

there are also significant peace-keeping forces under the leadership of the EU, the AU, NATO and the Pacific countries.

- ***A strengthened role for regional institutions.*** Much of the drive for change in approaches to conflict and fragility has taken place in regional institutions, in particular in Africa. The AU is now playing a significant role in leading international mediation efforts and in peace-keeping in highly-challenging situations such as Darfur and Somalia. Sub-regional institutions, such as ECOWAS, have played a critical role in mediation of peace processes and conflict prevention efforts.

20. These trends in the broader international aid architecture for fragile states create new demands upon the World Bank, in its assistance strategies and organizational response towards this client segment and in its partnerships.

### **III. WORLD BANK STRATEGY AND ORGANIZATIONAL SUPPORT FOR FRAGILE STATES**

#### **A. Background**

21. Post-conflict reconstruction in the war-torn economies of Western Europe was from the outset part of the rationale for the existence of IBRD. In the first three decades after the establishment of IDA, however, issues of conflict and fragility were generally peripheral to development debates. Where IDA played a large role in post-conflict reconstruction, this was generally carried out in the context of a clear end to an inter-state conflict: IDA-financed capital investments executed by well-functioning government counterpart agencies and designed in a similar manner to “regular” development programs. The post-conflict settlements of the mid 1990s, in West Bank and Gaza, the Great Lakes and the Balkans, posed a very different set of challenges. In these countries and territories, international re-engagement marked the beginning rather than the end of a complex political process to find lasting peace, and took place in a situation of partially collapsed public administrative capacity, requiring different approaches to rebuilding state capacity, delivering services and undertaking capital reconstruction.

22. The World Bank responded to these challenges by strengthening its work on conflict, in particular by research on conflict and development linkages<sup>25</sup> and introducing a new policy on conflict and development laying out the parameters for engagement.<sup>26</sup> The World Bank’s analytical work on conflict and growing operational experience during the 1990s in post-conflict reconstruction was strengthened and complemented by the 2001-02 task force on Low Income Countries Under Stress (LICUS), which highlighted the problems of a broader range of countries with weak institutions and governance. The Task Force noted that these fragile states are “significantly more prone to large-scale violence and civil conflict than other low-income countries.” The Task Force identified the need for a range of institutional changes – on country assistance strategies, partnerships, human resources, and operational policies and procedures – to improve the World Bank’s response.

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<sup>25</sup> Collier Paul et al (2003). “*Breaking the Conflict Trap: Civil-War and Development Policy.*” and Collier P. and Hoeffler A., (2002). “*Aid Policy and Growth in Post-Conflict Societies,*” World Bank Policy Research Working Paper 2902.

<sup>26</sup> OP 2.30 Conflict and Development

## **B. IDA's role and assistance strategies in fragile states and situations**

23. Given the evolving international thinking on assistance in fragile situations, there is need for clarity with respect to IDA's role and comparative advantage, while consulting on approaches with clients and other international actors and allowing for flexibility to adapt as international thinking develops over time. In line with the OECD-DAC Principles, the World Bank has recognized the importance of peace-building and state-building as common elements across fragile states and situations and has adopted a differentiated assistance strategy framework for different types of fragile states and situations.<sup>27</sup> IDA's role and comparative advantage differs in the context of these varied country situations and different aspects of fragile state assistance. This section first introduces the need for linkage with IDA's strengths in other client segments and outlines IDA's role in relation to state-building and peace-building objectives. It then reviews IDA's role and approaches in different types of fragile situations, discusses division of labor and partnership issues, and reviews results achieved to date.

24. ***Relationship to IDA's strengths in other client segments.*** Globally, client surveys indicate that IDA's perceived core comparative advantage lies in the quality of its policy advice and financing in the areas of economic growth, public finance management, capital investments and service delivery; and in its global reach and multi-sectoral perspective. IDA's role in fragile states mirrors these strengths, resting on its core economic and development competencies, while maximizing its cross-sectoral knowledge to build state capacity and accountability and contribute together with other partners to build linkages between the peace, security and development spheres. A challenge ahead in strengthening the links between assistance to different client segments lies in improving transfer of lessons learned from more strongly-performing countries amongst IDA's client base, many of whom have successfully exited from fragility and whose lessons of experience would be valuable to national counterparts and staff in countries currently facing fragile situations.<sup>28</sup>

25. ***IDA's role in strengthening state capacity and accountability.*** Economic and developmental assistance focused on building state capacity and accountability is crucial if countries facing fragile situations are to make a sustainable recovery. IDA's strengths in technical assistance and financing for public finance management and economic and sector policy, while valuable across all client segments, are particularly relevant to the challenges of state-building. IDA's financing for infrastructure and social and human development goes through national institutions and can be crucial to strengthening capacity and accountability. As IEG's evaluation<sup>29</sup> rightly points out, the challenge of state-building is complex, and the World Bank, like other donors, has had both successes and failures in its assistance for institutional development. IDA has however fulfilled a critical role in several fragile recovery situations,

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<sup>27</sup> See World Bank (2006). "*Fragile States – Good Practice in Country Assistance Strategies.*" and OECD-DAC High Level Meeting (2007). "*Policy Commitment and Principles of Good International Engagement in Fragile States.*" The approach is harmonized with approaches adopted by bilateral partners at the DAC and by other multilateral institutions such as the African Development Bank.

<sup>28</sup> The Bank has compiled this type of lessons learned by supporting the analysis of successful turnarounds (Institute of Development Studies 2006, World Bank-Netherlands partnership program) and, in partnership with UNDP and Norway, in drawing lessons on state-building.

