



**IDA15**

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**OPERATIONAL APPROACHES AND FINANCING IN FRAGILE STATES**

**International Development Association**

**Operational Policy and Country Services (OPCS) and  
Resource Mobilization Department (FRM)**

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## ABBREVIATIONS AND ACRONYMS

ADB	African Development Bank
AfDF	African Development Fund
ARTF	Afghanistan Reconstruction Trust Fund
AsDB	Asian Development Bank
AU	African Union
CDD	Community Driven Development
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
CPIA	Country Policy and Institutional Assessment
CRS	Creditor Reporting System
DPO	Development Policy Operations
EC	European Commission
ECOSOC	Economic and Social Council
ECOWAS	Economic Community of West African States
GEMAP	Governance and Economic Management Assistance Program
GNI	Gross National Income
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IEG	Independent Evaluation Group (World Bank)
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
LICUS	Low Income Country Under Stress
MDB	Multilateral Development Bank
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MDRP	Multi-Country Demobilization and Reintegration Program
MDTF	Multi-Donor Trust Fund
NGO	Non-Governmental Organization
ODA	Official Development Assistance
OCHA	UN Office for the Co-ordination of Humanitarian Affairs
OECD-DAC	Organization for Economic Co-operation and Development – Development Assistance Committee
OP	Operational Policy
OPCS	Operational Policy and Country Services
QAG	Quality Assurance Group
PA	Poverty Assessment
PBA	Performance-Based Allocation
PCF	Post-Conflict Fund
PCNA	Post-Conflict Needs Assessment
PCPI	Post-Conflict Performance Indicators
PER	Public Expenditure Review
PRSP	Poverty Reduction Strategy Paper
RETF	Recipient Executed Trust Fund
RRC	Rapid-Response Committee
SDR	Special Drawing Right
TRM	Transitional Results Matrix
UNDP	United Nations Development Program
UN-DPKO	United Nations – Department of Peace Keeping Operations

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# OPERATIONAL APPROACHES AND FINANCING IN FRAGILE STATES

## EXECUTIVE SUMMARY

1. **Purpose.** 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."<sup>1</sup> This paper responds to this request, with the exception of the systematic approach for arrears clearance, which is described in a separate paper.<sup>2</sup>
2. **The critical challenge of fragile states.** Fragile states, characterized by weak institutions and vulnerability to conflict, have increasingly become an area of focus for the development community in recent years. Fragile states represent a critical challenge for IDA: while they are home to less than 19 percent of the total population in IDA-eligible countries, they account for over one third of the extreme poor, almost two fifths of all child deaths, and one third of 12 year olds who did not complete primary school in 2005.
3. **High risk-high reward.** Development assistance is inherently risky in these environments, where weak policies and institutions correlate with a lower probability of successful project outcomes. Despite the risks, there is a strong rationale for engagement: the impact of well-designed and supervised aid-financed programs can potentially be very high, because these countries start from a very low level of achievement of the Millennium Development Goals (MDGs). A successful exit from fragility also has positive spillover effects on neighboring countries. A strong response from IDA in fragile states is therefore in the interests of all its members, as progress in these environments will also enhance and protect the development gains made in the stronger performers.
4. **Differentiated operational strategies.** In line with other donors at the OECD-DAC, the World Bank is focusing on its comparative advantage in different types of fragile states and situations by differentiating its assistance strategies and its role based on the direction and pace of governance change. Within this framework, the World Bank has a significant contribution to make by adapting its traditional economic and service delivery competencies to weak capacity environments and by tailoring its technical expertise to support the lead of the UN and other partners in efforts to consolidate peace and stability. In this regard, the World Bank's partnership with the UN in fragile states has strengthened significantly in recent years, and will be further bolstered by the adoption of a common recovery planning process and agreed fiduciary framework for collaboration in post-crisis situations.
5. **Operationalizing policy and institutional reforms.** The continued implementation of organizational, policy and procedural reforms recently endorsed by the Board of Executive Directors is important for realizing the full potential of the World Bank's contribution in fragile states. In particular, strengthening operational support and building on lessons learned, together

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<sup>1</sup> Chairman's summary from the first IDA15 meeting in Paris, March 5-6<sup>th</sup>, 2007.

<sup>2</sup> IDA (2007): "Further Elaboration of a Systematic Approach to Arrears Clearance."

with strengthening field presence and enhancing human resource systems to attract high quality staff and reward strong performance in these tough environments, will be critical.

6. **IDA's overall financial assistance.** Over the past decade, IDA allocated around SDR11 billion or 19 percent of its overall resources to fragile states, i.e. countries with Country Policy and Institutional Assessment (CPIA) ratings at or below 3.2. In addition, a majority of fragile states have benefited significantly from debt relief having received US\$13.4 billion of relief in NPV terms by mid-June 2007 under the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiatives (MDRI) initiatives. They also benefited from increasingly concessional resources through the provision of IDA grants (receiving 57 percent of IDA funds as grants to date in the IDA14 period as compared to 8 percent for non-fragile states).

7. **Fragile states financing classification.** From a financing perspective, IDA classifies fragile states into: (i) those receiving IDA resources through the Performance-Based Allocation (PBA) system; (ii) those qualifying for exceptional post-conflict allocations; (iii) those qualifying for exceptional allocations upon re-engaging with IDA after a prolonged period of inactivity; and (iv) those in non-accrual status.

8. **Gaps in current exceptional financing arrangements.** Of the 34 fragile states in FY07, 17 receive IDA allocations using the PBA system in line with their policy and institutional performance. In some carefully ring-fenced situations established during past replenishment rounds, IDA has deviated from the PBA system to provide exceptional allocations to post-conflict and re-engaging fragile states. While these exceptions have generally been working well, experience so far reveals some need for improvement. With respect to **post-conflict allocations**, three areas for improvement have been identified. These include the need to: (i) link post-conflict allocations to changes in the overall size of the IDA envelope; (ii) strengthen the review process of Post-Conflict Performance Indicators (PCPI) ratings on which these allocations are based and prepare for eventual disclosure of these ratings; and (iii) lengthen the phase-out period of post-conflict allocations. With respect to **countries re-engaging with IDA** after a prolonged period of inactivity, but which did not meet the qualifying criteria for exceptional post-conflict allocations, the following areas for improvement have been identified: (i) criteria for eligibility need to be elaborated; (ii) clearer guidelines for determining the size of exceptional allocations have to be established; and (iii) the drop in exceptional allocations has to be smoothed.

9. **Financial implications of the proposals.** In IDA15, it is proposed that the gaps in the current exceptional financing arrangements be addressed mainly by modifying the duration, pattern and volume of resources to post-conflict countries and those re-engaging with IDA after a prolonged period of inactivity (see Section IV for details). These proposed changes have financial implications for the IDA15 period estimated at an additional: (i) SDR430 million for current recipients of exceptional post-conflict allocations; (ii) SDR430 million for potential new entrants into this window; and (iii) SDR110 million for countries re-engaging with IDA after a prolonged period of inactivity.<sup>3</sup> These proposed modifications are dependent on the availability of the expected IDA15 commitment authority as discussed in section 1.7 of the accompanying IDA paper entitled, "*The Demand for IDA15 Resources and Strategy for their Effective Use.*"

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<sup>3</sup> Assuming that the nominal size of the envelope is unchanged in IDA15.

# 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."<sup>4</sup> This paper responds to this request, with the exception of the systematic approach for arrears clearance, which is described in a separate paper.<sup>5</sup>

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

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

<sup>5</sup> 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."<sup>6</sup>

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 countries<sup>7</sup> 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,<sup>8</sup> 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.<sup>9</sup> 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.

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

<sup>7</sup> Out of 82 IDA-eligible countries.

<sup>8</sup> 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.

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

8. In line with the OECD-DAC's guidance on fragile situations,<sup>10</sup> the 2006 Board paper<sup>11</sup> also notes that higher income or higher-performing countries facing fragile post-conflict or political transition situations (Balkans, Sri Lanka, Nepal), as well as fragile sub-national regions (Aceh, Mindanao) may benefit from drawing on similar operational approaches and tools. For the purposes of this report, the term *fragile states* refers to countries with CPIA ratings of 3.2 and below and is used in the discussion of aid flows, research, and the monitoring of results; the term *fragile situations* is used in the discussions of the World Bank's role, strategy and operational approaches.

#### **Box 1: Definitions of Fragile States**

Different organizations use different parameters to judge fragility, in general combining aspects of the capacity and accountability of institutions with indicators related to conflict risks.

The OECD-DAC does not have an agreed list of fragile states and situations, but for research purposes has used the bottom two quintiles of the World Bank's CPIA, resulting in a similar grouping to the World Bank's 3.2 cut-off line. The methodology developed by the US Fund for Peace measures twelve social, economic and political indicators related to fragility. The Fund for Peace's index identifies 28 countries as high risk in 2006, but does not include ratings for non-sovereign territories or small states which are included in the World Bank's list. DFID's 2005 policy paper on fragile states highlights the importance of territorial control, safety and security, capacity to manage public resources and deliver services and ability to protect the poorest and provides a list of 46 countries.

The AfDB defines fragile states as those with CPIA ratings below 3.0 and a Country Vulnerability Index of less than 0.351. This results in 25 countries being classified as fragile in Africa.

Amongst the MDBs, AsDB's paper "*Achieving Development Effectiveness in Weakly Performing Countries*," November 2006, compares the country lists produced by the World Bank, DFID and the Fund for Peace Index and notes that 11 countries in Asia qualify under two or more of these lists, compared to 8 on the World Bank's list alone.

## **B. Fragile states' development challenges**

9. Fragile states are furthest away from achieving the Millennium Development Goals (MDGs) and they contribute significantly to the MDG deficit (Table 1). Extreme poverty is concentrated in fragile states: while they are home to only 19 percent of the population of IDA-eligible countries, they account for over one third of the extreme poor, almost two-fifths of all child deaths, and one third of 12-year olds who did not complete primary school in 2005. Their low levels of human and social development are linked to weak institutional capacity and governance and to internal conflict, all of which undermine the capacity of the state to deliver basic social and infrastructure services and offer security to citizens.

10. Fragile states have consistently grown more slowly than other low-income countries. Although the average per capita growth of fragile states has picked up in recent years, this is partly due to accelerated expansion in a few fuel-producing countries. Among non-fuel-producing fragile states, real per capita growth rates recovered to an average of 2 percent per annum in 2001-05, after negative growth between 1986 and 2000. However, the outlook is for

<sup>10</sup> OECD Principles: "*Principles for Good International Engagement in Fragile States and Situations*," DAC Senior Level Meeting, April 2007. Also see footnote 22 and 25 in OPCS (2005). "*Good Practice in Country Assistance Strategies*."

<sup>11</sup> OPCS (2007). "*Strengthening the World Bank's Rapid Response and Long-Term Engagement in Fragile States*." The World Bank.

per capita growth for these countries to remain a full percentage point lower than that experienced by low-income countries as a whole, with a resulting increase over time in the proportion of the world's extreme poor living in these countries.<sup>12</sup> Lower investment relative to GDP in fragile states, linked in part to lower national savings rates (domestic savings and net transfers from abroad, including official transfers and worker remittances), has been one cause of their slower growth. Another is their high vulnerability to conflict.

