Sector Lending in Education

Richard K. Johanson

December 1985

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(Continued on back cover)
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Richard K. Johanson
Office of the Director
Education and Training Department

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Abstract

This review evaluates the processing and benefits of seven sector loans in education. These sector loans differ from conventional loans by the extent to which they: (1) focus on policy and institutional changes; (2) merge Bank financing with a public sector investment program; and (3) delegate functions traditionally handled by the Bank to an intermediary institution which allocates funds to subprojects according to agreed-upon criteria. The scope of benefits achieved, even in the early stages of sector lending, namely delegation of responsibility for subproject appraisal, appears to be a uniquely effective way to develop institutional capacity. The review also draws several procedural lessons to help in processing future sector loans. Sector lending requires a different sequence of steps than conventional lending. It requires unusually close governmental collaboration. It requires sector work focusing in policy and institutional analysis. And, above all, it requires capable borrowers and intermediaries. An extensive trial of subproject processing was found to be the best way to test this capability.
# SECTOR LENDING IN EDUCATION

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vi. This review also draws some procedural lessons that should help the processing of future sector loans: Sector lending requires a different sequence of steps than those that characterize the conventional project cycle (Chart 3). It requires close government collaboration in each step of the process. It requires sector work focussing on policy and institutional analysis. And, above all, it requires a capable borrower and intermediary.

vii. The selection and development of a capable intermediary has proved to be the most vexing aspect in the sector lending cycle. Bank staff have not had the benefit of systematic criteria for evaluating the administrative capability of borrowers and intermediaries. Institutional capacity has been viewed narrowly in terms of program administration rather than as capacity to carry out broad institutional and policy reforms.

viii. The review suggests that mistakes can be avoided in sector lending by:

- keeping the design of ESLs simple so as not to overload the intermediary;
- using specialists to analyze institutions and management;
- training the staff of the intermediary more systematically; and
- testing the capability of intermediaries more thoroughly through an extensive trial of subproject processing. This tests the feasibility of criteria and procedures, demonstrates the managerial capacity of the intermediary, and builds up a pipeline of subprojects for early implementation and disbursement.

ix. With these benefits and lessons in mind, sector lending would seem appropriate for a wider range of countries than the Bank has considered acceptable as recipients to date. Steps should be taken to prepare countries for sector lending by (a) financing policy and institutional analysis, (b) initiating the preparation of long-range investment programs, (c) sponsoring the development of criteria and procedures for investment decisions, and (d) gradually delegating to the borrower decisions on the allocation of project funds to beneficiaries.

x. Sector lending, if done properly, is inevitably a lengthy process. However, this review has found that sector loans do not require much more Bank staff time to develop than do conventional loans. The staff time spent to develop a sector loan, moreover, is applied to matters of greater importance. These findings suggest that sector lending should become a more prominent instrument in regional education lending programs.
Executive Summary

i. The first education sector loan (ESL) was approved in 1979 and since then seven others have been approved. One has been completed. All these sector loans differ from conventional education loans in the following respects: they focus on policy and institutional changes; they merge financing by the Bank with a public sector investment program; and they delegate functions traditionally handled by the Bank to an intermediary institution which allocates funds to subprojects according to agreed-upon criteria.

ii. To date, ESLs have proved to be more complex to develop and implement than standard projects. In particular:

- ESLs have taken much longer to process than conventional operations;
- all ESLs have started slowly and disbursed slowly at first;
- two of the eight ESLs have encountered major problems of management structure and have required redesign; and
- ESLs have been applied only in two regions and only in large, relatively advanced countries.

iii. In view of the above, this review examines whether sector lending constitutes a reasonable mode of operation of wider applicability in the education sector. Generally, the findings of this review support the use of sector lending in education.

iv. The scope of benefits achieved, even in the early stages of sector lending, seems to be far reaching. Substantial agreements have been reached on policy and institutional changes. The one completed ESL has accomplished extensive changes in policy and institutions. Most importantly, the mode of operation of ESLs, namely delegation of responsibility for subproject appraisal, appears to be a uniquely effective way to develop institutional capacity: it institutionalizes development planning at various levels; it strengthens decision-making capability; and it applies more objective criteria to wider government investments in education.

v. These benefits are not likely to have been achieved to the same extent under conventional projects. Sector loans in education have been broader in scope than traditional projects. They have placed policy and institutional changes at the top of the agenda for dialogue. And they have tended to use, influence and modify government procedures rather than attempt to bypass them.
Preface

This review provides staff with a guide for the development of sector loans in education. It reviews the experiences of education sector lending as practiced thus far, updates an earlier work (Sector Lending in Education, March 1981, by M. Zymelman), and takes into account the results of three seminars on sector lending in education attended by 75 Bank staff.¹

I. INTRODUCTION

1.01 Sector lending, a technique used to denote Bank participation in a government's sector investment program, was introduced in the 1970s mainly in infrastructure sectors such as transportation (highways), power, water and irrigation. Sector lending has been regarded as a device to achieve wider benefits compared with traditional project lending. OMS 1.19 states that sector lending has the potential for:

(a) broadening the developmental impact of lending operations by encompassing the whole investment program of a sector rather than dealing with discrete elements of it;

(b) strengthening local capabilities to plan and manage sector investment programs; and

(c) focusing the attention of Bank and borrowers on key policy issues necessary to achieve sectoral objectives.

In addition, it was believed that sector lending could reduce Bank staff input, enabling the Bank to commit larger sums and disburse funds more rapidly than under traditional project lending.

1.02 Four characteristics have distinguished sector loans from standard projects. The overriding objectives are policy changes (or maintenance of changes) and institutional development. The Bank finances part of an overall investment program for the sector.²

¹ Special thanks go to those who have been deeply involved in sector lending and have contributed most of the ideas included here, namely Shigeko Asher, Robert Drysdale, Gordon Hunting, Ralph Harbison, Sherry Keith, Eleanor Schreiber, Yves Tencalla and Manny Zymelman. This review also draws on the comparisons of sector lending across sectors forthcoming in a broader operational review by Eleanor Schreiber.

