IDA14

Supporting Small and Vulnerable States

International Development Association
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Table of Contents

Abbreviations and Acronyms

AAA	Analytical and Advisory Activities
AIDS	Acquired Immune Deficiency Syndrome
BB	Bank Budget
CAS	Country Assistance Strategy
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
CPIA	Country Policy and Institutional Assessment
EAP	East Asia and the Pacific
ESW	Economic and Sector Work
GEF	Global Environment Facility
HIV	Human Immunodeficiency Virus
HR	Human Resource
IBRD	International Bank for Reconstruction & Development
IDA	International Development Association
IDF	Institutional Development Fund
IMF	International Monetary Fund
LCR	Latin America and the Caribbean
LICUS	Low-Income Countries Under Stress
MDTF	Multi-Donor Trust Fund
PER	Public Expenditure Review
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WB	World Bank
WTO	World Trade Organisation

Supporting Small and Vulnerable States

I. Introduction

1. At their October 2004 meeting, IDA Deputies requested information on the adequacy and relevance of Bank assistance to small and vulnerable states, as these tend to have limited lending programs but at the same time need high-quality and extensive analytical advice and technical assistance. This note responds to that request by first reviewing issues in assisting small states (covering all small developing countries) and then focusing on a group of low-income, particularly vulnerable small states. The recommendations listed in the final section provide some options for enhancing the level of support offered to these states.

II. Background

2. ***Small States Overview***. Forty-five developing World Bank member states are "small,"[1] accounting for nearly one third of the total number of developing countries. There are small states in every geographic region, but most of them fall into three main groups: Africa (14 countries), Caribbean (13 countries), and the Pacific (11 countries). Together, the small states are home to 29 million people, 0.5 percent of the total population of developing countries. Their sizes differ greatly, from the seven smallest "micro-states" with fewer than 100,000 people each (Antigua & Barbuda, Dominica, Kiribati, Marshall Islands, Palau, Seychelles, and St. Kitts and Nevis) to eight countries with more than 1.0 million people (Botswana, Gabon, The Gambia, Guinea-Bissau, Jamaica, Mauritius, Swaziland, and Trinidad and Tobago).

3. ***A Wide Range of Development Status***. The small states differ greatly not only in their size, but also in per capita incomes, even within the groups eligible to borrow from the World Bank. Annex I lists the countries and their status vis-à-vis the Bank:

- Twenty small states are IDA-eligible, with per capita incomes ranging from less than US$600 in several African and Pacific countries (Comoros, The Gambia, Guinea-Bissau, Sao Tome and Principe, Solomon Islands, and Timor-Leste); to US$700-US$1,500 in such countries as Cape Verde, Guyana, Kiribati, Maldives, and Vanuatu; to more than US$3,300 in four blend borrowers (Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines).[2] All IDA-eligible small states are considered vulnerable, and referred to in this paper as small and vulnerable states.

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1 The World Bank does not have a formal category of small states. Among the World Bank's forty-five developing and transition member countries referred to above, forty-one have populations of 1.5 million or less. In addition, Botswana, Jamaica, Lesotho, and Namibia participated in the work of the Small States Task Force in 1998-2000, although their populations are above 1.5 million (see *Small States: Meeting Challenges in the Global Economy*, Commonwealth Secretariat/World Bank Joint Task Force report, April 2000, available at www.worldbank.org/smallstates).

2 Since 1985 IDA has accorded special treatment to small island economies which have per capita incomes above the IDA eligibility cut-off but have no or very limited creditworthiness, which limits or precludes access to IBRD borrowing; nine small island states currently have access to IDA under the small island exception.

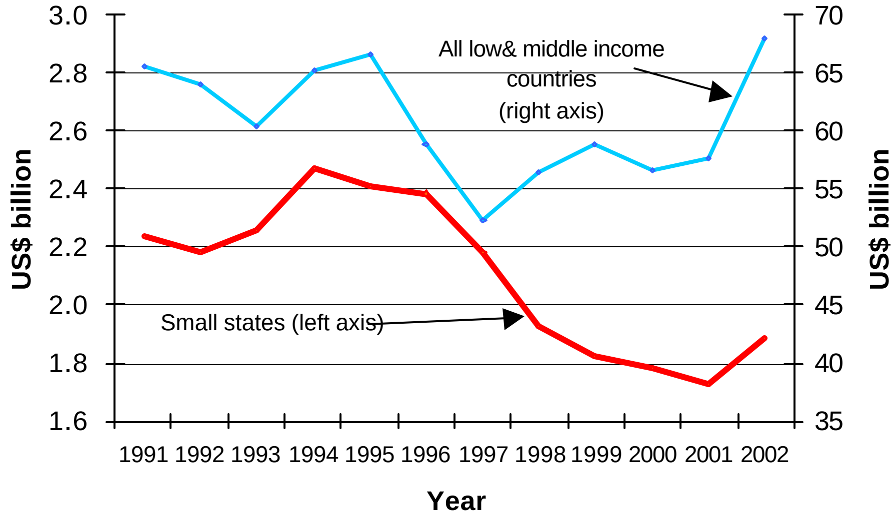
- Eighteen small states are IBRD-only borrowers, with per capita incomes ranging from just US$1,350 (Swaziland, near the IDA historical threshold) to more than US$7,000 in Palau, Seychelles, and Trinidad and Tobago).
- Seven of the forty-five small states do not have Bank borrower status (Bahrain, The Bahamas, Barbados, Brunei, Cyprus, Qatar and Malta).
- Among the IDA-eligible states, six are low-income countries under stress (LICUS) – i.e., countries that have weak policy and institutional performance. They consist of: Comoros The Gambia, Guinea-Bissau, Sao Tome and Principe, Solomon Islands, and Timor-Leste. In addition one of the IBRD countries (Equatorial Guinea) is also classified as LICUS. This group of seven countries is referred to in this note as the set of **small LICUS states.**