**Table 1: Fragile States Face the Largest Deficit in Most MDGs**

Indicator	Total in IDA-eligible countries (millions)	Total in Fragile States (in millions and % share)
Total Population (2004)	2,620	485 (19%)
MDG1 – Poverty (2004)		
Extreme Poverty	724	261 (36%)
MDG2 – Universal Education		
Children of relevant age that did not complete primary school in 2005	11.8	4 (33%)
MDG4 – Under-Five Mortality		
Children Born in 2005 not expected to survive to age five	8.5	3.3 (39%)
MDG5 – Maternal Health		
Unattended Births	42.5	8.9 (22%)
MDG6 – Diseases		
TB deaths	1.2	0.34 (28%)
HIV+	20.9	7.2 (35%)
MDG7 – Environmental Sustainability		
Lack of access to improved water	667	209 (31%)
Lack of access to improved sanitation	1,586	286 (18%)

*Source: Global Monitoring Report 2007*

11. More than four-fifths of fragile IDA countries are or have been subject to conflict.<sup>13</sup> Conflict is one of the major reasons why countries slide into fragility. Conflict can extract a high cost in terms of lives lost and physical damage, negatively affect growth and poverty and have lingering and hard-to-overcome legacy effects. While the number of conflicts in low income countries has been declining, conflicts have become more intense, with a significant negative impact on GDP growth averaging about a 12 percent decline per year of conflict. It takes longer for countries to regain their pre-conflict per capita income levels than was the case before 1990: 11.1 versus 3.6 years.<sup>14</sup> The risk of reversal in post-conflict countries is also very high, with

<sup>12</sup> World Bank (2007). "Global Monitoring Report 2007."

<sup>13</sup> According to the Uppsala Conflict Database which records conflicts based on the number of battle deaths, only Gambia, Mauritania, Sao Tome & Principe, Tonga, Vanuatu, Solomon Islands, and Zimbabwe have not experienced intermediate or severe conflicts. It should be noted that the eligibility of countries for exceptional post-conflict IDA financing is based on additional dimensions of conflict, as discussed subsequently in this paper.

<sup>14</sup> World Bank (2007). "Global Monitoring Report 2007".

around 40 percent of countries relapsing into conflict in the first decade of post-conflict recovery.<sup>15</sup>

### **C. Rationale for engagement and issues in development effectiveness**

12. Development interventions in fragile states are inherently risky: weak institutions undermine effectiveness and the high vulnerability to conflict increases the risks that gains made will be reversed. Engaging in very fragile environments can also create reputational and fiduciary risks for donor agencies which require careful mitigation. Despite these constraints, there is a sound rationale for engagement.

13. These countries merit attention despite the difficulties of the operating environment. There is a risk-reward trade-off in fragile states engagement. On the one hand, their weak institutions mean that the probability of successful outcomes for aid-financed programs is lower than in more strongly performing environments (section III looks at trends in IDA portfolio performance). On the other, their high deficit with respect to MDGs means that where country programs – including those financed from aid – are successful, their development impact can be very significant at the margin because these countries start from a low baseline. This can be seen in individual country examples: Timor-Leste achieved the highest rate of decrease in under-five mortality of all developing countries between 1990 and 2005, with an annual percentage decrease of 7.1 percent. Guinea and Burundi significantly improved primary education completion rates from 2000 to 2005: from 33.3 to 54.5 percent and from 25.1 to 35.7 percent, respectively.

14. The potential for successful development outcomes can also be seen in aggregate analysis of the fragile states group, but this appears to be highly variable by sub-sector.<sup>16</sup> Extreme poverty rates remained unchanged in fragile states during the last fifteen years, a period which saw significant poverty reduction in non-fragile IDA eligible countries as a group. However, in the some other MDGs, fragile states as a group have seen improvements. For example, they increased primary completion rates faster than non-fragile states in the period between 1995 and 2005 (from 40 to 72 percent in fragile states; from 70 to 79 percent in non-fragile IDA-eligible countries). Access to water jumped by 13 percent between 1995 and 2005 but increased by only 9 percent in non-fragile countries. Measles immunization rates increased slowly in fragile states between 1995 and 2005, but were unchanged in non-fragile, IDA-eligible countries. In other sectors, however, the pace of improvements in development outcomes lags behind non-fragile states: infant mortality decreased by 8 percent in fragile states between 1995 and 2005, but by more than 13 percent in more strongly performing countries. Further research would be needed to establish why development effectiveness varies significantly between different sectors of investment in fragile states.<sup>17</sup>

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<sup>15</sup> Collier, P., A. Hoeffler and M. Soderbom, (2006). “*Post-conflict risks*,” World Bank Working Paper and Journal of Peace Research (forthcoming).

<sup>16</sup> Indicators used in this paragraph have more than 90 percent coverage in fragile states, weighted by population.

<sup>17</sup> The reasons for such highly variable outcomes against different MDGs are unclear. A reasonable set of hypotheses would be that fragile states are more likely to make progress against indicators where improvements do not require sophisticated institutional capacity; are not highly correlated with broad-based growth; and where

15. For countries that make a successful transition from weak institutions and the legacy of conflict, there is a growing body of research indicating a shift in the risk-reward trade-offs: these environments remain risky, but the development impact of successful aid projects increases.<sup>18</sup> Again, this can be seen in specific country examples: countries such as Mozambique and Uganda have made significant progress towards the MDGs (Table 2).

**Table 2: Progress in Country-Level Development Results in Uganda and Mozambique**

Country Indicators	Uganda		Mozambique	
	1992	2006	1990/92	2005/06
GDP per capita (US\$)	177	267 (2005)	150	310
Average inflation (%)	42	6.6	39	9.7
Poverty incidence (%)	56	31	69 (1997)	54(2003)
Net primary school enrollment (%)	68 (1995)	91.7	43	71
Under-five child mortality (per 1,000)	160 (1990)	138 (2004)	235	152

16. Last, disengagement and failure to address the problems of fragile states imposes costs on their neighbors as well as their own citizens. For stronger performers, sharing a border with a fragile state is estimated to cause a loss of approximately 1.6 percent of GDP per annum.<sup>19</sup> This is of particular concern in Africa, where most countries that have succeeded in improving governance and realizing gains in growth and poverty reduction are bordered by at least one fragile state. Aid that diminishes fragility could therefore have positive spillover effects.

#### **D. Trends in the international aid architecture**

17. Overall donor assistance to fragile states declined steeply after the mid-1990s, as shown in Figure 1.<sup>20</sup> Aid levels began to recover in 1999, driven mainly by debt relief and emergency assistance. Assistance for core development programs is also showing an upward trend since 1999, but is still far below the peak reached in the mid-1990s. Donor re-engagement in the Democratic Republic of Congo, Sudan, and Afghanistan has had significant impact on recent levels of aid flows.<sup>21</sup> Despite the overall increase in aid flows, empirical evidence shows that fragile states as a group receive lower *overall* aid in relation to their level of performance and

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development goals are likely to receive broad societal support even amongst warring or oppositional segments of society.

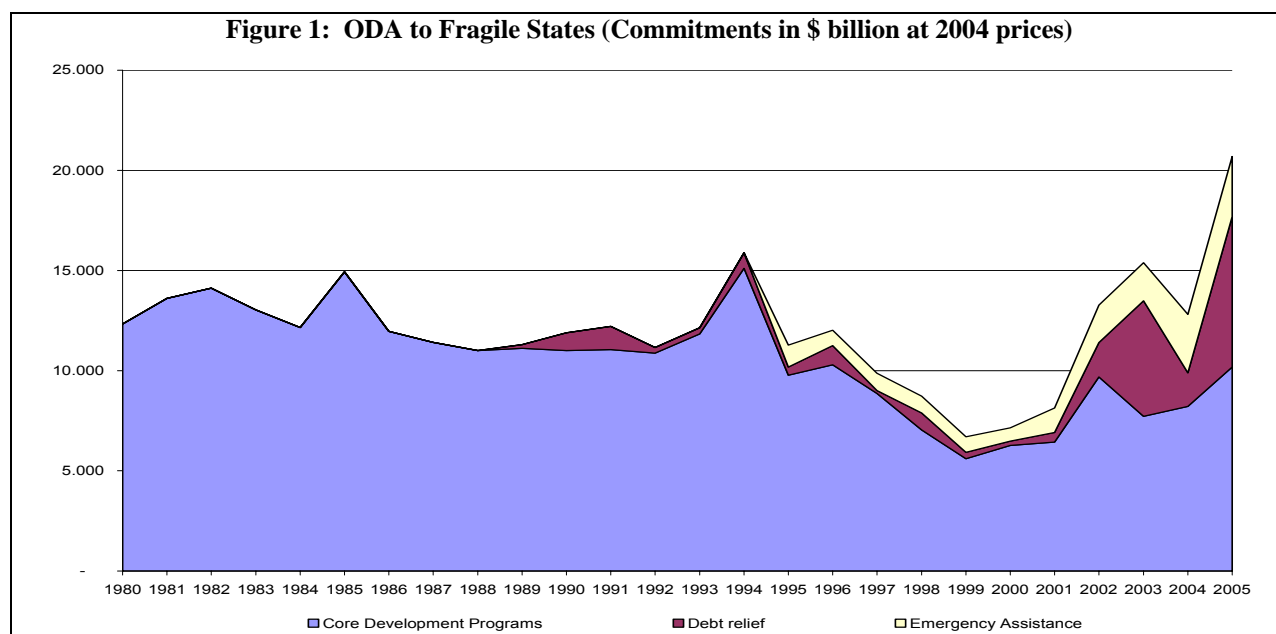
<sup>18</sup> World Bank (2002). "Aid, policy and growth in post-conflict societies," World Bank Policy Research Working Paper 2902; Addison, T. (ed) (2003). "From Conflict to Recovery in Africa." OUP; Anand, P.B. (2004). "Getting infrastructure priorities right in post-conflict reconstruction." McGillvray (2005). "Aid allocation and fragile states," WIDER.

<sup>19</sup> Chauvet, L., and P. Collier (2004). "Development Effectiveness in Fragile States: Spillovers and Turnarounds."

<sup>20</sup> This analysis is based on donor commitments reported to OECD's Development Assistance Committee. For analysis presented in this report on the MDGs, aid flows, and portfolio performance, a dynamic list of fragile states was used, based on the CPIA ratings for the last two decades which were recomputed to be comparable with current definitions. Because of the difficulties with comparability, this analysis should be used with caution.

<sup>21</sup> World Bank (2007). "Global Monitoring Report 2007."