² The scope of the "sector" in a sector loan can vary. All the ESLs described here cover subsectors of the education system, or even sub-subsectors (higher technical education). In smaller countries, a sector loan might encompass the entire education system.
delegates many of its traditional functions, such as decisions on the
destination of funds, to an intermediary within the context of agreed-upon
criteria and procedures. Finally, investments are channeled through
subprojects. 3

1.03 The first sector loan in education was approved in 1979. It
focused on higher technical education in Korea. This operation sought
policy changes on quality control among higher education institutions, on
flexibility of teaching programs, and on government financing of private
institutions. The Bank's loan of $100 million financed part of an overall
investment program of about $600 million over ten years. Under this
operation the Bank delegated decisions on the allocation of funds to sub-
projects (which, in this case, were assistance packages for individual
institutions) to an intermediary, the Ministry of Education, which operated
within the context of agreed-upon criteria and procedures. The criteria
included conditions of eligibility, guidelines on allocation of funds,
criteria for appraisal and approval of subprojects.

1.04 Since 1979 seven other ESLs have been approved in two regions.
These include loans for basic education in the Philippines; rural primary
education in Colombia; technician training, urban basic education and
science and technology in Brazil; university education in China; and
science education in Korea (Korea's second ESL). All these operations
differed from traditional projects by possessing the above four charac-
teristics, namely: focus on policy and institutional changes, merging of
Bank financing with the Government's overall investment program for the
subsector, delegation of traditional Bank functions to an intermediary
which allocates funds within agreed-upon criteria and procedures, and
expenditure of investment funds through subprojects.

1.05 Whether a project fits the definition of a sector loan is
essentially a matter of degree. It is best to conceive of a continuum of
lending operations with narrowly focused project lending (i.e., an
enclave-type operation) at one end of the continuum and "pure" sector
lending at the other. The eight education operations defined here as
sector loans all fall on the sector lending half of this continuum. Even
among the eight, however, there were variations in the degree to which they
met all of the characteristics of sector lending. The Korea and Brazil

3/ The policy and institutional focus was not particularly strong in the
Bank's early sector loans; rather, investment programs and delegation
were emphasized. Institutional measures were often limited to support
for implementation. More recently, and in nearly all the ESLs,
emphasis is given to policy and institutional concerns as well. In a
sense, ESLs as a group have a leading edge in combining all of the
sector loan features described in OMS 1.19.

4/ 'Sector adjustment loans' (or 'sector policy loans') differ from sector
loans in that they cover only the first two characteristics, (i) policy
and institutional change, and (ii) investment program. They do not
deal with delegation.
science and technology operations had heavy policy content, while the China and Brazil urban primary had comparatively less. All the ESLs, however, were high on financing a share of the Government's investment programs and on delegating decisions for fund allocation. Several recent "standard" projects assumed some characteristics of sector lending without fully qualifying as such. Examples include: (a) projects that delegate authority to the borrower to decide on school locations based on agreed-upon criteria, (b) projects that finance time slices of larger investment programs, and (c) projects under which central authorities are delegated authority to appraise and approve regional investment programs. Chart 1 shows the degree to which sector lending characteristics were present in various education loans.

1.06 It is too early to evaluate fully the final outcomes of the eight ESLs, but it is possible to summarize experiences in their development and initial implementation. ESLs have proved to be more complex to develop than standard projects. This complexity shows up in the length of time required to develop ESLs. As shown in Table 1, education sector loans generally have taken 50-90% longer (though not appreciably more staff time) to develop than their conventional counterparts. This reflects greater borrower participation and the costs of trial and error in a new form of lending. Second, some ESLs have run into implementation difficulties. Each of the eight ESLs has started slowly. The disbursement profile of ESLs has been disappointing in the first years of implementation, as shown in Figure 1. This is partly attributable to a lack of a sufficient number of approved subprojects ready for implementation at the time of Board approval. (An operation for which most beneficiaries have not been identified or appraised at the time of loan commitment will inevitably be slow disbursing). In addition, the Philippines and Colombia operations have both encountered major administrative problems in implementation which shows in the high supervision coefficients for these loans. Third, ESLs have been introduced so far only in relatively advanced, large countries and only in two of the Bank's six regions.

1.07 These experiences raise questions about whether sector lending constitutes an effective and efficient mode of operation for the education sector that can be applied in more than a few highly advanced countries. The remainder of this paper reviews the record of the eight ESLs to:
(a) ascertain whether the benefits of sector lending outweigh the costs,
(b) identify, as a guide for future use, the factors that are essential to success in sector lending, and (c) explore whether ESLs could be used more widely in the sector.

1.08 Generally, the findings of this review support the use of sector lending in education. The scope of benefits achieved, even in the early stages of sector lending, seems to be far reaching. The experiences and problems in sector lending suggest lessons that should facilitate greater success in future sector loans. By using these lessons, Bank staff may be able to apply sector lending in a wider array of countries than previously believed feasible. Each of these topics is discussed in sequence below.
## CHART 1

**DEGREE OF SECTOR LOAN CHARACTERISTICS PRESENT IN VARIOUS OPERATIONS**

<table>
<thead>
<tr>
<th>Sector Loans</th>
<th>Content</th>
<th>Focus on Policy</th>
<th>Focus on Broad Institutional Development</th>
<th>Financing Time Slice of Investment Program</th>
<th>Delegation of Responsibility for Fund Allocation</th>
<th>Use of Subproject</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Korea</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
</tr>
<tr>
<td>2. Philippines</td>
<td>elementary</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>medium</td>
</tr>
<tr>
<td>3. Colombia</td>
<td>rural primary</td>
<td>medium</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
</tr>
<tr>
<td>4. Brazil</td>
<td>technical</td>
<td>medium</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>medium</td>
</tr>
<tr>
<td>5. Brazil</td>
<td>urban</td>
<td>low</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
</tr>
<tr>
<td>6. Brazil</td>
<td>science &amp; technology</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
<td>high</td>
</tr>
<tr>
<td>7. Korea</td>
<td>science</td>
<td>high</td>
<td>medium</td>
<td>high</td>
<td>high</td>
<td>high</td>
</tr>
<tr>
<td>8. China</td>
<td>universities</td>
<td>medium</td>
<td>low</td>
<td>high</td>
<td>high</td>
<td>high</td>
</tr>
</tbody>
</table>