<sup>29</sup> Independent Evaluation Group (2006). "Engaging with Fragile States: An IEG Review of World Bank Support to Low-Income Countries Under Stress," The World Bank.

such as Afghanistan, Democratic Republic of Congo and Timor-Leste, as well as in more marginal fragile situations such as Cambodia and Tajikistan by: supporting government processes to develop budget priorities; leading analytical work on economic and governance issues; financing policy reform, infrastructure and basic service delivery through the state; supporting transparent public-private sector relationships; and building public finance management systems, including for the management of natural resource revenues. Utilizing common donor frameworks, such as the Governance and Economic Management Assistance Program (GEMAP) in Liberia, the Reform Trust Fund in West Bank and Gaza, and the Afghanistan Reconstruction Trust Fund, has proven to be particularly effective in harmonizing donor approaches towards supporting critical public sector reforms, building state capacity and enhancing public financial management systems and accountability. Future challenges in this area include adapting the World Bank's traditional competencies to the context of very weak capacity states, in particular moving from a more hands-off approach of providing analysis and advice to a more hands-on approach of assisting counterparts in very fragile and low capacity situations to establish basic functioning systems.

26. ***IDA's role in supporting peace-building.*** Adapting to the particular challenges of fragile states also requires being clear on what IDA does not do, in particular in relation to peace-building goals. IDA does not finance relief, peace-making or peace-keeping. While a recent Board paper<sup>30</sup> underlines the need for the World Bank to participate in integrated approaches to peace-building and to relief-to-recovery transitions, it also makes clear that the World Bank: (i) recognizes the lead role played by the UN and other partners in these areas; and (ii) participates only in areas of its core economic and development competencies. Within this clear focus on its core competencies, IDA has an important role to play, since economic and development issues are a crucial component of international efforts to address the causes of fragility and support countries engaged in fragile peace-building transitions to achieve sustainable recovery (Box 2).

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<sup>30</sup> World Bank (2007). "Towards a new framework for rapid Bank response to crises and emergencies."

**Box 2: World Bank's Role in Contributing to Peace-Building Goals**

The Board of Executive Directors has conducted several discussions which relate to the World Bank's role in supporting peace-building, including on the January 2006 *Good Practice Note on Country Assistance Strategies in Fragile States* and the February 2007 policy paper on the *World Bank's Rapid Response to Crises and Emergencies*. These papers recognize the lead role played by the UN and other partners in supporting peace-building efforts, and consolidate existing practice over preceding years into two types of support for peace-building, within the limits of the World Bank's Articles of Agreement and expertise. These are:

***Financing economic and development investments in support of peace-building goals.*** Within the World Bank's traditional economic and development competences, there is an opportunity to provide strong support for peace-building goals, since growth and employment generation, delivering visible reconstruction and service delivery to the population and stemming the economic rents which fuel conflict are critical to stabilizing fragile situations. Rapid Response Policy (OP 8.00) provides for operations to support peace-building goals within these areas of its traditional competence. Future challenges in this area are to improve the use of conflict analysis to inform country assistance strategies and program design, and to implement the stronger procedural and staffing response established by OP 8.00 to ensure that assistance can reach the ground quickly in fragile situations.

***Participating in integrated peace-building programs in areas of the World Bank's traditional competencies and expertise.*** The World Bank has provided specific assistance on public expenditure analysis and finance management to integrated programs of security sector reform; and on economic and public finance issues to peace talks. While its contribution to these programs is limited in scope and provided in support of an overall lead from the UN or other partners, the World Bank can provide an important contribution to improving the fiscal sustainability of transition plans in the political governance and security spheres, and to ensuring coherence between political, security and economic dialogue. This role is also laid out in the *Good Practice Note on Country Assistance Strategies* and in OP 8.00. Future challenges are to strengthen partnerships on these issues and document good practice and staff guidance.

IDA-financed programs in Afghanistan and the Democratic Republic of Congo are good examples of assistance strategies designed to address the economic and developmental aspects of fragility and peace-building goals, with an active donor coordination role, strong emphasis on strengthening capacity of the state to deliver basic services and pay its civilian and military employees, and an emphasis on strengthening transparency and accountability of public finance management systems (including in the security sectors). These emphases are combined with both rapid response and longer term sector investment programs to provide visible results on employment, growth and service delivery in order to consolidate peace-building efforts.

27. ***Differentiating IDA's role in different types of fragile situations.*** Reflecting the evolution in international thinking, since early 2006 IDA has followed a differentiated approach to country assistance strategy development in different types of fragile situations (Box 3).<sup>31</sup> The *Good Practice Note on Country Assistance Strategies in Fragile States* recognizes that there is a need to avoid a "one size fits all" approach. The framework considered by the Board in 2006 does not aim to typecast countries into particular categories, but rather to provide a basis for scenario planning in the development of country assistance strategies: country teams will therefore generally look at more than one scenario drawn from the approaches below in developing assistance strategies. The framework focuses IDA's role on its traditional development competencies, but shows how these competencies can be adapted to support peace-building goals and efforts to build state capacity and accountability in different types of fragile situations.

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<sup>31</sup> See footnote 27.

<b>Box 3: Differentiated Approaches Across the Spectrum of Fragility</b>	
<p><b>Deterioration</b></p> <p><i>Characteristics:</i> deteriorating governance, rising conflict risk and increased division between government and the international community on development strategy.</p> <p><i>IDA strategy:</i> focus on stemming the decline in governance and social indicators and preventing an escalation of conflict. Increased use of CDD, private sector, NGO and ring-fenced mechanisms. Dialogue with national authorities on transparency, addressing declining development indicators, and (in support of other development partners) approaches to decrease conflict risk.</p>	<p><b>Prolonged crisis or impasse</b></p> <p><i>Characteristics:</i> prolonged conflict or political impasse between key national stakeholders; no consensus between government and the international community on development strategy.</p> <p><i>IDA strategy:</i> focus on maintaining operational readiness to engage in the event of a turnaround, through small grant finance for training and national dialogue on economic and development issues; and pilot/demonstration projects, generally through non-government recipients.</p>
<p><b>Post-conflict or peace-building transition</b></p> <p><i>Characteristics:</i> Peace, national reconciliation or agreed transition process supported by the international community. Government priorities generally expressed through a transitional results framework, based on a joint national-international needs assessment.</p> <p><i>IDA strategy:</i> focus on supporting peace-building efforts and laying the basis for longer term institutional and economic recovery. Balance of visible results in private sector recovery, job creation, infrastructure rehabilitation, service delivery, and state institution-building. Focus on supporting transition from non-government, humanitarian service delivery to state coordination or delivery of services.</p>	<p><b>Gradual improvement</b></p> <p><i>Characteristics:</i> state capacity exists and reform efforts have made some progress, but situation remains fragile and capacity-constrained. Includes many post-conflict countries where reform progress has been positive but gradual.</p> <p><i>IDA strategy:</i> focus on building key state functions to take on a strong and accountable role in facilitating economic growth and service delivery; completion of larger scale capital investments; activities to strengthen domestic reform currents and national debate over long-term poverty-reduction strategy. Longer-term assistance strategy, with flexibility to adjust in response to periods of increased fragility.</p>