4. ***Common Characteristics of Small States.*** Small states face a number of well-known obstacles – because their economies tend to be undiversified and highly dependent on external trade, they are more vulnerable to economic shocks and have significantly more volatile growth rates than larger countries. In addition, the LICUS small states are characterized by fragility as a result of weaker governance, in several cases conflict, and (sometimes) a natural resource "curse." Many small states, including the vulnerable ones, are also prone to natural disasters (such as tropical storms and rise in sea level). Finally, the small LICUS states appear to face particular difficulties in sustaining support from donors.

5. ***Official Development Assistance Flows to Small States***. Although small states as a group are well aided relative to their population size, the sub set of the most vulnerable (i.e., the small LICUS states) experience more difficultly in mobilizing assistance. Compared to other developing countries, small states receive high levels of aid in per capita terms (Annex I): on average, they received US$178 per capita annually in 2001-02, compared to an average of US$11 per capita received by low-income countries. The small LICUS states, however, received on average about US$107 per capita in the same year. Official development assistance to small states has fallen in recent years – from a peak of US$2.5 billion in 1994 to less than US$2.0 billion annually in 1998-2002. While overall aid flows have recovered since 1998, this recovery has bypassed the small states (Figure 1). The decline has affected small states in all regions except Europe but it has been most pronounced and persistent in Africa and the Caribbean (Figure 2). Again, comparing these figures with those of the small LICUS states one finds that the latter have suffered an even greater decline: excluding Timor-Leste their total aid has fallen from US$581 million in 1991-92 to US$242 million in 2001-2002.[3] In most small states, the bulk of aid is from bilateral donors, with multilateral donors playing a significantly smaller role than in larger countries.

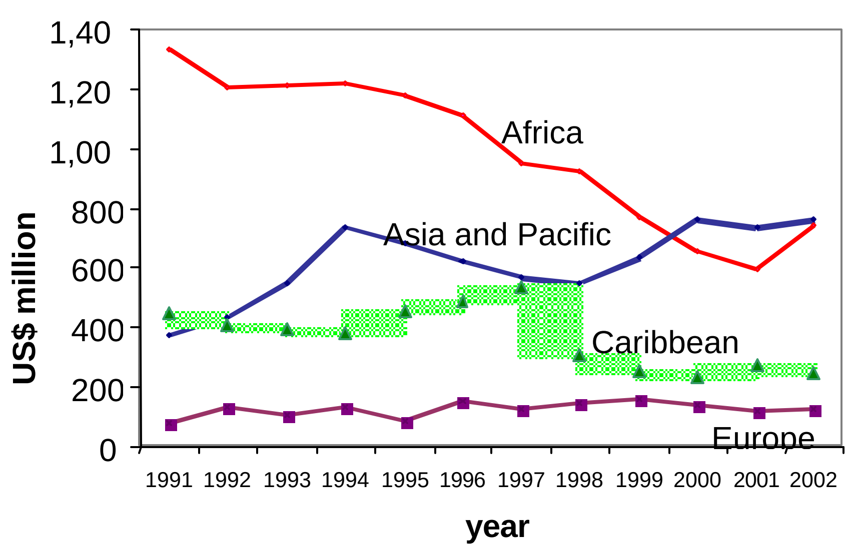
[3] Timor-Leste only started receiving aid in 2001-2002.

Figure 1: Small states have not yet benefited from recovery of ODA



Source: The World Bank based on OECD DAC data.