### Projects with Sector Loan Characteristics

<p>| 1. Bangladesh | primary II | medium | low | high | low | low |
| 2. Burkina III | primary | high | medium | low | low | low |
| 3. Malaysia V | secondary | low | medium | low | high | low |
| 4. Mali III | multi-purpose | high | low | low | low | low |
| 5. Pakistan | primary II | low | low | low | high | medium |
| 6. PNG II | primary | low | high | low | high | low |</p>
<table>
<thead>
<tr>
<th>Region</th>
<th>Loan by Region</th>
<th>Elapsed Time</th>
<th>Implementation</th>
<th>Supervision Coefficients</th>
</tr>
</thead>
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<tr>
<td></td>
<td></td>
<td>Loan/ Credit</td>
<td>Staff Input 8/</td>
<td>Period (years)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Board Approval (weeks)</td>
<td>(staff weeks)</td>
<td></td>
</tr>
<tr>
<td>Asia &amp; Pacific</td>
<td>Korea Higher Technical</td>
<td>100.0</td>
<td>118</td>
<td>177</td>
</tr>
<tr>
<td></td>
<td>Philippines Elementary Educ.</td>
<td>100.0</td>
<td>73</td>
<td>195</td>
</tr>
<tr>
<td></td>
<td>Korea Science &amp; Technology</td>
<td>100.0</td>
<td>90</td>
<td>113</td>
</tr>
<tr>
<td></td>
<td>China Univ. Development UI</td>
<td>145.0</td>
<td>99</td>
<td>108</td>
</tr>
<tr>
<td></td>
<td>Average for ELs</td>
<td>111.2</td>
<td>95</td>
<td>149</td>
</tr>
<tr>
<td></td>
<td>Standard Education Loan</td>
<td>50.4 b/</td>
<td>62 c/</td>
<td>132 d/</td>
</tr>
<tr>
<td></td>
<td>Average Comparator</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>Colombia Rural Basic Educ.</td>
<td>15.0</td>
<td>96</td>
<td>165</td>
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<tr>
<td></td>
<td>Brasil Technician Training</td>
<td>20.0</td>
<td>80</td>
<td>86</td>
</tr>
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<td></td>
<td>Brasil MCV Basic Education</td>
<td>40.0</td>
<td>106</td>
<td>161</td>
</tr>
<tr>
<td></td>
<td>Brasil Science &amp; Technology</td>
<td>72.0</td>
<td>111</td>
<td>189 d/</td>
</tr>
<tr>
<td></td>
<td>Average for ELs</td>
<td>36.7</td>
<td>98</td>
<td>130.2/</td>
</tr>
<tr>
<td></td>
<td>Standard Education Loan</td>
<td>21.7 e/</td>
<td>52 f/</td>
<td>139 h/</td>
</tr>
<tr>
<td></td>
<td>Average Comparator</td>
<td></td>
<td></td>
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</tbody>
</table>

| a/ | Staff weeks from appraisal to board approval. |
| b/ | Based on ten cases from the same fiscal period. |
| c/ | Based on nine cases from the same fiscal period. |
| d/ | Regional estimates. |
| e/ | Standard education loan has not been implemented beyond this point. |

Note: Comparator data are based on averages for standard education loans for the same fiscal years.
FIGURE 1
DISBURSEMENT PROFILE OF EDUCATION SECTOR LOANS
IN COMPARISON WITH STANDARD EDUCATION LOANS

Cumulative Disbursement

<table>
<thead>
<tr>
<th></th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
</tr>
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<tbody>
<tr>
<td>Sector Loan</td>
<td>1.2%</td>
<td>4.7%</td>
<td>14.7%</td>
<td>21.5%</td>
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<tr>
<td>Standard Loan</td>
<td>2.3%</td>
<td>11.8%</td>
<td>18.6%</td>
<td>22.1%</td>
</tr>
<tr>
<td>ESL as % of Standard Loans</td>
<td>52.2%</td>
<td>39.8%</td>
<td>79.0%</td>
<td>97.3%</td>
</tr>
</tbody>
</table>

Cumulative Percent of Loan Disbursed

Years of Implementation

- 6 -
II. BENEFITS OF EDUCATION SECTOR LENDING

2.01 What light does the initial experience with education sector loans shed on the assumed benefits listed in para. 1.01? In particular, how effective have ESLs been in introducing policy and institutional changes? The evidence with ESLs thus far suggests two conclusions, (1) the policy and institutional benefits of education sector lending are substantial; and (2) these benefits are not likely to have been achieved to the same degree under more standard project lending, as explained below.

2.02 These conclusions must be qualified by several caveats. Only one ESL has been completed. With the others, it is too early to tell much about implementation. Still, it is possible to distinguish between agreement on changes and their implementation. Overall, ESLs have been successful in focusing attention on policy and institutional issues and in reaching agreement with Governments on these matters. In the only completed education sector operation, sector lending also has been an effective mechanism for achieving the changes in policy and institutions. Finally, the method of operation of sector lending, i.e., delegation of responsibility for subproject appraisal to an intermediary within agreed-upon criteria and procedures, appears to be a uniquely effective way to develop institutional capacity.