28. **Division of labor.** As outlined above, IDA is well-positioned to play a leading role, in collaboration with other partners, in assisting to build state capacity and accountability; and a strong supporting role in contributing to peace-building objectives. The 2006 framework also indicates a differentiated role for IDA vis-à-vis other partners in different contexts. It will play a larger role in transition or gradual reform scenarios where there is a reasonable level of government capacity to act as a conduit for development finance to help it implement pro-poor policies and adhere to basic governance standards. In situations where government capacity is non-existent or severely constrained, other partners such as the UN system are more likely to be able to take the lead. In these cases IDA will focus on maintaining its own operational readiness to scale up engagement quickly in the event of a turnaround or to support evolving capacity in state counterpart institutions. In situations of deteriorating governance where state capacity is fairly strong, IDA cannot finance initiatives for improved political governance or peace-making; other partners will take the lead on these issues. Working in close conjunction with other donors, IDA often has a comparative advantage in focusing on economic dialogue and ring-fenced social

protection programs in these situations, as an entry point for improved transparency and cooperation between national stakeholders.<sup>32</sup>

29. **Post-crisis recovery.** Reaching agreement on effective coordination and division of labor arrangements has been particularly challenging in early post-crisis recovery, where a large number of actors scale up engagement simultaneously. While some countries have seen extremely cohesive international assistance programs, in others there have been tensions among international actors, including between the World Bank and the UN system, regarding relative roles and division of labor. To build on lessons learned and strengthen cooperation, the World Bank and the UN are working towards a new partnership agreement on responses in crises and emergencies (Box 4). The World Bank is actively working with the UN, the European Commission and bilateral donors at the OECD-DAC to revise the guidance for integrated post-conflict recovery planning, aiming to provide a shared platform to support greater coherence among political, security, development and humanitarian actors active in fragile transition situations.

**Box 4: World Bank – UN Partnership Note for Crises and Emergencies and Post-Crisis Recovery Planning**

The World Bank and the UN are working together on a new partnership note to support joint work in crises and emergencies. This should provide a platform to support stronger collaboration in the field, and will include:

- Guiding principles supported by the UN and the World Bank in crises and emergencies, such as the focus on strengthening resilience in national institutions.
- A commitment to a common platform for post conflict and post-disaster needs assessments and recovery planning, and to agreeing on country-specific division of labor through these processes.
- A fiduciary framework to govern financing of UN funds and programs under specific emergency situations and guiding principles for collaboration in multi-donor trust funds.
- A communications protocol for coordinating joint approaches in post-crisis situations, driven by field representatives and supported by headquarters.

Strengthening approaches to post-crisis recovery planning is an important part of this effort to achieve clearer coordination and division of labor at country level. In 2006, the World Bank and the UN Development Group reviewed experience in co-coordinating post-conflict needs assessments (PCNAs) and Transitional Results Matrices (TRMs). The review found that PCNAs had been effective in building a shared analytical platform and in mobilizing external resources, but had significant weaknesses in terms of: the lack of a strategic focus on peace-building; insufficient selectivity; insufficient coverage of reform and resource needs in political governance, rule of law and security institutions; and lack of focus on building national institutional capacity. Critical revisions to recovery planning approaches as a result of this review are underway at the World Bank and UN, in consultation with other partners. They include:

- A stronger focus on peace-building and state-building in recovery planning, including an upstream strategy process to identify the outcomes critical for peace-building; improved coverage of reforms and costs to the national budget stemming from peace process commitments in the political and security spheres; and explicit targets for building capacity and accountability of key national institutions.
- A clear framework for division of labor and linkages between peace-keeping, humanitarian and development planning processes.

<sup>32</sup> As noted in the OECD-DAC April 2007 Policy Commitment, donors also face a collective challenge in developing coordinated mechanisms to adjust assistance in the event of rapid deterioration in the governance environment. IDA is committed to working with other partners on stronger and more coordinated responses to these fragile situations.

30. **Other partnerships.** Because support to peace-building and state-building requires coordinated action across a wide spectrum of international actors, IDA is committed to continue investing considerable effort in partnership at both the policy and the country level. The IEG evaluation of the World Bank's Fragile States work<sup>33</sup> notes that while its global policy cooperation has been particularly strong, country level cooperation with other donors has been more variable. To strengthen this area, the World Bank has increased its participation in shared strategies with other donors, covering Cambodia, the Central African Republic, the Democratic Republic of Congo and Liberia in 2006-07 in addition to previous joint strategies with the UN for Togo and Somalia. The World Bank has also coordinated support for joint needs assessments and recovery plans with the United Nations, AsDB, AfDB, EC and bilateral donors in Afghanistan, Haiti, Liberia, Sudan and Somalia. Reflecting the growing importance of regional institutions in leading dialogue on conflict prevention and governance, the World Bank has strengthened collaboration with regional and sub-regional institutions such as the African Union (AU) and ECOWAS. In March 2007, the Heads of the Multilateral Development Banks (MDBs) also agreed to establish a working group on fragile or weakly performing states. The working group will provide recommendations to the Heads of MDBs at the time of the 2007 Annual Meetings.