Figure 2: Trends in aid flows to small states



Source: The World Bank based on OECD DAC data

6. ***Small States Task Force Report Agenda.*** In 2000, the Development Committee as well as the Commonwealth Heads of Government welcomed the report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States and its recognition of the common characteristics of small states and the challenges they pose to their economic and social development. The Task Force set out a focused agenda for: (i) tackling economic volatility, vulnerability, and natural disasters; (ii) strengthening public and private sector capacity; (iii) dealing with issues of transition to the changing global trade regime; and (iv) examining new opportunities and threats from globalization. To help ensure that the agenda continues to receive adequate attention in the international community, the World Bank committed to hosting a Small States Forum each year on the occasion of the World Bank Group/IMF Annual Meetings. The Forum provides an opportunity for representatives of the 45 participant small states and six main partner institutions – Commonwealth Secretariat, European Union, IMF, UNCTAD, World Bank, and WTO – to exchange information and ideas, assess progress on the Task Force report agenda, and set priorities for future work. Since 2000, the Bank has hosted four Forums and prepared annual progress reports on small-state related work programs at the six partner institutions mentioned above. In 2004-05 efforts are underway to strengthen the participation of small states in setting the agenda and consulting on a regional basis to prepare for discussions at future Forums.[4]

7. The following sections detail the levels of World Bank activity in small states, as well as the extent to which these states are accessing resources from Bank-administered Trust Funds and other sources of finance.

III. World Bank Activities in Small States

8. ***Bank Budget.*** While the World Bank's engagement in small states has to be balanced with the competing strong demand from larger countries, the former have slightly increased their share of the Bank Budget in the last four years. During FY00-04, total Bank Budget spending for small countries rose by 33 percent, while total Bank spending across all countries increased by 19 percent. The corresponding AAA (which includes Economic and Sector Work and non-project technical assistance) amounts rose by 49 percent for the Bank as a whole, and by 64 percent for small states. The share of total Bank budget allocations to small states is between 3 and 4 percent; a range that also applies to AAA spending (Table 1). By region, the share of budget allocated to small states is highest in Africa (around 6 percent); and lowest in 'Other Regions' (East Europe, Middle East and North Africa and South Asia), at about 2 percent. It should also be noted that, measured in terms of administrative costs per capita, small states have fared much better than their larger counterparts (Figure 3).[5]

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[4] More information about the Forum as well as the Small States Task Force Report agenda is available at www.worldbank.org/smallstates.

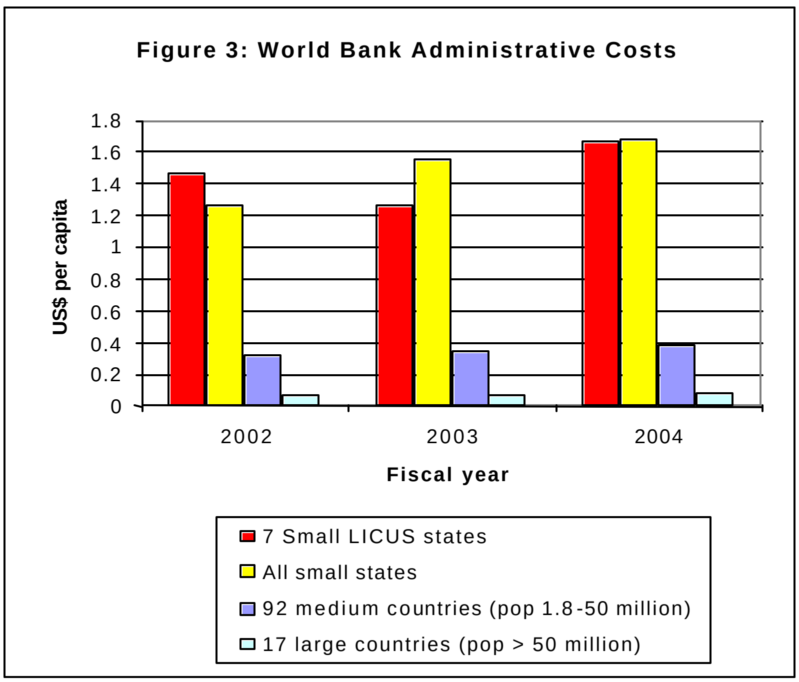
[5] The list of countries included as small states in Tables 1 and 2 and Figure 3 is for countries that have populations of 1.5 million or less **and** where the Bank is engaged in some operations.

9. Compared to the small states as a whole, the seven small LICUS states fared slightly less well, although they also saw an increase in spending: over the period FY00-04, Bank budget expenditures to them increased by 25 percent and expenditure on AAA went up by 21 percent.