2.03 First, substantial agreements on policy and institutional changes have already been achieved in most of the ESLs. These policy changes deal mostly with investment planning, resource allocation and financing. Examples include increased government financing of private education in Korea, procedures for regional allocation of investment budgets in Colombia and the Philippines, consolidation of schools in Brazil, and minimum sufficient funding of development projects in Colombia and Brazil. Agreed-upon institutional improvements pertain either to the reinforcement of central agencies or to the decentralization of functions. Examples include an attempt at integrated program management in Colombia, improved regional management in the Philippines, and streamlining of planning and financial transfers in Brazil. In the Brazil science and technology operation four different agencies, previously with overlapping functions, have agreed on a division of labor and common rules of operation. This ensures more efficient allocation of research funds. Long-term financing is provided instead of funding subprojects as an annual basis. For the first time, decisions on which proposals to finance are based on professional peer reviews. These various agreements achieved under ESLs are categorized and summarized in Chart 2. The overriding characteristic is the broad scope of the changes endorsed.5/

2.04 Second, the only fully implemented ESL has achieved the implementation of important policy and institutional changes, although it must be borne in mind that one cannot always attribute end results to Bank

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5/ ESLs have tended to introduce new policy and institutional measures, while support is largely for existing policy and institutional directives in sector loans in other sectors.
intervention or to the Bank's mode of operation. Under the ESL for higher technical education in Korea, the government has introduced a policy of subsidizing private higher education, introduced a policy of establishing minimum standards for higher education through the Korean Association of Colleges and Universities, and established an agency for manpower planning in the economic planning Board. Important changes were also achieved in making the rigid student quota system more flexible, but another policy objective of limiting the rate of increase in university admissions to technical fields was only partially achieved.

2.05 Third, perhaps the most important evidence of success relates to the institutional development already achieved through the ESL's mode of operation. The subproject appraisal process achieves institutional development by operationalizing development planning and strengthening local decision-making capability. Investment planning is required under sector lending, not only at the macro level, but also for subprojects. A five-year development plan was a condition in Korea for a higher learning institution's access to subproject funds. Government assistance was available to help prepare these development plans. In Colombia, loan requests at local level are essentially mini-development plans based on nationally established norms and extensive local analysis of deficits. In the Brazil urban primary, ESL states prepare annual investment plans for appraisal by Federal Authorities. Thus, sector lending in education has tended to encourage local planning. The typical mode of operation is for potential subproject beneficiaries to apply for loan/credit funds. This has had the effect of encouraging the development of local initiatives.

2.06 The subproject appraisal process itself has helped to strengthen local decision-making capability and to extend the application of objective criteria to wider Government investments in education. In both the technician and urban primary sector loans in Brazil tremendous improvement is already evident in the ability of Federal authorities to appraise state level investment plans. Under the China operation the Ministry of Education, which serves as the intermediary, has adopted a different, more objective, set of criteria for allocation decisions. This has resulted in less reliance on political criteria for allocation decisions and in the rejection of about 20% of the potential subprojects.

2.07 The benefits elaborated above are not likely to have been achieved to the same degree under traditional modes of operation. This does not mean that wider sector objectives cannot be achieved in traditional projects. The Bank has used sector conditionality increasingly in education projects (e.g., Burkina III). But the tendency in traditional projects is to be more limited and insular. The Bank's experience in Korea shows this contrast. The first four education projects in Korea sought change and improvement mainly within project-assisted institutions, whereas the two sector loans have sought, and to a large extent achieved, sector-wide changes in policy and institutions. In Brazil the Bank rejected two earlier requests for assistance to industry-specific research and development (e.g., in the chemical industry) because that narrow approach would not have given the Bank leverage over sector-wide procedures for funding and managing research.
<table>
<thead>
<tr>
<th>Sector Loan</th>
<th>On Policy</th>
<th>Institutional Development</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Allows flexibility in system of student allocation.</td>
<td></td>
</tr>
<tr>
<td>2. Philippines Elementary</td>
<td>Introduces new system for allocating investment budget according to equity.</td>
<td>Establishes bureau of elementary education and planning.</td>
</tr>
<tr>
<td>3. Colombia Rural Primary</td>
<td>Increases proportion of operating on non-salary lines.</td>
<td>Develops integrated school of engineering, Industry, and Management.</td>
</tr>
<tr>
<td>5. Brazil Urban Primary</td>
<td>Adjusts capex to evolving requirements.</td>
<td></td>
</tr>
<tr>
<td>6. Brazil Science &amp; Technology</td>
<td>Chooses pedestrians needing special assistance based on Brazil's competitive economic advantages (e.g., biotechnology).</td>
<td>Institutionalizes investment planning.</td>
</tr>
<tr>
<td>8. China University</td>
<td>Correlates enrollment imbalance between social sciences and technology.</td>
<td>Sector coordination of four major funding agencies.</td>
</tr>
</tbody>
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### Chart 2

<table>
<thead>
<tr>
<th>Ways of Agreements Derived under FTA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Korea Higher Technical</td>
</tr>
<tr>
<td>2. Philippines Elementary</td>
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<tr>
<td>3. Colombia Rural Primary</td>
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<tr>
<td>4. Brazil Technician</td>
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<tr>
<td>5. Brazil Urban Primary</td>
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<tr>
<td>6. Brazil Science &amp; Technology</td>
</tr>
<tr>
<td>7. Korea Science</td>
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<td>8. China University</td>
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2.08 In addition, sector lending gives priority to policy and institutional changes by making these topics the focus of the operation from the initial stages of program development. This is elaborated in para. 3.08. In traditional project lending, such changes tended to be included in the Bank's agenda late in the development cycle, if at all. Finally, sector lending is more likely to use, influence and modify regular government procedures whereas traditional lending often bypasses these procedures by using separate project implementation units. The Brazil sector loans for technician and urban primary education illustrate the ability to work within and improve routine government procedures for financial transfers to the states. These improvements benefit not only investments financed by the Bank, but also any others financed by the Government outside the scope of the sector operation.

2.09 In countries where it is appropriate, therefore, sector lending affords the opportunity to accomplish wider objectives than traditional lending. This being the case, what does experience thus far suggest we should do better or differently in developing ESLs? The next chapter answers this.

III. THE SECTOR LENDING CYCLE: LESSONS FROM EXPERIENCE

3.01 Overview. This chapter summarizes the findings of this review of ESLs developed and implemented thus far with a view to improving future operations. The most important findings of the review are (a) the different sequence of steps required to develop a sector lending operation, (b) the indispensable need for close government collaboration at every step of the process, (c) the qualitatively different kind of sector work required, (d) the importance of careful institutional analysis in selection of an intermediary, (e) the need to train borrower staff extensively in subproject appraisal based on guidelines and handbooks explaining agreed-upon procedures, and (f) the need for extended pilot testing of subproject processing, both to demonstrate intermediary capability and set the stage for rapid implementation and disbursements.