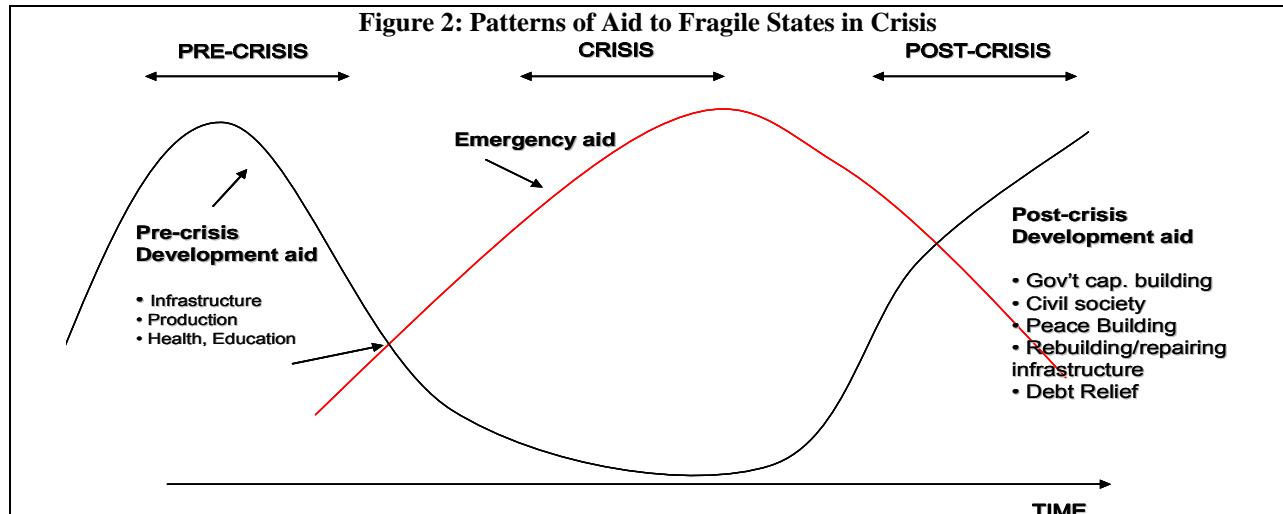
poverty. However, the extent of under-funding appears to be declining in recent periods.<sup>22</sup> In line with broader aid trends noted in the paper on aid architecture presented at the IDA15 Paris meeting,<sup>23</sup> about 75 percent of ODA to fragile states in 2005 was provided by bilateral donors, with the remaining 25 percent provided by multilateral institutions. The share of multilateral ODA came down from a peak of 40 percent of ODA to fragile states in the mid 1990s.



18. Within these overall trends, there are two distinctive patterns in the provision of ODA to fragile states: (a) countries that experience donor disengagement during conflict or other internal crises. In the event that there is an end to the conflict or crisis, this is followed by a revival of emergency aid which over time reduces as core development activities resume and is often accompanied by debt relief (Figure 2); and (b) countries that are poor performers and continue to receive unchanging and low levels of aid for core development activities.

<sup>22</sup> Ibid. The analysis in the GMR updated Dollar/Levine (2005). The coefficient on the fragile states dummy shows whether this group of countries receives more (i.e. the coefficient is positive and significant) or less (i.e., the coefficient is negative and significant) than would be predicted by the explanatory variables in the regression analysis, which include poverty, population and performance.

<sup>23</sup> IDA (2007). "Aid Architecture: An Overview of the Main Trends in Official Development Assistance Flows."



19. Concern over the risk of conflict in fragile states and its consequences in terms of global and regional spillovers has spurred other changes in the international architecture. These include:

- **Attention to coherence.** The last five years have seen a move to improve coherence between different government and multilateral agencies engaged in fragile developing countries, including coherence between diplomatic/political, humanitarian, security and development engagement. This trend, initially most evident as an internal debate within recipient and donor countries, has also found expression in the establishment of the UN peace-building commission, which brings together Security Council and Economic and Social Council (ECOSOC) members, donors and troop-contributing nations. At a country level, the push for increased coherence is seen in the development of more integrated approaches to peace-building and to relief-to-recovery transitions.
- **Commitment to peace-building and state-building goals** for both ODA-eligible and non-ODA eligible assistance in fragile states. The OECD DAC Policy Commitment and Principles for International Engagement in Fragile States and Situations<sup>24</sup> underline that effective state-building and peace-building in fragile states and situations are a pre-requisite to laying the basis for long-term progress against the MDGs, and commits DAC members to prioritize these areas as goals of development assistance and other types of engagement in fragile states.
- **Rise of international peace-keeping expenditures.** The cost of international peace-keeping missions has risen substantially in the last decade. The UN currently has 18 peacekeeping and political missions, with well over 100,000 civilian and uniformed personnel. The current budget for UN political and peace-keeping missions is \$5.48 billion, up from around \$2 billion in the 1990s. This does not include the cost of peace-keeping by regional and other multilateral institutions:

<sup>24</sup> DAC High Level Meeting, April 3-4, 2007.

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)**

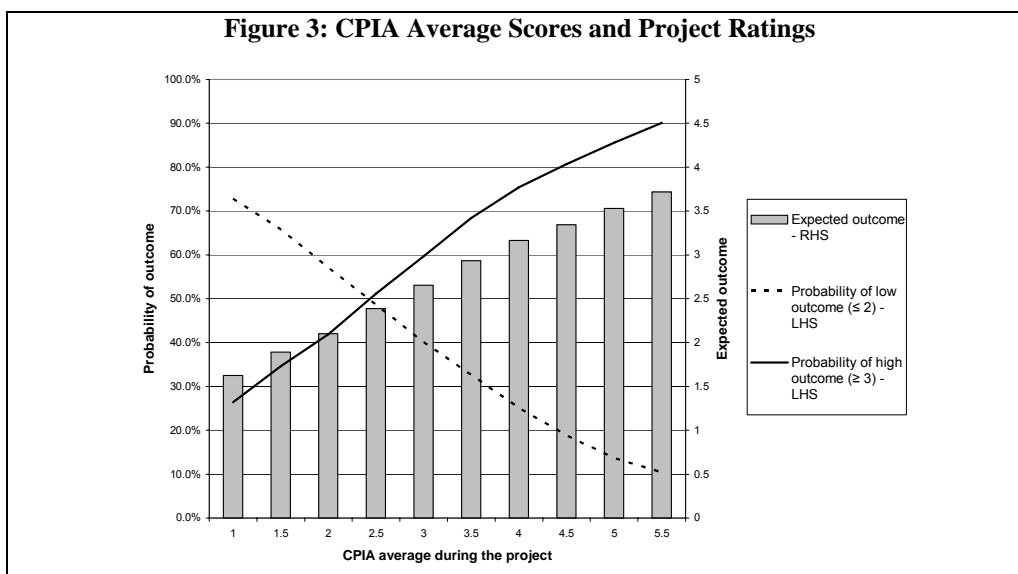
**IDA’s response and project performance under deteriorating governance conditions - Timor-Leste**

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.

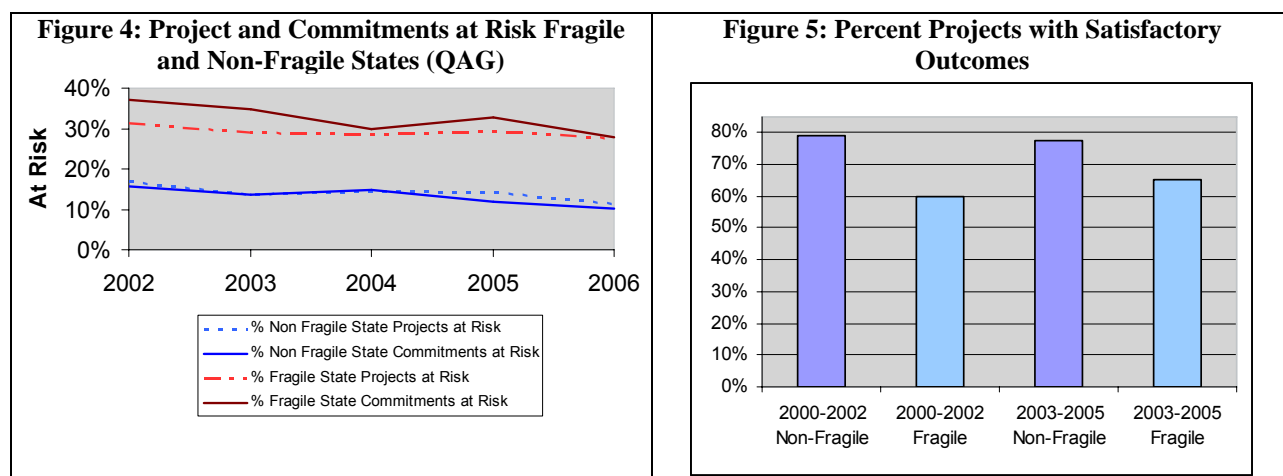
- Coverage of basic health services within a two-hour travelling distance of settled populations increased from 75 percent in 2001 to 86 percent in 2004.
- Use of the health system increased from an average one visit per person per year to at least 2.5 visits per year.
- Immunizations for the three rounds 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 4,370 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**

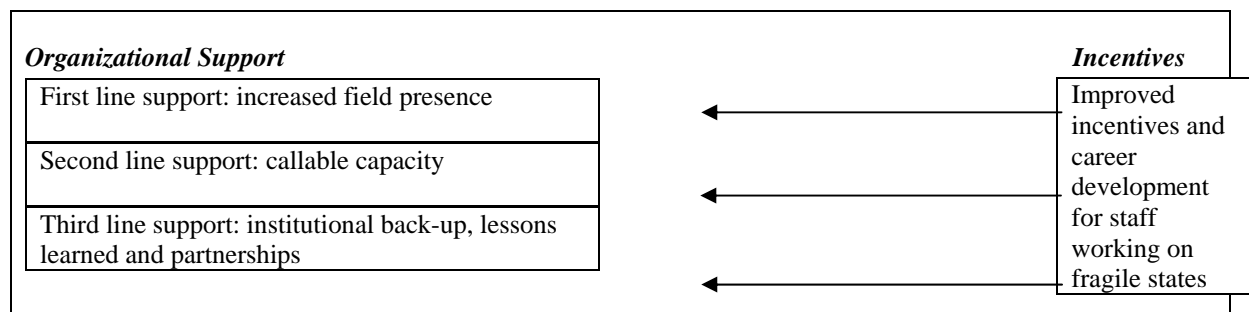
Analytical work is receiving increasing attention to help inform fragile state strategies and policies. The administrative budget for analytical work has more than doubled between FY02 and FY06 and its share of country services' budget rose from 18 percent to 30 percent during the same period (World 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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<sup>43</sup> Workshops for leaders and leadership workshops, OPCS/PREM, December 2004; Recent Interventions to Build Capacity of Leaders, OPCS/PREM/WBI, July 2006.