### C. Results

31. **Country-specific results.** IDA's focus on results in fragile states, as in other client segments, is country driven: each Interim Strategy Note (ISN) or Country Assistance Strategy (CAS) will lay out a results framework for IDA's assistance. Box 5 gives examples of development outcomes from IDA-financed or administered projects in different country environments. Specifically for the fragile states, the World Bank has also developed with the UN and other partners, a multi-donor results framework tool which can assist national authorities in post-crisis situations to agree on selective results in support of peace-building and state-building goals with partners.<sup>34</sup>

32. **Beyond country-specific examples.** At an aggregate level, there are several difficulties in measuring the results of IDA's intensified engagement in fragile states. First, the task of monitoring results is complicated by the focus on peace-building and state-building outcomes: unlike the MDGs, there is no set of internationally agreed indicators to measure progress in these spheres.<sup>35</sup> The World Bank intends to collaborate with other donors at the OECD-DAC to develop better indicators of progress. Second, systematic evaluation of project-level outcomes following the adoption of the fragile states initiative is necessarily preliminary, since a relatively small number of the projects launched since 2003 are completed and evaluated. There is however sufficient data available to make an initial analysis of trends in portfolio performance.

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<sup>33</sup> See Independent Evaluation Group (2006). "Engaging with Fragile States – An IEG Review of World Bank Support to Low-Income Countries Under Stress," The World Bank.

<sup>34</sup> See Box 4 for details of the on-going UN-WB reform of this results-based planning framework.

<sup>35</sup> The Post-Conflict Performance Indicators, which to some extent proxy basic state capacity and accountability across different functions, give a sense of country-level progress on state-building goals for a sub-set of fragile states. Of 15 countries covered by the PCPIs since 2003, eight have shown improvement (Afghanistan, Angola, Burundi, Congo, Democratic Republic of Congo, Central African Republic, Haiti, Liberia); four have deteriorated (Cote D'Ivoire, Eritrea, Timor-Leste, Zimbabwe); and two demonstrate little change (Somalia, Togo).

### **Box 5: IDA's Assistance to Fragile States**

**Afghanistan.** IDA's assistance in Afghanistan since 2002 has reached an aggregate total of \$1.5 billion in IDA grants and credits and another \$1.5 billion contributed by 27 donors has been disbursed through the Afghanistan Reconstruction Trust Fund (ARTF), administered by IDA. Aid-financed programs in Afghanistan have taken place under difficult circumstances, in particular as security conditions have deteriorated significantly in some parts of the country in the last two years. In addition, changes in government ministers and key officials required intense dialogue and resulted in delays and adjustments to the program as some of the priorities shifted, new incumbents mastered their portfolios and implementation capacity changed. Nonetheless, IDA-financed or administered programs have delivered significant results. Examples include:

- Payment of salaries and wages of more than 200,000 civil servants through the ARTF, complemented by on-going IDA operations to establish and strengthen capacity in procurement, financial management, payroll, project management, and central bank payment systems.
- Emergency employment generation and rural development:
  - 9,000 kilometres of rural roads and nearly 13 million labor days paid by late 2006.
  - 13 microfinance institutions established with a network of more than 209 branches and 250,000 clients; 75 percent of clients are women; 96 percent repayment rate.
- Other physical infrastructure:
  - Assistance to reconnect Kabul with northern Afghanistan and the Tajikistan border, including Salang tunnel rehabilitation.
  - Rehabilitation of satellite earth station and expansion of telecommunications transmission links.
  - Rehabilitation of numerous smaller irrigation systems that had fallen into disrepair during the conflict.
- Community empowerment. National Solidarity Project active in 276 districts in all the country's 34 provinces; 16,300 Community Development Councils elected; more than 25,000 community projects focused on social and economic infrastructure financed.
- Health. In 11 provinces covered, including strife-torn areas such as Helmand, patient visits tripled and pregnant women receiving ante-natal care went from 5 to 30 percent nationwide. 40,000 more babies survive each year.

#### **IDA's support for gradual reform processes – Lao PDR**

A land-locked, natural resource-dependent country with a history of poor governance and weak institutions, Lao PDR has many characteristics which correlate with poor aid effectiveness. Despite these structural risks, Lao PDR has made strong progress against the MDGs, and IDA-financed programs have performed more strongly in recent years (as reflected in the portfolio-at-risk indicator, which improved from 30 percent in 1998 to 17 percent in the first quarter of 2007).

IDA's assistance strategy, combined with strong dialogue on growth, governance and participation (in particular linked to the requirements for the financing of the Nam Theun 2 hydroelectric project), and community-based programs to strengthen quality, participation and accountability in service delivery and has helped contribute to significant results:

- Education sector assistance has built 277 primary schools and supported curriculum development and materials, in the process supporting an increase in primary school net enrolment from about 63 percent in the mid-1990s to 84 percent in 2005.
- IDA has financed one-fifth of all electrification to households.
- A poverty reduction fund has helped establish nearly 2,000 village councils, strengthening participatory decision-making and local consensus-building processes.
- Technical assistance has helped introduce independent external audits for large state-owned enterprises.
- IDA support to public expenditure management has helped to achieve a sharp reduction in salary arrears to health workers and teachers.

Portfolio reviews show that the overall performance has improved. While progress against the MDGs in Lao PDR has been strong, there are also significant challenges in governance and managing income inequities ahead. In particular, corruption remains a risk to aid effectiveness. While external ratings show an improvement in voice and accountability in recent years, control over corruption is estimated to have deteriorated.