3.02 The Sector Lending Cycle. A central finding of our review of ESLs is that sector lending follows a different project cycle from that of traditional lending, which consisted of identification, preparation, and appraisal. Three major stages encompassing seven major steps have been identified in the process of developing education sector loans (Chart 3). These will be discussed in sequence below.

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6/ This sharp distinction between sector and standard projects obtained in the past; however, the increasing attention to policy change in conventional projects will likely minimize such differences in the future.
Chart 3

DEVELOPMENT STAGES IN THE SECTOR LENDING CYCLE

I. AGREEMENT ON APPROACH AND OBJECTIVES

Step 1. Determine Country Eligibility and Government Interest
   a. Determine Country Eligibility
   b. Determine Government and Bank Interest

Step 2. Set Policy Objectives
   a. Diagnose Sector Issues
   b. Agree on Policy Framework

II. PROGRAM FORMULATION

Step 3. Formulate and Appraise Program Contents
   a. Identify Action Program
   b. Identify Content of Sub-Projects
   c. Set Performance Indicators

Step 4. Define and Appraise Investment Program

Step 5. Determine Management Framework (Mode of Operation)
   a. Select Intermediary
   b. Establish Criteria and Procedures for Sub-project Processing

III. INITIAL OPERATION AND REVISION

Step 6. Train Intermediary Personnel in Sub-project Processing

Step 7. Pilot Testing and Revision of Sub-project Processing
STAGE I: AGREEMENT ON APPROACH AND OBJECTIVES

Step 1: Determine Country Eligibility and Government Interest.

3.03 Step la: Determine Country Eligibility. The principal prerequisite for entering into a dialogue with a government about sector lending is that the borrower have the capacity to carry out the program. This capacity is divided into several parts:

(i) decision-making power, as vested in a Ministry or agency;

(ii) capacity to implement policy reforms;

(iii) capacity to undertake major administrative reforms;

(iv) technical capacity to prepare plans and programs, appraise sub-projects and evaluate performance; and

(v) capability to administer the program through auditing, financing, legal procedures, personnel actions, etc.

The best, but not the only, evidence of a country’s administrative capability is successful performance in implementing previous reforms and education projects. In the Philippines' elementary education sector loan, the Bank ran into difficulties because it accepted the good performance of a specialized implementing agency, EDPITAF, as a proxy for the implementation capacity of an untested agency, the Bureau of Elementary Education. To start the process of sector lending, the Bank must have confidence that the intermediary has at least the minimum capacity necessary to implement the type of program envisaged, but the further development of that capacity can be an overall objective of the operation. If the minimum capacity does not exist, efforts should be made through traditional investments to build up the capacity (see para. 3.18).

3.04 Step lb: Ascertain Country and Bank Interest. The stages in the sector lending cycle must be understood by all parties. Experience thus far suggests that one or several missions are important at the outset for the purpose of explaining and agreeing on the above. During these missions, the Government should be advised of the potential advantages and disadvantages of sector lending. The advantages and disadvantages differ for the Bank and Borrower. Chart 4 lists some of these points:

7/ Of course, this ultimately depends on the size and complexity of the yet-to-be defined program and therefore requires further evaluation (see Steps 5a and 6).
## Chart 4

### Advantages and Disadvantages of Sector Lending

<table>
<thead>
<tr>
<th><strong>Bank:</strong></th>
<th><strong>Advantages</strong></th>
<th><strong>Disadvantages</strong></th>
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<tr>
<td></td>
<td>Concentrates time and attention on broad policy issues and on institutional changes.</td>
<td>Longer gestation period.</td>
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<td></td>
<td>More efficient means of dealing with large scale, dispersed operation.</td>
<td>Greater risk of changes in policy.</td>
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<td>Greater control over allocation decisions.</td>
<td>Greater risk of fund mis-allocation due to loss of immediate control by Bank over allocation decisions.</td>
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<td>Greater flexibility in dealing with changed or unforeseen conditions during implementation (and, hence, less risk of cancellation of loan funds).</td>
<td>Greater Bank involvement in policy matters, which may be regarded as unwanted interference.</td>
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<tr>
<td></td>
<td>Potential for greater flow of development assistance.</td>
<td>Greater government workload in development and appraisal of subprojects.</td>
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<tr>
<td></td>
<td>Institution-building aspects, e.g. more objective basis for allocation decisions, greater decentralization of program planning and implementation.</td>
<td>Less Bank involvement in allocations, which may subject authorities to greater political pressures for subloan funds.</td>
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<tr>
<td><strong>Government:</strong></td>
<td></td>
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In Korea, the government was reluctant initially to enter into sector lending for two of the reasons cited above, namely, increased Bank involvement in policy decisions and the amount of work that subproject appraisal would impose on the Ministry of Education. These initial reservations were overcome through discussions at the highest levels of the planning authority, during which the advantages of autonomy were stressed. The reservations were never expressed in development of the second sector operation in education, indicating the Government's satisfaction with the process.

3.05 Skepticism must also be overcome within the Bank. In the development of the China and Brazil science and technology operations, some Bank officers needed to be convinced that the risk of delegating decisions on the destination of funds was worth taking. This was accomplished by stressing that the benefits of decentralized decision making were substantial, and that the Bank had secondary control through enforcement of the use of mutually agreed-upon procedures and criteria for those decisions. It is significant that education sector lending received strong Bank management support in the two regions in which the eight ESLs have been developed.

**Step 2: Set Policy Objectives.**

3.06 **Step 2a: Diagnose Sector Issues.** Sector lending requires more and better sector analysis than has been done typically in the past, so as to identify the underlying policy issues as a point of departure for dialogue with the government. The low level of policy content in the China loan and in the urban primary ESL in Brazil can be attributed to an insufficiency of sector work.

