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 leverage of the Asian Development Bank (ADB) for promoting policy and institutional reforms.

¹ In this *Operations Manual*, “PBL” refers to a policy-based loan; policy-based lending; or the policy-based loan component of a sector development program, as the context requires. The term “program” as used in the context of a PBL is the same as the term “project” used in the context of other modalities. The terms “lending” and “loan(s)” include Asian Development Fund grant(s) and guarantee(s), except that policy-based guarantee and special PBL of the ADB are financed only from regular ordinary capital resources.

² ADB. 2023. Sovereign and Sovereign Guaranteed-Financing. *Operations Manual*. OM D11. Manila; ADB. 2023. Policy-Based Lending. *Operations Manual*. OM D4. Manila; and where applicable, ADB. 2023. Sector Lending. *Operations Manual*. OM D3. Manila; ADB. 2023. Financial Intermediation Lending. *Operations Manual*. OM D6. Manila; and ADB. 2023. Technical Assistance. *Operations Manual*. OM D12. Manila.

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6. The government's strong commitment to sector reform is essential for the success of the SDP. Implementation experience with past PBLs and SDPs and with policy conditions attached to project and sector loans in a DMC and sector concerned is an important factor for determining eligibility for SDP assistance.

7. 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.

D. Key Features and Requirements

8. **Sector analysis.** 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. Technical assistance may be processed with the SDP to identify, study, and/or address any unresolved policy issues or to strengthen the capacity of key sector institutions.

9. An assessment of the impact of proposed sector reforms on the poor and other vulnerable groups must be carried out.³ 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.

10. **Project readiness.** 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.

11. **Macroeconomic linkage and aid coordination.** SDPs must take into account the linkage between the proposed sector program and the macroeconomic conditions in the DMC. In particular, the general direction of macroeconomic conditions and policies must be deemed satisfactory for an SDP to be considered. The effects of untied capital inflows from the PBL component on money supply and exchange rate must also be considered. ADB will systematically consult and closely coordinate with the International Monetary Fund, the World Bank and, where applicable, other multilateral development banks and major bilateral funding agencies in formulating and implementing SDPs. Aid coordination must particularly address the interface of the PBL and investment components supported by the SDP with the macroeconomic aspects.

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

³ ADB operations incorporate social dimensions to ensure social development outcomes, especially for the poor, vulnerable, and excluded groups. ADB. 2023. Incorporation of Social Dimensions into ADB Operations. *Operations Manual*. OM C3. Manila; and ADB. 2023. Gender Equality and Women Empowerment in ADB Operations. *Operations Manual*. OM C2. Manila.

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13. Regarding the investment component, tranching is generally not feasible or advisable for a project loan.⁴ 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 PBLs including under a programmatic approach or SDPs in a sector, or through the adoption of a longer time frame for a single PBL or SDP.

15. **Loan amount.** 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 (i) ADB's overall lending program to the DMC, (ii) the alternative sources of financing, (iii) the sectoral investment needs, (iv) the intersectoral priorities for the investment component, and (v) the development financing needs for the PBL component as the budget support.

16. **Ceilings.** The PBL component of an SDP is added to the freestanding PBLs when considering the ADB-wide ceiling for PBL.

Basis

iADB. 1996. *Review of the Bank's Program-Lending Policies*. Manila.

⁴ Where appropriate, frontloading of key policy conditions could be required where severe sector distortions are in evidence.