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

<sup>45</sup> 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

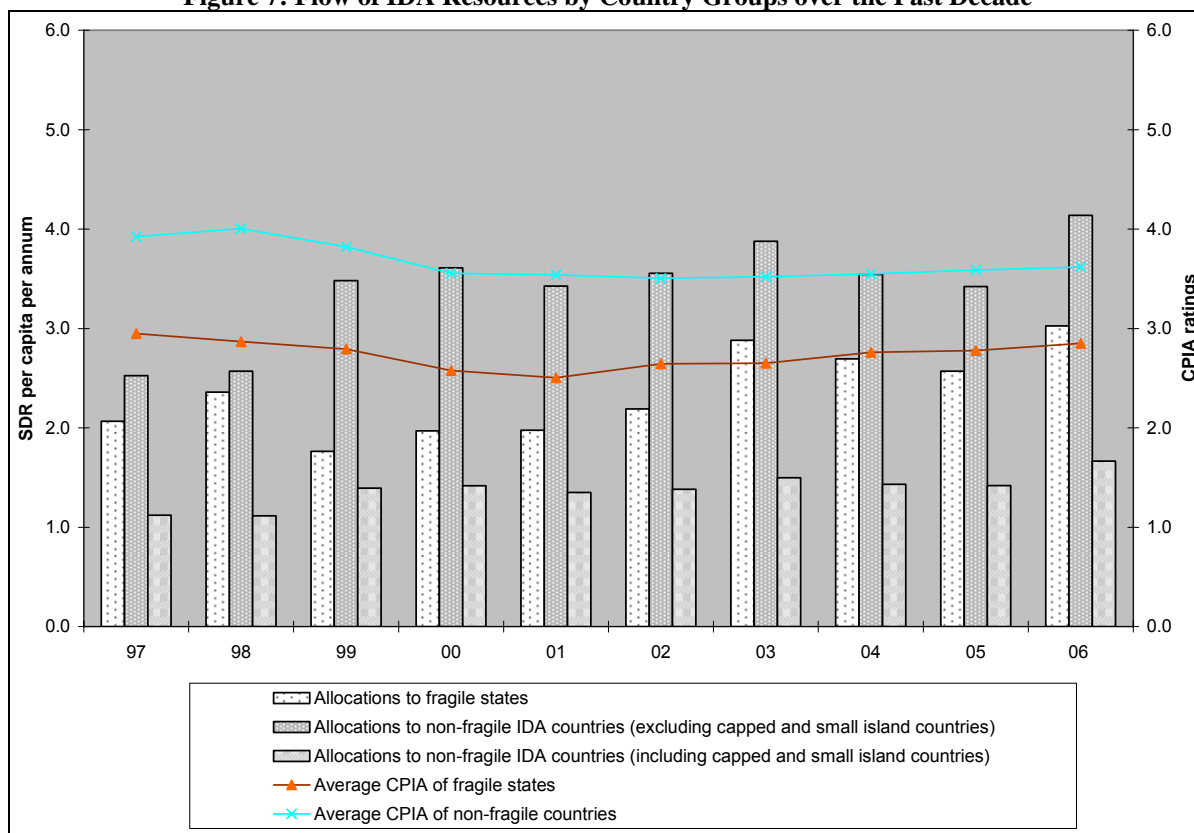
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<sup>48</sup> In their paper entitled "*The Forgotten States: Aid Volumes and Volatility in Difficult Partnership Countries (1992-2002)*", Dollar and Levin use elements of IDA's PBA formula – CPIA, population, and GNI per capita – to establish a benchmark 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.

people earning less than a dollar a day were allocated around SDR 3.4 per capita per annum. Therefore, on average, fragile states received around 70 percent of the per capita annual allocation of non-fragile IDA countries, excluding capped countries. If capped-blend countries are included, non-fragile states with an estimated 724 million people living below a dollar a day received SDR1.4 per capita per annum. See Figure 7 and Table 3.

**Figure 7: Flow of IDA Resources by Country Groups over the Past Decade**



**Table 3: IDA Allocations Per Capita and Number of People Living Below a Dollar a Day**

	Fragile States <sup>1</sup>	Non-Fragile IDA Countries	Non-Fragile Countries (Excluding capped countries and small islands)	Capped Countries <sup>2</sup>
Number of people living below a dollar a day <sup>3</sup>	261 million	724 million	324 million	400 million
IDA allocations per capita (SDR)	SDR2.3	SDR1.4	SDR3.4	SDR0.7

Notes:

1/ Countries with CPIA ratings of 3.2 or below

2/ India, Indonesia and Pakistan

3/ Approximations based on staff estimates.

53. **Terms of IDA assistance to fragile states.** Fragile states have benefited from the increased concessionality of IDA assistance that has resulted from the introduction of grants in IDA13 and IDA14. Around 30 percent of resources committed in fragile states during IDA13 (FY03-05) were in the form of grants compared to 15 percent in non-fragile states. This pattern has strengthened in IDA14 (FY06-08), when 57 percent of resources committed to date in fragile states have been in the form of grants compared to 8.5 percent of resources in non-fragile states. See Table 4. This is because grants are provided on the basis of the countries' risk of debt distress under the IDA14 policy framework (also see paragraph 58).

**Table 4: FY07 List of Fragile States, Financing Status, Debt Relief and Grant Eligibility**

	IDA Financing Status	MDRI/HIPC eligible?	Eligible for grants in FY07?
<b>Severe</b>			
Afghanistan	Post-Conflict	HIPC-eligible	100%
Central African Republic	Re-Engaging	HIPC pre-DP	100%
Comoros	PBA	HIPC pre-DP	100%
Cote d'Ivoire	Arrears	HIPC pre-DP	100%
Liberia	Arrears	HIPC pre-DP	100%
Myanmar	Arrears		-na-
Somalia	Arrears	HIPC pre-DP	-na-
Togo	Arrears	HIPC pre-DP	-na-
Zimbabwe	Arrears		-na-
<b>Core</b>			
Angola	Post-Conflict		50%
Burundi	Post-Conflict	HIPC DP	100%
Chad	PBA	HIPC DP	100%
Congo, Dem Rep	Post-Conflict	HIPC DP	100%
Congo, Rep	Post-Conflict	HIPC DP	100%
Eritrea	Post-Conflict	HIPC pre-DP	100%
Guinea	PBA	HIPC DP	100%
Guinea-Bissau	PBA	HIPC DP	100%
Haiti	Re-Engaging	HIPC DP	100%
Kosovo <sup>1</sup>	Special Provision		100%
Lao PDR	PBA		100%
Solomon Islands	PBA		100%
Sudan	Arrears	HIPC pre-DP	100%
Timor-Leste <sup>1</sup>	Post-Conflict		60%
Tonga	PBA		100%
Uzbekistan	PBA		0%
<b>Marginal</b>			
Cambodia	PBA		100%
Djibouti	PBA		100%
Gambia	PBA	HIPC DP	100%
Mauritania	PBA	HIPC CP	0%
Nigeria	PBA		0%
Papua New Guinea	PBA		0%
Sao Tome and Principe	PBA	HIPC CP	100%
Sierra Leone <sup>1</sup>	PBA	HIPC CP	100%
Vanuatu	PBA		0%

1) Kosovo receives special allocations from IDA because it is an UN administered territory, Timor-Leste's grant percentage was set during the IDA14 replenishment discussions and Sierra Leone received post conflict allocations until FY06. **Notes:** Marginal LICUS countries are identified for monitoring purposes only. (Also see [http://www.worldbank.org/ieg/licus/licus06\\_map.html](http://www.worldbank.org/ieg/licus/licus06_map.html)). DP stands for Decision Point and CP stands for Completion Point.

54. ***Debt relief from IDA.*** Twenty fragile states are eligible for debt relief under the Enhanced HIPC initiative. Of the twenty, three have already reached the HIPC completion point, eight have reached the HIPC decision point and are receiving interim debt relief from IDA, and nine have yet to reach the decision point. The three countries (Mauritania, Sao Tome and Principe, and Sierra Leone) that reached the completion point have also received full cancellation of their debts outstanding to IDA under the Multilateral Debt Relief Initiative (MDRI). Such assistance will also be extended to the other eligible countries once they reach completion point. Total HIPC and MDRI assistance delivered as of mid-June 2007 to fragile states is around \$13.4 billion in NPV terms.

## **B. Diverse Fragile States and IDA's Financing Arrangements**

55. ***IDA's PBA system continues to be the basis for IDA allocations, with some key exceptions.*** IDA financing is provided primarily through the Performance-Based Allocation (PBA) system which, while emphasizing performance, also factors in country needs.<sup>50</sup> This system has been continuously refined over the last 30 years and has allocated greater resources to countries achieving the best development outcomes.<sup>51</sup> There are a few carefully ring-fenced exceptions for some types of fragile states, which were introduced over the recent replenishments to address the specific *needs* of clearly identifiable sub-categories of fragile states.

56. ***Defining fragile states from a financing perspective.*** Given that fragility is a continuum<sup>52</sup> and that countries move in and out of fragility,<sup>53</sup> using fragile states as one category is not an appropriate basis on which to allocate IDA resources. In addition, the current definition of fragile states is too broad<sup>54</sup> and encompasses countries with very diverse characteristics for IDA to have a uniform financing arrangement for all of them. Therefore, for financing purposes, IDA groups fragile states in four categories: (i) countries receiving allocations based on IDA's PBA system; (ii) countries receiving exceptional post-conflict allocations; (iii) countries receiving exceptional allocations upon re-engaging with IDA after a prolonged period of inactivity but which did not qualify for post-conflict assistance; and (iv) countries that do not receive IDA financing because they are in arrears on IDA repayments. Figure 8 below shows the country categories, shares of estimated IDA14 funding, and diverse types of financing arrangements that meet the needs of fragile states.

57. ***Mapping strategic and financing classifications.*** While countries cannot be automatically "cross-mapped" between the operational (described in paragraph 27) and financing classifications, some overlapping patterns emerge. There is, hence, a high probability that countries in a prolonged crisis or impasse may also be countries that do not receive IDA financing because they are in arrears to the World Bank Group. Similarly, countries that are experiencing gradual improvement or deteriorating quickly may be receiving funding based on

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<sup>50</sup> IDA (2007). "IDA's Performance Based Allocation Formula: Options for Simplifying the Formula and Reducing Volatility."

<sup>51</sup> IDA (2007). "Selectivity and Performance: IDA's Country Assessment and Development Effectiveness."