**Box 5: IDA’s Assistance to Fragile States (cont’d)**

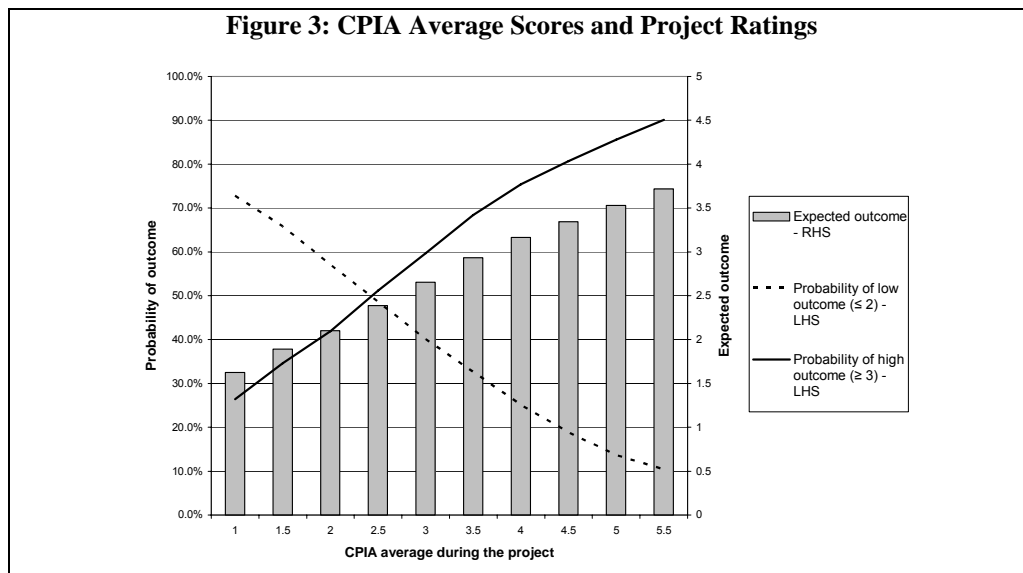
**IDA’s response and project performance under deteriorating governance conditions - Timor-Leste**

Two elements are notable in IDA’s response to the crisis in Timor-Leste in 2006. First, IDA, like other donors, had underestimated the potential for internal conflict. But due to analytical work on the dynamics of conflict and continuous dialogue with a range of national stakeholders and donors, IDA has been able to identify emerging trends and to respond to them rapidly and in close coordination with other international players. IDA has been instrumental in helping the government reorient its priorities to address the causes of fragility, and is articulating a new program that stresses the importance of security and justice reform, addressing youth unemployment and exclusion, the preservation of governance gains in the petroleum sector, and the development of budget systems that will speed up and decentralize budget release without losing fiduciary control.

Second, a number of IDA’s programs proved resilient to the deteriorating governance environment. As one example, health sector programs financed by IDA and other donors through a multi-donor trust fund helped bring significant improvements in health outcomes (below). Timor’s health system remained functional throughout the crisis, and although performance indicators undoubtedly dipped, the system was able to adjust to new demands.

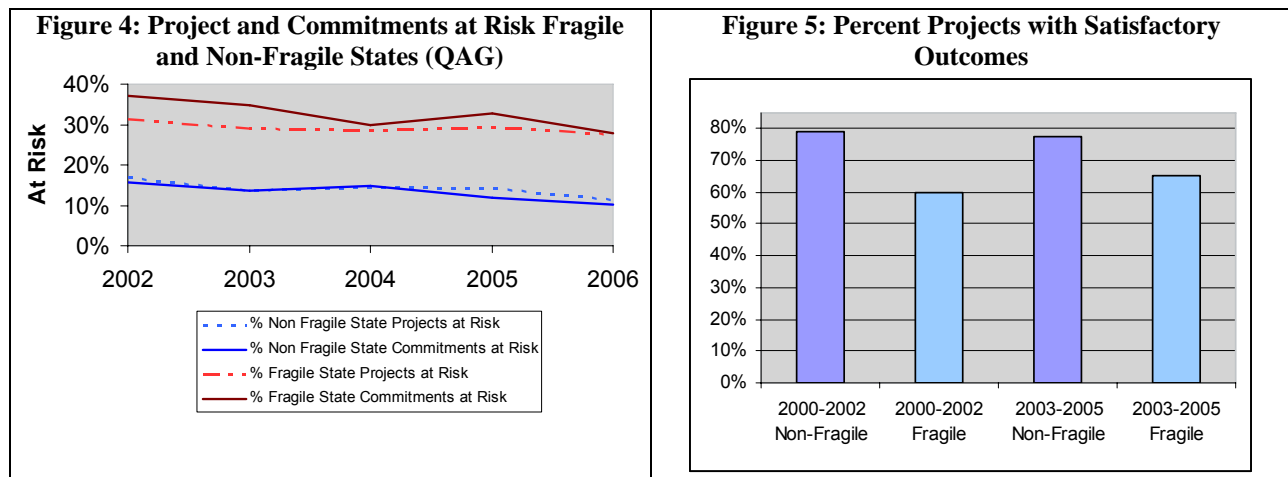
- Coverage of basic health services within a two-hour travelling distance of settled populations increased from 75 percent in 2001 to 86 percent in 2004.
- Use of the health system increased from an average one visit per person per year to at least 2.5 visits per year.
- Immunizations for the three rounds of Diphtheria-Tetanus-Polio increased from 34 percent in 2001 to 73 percent in 2004, and for measles from 26 percent to 73 percent.
- Skilled attendance at births increased from 26 percent to 41 percent.

33. **Portfolio performance levels.** Research on IDA’s own portfolio points to a lower probability of successful project outcomes at lower CPIA levels.<sup>36</sup> Analysis of 4,370 projects between 1980 and 2004 demonstrates that during this period projects in countries with higher CPIA score had greatly increased probability of achieving satisfactory development outcomes (Figure 3).



<sup>36</sup> IDA (2007). “*Selectivity and Performance: IDA’s Country Assessment and Development Effectiveness.*” The paper presented at the first IDA15 meeting in Paris drew on 4370 closed projects evaluated for all countries between 1980 and 2004 by the World Bank’s Independent Evaluation Group (IEG) and included an IDA dummy to distinguish between IBRD and IDA projects in blend countries.