Table 1: Small States' Share of Bank Budget Expenditures (%)

		FY00	FY01	FY02	FY03	FY04
Africa	**Total**	**6.7**	**7.7**	**7.1**	**7.0**	**6.8**
	Of which AAA	4.2	5.8	4.2	5.4	6.0
LCR	**Total**	**4.7**	**5.5**	**4.7**	**4.5**	**4.4**
	Of which AAA	2.3	2.5	5.1	4.4	4.7
EAP	**Total**	**4.2**	**5.5**	**4.7**	**4.5**	**4.4**
	Of which AAA	7.0	6.8	6.3	5.0	5.2
Other Regions	**Total**	**1.8**	**1.5**	**1.7**	**1.8**	**2.1**
	Of which AAA	2.5	1.3	1.0	1.4	1.3
All Regions	**Total**	**3.9**	**4.3**	**4.3**	**4.1**	**4.1**
	Of which AAA	3.5	3.6	3.5	3.5	3.9

Note: 'Total' includes AAA, plus expenditures related to lending and project supervision. In each case the figure given is as a percentage of the same category for the region concerned.
Source: The World Bank



Source: The World Bank

10. ***Economic and Sector Work.*** An analysis of ESW for small states in terms of outputs shows that ESW products increased in number from 14 in FY01 to 23 in FY04 (all small states), and from 1 in FY01 to 4 in FY04 (small LICUS states). Increased emphasis on analytical work in LICUS shows through the increased level of core diagnostics per country in LICUS compared

to small states as a whole, despite poor data availability and insecurity in many small and vulnerable states. Nevertheless the number of core diagnostic products completed in the past 5 years in both small states and small LICUS states remain below the average for IDA and IBRD countries (Table 2).

Table 2: Small States and LICUS ESW Outputs

	# ESW products FY 01	# ESW products FY 02	# ESW products FY 03	# ESW products FY 04	Core diagnostics (last 5 yrs)[6]	Average core diagnostics per country
Small States	14	13	28	23	29	1.0
Small LICUS States	1	3	6	4	10	1.4
All LICUS States	-	-	-	-	83	2.5
All IBRD/IDA	-	-	-	-	386	2.7

Source: The World Bank.

11. ***Human Resources*:** Data on Bank field staff show that staffing levels for small states have increased in recent years, from a total of 13 staff in 2000, to 29 in 2004: an increase from 0.5 percent to 1.1 percent of total Bank staff. States covered include Gabon, The Gambia, Guinea-Bissau, Guyana, St. Lucia and Timor-Leste. Timor-Leste (2000), The Gambia (2003), and Guinea Bissau (2002) have had staff located there since 2000; in addition staffing levels have increased in the Sydney office, which oversees the Pacific Islands. Despite the upward trend, however, most small states do not have country offices and are unlikely to warrant them based on the size of current programs. Aside from field staffing levels, a further issue affecting small LICUS states is the relative unattractiveness of working in them, compared to the better performing countries. As was identified in the LICUS Task Force report, weak performing states are challenging environments to work in and require high levels of energy and particular skills in dealing with difficult political environments. The Bank has responded to this by increasing staff incentives to work in difficult countries (see para.15 below).

IV. Recipient-Executed Activities in Small States

12. ***IDA credits/grants and IBRD loans.*** In recent years, only nine small states have been frequent recipients of IDA credits/loans or IBRD loans, 16 have been occasional recipients, and 14 have not been active recipients during the last five years (Table 3).[7] Six of the seven small LICUS states have received occasional financial assistance from IDA/IBRD. The number of active projects for these seven countries ranged from zero (Equatorial Guinea) to more than eight

6 Data from "Improving the Bank's Analytics and Advisory Services" (OM2004-0047/1), OPCS, Progress report, October 27, 2004.

7 Notwithstanding that World Bank lending to most small states comprises only a few projects per decade, the administrative costs of the World Bank project portfolio in small states – spending on lending (preparation and appraisal) and project supervision – have ranged between 4.3 percent and 4.7 percent of the Bank-wide total in the last three years. Within two of the three most affected Regions, this share is even larger: 7.1-8.5 percent in the Africa Region and 5.5-7.7 percent in the Latin America and the Caribbean Region. In the East Asia and Pacific Region, where most small states are inactive or only occasional borrowers, about 4 percent of spending on lending and supervision is in such states.

in Timor-Leste at the end of FY04. In terms of net commitment values, the portfolios of these small LICUS states range from US$13 million (Comoros) up to a maximum of US$99.5 million (The Gambia).

13. ***Other activities.*** For the majority of small states, financing assistance from the World Bank is mainly from sources other than regular lending operations (i.e., IBRD/IDA). For example, they have received substantial assistance in the form of grants from the **Global Environmental Facility (GEF)**, totaling US$86 million for 23 World-Bank Group-implemented projects, though only The Gambia from the subset of small LICUS states currently receives GEF finance. The **Institutional Development Fund (IDF)** has also been an important source of grants: 11 percent of both number of projects and commitment amount have been to small states. All of the seven small LICUS states have utilized the IDF. In Sao Tome and Principe's case, there were ten separate IDF grants. The total amount of grants approved for this group of countries from the IDF since 1993 is US$6.18 million. Tables 4 and 5 compare the number and amount of grants to the LICUS small states group with those to small states overall by region, and global totals, for these two facilities. The **LICUS Trust Fund** exists to provide small levels of grant finance to LICUS countries in non-accrual (and to active countries in exceptional circumstances) to support basic reform, improved governance and service delivery (especially HIV/AIDS) during periods of transition in LICUS which otherwise have no sources of Bank finance to utilize. Of the small LICUS states, only Comoros has utilized the LICUS Trust Fund to date, though Guinea Bissau is also currently eligible. **Country-specific, multi-donor trust funds** have also been used in small states for capacity building projects with costly technical assistance components. For instance, in Timor-Leste, the Bank is preparing a Planning and Financial Management Capacity Building Program, the cost of which is currently estimated at US$ 30 million for five years. For this, the Bank is leveraging co-financing from several bilateral donors.