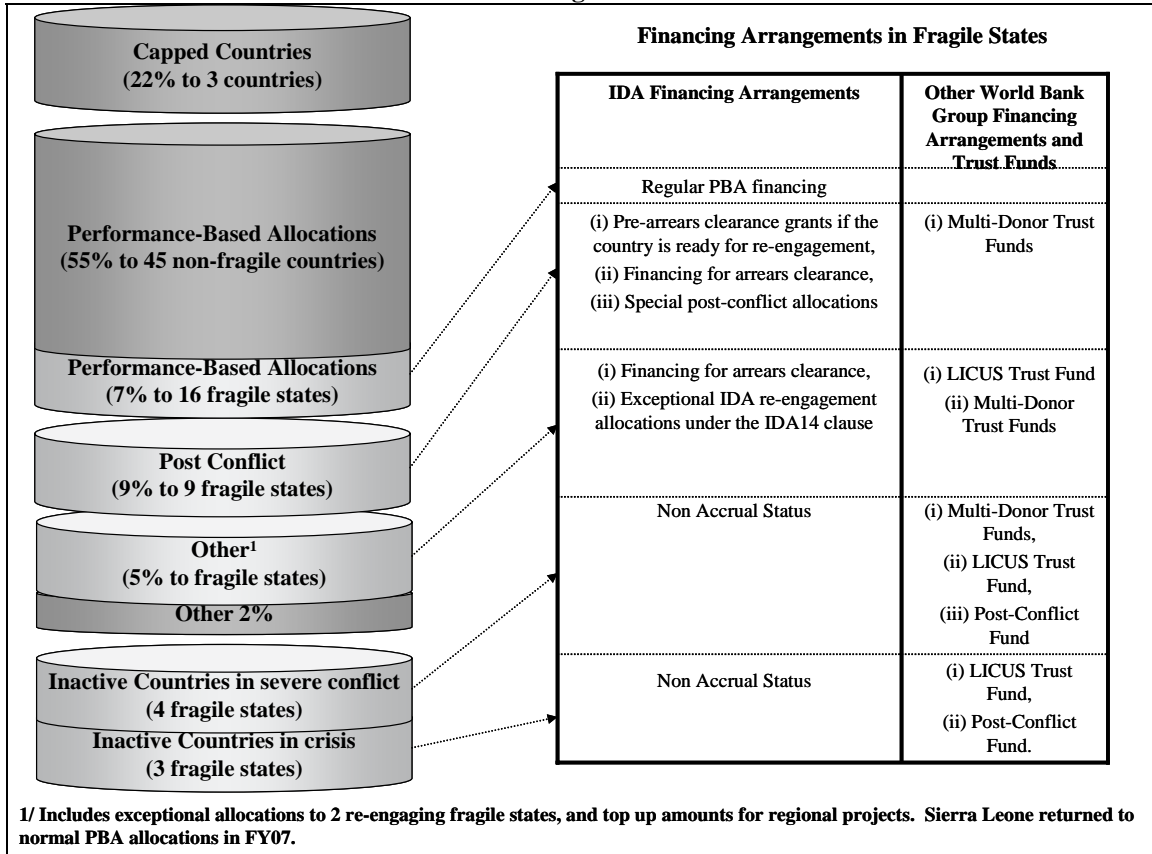
<sup>52</sup> There is no clear threshold above which a country ceases to be fragile – this is especially true since CPIA ratings are subject to a margin of error.

<sup>53</sup> Over the past decade alone, around 11 countries have moved in and out of the fragile states classification.

<sup>54</sup> Includes 40 percent of IDA countries each year. Over the past 15 years, about three-fourths of the IDA recipients have been classified as fragile at some point.

PBA allocations, which take into account such changes at the country level. Finally, countries in the post-conflict category could be benefiting from special allocations.

**Figure 8: Fragile States: Broad Financing Categories, Estimated Share of IDA14 Resources, and Financing Arrangements**



### B1. Fragile States Receiving Financing through the PBA System

58. **Fragile states and PBA allocations.** Some fragile states receive IDA financing through the PBA system. Modifications made to the PBA system in the recent IDA replenishment rounds had important implications for fragile states. These modifications include: the grants system in IDA13 and IDA14, MDRI, and base allocations for small states.

- During IDA13, grants were provided to the poorest countries, debt-distressed poorest countries, post-conflict countries, and for HIV/AIDS and natural disasters. Many of these provisions benefited fragile states.
- Starting in IDA14, grants are being provided based on a country's risk of debt distress. Policy-determined debt burden thresholds were established based on the idea that countries with better policies and institutions can carry more debt. Because fragile states have weak policies and institutions, they also have lower debt-carrying capacity and therefore receive allocations mostly in the form of grants to meet their special needs.

- During IDA14, the MDRI led to the cancellation of debt from IDA, AfDF and IMF for all countries reaching HIPC completion point, thus freeing resources to help these countries meet their developmental needs. Three fragile states have already benefited from debt cancellation through this initiative and another 17 HIPC-eligible fragile states will also benefit from debt cancellation upon reaching completion point.
- Some fragile states are also small, and benefit disproportionately from the base allocations.

59. **Poor policy and governance performance.** Of the 34 fragile states in FY07, 17 received allocations through PBA system mainly in the form of grants.<sup>55</sup> In this year, PBA allocations to these countries ranged from SDR1 to SDR4 per capita, excluding small countries which typically have higher per capita allocations.<sup>56</sup> Fragile states receive lower allocations through the PBA system in line with their lower absorptive capacity.<sup>57</sup> Moreover, these countries typically have poor governance environments, with average governance ratings of 2.7 on CPIA governance cluster (compared to 3.4 for non-fragile states).<sup>58</sup> As discussed at the IDA14 Mid-Term Review,<sup>59</sup> governance is important for improving the development performance in partner countries as well as for mitigating risks to aid funds. The PBA system calibrates assistance to fragile states in line with their governance and policy performance and making exceptions for all of them would seriously undermine IDA's PBA system.

## B2. Post-Conflict Countries

60. **Selected deviations from PBA system.** In some carefully ring-fenced cases, IDA makes exceptional allocations to fragile states to meet special needs. One such case is the exceptional post-conflict allocation. IDA re-engages with countries emerging from conflict if there is a credible, internationally-recognized window of opportunity for peace. In addition to pre-arrears clearance grants, countries emerging from conflict have received exceptional post-conflict allocations since IDA13. The rationale for these exceptional allocations is to help countries meet their special reconstruction needs following a conflict. Preliminary research also shows that aid is "atypically effective" in augmenting growth in post-conflict settings.<sup>60</sup>

61. **IDA resource flows to post-conflict countries.** Around 9 percent of total IDA allocations are estimated to go to post-conflict countries during the IDA14 period. During the first four years of exceptional allocations, post-conflict countries receive on average around SDR 6 per

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<sup>55</sup> These are: Cambodia, Comoros, Chad, Djibouti, Gambia, Guinea, Guinea Bissau, Lao PDR, Mauritania, Nigeria, Papua New Guinea, Sao Tome and Principe, Sierra Leone (starting FY07), Solomon Islands, Tonga, Uzbekistan, and Vanuatu.

<sup>56</sup> If small countries are included, the range of PBA allocations to fragile states extends to SDR11 per capita in FY07.

<sup>57</sup> IDA (2007). "*Selectivity and Performance: IDA's Country Assessment and Development Effectiveness.*"

<sup>58</sup> These countries also rank low on governance using external governance indicators.

<sup>59</sup> IDA (2006). "IDA's Performance Based Allocation System: A Review of the Governance Factor."

<sup>60</sup> Collier, P., and A. Hoeffler (2003). "Aid, Policy and Growth in Post-Conflict Countries," *European Economic Review*, 48 (2004), pages 1125-1145. This research is preliminary and the authors caution that since their study is based on limited observations, "the degree of confidence in the results must be correspondingly discounted."

capita per annum, which is much higher than allocations warranted by their policies and performance using the regular PBA formula. Interestingly, they have absorbed resources rapidly, committing around 95 percent of the resources made available to them in comparison with the remaining fragile states that committed only around 77 percent of IDA resources allocated to them over the past decade.

62. ***Criteria for re-engagement and qualification for post-conflict assistance.*** The methodology for providing exceptional allocations to post-conflict countries was adopted in IDA13, after having been piloted during the last half of the IDA12 period.<sup>61</sup> With respect to the timing of re-engagement this approach relies on established World Bank policy, in particular Operational Policy (OP) 2.30, which sets out four conditions: (i) sufficient reduction of conflict to allow implementation of IDA-supported activities, (ii) reasonable expectation of continued stability, (iii) presence of an effective Government counterpart and (iv) evidence of strong international cooperation.<sup>62</sup> In terms of eligibility for exceptional support, the methodology relies on three indicators of conflict impact: (i) extent of human casualties directly or indirectly caused by the conflict, or (ii) proportion of population that is either internally displaced or in exile, or (iii) extent of physical destruction. Impact must be judged high against any *one* of these indicators for a country to qualify for exceptional post-conflict allocations.

63. ***Duration and pattern of post-conflict assistance.*** When the post-conflict window was set up in IDA13, it was envisaged to provide 5 years of exceptional allocations, including 2 years of phase out to normal PBA allocations. At the IDA13 Mid-Term Review, the duration of exceptional allocations was increased to 7 years, including 3 years of phase out to normal PBA allocations (Figure 9). This modification in duration of allocations was based on research by Collier,<sup>63</sup> which concluded that it may be desirable to have somewhat lower early allocations but to provide exceptional post-conflict assistance over a longer period of time. Therefore, at the IDA13 Mid-Term Review, the post-conflict allocations were stretched over 7 years, while the overall amount of post-conflict allocations was left unchanged.<sup>64</sup>

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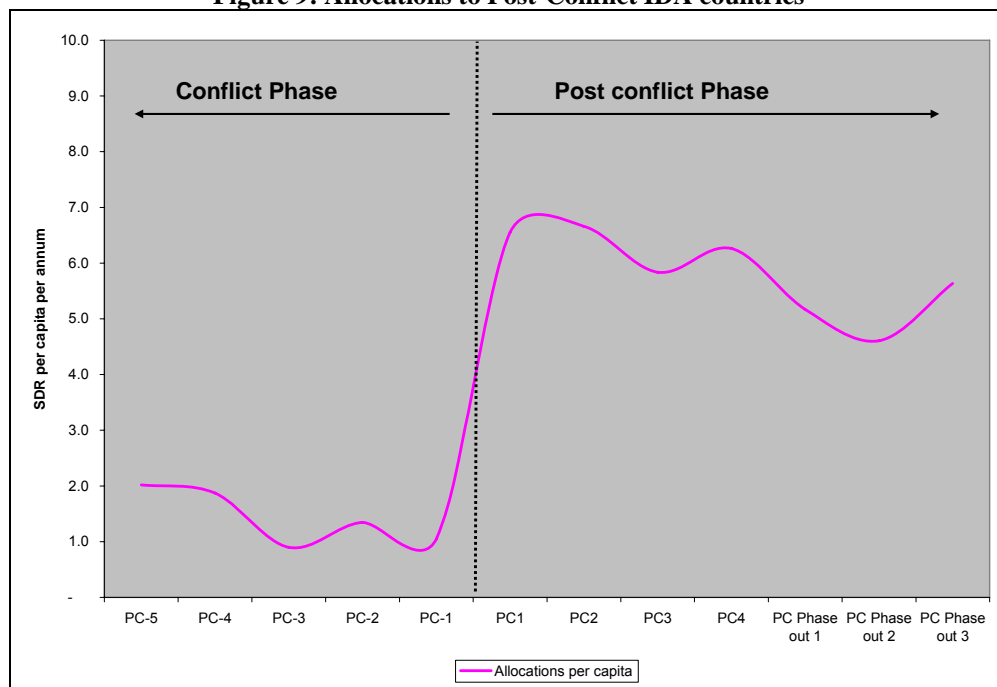
<sup>61</sup> IDA (2002). “*Additions to IDA Resources: Thirteenth Replenishment. Supporting Poverty Reduction Strategies.*” and IDA (2001). “*Adapting IDA’s Performance Based Allocations to Post-Conflict Countries.*” The criteria for eligibility for assistance under the post-conflict window are laid out in Annex 2 of this report.