34. **Portfolio performance trends.** Project performance is expected to be weak in fragile states due to the weaker policy and institutional environment, but the gap in IDA’s portfolio performance between fragile and non-fragile states has narrowed since the establishment of the World Bank’s fragile states initiative. While lending to fragile states has slightly increased over the period 2003 to 2006, driven by increases to post-conflict countries, the percentage of commitments at risk and projects at risk are both trending downwards, decreasing from 36 percent to 30 percent and 30 percent to 28 percent respectively (Figure 4). Figure 5 demonstrates that the percentage of satisfactory outcomes for closed projects in fragile states increased in the 2003-05 period in comparison to 2000-02.<sup>37</sup> The gap in performance with non-fragile states decreased from 20 percent in 2000-2002 to 12 percent in 2003-2005.



35. **Future challenges.** It is too early to tell whether these early trends in portfolio performance will be sustained in these intrinsically high-risk environments. Areas that require attention to improve and sustain outcomes include stronger efforts to document lessons learned in sector policy dialogue and program design and, in particular, increased efforts in supervision. Recent research<sup>38</sup> demonstrates that supervision is differentially effective in fragile states: that is, higher quality supervision produces a larger increase in the probability of a satisfactory project outcome in fragile states than it does in non-fragile states. Yet the study notes that the quality of supervision is lower in fragile states than in other IDA-eligible countries, with 29 percent unsatisfactory supervision compared to 19 percent for non-fragile states. This in turn is likely correlated to the staffing and incentives issues covered below.

#### D. Organizational support and institutional reform

36. **Shift from strategy and policy focus to institutional reform and country-level implementation.** At the time of the 2002 Task Force, lack of international consensus on how to “engage differently” in fragile states was perceived to be the binding constraint on a more effective response from the World Bank and other donors. While the World Bank still has a

<sup>37</sup> Satisfactory performance includes projects with highly satisfactory, satisfactory and moderately satisfactory outcomes.

<sup>38</sup> Chauvet, I., P. Collier, Fuster (2006). “Supervision and Project Performance – a Principal-Agent Approach.”

great deal to learn about effective approaches in these environments, Board discussions in 2006 consistently emphasized the good progress made at the policy level, and highlighted the need to move from global policy and good practice to the organizational and institutional reforms necessary to ensure more consistent application of the framework in country operations.

37. **IEG evaluation.** This was reinforced by the IEG evaluation, which commended the World Bank for its increased engagement, efforts to anchor strategies in better socio-political understanding, global policy work and some country level results, but highlighted a need for increased staff guidance and sharing of lessons learned between country programs, and criticized lack of progress on internal reforms, in particular on human resource, policy and procedural issues. Since the publication of the IEG report, the World Bank has made considerable efforts to define and agree on a series of internal organizational reforms to improve the World Bank's response and support clients and staff in the field.

38. **Early progress.** The World Bank implemented a number of reforms early in the LICUS/Fragile States initiative to improve its responsiveness in fragile states. At the organizational level, early reforms covered: (i) establishment of the LICUS Trust Fund to support activities in non-accrual and, under exceptional circumstances, fragile active IDA countries; (ii) amending the CPIA to better reflect performance improvements at the bottom of the performance spectrum; (iii) delinking budgets for analytical work from lending volumes, resulting in a significant increase in the volume of analytical work; (iv) increasing management attention, with quarterly meetings held between Managing Directors and Country Directors; and (v) introducing Interim Strategy Notes for countries facing significant uncertainty in the country context (also see Box 6). This remainder of this section focuses on more recent reforms and upcoming challenges, particularly in those areas highlighted by the IEG evaluation: human resource reforms; staff guidance and knowledge management; procedural reform; and systems to manage fiduciary risk.

#### **Box 6: Knowledge Work**

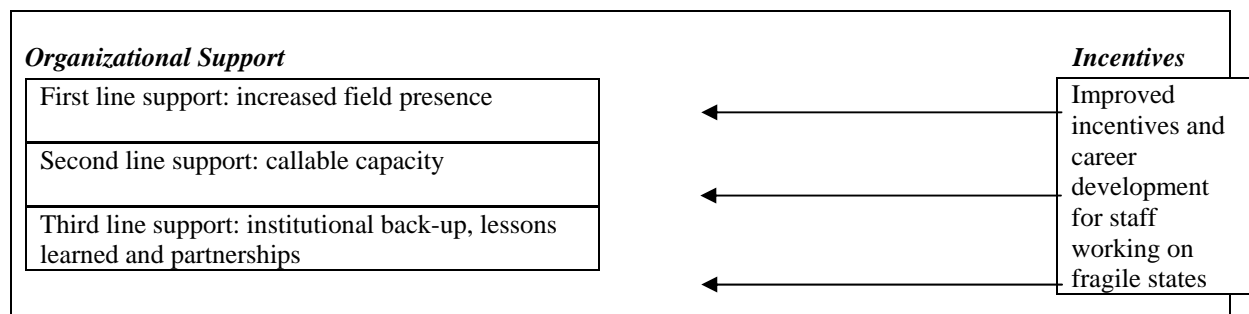
Analytical work is receiving increasing attention to help inform fragile state strategies and policies. The administrative budget for analytical work has more than doubled between FY02 and FY06 and its share of country services' budget rose from 18 percent to 30 percent during the same period (World Bank, *Annual Report on Portfolio Performance*, 2006). The quality of products has remained satisfactory (IEG, *Engaging With Fragile States*, 2007).

Diagnostic work gives priority to fiduciary management and public accountability where fragile states tend to be weak: 85 percent of countries have an up-to-date Public Expenditure Review (PER) and a Country Financial Accountability Assessment (CFAA); about 80 percent have Country Procurement Assessment Reports (CPAR). Non-core diagnostic products include conflict analysis, post-conflict needs assessments and sector reviews. Areas requiring more attention include statistical capacity, political economy analysis to deepen understanding of country circumstances and translating analytical findings to inform country strategies and reform policies, in particular through greater emphasis on short options notes to meet client demands and greater effort in dissemination, dialogue and training activities.

