

OPERATIONAL APPROACHES AND FINANCING IN FRAGILE STATES

I. INTRODUCTION

1. At the first meeting of the IDA15 Replenishment negotiations, the IDA Deputies requested that IDA's role in fragile states be addressed as one of the three special themes for the replenishment. Specifically, they asked that the following issues be addressed: "IDA's strategy, instruments and operational response in supporting fragile states; IDA financing for fragile states; and a systematic approach to arrears clearance."⁴ This paper responds to this request, with the exception of the systematic approach for arrears clearance, which is described in a separate paper.⁵

2. At the outset, it is worth noting that IDA support for fragile states has been a feature of a number of previous replenishment discussions. IDA Deputies have recommended a number of enhancements to IDA's policies and financing arrangements, based on either lessons from experience or on research. Thus the IDA12 Replenishment report included an authorization of pre-arrears clearance grants to allow IDA to engage earlier in countries in arrears that are emerging from severe conflict. Similarly, the IDA13 Replenishment report introduced a provision for exceptional financing to post-conflict countries and included several grant categories that benefited fragile states. Finally, the IDA14 Replenishment report added a provision for exceptional allocation for countries re-engaging with IDA after a prolonged period and introduced a new grant allocation system based on countries' debt sustainability prospects that provides significant benefits for many fragile states at risk of debt distress. IDA has also worked to address debt sustainability in many fragile states through the Heavily Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).

3. In addition to the specific enhancements of IDA's financing in support of fragile states, the IDA replenishment process has also provided useful guidance on non-financial policy. This involved addressing the need to remain engaged in fragile states, responding appropriately to their different circumstances, and deepening collaboration with other donors and the United Nations (UN). Policies with specific reference to fragile states have been approved by the Board of Executive Directors. This strengthened the World Bank's strategy and policies for fragile states in recent years.

4. This paper reviews the World Bank's current operational approach in fragile states. It also examines how IDA provides financial support to fragile states with a view to identifying where enhancements could still be needed. The paper is organized as follows. Section II provides an overview of fragile states, including with respect to the development challenges these countries face, the rationale for engagement and issues in development effectiveness, and trends in the international assistance to these countries. Section III reviews the evolution of IDA's strategy for fragile states, describes initial results achieved through IDA-supported programs, and examines progress and future challenges in the World Bank's institutional response. Section IV examines IDA's financial support for fragile states, including with respect to exceptional allocations for post-conflict and re-engaging countries, and makes proposals for

⁴ Chairman's summary from the first IDA15 meeting in Paris, March 5-6th, 2007.

⁵ IDA (2007): "*Further Elaboration of a Systematic Approach to Arrears Clearance.*"

selective enhancement of this support. Section V outlines how IDA supports fragile states through World Bank and donor-financed trust funds, as well as through the World Bank's budget. Section VI summarizes the conclusions of the paper.

II. FRAGILE STATES AND THE INTERNATIONAL AID ARCHITECTURE

5. This section provides the broader context for IDA's operational approach and financial assistance to fragile states, by describing their characteristics, the challenges they face, rationale for engagement and issues in development effectiveness, and trends in the international aid architecture.

A. What is a fragile state?

6. Fragile states is the term used for countries facing particularly severe development challenges such as weak institutional capacity, poor governance, political instability, and frequently on-going violence or the legacy effects of past severe conflict. While there is no one agreed definition of fragile states (Box 1), development partners have been converging around an approach developed by the OECD, which recognizes common characteristics of weak governance and vulnerability to conflict, together with differentiated constraints and opportunities in fragile situations of: (i) prolonged crisis or impasse, (ii) post-conflict or political transition, (iii) gradual improvement, and (iv) deteriorating governance. The OECD-DAC emphasis on fragile situations as well as fragile states is designed to recognize the need for strong international support to address "episodes of temporary fragility in the stronger performers."⁶

7. The World Bank's definition of fragile states covers low-income countries scoring 3.2 and below on the Country Policy and Institutional Assessment (CPIA), which is the primary tool used to assess the quality of country policies and the main input to IDA's Performance-Based Allocation (PBA) system. In FY07 this covers 34 IDA-eligible countries⁷ which are: Afghanistan, Angola, Burundi, Cambodia, Central African Republic, Chad, Democratic Republic of Congo, Republic of Congo, Comoros, Cote d'Ivoire, Djibouti, Eritrea, The Gambia, Guinea, Guinea-Bissau, Haiti, Lao PDR, Liberia, Mauritania, Myanmar, Nigeria,⁸ Papua New Guinea, Sao Tome and Principe, Sierra Leone, Solomon Islands, Somalia, Sudan, Timor-Leste, Togo, Tonga, Vanuatu, Uzbekistan and Zimbabwe as well as the territory of Kosovo.⁹ The list of fragile states is updated annually, based on the computation of the countries' individual CPIAs. Over the medium to long term, there is significant movement in and out of the fragile states category.

⁶ "Fragile States: Policy Commitment and Principles for Good International Engagement in Fragile States and Situations," DAC Senior Level Meeting, December 5–6, 2006.

⁷ Out of 82 IDA-eligible countries.

⁸ As a large federal state, Nigeria includes both strongly performing states and those affected by very weak institutions and conflict. Nigeria and Cambodia have also made strong reform efforts in recent years and have CPIA ratings very close to the cut-off line at which they would exit the fragile states group.

⁹ West Bank and Gaza is on the World Bank's FY07 LICUS list but is not IDA eligible.