<sup>62</sup> See OP 2.30 – Development Cooperation and Conflict, January, 2001.

<sup>63</sup> World Bank (2003). “*Breaking the Conflict Trap: Civil War and Development Policy.*”

<sup>64</sup> IDA (2003). “*IDA’s Performance Based Allocation System: Current and Emerging Issues.*”

**Figure 9: Allocations to Post-Conflict IDA countries**



64. **Post-Conflict Performance Indicators.** These exceptional post-conflict allocations are provided on the basis of Post Conflict Performance Indicators (PCPI) (see Annex 1 for PCPI criteria) and portfolio performance ratings where available. In some respects, the PCPI indicators cover the same areas as the CPIA, although the expected performance is less ambitious. In addition, the PCPIs measure progress in areas that are critical for transition processes but are not captured in the CPIA – security, demobilization and reintegration of ex-combatants, political and reconciliation processes, and reintegration of displaced populations. PCPI ratings are used to set the allocation levels using the following table as a guideline, which was put in place at the IDA13 Mid-Term Review (see Table 5).

Post-Conflict Performance Indicator (PCPI)	Allocation Maximum (\$ per capita per annum)
2.0 to 2.5	3.4
2.5 to 3.0	6.0
3.0 to 3.5	8.5
3.5 to 4.0	11.9
4.0 to 4.5	14.4
4.5 to 5.0	17.0

65. **Determining allocations in the phase-out period.** As mentioned in paragraph 63, exceptional allocations are provided for a period of seven years. For the first four of the seven years, the level of exceptional allocation is determined based on the table above.<sup>65</sup> In the

<sup>65</sup> In addition to the table above, allocations in the first year to post-conflict countries involve some judgment based on: (i) prospects of peace, (ii) country needs, capacity and resources, (iii) government commitment to

remaining three years, exceptional allocations are gradually phased down to the levels determined by IDA's PBA formula. To calculate allocations during each year of the phase-out period, the post-conflict premium (calculated as a difference between allocations computed using the PCPI and those computed using the PBA formula) is gradually reduced. The country is allocated the PBA amount plus three-fourths of the post-conflict premium in the first phase-out year. In the second phase-out year, it receives the PBA amount plus half the post-conflict premium and in the third phase-out year, it receives the PBA amounts plus one-fourth of its post-conflict premium and finally reaches PBA allocations in the fourth year at the end of the phase-out period.

66. **Looking ahead.** With respect to post-conflict allocations, three areas for improvement have been identified. These include the need to: (i) link post-conflict allocations to changes in the overall size of the IDA envelope; (ii) strengthen the review process of PCPI ratings and prepare for eventual disclosure; and (iii) lengthen the duration of post-conflict allocations. Each of these is discussed below.

67. **First, link post-conflict allocations to changes in size of IDA envelope.** When the size of IDA replenishment changes between replenishment periods, allocations of all PBA-driven countries are affected. However, since post-conflict allocations are based on a fixed conversion table, their allocations are not affected by changes in the overall IDA envelope. So if the size of a replenishment were lower, post-conflict countries would still be allocated the same per capita allocations as determined by the table above, thus reducing the envelope available for the remaining countries. Therefore, the share of post-conflict allocations in the total IDA envelope would increase relative to that of PBA-driven countries. The opposite is true if the replenishment size were to increase. This raises issues of equity of treatment compared to the rest of the IDA countries, especially in comparison to the capped-blend countries, whose low per capita allocations – determined as a share of the total IDA envelope – vary with the size of the replenishment.

68. Management proposes modifying the post-conflict allocations to account for changes in the overall envelope. For example, if the PBA envelope increases by 20 percent, overall post-conflict allocations would be revised upwards by the same proportion. This would ensure that the share of post-conflict countries relative to the PBA countries does not change (unless countries enter or leave the post-conflict pool in which case the overall share going to post-conflict countries would be adjusted accordingly). The post-conflict countries would compete for this share based on performance as measured by their PCPI.<sup>66</sup>

69. **Second, strengthen review of PCPI ratings and prepare for eventual disclosure.** Although a large volume of IDA resources are allocated based on PCPI ratings, they receive

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sustainable development, and (iv) moral hazard considerations. For more detail, see IDA13 Deputies report (page 49) as well as Attachment I (page 52).

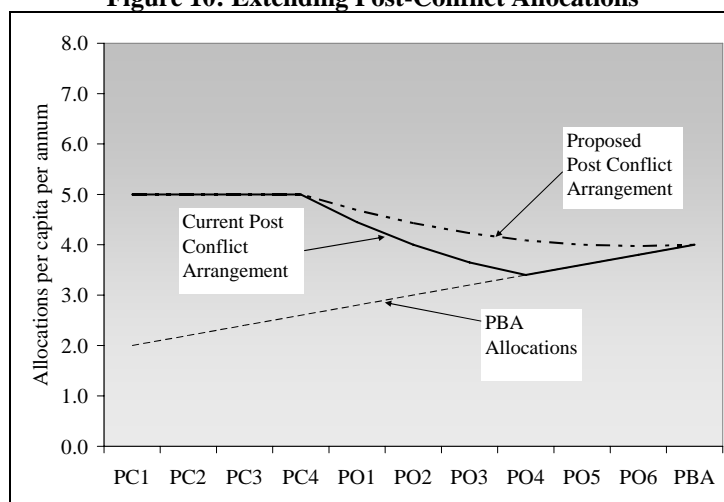
<sup>66</sup> For example, assume an overall replenishment of SDR100 million, of which post-conflict allocations account for SDR20 million. So the share of post-conflict countries is 20 percent. Now assume that the overall replenishment doubles to SDR200 million. To ensure that the increase in the replenishment size is distributed equitably, the share of post-conflict allocations must also be doubled to SDR 40 million, for which the post-conflict countries would compete based on their PCPI.

relatively less scrutiny than the CPIA ratings. To enhance the robustness of PCPI ratings for the purpose of IDA resource allocation, Management proposes the following:

- *Strengthen the internal review process.* The PCPI ratings exercise would be strengthened through an enhanced World Bank-wide review similar to the current CPIA process. Since the CPIA and PCPI share some similar criteria, Management will also seek better coordination of the two processes.
- *Prepare for eventual disclosure.* As was done with the CPIA during IDA14, an external panel should be set up to review the PCPI ratings and methodology. Such a review by an external panel to check the robustness of the ratings could precede eventual disclosure of PCPI (either externally or to the Board for information) by the end of the IDA15 period.

70. **Third, lengthen the duration of exceptional post-conflict allocations.** Since post-conflict allocations are designed to be exceptional and above the PBA norms, there will inevitably be a drop in allocations as they are phased out to reach PBA norms. However, the current three year phase-out period results in a relatively sharp drop-off in IDA allocation, which can be disruptive for country programs – an issue that a number of country teams have highlighted as a cause for concern. Extending the phase-out period would thus help to prevent sharp reductions in IDA assistance. Apart from implementation experience, current emerging research also suggests that exceptional post-conflict allocations should be provided for around ten years to increase the chances of reinforcing economic recovery in these countries.<sup>67</sup> In light of this, management proposes extending the duration of exceptional allocations up to ten years by doubling the phase-out period from three to six years. See Figure 10.

**Figure 10: Extending Post-Conflict Allocations**

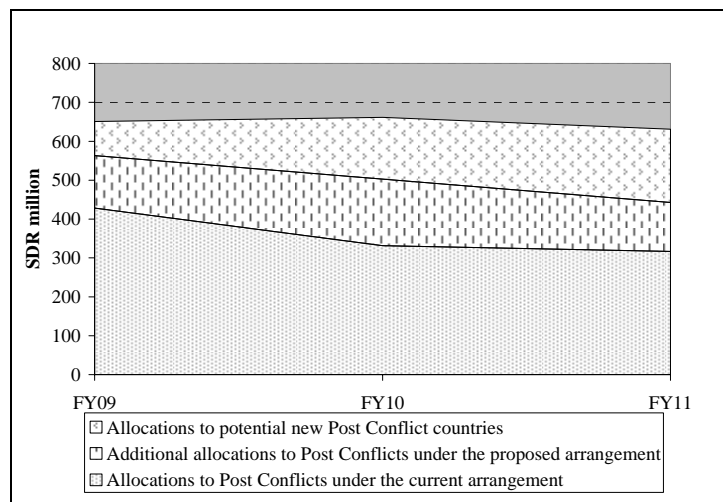


71. **Impact of the proposed change.** A simulation shows that the cost of increasing the phase-out period from 3 to 6 years implies an additional SDR 430 million during the IDA15

<sup>67</sup> For example, Collier and Hoeffler (2003) argue in their paper “*Aid, Policy and Growth in Post-Conflict Societies*” that “...the pattern of aid disbursements should probably rise during the first four years and gradually taper back to normal levels by the end of the first *post-conflict decade* [emphasis added].”

period for countries currently eligible for post conflict allocations.<sup>68</sup> Potential new entrants into this window could add a further SDR430 million (Figure 11), assuming that there is a 50 percent probability that Sudan will re-engage during IDA15.

**Figure 11: Impact of the Proposed Change**



72. **Early graduations.** While management proposes extending post conflict allocations to up to ten years, under certain circumstances, countries would revert to regular PBA allocations before the end of the ten-year period. These circumstances would include, for example, (i) attaining “gap” country status, which would mean that per capita income would have exceeded IDA’s operational cutoff; (ii) attaining “blend” country status, which would suggest creditworthiness and access to other sources of financing; or (iii) violation of IDA’s non-concessional borrowing policy.

73. In IDA15, it is proposed that the following changes for post-conflict allocations would be made:

- Link the share of post-conflict allocations in overall allocations to changes in the overall replenishment size.
- Extend the phase-out period for post-conflict allocations from 3 to 6 years, without reducing the post-conflict premium, bringing the duration of exceptional post-conflict allocations up to 10 years.
- Retain additional flexibility in deciding post-conflict allocations in the first year as agreed during the IDA13 Replenishment discussions.
- “Graduate” some post-conflict countries earlier than 10 years based on criteria described above.
- Tighten existing review process for PCPI and appoint an external panel to review the PCPI ratings and to prepare them for eventual disclosure.

<sup>68</sup> Assuming that IDA15 envelope is the same as IDA14 envelope in nominal terms.

### **B3. Countries Re-engaging with IDA after a Prolonged Period of Inactivity**

74. ***Ring fencing exceptional allocations.*** To avoid undermining IDA's PBA system, Deputies had previously limited access to IDA resources outside the PBA only to exceptional post-conflict allocations. The IDA13 Replenishment report clearly stated that "this access needs to be properly ring-fenced with eligibility criteria so that perennial poor performers with some record of conflict can be distinguished from countries that are making a determined effort to emerge from a protracted and highly destructive conflict" (see Annex 2 of the IDA13 report).