3.07 **Sector analysis for sector lending must be qualitatively different from traditional sector analysis.** Its principal focus must be on policy analysis. It must result in the elaboration of a set of policy alternatives addressing priority issues and useful as a basis for dialogue. Second, it needs to focus on institutional structures (i.e., the way institutions work) and on management of the system. Finally, it needs to be collaborative, or better still, to be done by the borrower itself. Collaborative analysis is essential if both parties are to understand the basis for current policies. It paves the way for the next step, which is agreement on policy changes. Some would argue that the above three criteria apply to all good sector work. The difference is that the requirements are desirable for standard project work but are essential for success in sector lending.

3.08 **Step 2b: Agree on Policy Framework.** Before proceeding with the development of a sector lending operation it is important to reach agreement with the government about the main policy interventions to be employed. Based on the Colombia and Brazil cases, an important test is whether government has signed off on the selected policy interventions.

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8/ Studies by an external agency, no matter how competent, seldom penetrate sufficiently the thinking behind a country's policies.
Experience also suggests the importance of involvement in the policy dialogue of those parties expected to implement the changes (e.g., teachers, universities). Moreover, experience thus far suggests it is best to keep the set of policy agreements short and simple and avoid the tendency to try to do too much. Selectivity is important so as to focus on priorities. In the Korea science sector loan, for example, agreement was achieved on the proportion of class time that would be devoted to practical science activities, but no agreement was reached on the matter of changing the traditional lecture method of instruction. This method was deeply imbedded in the culture, and it was ultimately left aside without jeopardizing the main policy goals of the operation. Experiences in the Philippines point to the importance of choosing carefully the means used to achieve the underlying objectives. In this case, equity was sought through changes in the formula by which development funds were allocated to regions. The changed formula was intended to divert more resources to less privileged areas. However, the formula became an end in itself. The central authorities were unable to manage its application flexibly so as to achieve the desired policy objective.

STAGE II: PROGRAM FORMULATION

Step 3: Formulate and Appraise Program Contents.

3.09 Step 3a: Prepare Action Program. After formal agreement on policy changes, the next step is to work out a program by which to translate the policies into action. A weakness in the first Korean sector operation, observed during implementation, was the failure to operationalize the precise actions needed to implement policy changes, and to establish a variety of indicators to measure their achievement. A weakness in the Philippines case was the failure to think through the mechanisms by which policy changes would be implemented.

3.10 Step 3b: Identify Content of Subprojects. The concept of subproject is not the same as a project component in a standard operation, e.g., textbooks or buildings. In effect, subprojects are mini-investment projects, usually numerous, which are the discrete sets of action of the investment program to be assisted by a sector loan. In their aggregate, subprojects constitute the content of the investment program supported by the sector loan. The scope of subprojects have varied considerably under ESLs. In some sector loans, notably the first Korean and Brazilian ESLs dealing with technical education, subprojects were investment packages for individual schools. In other ESLs (e.g., the Colombian and urban Brazilian) subprojects were investment packages for geographical groupings of schools. Ideally, the investment program can be broken into many replicable subprojects of a single type, i.e., of identical characteristics, for which a single set of processing rules suffices (see below). The quantities of the various inputs for each subproject will vary according to local needs, but the type of contents is the same for each group of subprojects. Careful analysis of subproject content is necessary to ensure that it constitutes an effective and efficient response to the issues identified.
3.11 Step 3c: Set Performance Indicators. Under sector lending the Bank’s role in monitoring and supervision differs considerably from traditional lending. Instead of supervising the distribution of funds to beneficiaries, the Bank’s role is to supervise the operations of the intermediary and monitor progress towards achievement of policy and institutional objectives. Effective performance indicators and a reliable information system are essential for proper monitoring of a sector loan. These form the basis for annual or semi-annual meetings with the Borrower to discuss policy implementation and to agree on targets for the following year. Experience in both Korea and the Philippines underscores the importance of precise, relevant and easily monitored performance indicators. (For structural adjustment loans, the phrase has been “reasonable, actionable and monitorable.”) In Korea, a single indicator was used as a proxy for quality of instruction, i.e., reduction in staff-student ratios to targeted levels. The targets were inserted in the legal documents. This proved to be an overly simplistic measurement, and its non-achievement brought the whole loan unfairly into non-compliance. The second ESL in Korea improved upon the first by adopting a variety of indicators and procedures as targets and monitoring these annually. These were not specified in the legal documents but in an action program and letter on sector policy that the Government submitted to the Bank. A different problem arose with the indicators in the Philippines. An objective of the operation was to reduce the staffing costs of elementary education by reducing the number of non-teaching staff in the system. The indicator chosen to represent this was the proportion of non-teaching staff in the total. Dramatic changes were achieved quickly according to the indicator. However, upon closer examination in the field, it was discovered that merely the titles of non-teaching staff had been changed (to teaching staff). A variety of indicators and annual targets might help to avoid these problems. (See Appendix 6 for indicators used in the second Korean sector loan.)

Step 4: Define and Appraise Investment Program.

3.12 An investment program needs to be prepared and appraised, based on the overall needs assessment and the contents of the action program. This investment program, or a proportion of it defined by time, then becomes the “project” cost. The Bank finances a share of the overall investment program rather than discrete parts of it. After the subprojects have been adequately defined, it is possible to prepare a model subproject budget or cost table, one for each reasonably distinct type of subproject. Aggregated over the number of subprojects, the model budgets form the basis for overall uses of funds. However, the approximate number of subprojects which will eventually make up the investment program should be determined from a careful projection of resources likely to be available—i.e., from assessment of the sources of funds (including the prospective loan) available for education as a whole and for that part of the sector treated

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9/ This feature, while prominent in ESLs, has not been carried out as strongly in sector loans in other sectors, except financial intermediary operations.
in the investment program. Careful analysis of sources and uses of funds is necessary to ensure that the physical content of the investment program is consistent with the budgetary resources likely to materialize. In Korea this was done late into the project cycle with the consequence that it was not possible to scrutinize the investment program in depth.