39. **Organization and human resource reforms.** In February 2007, the Board discussed a new strategy on organization and staffing in fragile states, with four main pillars (Figure 6): (i) increasing field presence, with around 30 new staff posts to be created in FY08; (ii) strengthening ability in sectors to document lessons learned on good practice and deploy experienced staff between regions and country programs, by establishing specific work-programs

in Network Anchors for knowledge management in fragile states, and identifying callable rosters of sector staff; (iii) establishing specialized institutional back-up teams for emergency projects and a secretariat to support rapid response in crises and emergencies; and (iv) enhancing incentives for staff working on fragile states. Different staffing approaches have been identified for different types of fragile state situations.

**Figure 6: Organizational Support to Fragile States**



40. **Progress and future challenges.** Some steps have already been taken to implement the proposed reforms across the various pillars. On field presence, a new field office has been established in the Central African Republic and the number of staff deployed in South Sudan significantly increased. Management has also reviewed the mandate and functions of the Fragile States Group and the Conflict Prevention and Reconstruction Unit (CPRU) and agreed on an organizational restructuring to provide clarity on responsibilities and improve the effectiveness of the World Bank’s response to fragile and conflict-affected countries.<sup>39</sup> Key near-term challenges in the area of organization and staffing will be to finalize parameters for appropriate changes to incentive systems to attract strong staff to fragile states work; and ensure that fragile states knowledge management and operational support is strengthened and deepened in the regions, sectors and central anchor units while dealing appropriately with trade-offs in a flat budget environment.

41. **Staff guidance and training.** The World Bank has produced staff guidance and briefings on using results based transitional frameworks in fragile states;<sup>40</sup> the design of Development Policy Operations (DPO) in fragile post-conflict and gradual reform environments;<sup>41</sup> characteristics and key success factors for project design in fragile states;<sup>42</sup> and leadership

<sup>39</sup> The Fragile States Group will take responsibility for external partnerships on conflict and fragility, for policy and institutional reforms, and for multi-sectoral country support, including the rapid-response secretariat. Sustainable Development Network will continue and strengthen the CPRU’s capacity to provide analytical thinking and country support relating to conflict and fragility in the social, environment and infrastructure sectors. This type of capacity, dedicated to sector lessons learned and surge capacity to assist country teams in fragile and conflict-affected states, will be replicated in the other Networks.

<sup>40</sup> World Bank and United Nations Development Group (2005). “An Operational Note on Transitional Results Matrices - Using Results-based Frameworks in Fragile States.”

<sup>41</sup> Operations Policy and Country Services, (2005). “Good Practice Note for Development Policy Lending – Development Policy Operations and Program Conditionality in Fragile States.”

<sup>42</sup> See World Bank (2007). “Aid that Works, Characteristics of Effective Projects in Fragile States.”

capacity-building in fragile states.<sup>43</sup> New work is currently underway to incorporate evaluation of the World Bank's support to Poverty Reduction Strategies in fragile and conflict-affected environments into staff guidance. The World Bank also piloted a new scenario-based training program for staff in May 2007, in collaboration with UN-Department of Peace Keeping Operations (DPKO), UNDP and the Governments of the United Kingdom, Norway, Canada and Australia.

42. ***Future challenges.*** The IEG evaluation noted that the World Bank's record in capacity-building is mixed, and that the World Bank would need to deepen its knowledge of approaches that work in order to successfully adopt a central focus on building state capacity and accountability in fragile states. To address this, the World Bank is undertaking new work on building institutions after conflict;<sup>44</sup> has commissioned a series of studies on lessons learned in strengthening capacity and accountability in basic public finance and service delivery functions;<sup>45</sup> and is incorporating lessons learned from support to poverty reduction strategies in fragile and conflict-affected states into staff guidance. Such guidance work will have a strong focus on gradual reform and deteriorating governance scenarios as well as post-crisis situations.

43. ***Rapid response to crises and emergencies.*** Fragile states are particularly prone to crises and emergencies which require a rapid response from international partners. The need for a rapid response occurs in particular in two types of fragile situations: in countries in post-conflict and political transition, where delivering rapid visible results and capacity-building assistance may be critical to stabilize a fragile peace and prevent renewed conflict; and in situations of deteriorating governance or rising conflict risk, where rapid action may be needed to restructure IDA's portfolio to respond to new realities and challenges on the ground.

44. ***New policy and procedural reform.*** In February 2007, the Board approved a new policy on rapid response in crises and emergencies. The policy and procedures are expected to apply to only a relatively small subset of fragile situations where the conditions above apply, as well as to a response to natural disasters. The new policy and procedures target a decrease in the time needed to take emergency projects from concept to first disbursement on the ground from nine months to three months. They include provisions to move from cause to impact in the definition of an emergency; to recognize that delays are a source of reputational risk for the World Bank in emergency response; to establish specific rapid assistance for start-up activities in weak capacity environments; and to streamline clearances which were previously provided sequentially into a one-stop decision meeting.

45. ***Progress and challenges.*** Rapid Response Committees have been convened by country teams in regions for the review of emergency projects; and a Rapid Response Committee chaired by the Managing Directors has also been established for Sudan, Somalia and the Democratic Republic of Congo. Two meetings of the Committee have been held and resulted in concrete follow-up actions, including fielding a rapid response team to South Sudan to assist in providing real-time support for resolving operational bottlenecks that have constrained project

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43 Workshops for leaders and leadership workshops, OPCS/PREM, December 2004; Recent Interventions to Build Capacity of Leaders, OPCS/PREM/WBI, July 2006.

44 Cliffe, S., and Manning, R. (2007). "*Building institutions after conflict.*" International Peace Academy, (forthcoming).