V. Options for Increasing Support to Small and Vulnerable States

Strengthening Bank Activity

14. ***Increasing tailored ESW for small LICUS states.*** The data above show that, though the provision of ESW for small states and small LICUS states has increased, a gap remains vis-à-vis other countries. In reducing the gap further, the 2004 AAA progress report recommends that providing more tailored products is appropriate in most cases. Specifically, four options for strengthening the Bank's AAA work in these countries are suggested:

- Undertake selective, targeted Bank knowledge activities where there is effective demand for Bank involvement;[8] this will be the approach proposed, for example, in the upcoming CAS for the Pacific Member Countries. Quick-response policy notes to address specific

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[8] For example, there were four studies on the financial sector, investment climate, infrastructure, and a CFAA in Bhutan during FY02-04. There were 6 studies in Timor-Leste during FY01-04, including a CEM, PER, CFAA, Country Procurement Review, Education Sector Review and Poverty Assessment. Other countries covered include Barbados, Cape Verde, Dominica, Djibouti, Estonia, Gambia, Grenada, Jamaica, Lesotho and Maldives and St. Kitts.

concerns of the small states may be a useful way of utilizing scarce Bank administrative resources.

Table 3: Small States Frequency and Amount of Borrowing from IBRD/IDA

	FY05 Eligibility	Number of operations approved Last 5 years (FY00-04)	Number of operations approved Previous 5 years (FY95-99)	Amount approved Last 10 years ($ Million, FY95-04)
9 Frequent Borrowers (>3 operations last 5 years)				
Bhutan	IDA	4	1	72.9
Cape Verde	IDA	7	7	153.0
Djibouti	IDA	7	3	97.0
Grenada	IDA&IBRD	4	1	35.6
Guyana	IDA	4	8	86.6
Jamaica	IBRD	7	4	432.7
Lesotho	IDA	4	4	173.6
Samoa	IDA	4	1	41.2
St. Lucia	IDA & IBRD	5	2	43.3
16 Occasional Borrowers (1-3 operations last 5 years)				
Barbados	IBRD*	1	0	15.2
Belize	IBRD	2	2	32.9
Comoros	IDA	3	4	59.2
Dominica	IDA&IBRD	2	1	12.3
Estonia	IBRD	1	4	70.3
Gambia, The	IDA	3	3	99.0
Guinea-Bissau	IDA	3	3	106.0
Maldives	IDA	1	1	31.0
Mauritius	IBRD	3	3	105.5
Sao Tome and Principe	IDA	3	0	16.5
Solomon Islands	IDA	1	1	16.0
St. Kitts&Nevis	IBRD	3	1	33.0
St. Vincent & the Grenadines	IDA&IBRD	3	0	15.3
Timor-Leste[9]	IDA	1	0	4.0
Tonga	IDA	2	0	16.8
Trinidad and Tobago	IBRD	1	4	117.1
14 Inactive Borrowers (no operations last 5 years)				
Kiribati, Vanuatu	IDA			
Antigua & Barbuda, Botswana, Equat. Guinea, Fiji, Gabon, Marshall Islands, Micronesia, Namibia, Palau, Seychelles, Suriname, and Swaziland	IBRD		4	49.2
Regional Borrowers: OECS Countries/Caribbean	IDA&IBRD	1	2	26.5
Total small states operations		**80**	**64**	**1961.7**

* = Exceptional access/eligibility as Barbados is currently not a borrower; an additional 6 small states are also not borrowers (Bahamas, Bahrain, Brunei, Cyprus, Malta, and Qatar).

Source: The World Bank.