**Step 5: Determine Management Framework (Mode of Operation).**

**3.13 Step 5a: Select Intermediary.** Apart from agreement on policy and institutional changes, selection of the intermediary is the single most important factor for the success of a sector loan. This is because the intermediary is responsible for managing the functions usually carried out by the Bank, i.e., identification, preparation, appraisal and approval of funds for particular beneficiaries, as well as managing the process of supervision of subprojects. Consequently, the management capacity of the intermediary must be strong, as evidenced by a proven record of good performance in policy and project implementation. The intermediaries selected in ESLs generally have been particular agencies of the Ministry of Education. The Brazil science and technology sector loan used multiple intermediaries.

**3.14** The Bank has no clear set of criteria by which to determine whether an intermediary has the capability to carry out a sector operation. In Korea, the criteria used were: (a) good record of project implementation, (b) clear organizational responsibilities, (c) existence of workable procedures, and (d) reasonable numbers of qualified staff and local consultants to handle the expected workload. Lessons from the ESLs to date point to the need to use specialist expertise on institutional analysis during sector work and appraisal so as to acquire knowledge in detail about structures, procedures and staffing. Failure to look hard at institutional organization and at the capabilities of staff was a major weakness in the Philippines case. Management expertise on appraisal, however, is not enough to ensure that the intermediary has the capacity to carry out the sector program. The Colombia sector loan benefited from expert advice on management, but still ran into serious administrative difficulties. At the root of the problem was an unworkable management structure which the Bank and Government had designed jointly. This experience suggests that a further, more rigorous test of administrative capability is needed (see para. 3.18).

**3.15 Step 5b: Establish Criteria and Procedures for Subproject Processing.** Under sector lending the Bank delegates decision-making on the allocation of funds to subprojects to the intermediary. The main security for the Bank, apart from selection of a competent intermediary, rests with the procedures and criteria by which the funds will be distributed. In addition, an important institutional objective of sector lending is for the borrower to adopt a more objective set of criteria for fund allocation. Therefore, considerable care must be taken in the design of procedures and criteria for subproject processing. An example of the procedures followed for the Korean higher technical education sector loan, in flowchart format, is shown at the end of Appendix I. Several sets of criteria are needed for subproject processing, as follows:
(a) Eligibility Criteria. These set the conditions by which subproject funds may be sought. The criteria may specify the regions, types of institutions or courses of study for which the funds are intended. They can also indicate whether the funds will finance existing or new institutions. If consolidation or economy in use of resources are objectives, then minimum size of institution might be stated. A basic condition for access to funds is a long-term investment plan to address priority problems.

(b) Contents of Loan Applications for Subprojects. One of the institutional objectives of sector lending is to facilitate the application of resources to the solution of urgent problems at the local level. The subproject loan application is one means to help accomplish this. The application calls for a diagnosis of major problems at the institutional or local administrative level, the proposal of remedial measures according to standard norms supplied by the intermediary, and the preparation of a mini-investment plan setting out the costs of the solutions. Some ESLs thus far (notably Colombia and Brazil) have developed operational manuals (available from regional division files) with guidance to applicants on how to prepare these local investment plans.

(c) Guidelines for Allocation of Loan Funds. There is always a risk that aggressive applicants could garner the lion's share of subproject funds to the detriment of slower, but equally needy, applicants. Therefore, to ensure reasonable balance in the allocation of funds, it is necessary to agree with the intermediary in advance on general guidelines. These guidelines cover such things as regional distribution of funds; minimum funding per subproject; distribution of loan funds by level of education; minimum total allocations to private or public institutions; and, for efficiency and equity, maximum and minimum allocations per subproject.

(d) Criteria for Appraisal and Approval of Subprojects. These criteria are perhaps the most important because the presumption is that they will govern, in due course, allocation of the borrower's own investment funds. They are, for the most part, similar to those the Bank uses in its own appraisal process. Appendices 1 and 2 give these criteria for the first Korea and Philippines education sector loans.

STAGE III: INITIAL OPERATION

Step 6: Train Intermediary Personnel in Subproject Processing.

3.16 Staff of the intermediary, especially where there is no precedent for sector lending, need to be trained in how to conduct subproject appraisal. This training needs to be based on written tools (e.g., guidelines and handbooks) that spell out procedures and criteria. Training
will usually involve Bank participation in subproject appraisal missions to check appraisal techniques and preparation of reports for decisions. Bank staff responsible for the China sector loan thought in retrospect this should have been done more extensively. Training may take considerable time, depending on the complexity of the operation and the caliber of staff. Not enough time or resources were available to train state-level personnel in the Brazil urban primary sector loan, a geographically complex operation involving three levels of government and nine states. This contributed to initial delays and meant that the first several supervision missions had to devote considerable resources to the training of state-level staff. In addition, if staff turnover is typically high, as in Brazil, arrangements need to be made for recurrent training in appraisal skills, perhaps through a "project-related training" component.

Step 7: Pilot Testing and Revision of Subproject Processing.

3.17 No matter how well designed, the initial management rules are inevitably subject to errors. Areas needing modification and improvement are certain to appear during subproject processing. Before presenting a sector loan to the Bank's Board for approval, it is essential to be able to certify that the mode of operation is adequate and workable—i.e., that the intermediary is able to implement the sector program effectively and efficiently. Typically, therefore, the borrower launches the sector program by undertaking identification, preparation and appraisal of an initial group of subprojects. This process of pilot testing serves three important purposes. It tests the feasibility of the criteria and procedures. It demonstrates the managerial capacity of the intermediary. And it builds up a pipeline of subprojects for early implementation and disbursement.

3.18 One major lesson from the ESLs is that the testing stage of the sector loan cycle has not been extensive enough. Management weaknesses in the Bureau of Elementary Education of the Philippines would have been revealed by an extensive tryout before Board presentation. The same applies to Colombia. In retrospect, the Colombian Ministry of Education should have been given at least a year, with carefully selected technical assistance, to establish the management structure and try out the process of subproject development on a limited scale before trying to initiate full implementation. The lack of pilot implementation of subprojects in the Brazil urban primary sector loan meant that the Bank was unable to appraise fully the managerial and operational capacity of the three levels of government.