75. ***Current financing arrangements.*** During the IDA14 Replenishment discussions, an additional exception to the PBA was introduced for countries re-engaging with IDA after a prolonged period of inactivity. The IDA14 policy framework provided for these exceptional allocations to last for a period up to three years. According to the IDA14 Replenishment Report,<sup>69</sup> "additional allocations may be provided on a one-time basis to countries that are in the process of re-engaging with IDA after a prolonged period of inactivity on the basis of a strong transition plan with concerted donor support. This exception will be used after all other options have been exhausted, and its use is expected to be very limited in the IDA14 period. The level of resources made available will be less than what is typically provided under the post-conflict allocation system, and the duration of exceptional allocations will not exceed two years, with one further year's support possible subject to strong performance" (page 48).

76. To date, Haiti and the Central African Republic have received such "re-engagement" allocations. On per capita terms, the financial assistance provided under the IDA14 clause has been between three to five times their PBA allocations. During the IDA15 period, management estimates that two more countries, Togo and Zimbabwe, could access exceptional re-engagement financing allocations. A third potentially eligible country, Myanmar, is not likely to engage during the IDA15 period. In view of the requirement for eligibility that there has to be a prolonged period of inactivity, management does not consider it likely that other countries would be eligible during IDA15.

77. ***Looking ahead.*** Three gaps have been identified in the current financing arrangements for countries re-engaging with IDA after a prolonged period of inactivity. *First*, the criteria for eligibility need to be elaborated. *Second*, the additional resources directed to these countries were determined flexibly during the pilot phase in IDA14. Clearer guidelines for determining the size of exceptional allocations have to be established. *Third*, experience has shown that the drop in going from exceptional allocations over the three year period back to an allocation determined solely by the PBA has been sharp.

78. Management proposes sharpening the criteria for qualifying for this window, establishing clearer guidelines for top-off amounts, and extending the duration of exceptional allocations up to 5 years.

79. ***Sharpening the eligibility criteria.*** Eligibility criteria for exceptional allocations under the re-engagement window include: (i) evidence of partial collapse of the state, but ineligible for

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<sup>69</sup> IDA(2005). "Additions to IDA Resources: Fourteenth Replenishment. Working Together to Achieve the Millennium Development Goals."

IDA post-conflict assistance; (ii) existence of a strong transition plan supported by concerted donor support, (iii) and disengagement from IDA for a *prolonged period* and accumulation of *sizeable* arrears to the World Bank Group. With respect to the timing of re-engagement, as with post-conflict countries, all relevant World Bank policies would apply<sup>70</sup> and eligibility is not automatic. The continuation of exceptional support through this window would be predicated on evidence of improvement in performance.

80. ***Establishing guidelines for determining lending volumes and duration.*** Countries that qualify for this window often experience social and economic deterioration, although of smaller magnitude and intensity than the one experienced in post-conflict countries. Management proposes that the allocation to these countries be made using the PCPI using Table 5, but halving the per capita amounts at each level of the PCPI ratings.<sup>71</sup> At the same time, because of the lower intensity of crisis, Management proposes to limit the exceptional treatment up to five years, including two years of exceptional allocations and three years of phase out to normal PBA allocations by the sixth year.<sup>72</sup> This would require an additional SDR110 million during IDA15, assuming Togo and Zimbabwe re-engage.

81. In IDA15, it is proposed that the following changes for countries re-engaging with IDA after a prolonged period of inactivity would be made:

- Sharpen the eligibility criteria and determine lending volumes based on PCPI, but halve the per capita amounts at each level of the PCPI rating.
- Provide exceptional allocations for a period of five years, including two years of exceptional assistance and three years of phase out to reach PBA allocations by the sixth year.
- Retain some additional flexibility in deciding allocations in the first year.
- Continue to “graduate” some countries earlier than 5 years, if performance is not improving as mentioned in the IDA14 Replenishment report.

#### **B4. Countries in Non-Accrual Status**

82. ***Unable to access IDA resources.*** World Bank policies do not allow provision of regular IDA financing to countries while they are in non-accrual status.<sup>73</sup> However, countries in non-accrual status need to be supported in limited ways that are carefully tailored to their specific circumstances. These countries can access limited grant financing from the Post Conflict Trust Fund and the LICUS Trust Fund, as well as through donor-financed trust funds.

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<sup>70</sup> For a more detailed discussion of applicable Bank policy see IDA (2007). “*Further Elaboration of a Systematic Approach to Arrears Clearance.*”

<sup>71</sup> Note that the countries that qualify for such re-engagement allocations could also qualify for exceptional support for arrears clearance.

<sup>72</sup> As in the case of post-conflict allocations, allocations to re-engaging countries could involve some judgment in the first year based on the relevant factors described in footnote 65.

<sup>73</sup> Loans and credits are placed in non-accrual status when the oldest payment arrears are six months overdue – that is, when the second consecutive payment is missed on the loan/credits with the oldest arrears. In order to be eligible for new credits/grants, the country concerned must clear all payment arrears in full. Once all arrears are cleared, all loans/credits to, or guaranteed by, the country are generally restored to accrual status.

83. **Re-engagement imminent?** Furthermore, once a credible window of opportunity for peace materializes, IDA can provide limited grant financing even before arrears are cleared and the country is restored to accrual status. Such grant funding is subject to a number of conditions and has only been available to countries that are eligible for exceptional post-conflict IDA allocations.<sup>74</sup> To date, Afghanistan, the Democratic Republic of Congo and Liberia have received such pre-arrears clearance grants.

### **C. Implications of the Proposed Changes on Overall Shares of IDA Resources**

84. Under the proposed modifications, an additional four percent of overall IDA resources are expected to be redirected to post-conflict and re-engaging countries from the PBA pool. Of this four percent, two percent is due to the reactivation of Cote d'Ivoire, Liberia and Sudan (with a 50 percent probability), and is unaffected by changes in the duration of the phase out period. This redirection of resources would happen regardless of the proposed changes to the post conflict arrangements. Therefore, the real additionality comes from the two percent attributable to the extension of the post conflict phase out period for the existing countries.

85. The financing requirements associated with proposed modifications in post-conflict and re-engagement allocations<sup>75</sup> add to the IDA15 financing requirements as mentioned in the accompanying paper entitled, *"The Demand for IDA15 Resources and Strategy for their Effective Use."* As discussed in section 1.7 of that paper, without the proposed increase in IDA15 commitment authority, the implementation of these changes will not be feasible as it would take away resources from the PBA pool.

### **V. THE ROLE OF TRUST FUNDS IN FRAGILE STATES**

86. Trust funds of various types have grown into a significant source of support for fragile states in recent years, and have become an important tool for rapidly scaling up donor support, particularly in post-conflict settings. While the bulk of the World Bank's support for fragile states as a group continues to be channeled through IDA, in some fragile states donor resources are channeled through World Bank-managed trust funds. This is especially notable in Afghanistan, which receives the bulk of the aggregate resources for fragile states, and also in countries where IDA activities are constrained by the presence of arrears, such as Sudan. The trust funds are often used to finance recurrent costs and therefore complement IDA's financing that primarily focuses on financing crucial investment expenditures (e.g. in Afghanistan).

87. Over the past five years, contributions to trust funds aimed at fragile states have seen a six-fold increase, from \$136 million in FY02, to \$821 million in FY06 (see Table 6). There has been a parallel growth in disbursements, which rose from \$130 million in FY02 to \$679 million in FY06, to an aggregate five year total of over \$2.2 billion. The bulk of these resources were channeled through so-called Recipient Executed Trust Funds (RETFs) which, like regular IDA operations, enable recipients to execute or spend resources on various development activities

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<sup>74</sup> IDA (2005). *"Additions to IDA Resources: Fourteenth Replenishment. Working together to achieve the Millennium Development Goals."* Paragraph 75, p. 27.

<sup>75</sup> If the proposed changes are accepted and the anticipated IDA15 financing under the base scenario materializes, then consideration would be given to modifying the FY08 allocations (final year of IDA14) of the affected countries after notifying the Board.

including investment and recurrent expenditure to meet service delivery, capacity building, and technical assistance needs.

88. While RETFs for fragile states can be linked explicitly to a specific IDA operation, they are increasingly being designed as free-standing funds. They can also be single or multi-donor in nature; during FY02-06, the bulk of disbursements (nearly 70 percent) were channeled through multi-donor or pooled arrangements. The Afghanistan Reconstruction Trust Fund (ARTF) is by far the largest of the multi-donor trust funds (MDTFs) that support fragile states, having received by April 2007 nearly \$1.8 billion of contributions from 27 bilateral donors.

**Table 6: Trust Fund Contributions to Fragile States (\$ millions)**

<b>Trust Fund Name</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>Total</b>
Afghanistan Reconstruction Trust Fund	41	230	280	449	363	1,363
West Bank and Gaza - Non IBRD Funded	6	34	73	181	120	414
Iraq Reconstruction Trust Fund	0	0	220	52	53	325
Multi-donor Trust Fund for Government of South Sudan	0	0	0	0	167	167
West Bank and Gaza - IBRD Funded	0	13	80	0	0	93
Trust Fund for Timor-Leste - Bank Executed	51	9	0	15	5	80
Multi-donor Trust Fund for North Sudan	0	0	0	0	73	73
Low Income Countries Under Stress Trust Fund	0	0	25	0	26	51
Post-Conflict Trust Fund	8	9	9	8	8	46
Other	37	7	4	1	13	63
<b>Total</b>	<b>136</b>	<b>293</b>	<b>683</b>	<b>697</b>	<b>821</b>	<b>2,630</b>

89. The flexibility that trust funds offer makes them an important complement to the support that donors deliver to fragile states through IDA. They allow for one or more donors to concentrate and scale up support to selected countries. Furthermore, through trust funds, donors have a cost-effective tool for supporting countries they otherwise may not have been able to support, or could support only at a much greater cost. Trust funds also allow donors to take advantage of the World Bank's expertise in terms of country dialogue, policy advice and project preparation. The risks to donor resources are also reduced through the World Bank's high fiduciary standards and experience in project management. Lastly, trust funds, and especially MDTFs, offer a way to reduce the tax of donor assistance on local capacity by facilitating the channeling of many streams of donor funds through one mechanism. Also see Box 7.

90. In terms of the effectiveness of support for fragile states delivered through multi-donor trust funds, a recent review of post-crisis multi-donor trust funds concluded that MDTFs are important for resource mobilization, policy dialogue, risk and information management in difficult settings.<sup>76</sup> While the performance of individual MDTFs has varied, the review concluded that on the whole the World Bank has managed budget support and large scale

<sup>76</sup> See "Review of Post-Crisis Multi-Donor Trust Funds." Final Report, February 2007. The review was commissioned by the World Bank and Norway, and supported by Canada, UK and the Netherlands. It assessed experience with 18 MDTFs, of which 13 were administered by the Bank and five by the UN.

projects well. Off-budget and small-scale projects, which represent only a small share of the overall MDTFs, have, on the other hand, generally taken too much time to approve and fund. The review notes that there is now an emerging consensus on "good practice" in design and implementation, and that given the high-risk, high-cost environments in which they operate, MDTFs require flexible and adequate funding from donors. The review recommended that the World Bank adapt its procedures for post-crisis support to avoid delays and increase staffing in the field in countries with MDTFs; the World Bank has responded to this through the new rapid response policy and fragile states staffing strategy.