9 Does not include Trust Fund for Timor (TFET) operations.

Tables 4: Use of IDF by Small States and 7 Small LICUS States

	FY93-96	FY97-00	FY01-04	Total
Africa small states				
Number of grants	23	16	12	51
Amount (US$ thousand)	5,198	3,798	3,983	12,979
Asia small states				
Number of grants	4	4	13	21
Amount (US$ thousand)	620	961	3,516	5,097
Latin America & Caribbean small states				
Number of grants	9	4	2	15
Amount (US$ thousand)	1,627	515	550	2,692
Total small states (all Regions)				
Number of grants	38	27	27	92
Amount (US$ thousand)	7,841	5,948	8,050	21,838
Of which 7 small LICUS states				
Number of grants	7	10	12	29
Amount (US$ thousand)	1,101	2,345	2,741	6,186
Total All Countries				
Number of grants	313	311	290	914
Amount (US$ thousand)	82,823	92,098	93,712	268,633

Source: The World Bank

Table 5: Use of GEF by Small States, FY92-04

	World Bank Group-Implemented GEF Projects	
Country	Amount (US$million)	Number of projects
Belize	1.6	2
Bhutan	10.0	1
Cape Verde	4.7	1
Gambia	1.0	1
Grenada	0.7	1
Jamaica	3.8	1
Lesotho	7.3	1
Mauritius	5.3	3
Namibia	7.1	1
Samoa	0.9	1
Seychelles	3.8	3
Regional/multi-country projects		
Caribbean	16.7	3
OECS Countries	16.2	2
Western Indian Ocean Islands	3.9	2
Total small states	**83.0**	**23**
Total all countries	**1,776.7**	**244**
Share of small states	4.7%	8.3%

Source: The World Bank

- Use a regional approach where appropriate. To some extent this is already being done; in recent years the Bank carried out five regional studies for the Caribbean small states and three regional studies for the Pacific small states.[10]
- Support regular consultation on a review of public expenditures (PER) with the IMF, to tackle fundamental public financial management weaknesses.
- Ensure that central departments, especially DEC, are doing research that is relevant to small and vulnerable states and that small states are not marginalized in the preparation and dissemination of institutional "flagship" products, such as the *World Development Report*. This would imply making available resources to cover variable costs associated with additional research on these countries.
- Strengthen the existing knowledge network on small countries for staff to share innovative ideas, approaches and best practices.

15. ***Human resource strategies:*** Another set of options relate to staff working on small vulnerable states. An objective here could be to strengthen the capacity of regional Bank offices serving these countries, along with enhancing incentives for talented Bank staff to take up assignments. The specific options are:

i) Changes introduced under the LICUS initiative to HR policies and incentives could also be applied to small and vulnerable states that are not part of the LICUS Group. These changes include creation of a 'Global Mobility Center' to support spouses and families, and more targeted retention tools such as the scarce skills premium and a recruitment bonus.

ii) In addition, hardship allowances are now applied to environments considered risky and this is also applicable to small and vulnerable states. At present an extra premium is already being applied to LICUS.

iii) Another option that is currently being discussed is job design, i.e., combining assignments in smaller countries with other activities, such as attractive research opportunities and multi-country work.

Some of these proposed staffing strategies may require increases in administrative budget and/or shifting of administrative resources away from larger countries.

16. ***Increasing IDA funding to small states:*** The formula for allocating IDA resources has a 'fixed' component, which favors small states by allocating a lump sum amount to each country

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[10] Examples include: *Caribbean Youth Development: Issues and Policy Direction*. 2003. It covers education, health and employment issues in the Organization of Eastern Caribbean States: Belize, Dominican Republic, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago. *A Comparative Study of Coastal Resource Management in the Pacific Islands*, 2000. It covers environmental issues in communities in Fiji, Palau, Samoa, Solomon Islands and Tonga. *Natural Hazard Risk management in the Caribbean: Revisiting the Challenge*. 2002, covers 12 small Caribbean states: Antigua & Barbuda, Bahamas, Barbados, Cuba, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, St. Kitts, St. Lucia and US Virgin Islands. *Caribbean Economic Overview 2002: Macroeconomic Vulnerability, Household Vulnerability and Institutional and Policy Responses*.

irrespective of its CPIA performance assessment. By providing a fixed element of SDR 3 million to all countries, irrespective of population or performance, small countries are guaranteed a minimum allocation considerably greater than they would receive if the entire allocation were based on population and performance ratings.[11] This figure of SDR 3 million, however, was fixed at the beginning of IDA10 (FY94-96) and has not changed since then. At the same time, IDA replenishments have increased by about 10 percent in SDR terms between IDA10 and IDA13. Management therefore recommends an increase in this fixed component of allocation to reflect that – i.e., to raise the minimum from 3 million to 3.3 million SDR in IDA14. With 81 countries, the implication is that an additional SDR 24.3 million would be allocated outside the performance based system.