45 The activities on building basic state functions will be carried out under a recently-established multi-donor trust fund financed by Australia, Canada, Norway, and the United Kingdom.

implementation under the Multi-Donor Trust Fund. Key challenges for implementation of the rapid response policy and procedural reform will be availability of experienced staff to support application of the new procedures in country-level operations.

46. ***Management of fiduciary risk.*** Many fragile states and situations involve a relatively high level of fiduciary risk. The general guiding principle for IDA's engagement in high-risk fragile situations is based on a clear identification of risks and the adoption of appropriately designed risk mitigation measures that also aim at supporting the development of improved public financial management and control systems in the longer term. Reputational and fiduciary risk associated with the IDA's work in fragile states is also mitigated by additional oversight and governance measures designed to facilitate its engagement while reducing its overall exposure. For example, while development policy operations in situations such as Afghanistan, Burundi, the Central African Republic and Timor-Leste have played a crucial role in stabilizing fragile transition processes and building state capacity and accountability, they also involve high fiduciary risk: the World Bank has developed specific staff guidance on appropriate risk mitigation measures.<sup>46</sup>

47. ***Fiduciary oversight in situations that require a rapid response.*** The World Bank's new policy on "rapid response" clearly recognizes the inherent risks involved in working in emergency situations as well as the risks and lost opportunities associated with a delayed response. The new policy calls for streamlined and simplified ex-ante requirements and provides for a different balance between ex-ante and ex-post controls and risk mitigation measures in emergency operations compared to regular operations. These principles are laid out in staff guidelines<sup>47</sup> and are to be achieved through intensified supervision, particularly during earlier stages of project implementation when fiduciary arrangements are being put in place; more frequent physical and financial audits; and ex-post financial management and procurement reviews. To address low capacity constraints, the new policy also permits the World Bank to agree, at the borrower's request, to alternative implementation arrangements that draw on the services of UN agencies and programs and other public or private entities operating in the country for core functions such as financial management, procurement and monitoring and evaluation, covering a transition period during which local capacity is being built. A key challenge for the implementation of these arrangements is the consistent deployment of seasoned designated fiduciary staff, and the development of a roster of fiduciary experts.

48. The World Bank's intensified engagement in fragile states has gone through several phases since 2002. In the initial period, the focus was on learning from country experiences on how to engage differently in these environments: this then informed the differentiated country assistance strategy framework described above. The World Bank also made some early changes to performance measurement and financing systems, including the amendment of the CPIA and the establishment of the LICUS Trust Fund. More recently, the focus has been on organizational reform to strengthen the implementation of these approaches at the country level, in particular through the rapid response policy and staffing strategy. As these operational approaches and

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<sup>46</sup> Operations Policy and Country Services, (2005). "Good Practice Note for Development Policy Lending – Development Policy Operations and Program Conditionality in Fragile States."

<sup>47</sup> Draft Guidelines: Financial Management Aspects of Investment Operations Processed under OP/BP 8.00" May 2006.

organizational reforms deepen, it is an appropriate juncture to review IDA's financing arrangements in fragile states, to ensure that these reflect the lessons emerging from country experience, research and policy debates.

#### IV. FRAGILE STATES AND IDA'S FINANCING ARRANGEMENTS

49. **Background.** IDA allocates the bulk of its resources to partner countries using the Performance-Based Allocation (PBA) system. This system rests on research which shows that aid funds are better used in poor countries with better policies and institutions. Fragile states, with CPIA ratings at 3.2 or below, have weak policies and institutions and are therefore allocated relatively less aid per capita. Some recent studies have questioned whether sufficient aid is going to meet the needs of countries with weaker policies and institutions.<sup>48</sup>

50. **IDA balances country performance with needs in allocating aid.** In general, IDA strikes a balance between performance and needs of fragile states in three ways. First, needs are stressed by targeting IDA resources mainly to countries that have low per capita incomes below \$1,025 per capita.<sup>49</sup> Second, although a majority of IDA countries are poor, IDA's allocation formula has an additional bias towards needs through the population and GNI per capita elements in its formula. Third, allocations to countries like India, Indonesia and Pakistan are capped at levels well below what their performance would warrant because they have access to other sources of financing. This releases resources to meet needs of the remaining PBA-based countries. *More specifically*, IDA takes country needs into account by deviating from the PBA formula in some specific instances involving fragile states where special considerations call for more aid than warranted just by the countries' policy and institutional performance.

51. **Purpose and layout.** This section reviews IDA's financing arrangements in fragile states, identifies gaps in these arrangements, and proposes ways of enhancing them. Section A provides an overview of IDA's assistance to fragile states over the past decade. Section B reviews IDA's current financing arrangements in fragile states, identifies gaps and recommends ways to better assist fragile states. Section C looks at the impact of these recommendations on performance-based allocations.

##### A. Overall IDA Resource Flows to Fragile States

52. **IDA resources to fragile states over the past decade.** IDA allocated SDR 11 billion to fragile states (corresponding to 19 percent of total IDA resources) over the past decade. Fragile states, with an estimated 261 million poor people living on less than a dollar a day, were allocated around SDR 2.3 per capita per annum over the past decade. During the same period, non-fragile IDA countries (excluding capped blend countries), home to around 324 million

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<sup>48</sup> In their paper entitled "*The Forgotten States: Aid Volumes and Volatility in Difficult Partnership Countries (1992-2002)*", Dollar and Levin use elements of IDA's PBA formula – CPIA, population, and GNI per capita – to establish a benchmark against which they examine *overall* aid flows to fragile states and conclude that difficult partnership countries "receive around 40 percent less aid than predicted by their policy and institutional strength ... primarily due to disproportionately low flows from bilateral donors." While this study may have implications for overall aid flows, IDA already allocates resources to a majority of countries – including many fragile states – in line with their policy and institutional strength using the PBA formula.

<sup>49</sup> Excluding the small island economies and gap countries which have incomes above the IDA operational cut-off, average per capita income of all IDA countries is around \$495 (Atlas GNI) in 2005.