3.19 These mistakes were not repeated in the Brazil science and technology operation. The pilot test of subproject processing took about one year to complete before Board presentation. It resulted in the generation and appraisal of about 2,500 proposals, of which about 360 were selected and initially funded by the Government. This test served not only to identify weaknesses, but also to demonstrate whether the institutional mechanisms for correcting deficiencies actually worked. They did, so that when the loan was presented to the Board the Bank had confidence that the mode of operation would work even better in the next phase. This stage is so vital to success of the sector operation that as a rule future sector
lending operations should allow ample time for extended pilot testing. An engineering or technical assistance loan may be necessary to finance the costs of this initial testing.

**Comments on the Sector Lending Cycle**

3.20 The central requirement for a sector loan is sufficient capacity of the intermediary to assume responsibility for managing the development and execution of the sector program. It has proved difficult to determine whether these minimum necessary institutional conditions are met. There are no foolproof guides. Some empirical basis for judgment can be acquired by viewing each of the above stages as a series of tests which the borrower must pass with reasonable success. The Bank's role from this perspective is to assess the degree to which the borrower at each stage performs adequately, and to identify shortfalls in performance so as to remedy them.

3.21 The stages set forth above need not be dealt with by separate Bank missions. In fact, experience shows that any given mission may assess borrower performance in at least two or three of the steps simultaneously. Each step is accomplished through a process of successive iterations in which the results of any trial may lead to revisions of earlier steps. All this argues for a series of short and frequent Bank missions rather than a long, all-encompassing appraisal. In addition, despite intermixing of steps, the three major stages are distinct and logically sequenced. It is essential that each major stage be completed before moving on to the next. The issues analysis and policy framework must be completed before preparation of the investment program and management rules. And the program must be defined in content, finance and administration before testing and revision. The basis for each stage is completion of the previous one.

3.22 Moreover, a fundamental measure of readiness for full scale implementation is the degree to which the outputs of the stages are consistent—i.e., issues are effectively addressed in the policy objectives; policy objectives are likely to be achieved through the scope and content of the investment program; the investment program can in fact be delivered through the subproject processing rules, as demonstrated in the test of intermediary capability to produce acceptable subprojects.

3.23 **Steps Toward Sector Education Lending.** Sector lending would seem to be applicable in a wider range of countries than heretofore attempted. A fair number of countries, even in less developed regions, already have the minimum administrative capability to qualify for a sector lending process. Other countries can be prepared for this by (a) financing policy and institutional analysis, (b) initiating the preparation of long-range investment programs, (c) sponsoring the development of criteria and procedures for investment decisions, and (d) gradually delegating to the borrower decisions on the allocation of project funds to beneficiaries. The second primary education project in Pakistan attempts this: Federal authorities are delegated the power to appraise and approve annual provincial investment tranches. Other examples of semi-sector loans can be found in Malaysia. The borrower is delegated decisions on allocation of funds to primary and secondary schools within agreed-upon criteria. The
borrower's good performance in these projects has contributed to the
development of a full-fledged sector loans scheduled for FY86. The ESL for
technician training in Brazil can also be regarded as a preparatory
operation for more massive sector lending. It is modest in scope, designed
to yield longer-term policies, and plans development of the subsector.
Finally, it equips agencies at all levels with skills needed to implement
more ambitious ESLs in the future. In view of the potential for wider
benefits, regions should identify countries where sector lending operations
(1) might be possible now or (2) could be phased in over time. The goal
should be to bring as many countries as possible to the stage of readiness
for sector lending.
IV. CONCLUSIONS

4.01 Seven years of experience in the development of sector loans in education have revealed that the nature and phasing of tasks to be accomplished differ from the standard project cycle. A different kind of sector work is needed. Its principal focus must be on policy issues and must result in a set of policy alternatives. It must analyze institutional capacities. And it must be done collaboratively with the borrower.

4.02 The administrative capability of the borrower and intermediary chosen is vitally important to the overall success of the operation. The Bank has not analyzed well the institutional capacity of the intermediary in any of the ESLs thus far. Institutional capacity has been defined too narrowly, concentrating on capacity to implement an investment program. Capacity to carry out administrative and policy reforms has been neglected. Moreover, Bank staff lack a systematic set of criteria by which to evaluate institutional capacity.

4.03 The immediate lessons to be drawn from this are: (1) Specialists in institutional analysis and management are essential for mission work on sector loans. (2) The design of sector loans should be kept simple so as not to overload the intermediary. The tendency in ESLs has been to strive for a complex set of policy and institutional changes. In particular, a full-fledged sector loan may need to follow rather than accompany major administrative reforms. The combination of such reforms with the transfer of responsibility for subproject processing clearly contributed to major problems in the Philippines and Colombia. (3) Training of the staff of the intermediary has been an important, but underemphasized, task in the sector loan cycle. (4) In the final analysis, the acid test of intermediary capacity is an extensive pilot operation of its subproject processing. Major administrative problems with two of the ESLs (Philippines, Colombia) could have been identified, and presumably rectified, before Board approval if more extensive pilot testing had been done. Pilot testing also addresses another problem common in ESLs, slow initial disbursements.

4.04 It is clear that sector lending, if done properly, is a lengthy process. This is attributable in large measure to the fact that it must be done collaboratively with the governments concerned. But a surprising finding of this review is that sector loans do not require appreciably more Bank staff time to develop than conventional operations.

4.05 The benefits of good sector lending are far reaching. Sector lending tends to be wider in scope than traditional projects. Broad policy and institutional changes are placed foremost on the agenda. And the very process of subproject appraisal has been effective in stimulating local initiatives, in spreading the discipline of investment planning, and in propagating the wider use of objective criteria in allocation decisions. Since institution building and long-term policy changes are the essence of development, greater effectiveness in these matters makes sector lending a step forward in development financing. Sector lending should become a more prominent instrument in regional education lending programs.