Options for Recipient-Executed Activities

17. While small states as a group are well aided relative to their population size, it is clear that the subset of weaker small states has more difficulty leveraging sustained levels of support and interest. Increasing access of these states to existing and new instruments available within the Bank to support capacity building and technical assistance is one potential approach to tackling this handicap. The following specific possibilities could be considered:

i) The **LICUS Trust Fund** was established in FY04 with a budget of US$25 million, of which US$20 million has already been committed. It has a very clear focus on supporting countries in non-accrual to make progress through fragile transition processes with targeted grants to support governance and social service delivery activities defined in the Bank's country assistance strategy. Only in exceptional circumstances can grants be awarded to active countries (e.g., Comoros), where IDA and other resources cannot be accessed. Under the second replenishment of the LICUS Trust Fund (likely end FY05), consideration could be given to expanding eligibility for the LICUS Trust Fund to include small LICUS states that are not in non-accrual (i.e., that have active IDA programs). This is now possible only in exceptional circumstances. The advantage of this approach is that the needs of the small and vulnerable states in question are similar in many ways to LICUS non-accrual countries for which the Trust Fund was designed. In addition procedures are already in place for the management of the Trust Fund so that assistance could be delivered readily. If implemented, there would likely be an impact on the volume needed at the next request for a replenishment of the LICUS Trust Fund from surplus.

ii) Small states in general make good use of small grants from the **Institutional Development Fund,** which was established in 1992 to finance quick, action-oriented upstream capacity building activities. A prominent role of the IDF in small states is appropriate, both because a typical IDF operation is small (and hence adapted to limited size and scope of operations in most small states) and because small states often have access to bilateral grants for much of their development programs and thus are unlikely to obtain IDA or IBRD projects which could bring them the benefit of the Bank's technical assistance based on global knowledge. This gap is most acute in the LICUS small states.

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[11] For details of how the allocation works see "*Additions to IDA Resources: Thirteenth Replenishment*," Annex 1.

To enhance small and vulnerable states access to finance for essential capacity building, further special provision could be made for small vulnerable states under the IDF, to increase volumes of assistance of this type. As described above, the IDF has a track record of experience and results, including in several of the small vulnerable states. Bank execution of IDF may be considered in the case of small and vulnerable states that have capacity problems in managing the fund.

iii) Other proposed instruments to support capacity building activities could make special provisions for small and vulnerable states that urgently need capacity building assistance. One option would be to explore the possibility of creating a 'window' for small and vulnerable states in the (proposed) **Multi-donor Trust Fund for Capacity Building (MDTF)** to be launched in the early part of 2005. Some donors, such as the Netherlands, Canada, the Nordic states and Germany, have expressed interest in the Fund, which could strengthen a number of existing facilities that support capacity building to small states within the Bank. The World Bank Institute has provided assistance to small states through regional AAA programs, such as training, capacity building, advisory work, leadership workshops and strengthening of specific national institutions. The Caribbean Distance Learning Network funded by Canada and DFID is an example of such a regional program. There is potential to have a component of the MDTF designated to focus on capacity building for small and vulnerable states but three concerns need to be addressed. First is to ensure that funding for the small states component of the MDTF is additional to the currently proposed envelope and does not crowd out existing Trust Funds. Second, allowing funds from the small states window to augment AAA budgets and cover World Bank staff costs[12] would help to address the incentive problem of attracting skilled Bank staff to work in these states. This possibility needs to be explored. Third it is important to ensure that the capacity building for a small and vulnerable country is done in a way that is consistent with the CAS.

iv) For those small and fragile states where the countries and donors are coalescing around shared objectives and strategies, another option is to establish **country-specific, multi donor trust funds** to be funded by bilateral partners, which covers AAA. An example is Timor-Leste, where some key AAA outputs (e.g., Poverty Assessment, Education Sector Review, Doing Business) have been co-financed by other donors.

v) Since the LICUS Trust Fund faces competing demand from larger countries and IDF amounts are very small, another possibility is to scale up the existing **untied bilateral Trust Funds** by increasing the amount of resources and by covering Bank staff costs.

VI. Conclusions

18. Of the 45 World Bank member states that are considered small, 20 are IDA-eligible, with per capita incomes ranging from less than US$600 to more than US$3,300 for four blend countries; 18 are IBRD-only borrowers, and the rest are non-Bank borrowers. Among the small

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[12] Some trust funds – Belgian Trust Fund, the Australian Pacific Facility, and the DFID AAA Trust Fund for India – allow for the coverage of variable costs of the Bank staff.

states, seven are classified as LICUS, characterized by weak governance and conflict. Hence small states span a wide range of living standards, but all face common problems of lack of diversification and vulnerability to shocks. In addition, a number are prone to natural disasters. The paper focused on the 20 IDA-eligible countries as small and vulnerable states.

19. Donor support to small states has been declining, from a peak of US$2.5 billion in 1994 to less than US$2 billion a year in 1998-2002. The decline has been most pronounced and persistent in the small states of Africa and the Caribbean. In spite of this fall in donor resources, small states still receive per capita aid that is more than sixteen times higher than low-income countries as a group. Furthermore, the donor community has begun to look more closely at how best such states can be helped in addressing their specific problems. In 2000 the Commonwealth Secretariat/World Bank Joint Task Force set out an agenda for tackling these problems through a common donor framework with small states.