**Box 7: Examples of Multi-Donor Trust Funds for Fragile States**

- *The Afghanistan Reconstruction Trust Fund (ARTF)* was established in May 2002 to serve as a coordinated financing mechanism for the Government's recurrent budget and priority reconstruction programs and projects. To date, ARTF has successfully mobilized \$1.8 billion in grant contributions from 27 bilateral donors; \$1.5 billion had been disbursed as of April 20, 2007. There were 10 ongoing investment projects with a combined allocation of \$419 million, of which \$327 million had been disbursed. To enhance strategic use of resources, the Government has prepared and is using a medium-term fiscal framework to underpin resource allocations for priority programs. A Monitoring Agent helps ensure proper fiduciary management. Recently ARTF donors and the government have agreed on a results framework (the Performance Assessment Matrix) and associated strategic dialogue process to further enhance the effectiveness and impact of this trust fund.
- *Sudan Multi-Donor Trust Funds:* Following the peace agreement, two funds, to be administered by the World Bank, were set up to facilitate the coordination of external donor financing of Sudan's reconstruction and development needs – one for the new Government of National Unity for war-affected areas in the north and transition zones, and the other for the Government of Southern Sudan. To date, \$540 million has been committed to the two MDTFs, and \$282 million has been paid in, including \$10 million from the World Bank's net income. Eleven Grant Agreements have been signed, worth \$146 million. Co-financing by Government leverages an additional \$195 million. After a slow start, disbursements are now \$55 million.
- *The Great Lakes Multi-Country Demobilization and Reintegration Program (MDRP)* was established in 2002 and provides support to national governments to implement national demobilization and reintegration programs (DRPs) in nine countries in central and southern Africa. The objectives of the Trust Fund include (i) providing a regional framework for demobilization, reinsertion and reintegration efforts; (ii) establishing a single mechanism for donor coordination and resource mobilization; and, (iii) serving as a platform for national consultative processes that lead to the formulation of national DRPs. As of September 2006, the Trust Fund had mobilized a total of \$ 650 million, 65 percent of which was already disbursed.

91. **World Bank-financed trust funds for fragile states:** The World Bank also provides resources for fragile states through single and multi-country trust funds financed from IBRD's income. Such trust funds are intended to be complementary to the support provided through IDA, by financing countries and purposes for which IDA resources cannot be used, for example because of the presence of arrears. Furthermore, resources from the Low Income Countries Under Stress trust fund (LICUS TF) and the Post-Conflict Fund (PCF) can be deployed rapidly.

- *The LICUS TF*, which was established in March 2004, targets its financial assistance mainly to countries in non-accrual status, and to those where IDA funds cannot be used easily used in a timely manner to support the objectives of the trust fund. The main objectives of this trust fund are to: (a) support early policy and institutional reform to improve performance and facilitate reengagement with the international community; (b) develop resilient systems for social service delivery that can continue to operate effectively even in situations of political instability; (c)

develop harmonized multi-donor approaches that combine scarce resources behind a selective strategy for reform; and (d) promote the delivery of visible results in support of peace-building efforts.<sup>77</sup> To date, the LICUS TF has received \$80 million from IBRD surplus, and \$2 million from bilateral donors. Five fragile states (Central African Republic, Cote d'Ivoire, Haiti, Liberia and Sudan) account for 78 percent of its commitments.

- *The PCF* was established in FY98 to help deepen understanding of conflict-affected countries and provide appropriate assistance. Grants from the PCF tend to be relatively small and support diverse, often community-based activities. The cumulative resources of the PCF since inception total \$90.3 million, including \$8.7 million donor contributions. About half of the 40 middle and low income countries covered by the PCF are fragile states; they account for 56 percent of grants. Five countries (Afghanistan, Burundi, Haiti, Somalia and Sudan) account for 51 percent of total grants approved for fragile states.

<b>Box 8: LICUS Trust Fund Results</b>	
<b>Haiti (\$6.5 million)</b>	
<u>Visible results</u>	<ul style="list-style-type: none"> <li>▪ 200,000 person-days of employment through labor-intensive works program;</li> <li>▪ Daily school feeding for more than 25,000 poor children, including Cite Soleil;</li> <li>▪ Three rural water systems rehabilitated; and</li> <li>▪ 44 community sub-projects executed successfully.</li> </ul>
<b>Liberia (\$4.7 million)</b>	
<u>Institution-building and donor coordination:</u>	<ul style="list-style-type: none"> <li>▪ Supported results-based transition framework for donor coordination, and multi-donor platform for concerted action on governance leading to agreement at UN Security Council;</li> <li>▪ Forestry concession review completed;</li> <li>▪ Public procurement legislation enacted; and</li> <li>▪ Financial management training unit established</li> </ul>
<u>Visible results:</u>	<ul style="list-style-type: none"> <li>▪ Voinjama-Zor-Zor highway kept accessible during rainy season; and</li> <li>▪ CDD program of more than 30 projects for reconstruction needs of most vulnerable population.</li> </ul>
<b>Central African Republic</b>	
<u>Institution-building and donor coordination:</u>	<ul style="list-style-type: none"> <li>▪ Development of results-based transition matrix;</li> <li>▪ Code of Conduct for domestic political stakeholders during elections, developed through UN/World Bank convened leadership seminars;</li> <li>▪ Audit of payroll completed; and</li> <li>▪ Treasury account systems upgraded.</li> </ul>

92. These funds play a particularly critical role in laying the basis for IDA's re-engagement in countries in non-accrual. Programs under the LICUS Trust Fund in non-accrual countries are integrated, generally covering both visible results in support of peace-building and longer-term institution building and governance components. Significant results have been achieved through the Fund with relatively small financial allocations (Box 8). In line with the consolidation of capacity between the Conflict Prevention and Reconstruction unit and Fragile States Group, management also intends to bring the LICUS TF and PCF within a more unified framework.

<sup>77</sup> These activities will include, for example, rapid labor-intensive employment initiatives in conflict-affected areas. Moreover, all activities in support of peace-building will be consistent with the Bank's Articles of Agreement and applicable Bank policies and guidelines.

Active IDA LICUS countries are eligible for assistance for small and urgent activities not easily funded under regular IDA credit or grant operations. Consequently, challenges also arise with the use of the LICUS TF in such countries due to demands for support to stabilize transition situations in fragile sub-national areas (e.g. Mindanao, Caucasus) and to support new government reform initiatives (e.g. Guinea, Guinea-Bissau, Nepal).

93. The World Bank has also provided substantial support for individual countries emerging from serious conflict. It used IBRD surplus to support recovery and reconstruction efforts in Kosovo, Sudan, Timor-Leste and Liberia.

94. In conclusion, the World Bank's and the international community's efforts to assist fragile states have been significantly strengthened by the recent scaling up of trust fund support. MDTFs in particular play a useful and cost-effective role in channeling donor resources in ways that take advantage of the synergies that the World Bank can provide while also reducing the tax on scarce recipient capacity. Trust funds financed through IBRD surplus also play a useful and complementary role to IDA financing, by allowing for the rapid deployment of resources to support small scale efforts in countries in arrears, or in the early phases of re-engagement.

## VI. CONCLUSION

95. Fragile states and situations are difficult environments most importantly for national reformers struggling to bring about peace, improved governance and protection of the population but also for the staff of the World Bank and other donor agencies who work to support them under difficult conditions. The risks of engagement in these contexts will not go away – these are environments where development programs will always be vulnerable to periodic setbacks. But the rewards of prudent engagement are worth the risk: these are also the environments where well-designed development assistance can really make a difference.

96. IDA focuses on its comparative advantage in different types of fragile situations by differentiating assistance strategies and its role to the direction and pace of governance change. Within this framework, IDA has a significant contribution to make: by building on its traditional strengths in economic governance, public finance management and service delivery to weak capacity environments; and by tailoring its financing assistance and technical expertise to work with other partners in support of peace-building goals. Division of labor between IDA and other donors will and should continue to be determined at the country level, taking into account country-specific priorities, capacities, and the contribution of other donors. In this regard, the World Bank's partnership with the UN in fragile states has strengthened significantly in recent years, and will be further bolstered by the adoption of a common recovery planning process and agreed fiduciary framework for collaboration in post-crisis situations.

97. Internally, the World Bank also faces many implementation challenges in making its new policy, procedural and organizational approaches a reality on the ground. Continued strong management attention, guidance and operational support to staff working in these difficult environments; adjusting approaches and analyzing lessons learned; and enhancing human resource systems are all central to full realization of IDA's strengths and ability to develop partnerships to assist this most vulnerable group of partner countries.

98. IDA's financial support to fragile states has also been differentiated. The majority of countries have been provided IDA allocations under the PBA system; a small number of post-conflict and re-engaging countries have benefited from exceptional levels of support for transitional periods; and countries which are in non-accrual have benefited from the LICUS and Post-Conflict Trust Funds. IDA's focus on achieving and maintaining debt sustainability has substantially benefited fragile states both through the HIPC/MDRI debt relief as well as through the provision of grants under IDA13 and IDA14. There is potential to smooth the transition for post-conflict and re-engaging countries and to improve transparency and disclosure of the PCPI indicators that underpin the exceptional allocations to better address their needs.

## **Annex 1. Post Conflict Performance Indicators**

99. The PCPI ratings assess countries on four major areas: (i) Security and reconciliation, (ii) Economic recovery, (iii) Social inclusion and social sector development, and (iv) Public sector management and institutions.

<p><b>A) Security and Reconciliation</b></p> <ul style="list-style-type: none"><li>1) Security</li><li>2) Reconciliation</li><li>3) Disarmament, Demobilization and Reintegration</li></ul> <p><b>B) Economic Recovery</b></p> <ul style="list-style-type: none"><li>4) Fiscal and Monetary Policies, Debt and Inflation</li><li>5) Trade and Foreign Exchange Policies and Private Sector Environment</li><li>6) Management and Sustainability of National Recovery Program</li></ul> <p><b>C) Social Inclusion and Social Sector Development</b></p> <ul style="list-style-type: none"><li>7) Reintegration of displaced populations</li><li>8) Building Human Resources</li><li>9) Social Cohesion, Non-Discrimination and Human Rights</li></ul> <p><b>D) Public Sector Management and Institutions</b></p> <ul style="list-style-type: none"><li>10) Fiscal and Budgetary Management and Efficiency of Revenue Mobilization</li><li>11) Re-establishing Public Administration and Rule-Based Governance</li><li>12) Transparency, Accountability and Corruption in the Public Sector</li></ul>
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100. In addition to the PCPI ratings, IDA allocations also depend on portfolio performance ratings, where available.