20. For its part the Bank has increased its support to small states through AAA, for instance in the number of pieces of ESW carried out. Since FY00 it has also substantially increased the budget allocation for AAA to small states by 64 percent and the total budget to such states by 33 percent. Even with these increases, however, the number of pieces of ESW per country is less than the average for all Bank countries. The small states' share in Bank-wide AAA budget has also increased slightly during this period. Although these increases in AAA support are warranted, the Bank does face strong competing demand for its limited resources from the larger countries, where demands have also been increasing. The challenges for the future are to improve further AAA products, to enhance their impact and efficiency and to mobilize more donor resources to finance IDA support to these states.

21. Along with the strong increase in AAA support in terms of the budget amount, there has been an increase in allocation of human resources: staff numbers have increased, including a greater level of field presence, either in the countries themselves or in regional offices that serve these countries. More can and is being done to encourage Bank staff to work on small states.

22. In terms of lending, the Bank's role in small states remains modest, with only seven of the twenty IDA-eligible countries being frequent borrowers over the last five years. Annual approved amounts are also small: of the order of US$7-8 million per country per year for frequent borrowers. The administrative costs of such small operations relative to the volume of lending, are, of course, correspondingly high. Scaling up lending or AAA for small and fragile states, especially by using Bank staff, will result in higher Bank administrative budget.

23. In the light of the problems that have been identified above, the following actions in support of small and vulnerable states are proposed for consideration:

a) Modify the funding allocation formula, so that the lump sum component is increased from SDR 3 million to SDR 3.3 million for the 14^{th} IDA replenishment. This will benefit each small state by almost the full value of the increase, while the impact on larger states will range from small to negligible.

b) Undertake selective, targeted and flexible knowledge activities in these countries, making greater use of quick-response policy notes and increased regional approaches where appropriate. It is also important to carry out fiduciary ESW where there is a demand by the country for policy lending and to facilitate transition to the use of country systems, which would have a high pay-off in speeding harmonization and reducing the burden that donor procedures put on the very weak capacity of small states. All this will require additional resources, especially for staff travel to remote places, which could be met out of trust funds that permit such expenditures (see (d) below).

c) Provide more incentives for staff to work on small states, including revised promotion criteria and hardship allowances.

d) Enable the LICUS Trust Fund, the Institutional Development Fund, the proposed Multi-donor Trust Fund for Capacity Building, and other Trust Funds to finance costs related to capacity building for small and vulnerable states, where appropriate. Explore possibilities for setting up country-specific trust funds where appropriate.

Annex I

Small States: Status and Annual Aid Per Capita (Current US$)

	Status	1991-92	1996-97	2001-2002
Africa				
Botswana	IBRD	91	63	20
Cape Verde	IDA	318	287	187
Comoros	IDA	125	65	52
Djibouti	IDA	213	150	99
Equatorial Guinea	IBRD	170	66	34
Gabon	IBRD	107	72	31
Gambia, The	IDA	107	33	42
Guinea-Bissau	IDA	104	123	42
Lesotho	IDA	85	58	37
Mauritius	IBRD	53	27	19
Namibia	IBRD	109	104	62
Sao Tome and Principe	IDA	449	296	211
Seychelles	IBRD	295	235	131
Swaziland	IBRD	68	33	25
Africa Small States Average		*164*	*115*	*71*
Asia and Pacific				
Bahrain	NB	107	143	64
Brunei	NB	17	6	-2
Bhutan	IDA	94	88	80
Fiji	IBRD	73	59	37
Micronesia Fed. Sts.,	IBRD	71	95	1031
Kiribati	IDA	312	173	177
Maldives	IDA	155	115	92
Marshall Islands	IBRD	85	1374	1287
Palau	IBRD	0	2817	1636
Qatar	NB	3	3	3
Solomon Islands	IDA	123	111	98
Timor-Leste	IDA	0	0	270
Tonga	IDA	224	306	211
Vanuatu	IDA	301	166	145
Samoa	IDA	329	180	231
Asia Small States Average		*146*	*463*	*357*
Latin America and Caribbean				
Antigua & Barbuda	IBRD	94	118	148
Bahamas, The	NB	11	9	22
Barbados	NB	5	17	4
Belize	IBRD	122	82	88
Dominica	IDA/IBRD	212	396	350
Grenada	IDA/IBRD	158	107	102
Guyana	IDA	150	272	106
Jamaica	IBRD	58	26	15
St. Kitts and Nevis	IBRD	186	172	421
St Lucia	IDA/IBRD	185	217	157
St. Vincent and Grenadines	IDA/IBRD	157	144	62
Suriname	IBRD	153	225	40
Trinidad and Tobago	IBRD	2	20	-3
Caribbean Small States Ave.		*115*	*139*	*116*
Europe				
Cyprus	NB	48	44	65
Estonia	IBRD	39	45	50
Malta	NB	37	124	16
Europe Small States Ave.		*41*	*71*	*44*
All Small States Average		**135**	230	178

NB: Non-borrower
Source: The World Bank and OECD Data