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## African Development Bank's Experience in Fragile States



African Development Bank

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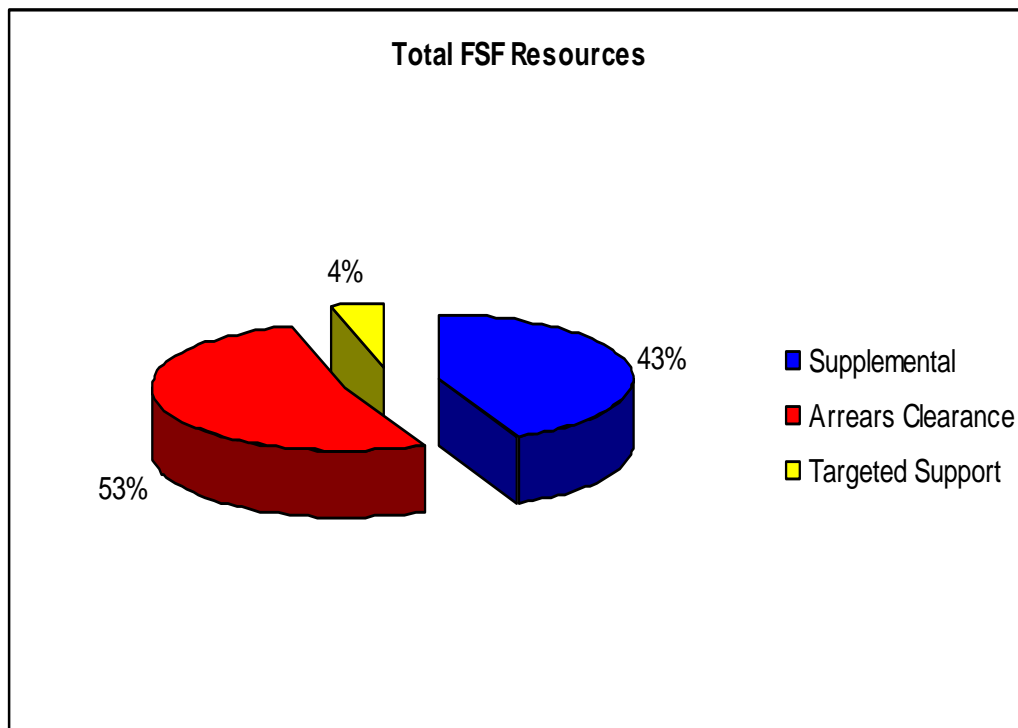
# **African Development Bank's Experience in Fragile States**

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## 1. Introduction

The Bank's policy on fragile states, as outlined in its Policy for Enhanced Engagement in Fragile States, is to assist fragile states move from the condition of fragility to a path of sustainable recovery and development by providing them with tailored assistance at critical junctures of their re-engagement and recovery process. To achieve these objectives, the Bank set up the Fragile State Facility as a distinct financing vehicle in March 2008. The Fragile State Facility has three pillars: supplemental support, arrears clearance and targeted support. The cumulative resource envelope of the Fragile State Facility was US\$888 million as of end December 2009. These resources were mainly from the African Development Fund (ADF) and African Development Bank net income. The Facility welcomes donor contributions, which has been modest to date. The chart below, showing the allocation of the total resource envelope across the three pillars, indicates that just over half of the initial portfolio of the Fragile State Facility was allotted to arrears clearance. However, the demand for targeted support for capacity building and knowledge management is now very high at more than 60% of current demand from beneficiary countries.



### Pillar I – Supplemental Support

This window provides support for infrastructure investment, rehabilitation and governance to post crisis/transition countries. Of the US\$383 million allocated to Pillar I, US\$132 million have been disbursed as at first quarter 2010 and US\$164 million are earmarked for the 2010 FSF pipeline of operations.

### Pillar II – Arrears Clearance

Support under this pillar is intended to help eligible countries clear their debt arrears. As of September 2009, Togo and Côte d'Ivoire had received US\$385 million under this window. Support for Cote d'Ivoire and Togo brought the total number of countries that have benefited from the Bank's arrears clearance program to seven countries - Burundi, Republic of Congo, Central African Republic, Comoros, Liberia, Cote d'Ivoire and Togo.

### Pillar III – Targeted Support

This pillar provides targeted support for capacity building, service delivery and knowledge development. The support provided falls within four categories. The share of each category in the total for Pillar III is indicated below in parenthesis.

- ▣ public finance management and public administration (63%),
- ▣ private sector and institutional development(20%),
- ▣ agriculture and extractive industries (13%) ; and
- ▣ social sectors (5%).

## **2. Impact of AfDB Support**

At present, an assessment of the impact of the Fragile State Facility may be premature, given that the Facility was established only two years ago. Nevertheless, there are indications of tangible benefits for some countries. The FSF arrears clearance process, for example, has enabled countries under arrears-induced sanctions to quickly re-engage with the international. The process has also proven effective in stabilizing countries coming out of conflict or crisis with difficult economic and financing challenges and needs and has opened the door for such countries to gain access to HIPC and MDRI, thus providing them with much needed resources for supporting their socio-economic recovery programs. The FSF has also supported the provision of vital basic services, especially the provision of water supply and sanitation to countries like Comoros, Liberia and Zimbabwe, thus improving the living standards of project beneficiaries. The provision of well targeted technical assistance (TA) and capacity building programs have contributed in the development of credible country systems that are crucial in fighting corruption and ensuring that the scarce public resources in fragile states reach the

intended beneficiaries. There is also evidence of increasing demand for support for improved transparency and accountability through the strengthening of public financial management systems. Currently this support is provided in the DRC, Liberia, Sudan, Togo and Zimbabwe.

Projects in the pipeline include US\$6.6 million in institutional support to Togo for governance and economic reform, US\$54 million in Burundi to pursue a road infrastructure project and economic reforms program, US\$9.8million in Sierra Leone to finance a water supply and sanitation project, and US\$90million in DRC to support an electricity power generation and distribution project.

### **3. Lessons Learnt**

Operationally, the Fragile State Facility remains a rapid response and development instrument in very weak institutional environments. The following are some of the lessons that the Bank has learnt in supporting the efforts of fragile states to grapple with the numerous challenges facing them.

Sequencing is critical to the success of reform in fragile states. Zimbabwe is a striking example of a country where sequencing of reform was particularly important. Over the years the country's relationship with donors became strained, leading to the imposition of sanctions. Macroeconomic indicators deteriorated, culminating in hyperinflation, and the collapse of the national currency. The signing of a power-sharing agreement between the government and the opposition in 2009 provided an opportunity for a renewed engagement with development partners. Reform was needed on all fronts: On the macroeconomic front there was a need for fiscal adjustment to cut chronic budget deficits and stabilize the economy; determining whether to introduce a new currency given the collapse of the existing currency; determining the appropriate exchange rate regime; reforming and re-capitalising the central bank, and defining its mandate and areas of activity; and correcting price distortions. Getting the order of these and other reform measures right was a major challenge.

The African Development Bank can take the lead in supporting countries like Zimbabwe facing isolation by the international community. It can do so by providing emergency financial assistance, supporting policy reform and through advocacy. The Bank is able to leverage the flexibility of its procedures to adapt to country-specific circumstances. Being an African institution, Regional Member Countries perceive the Bank as their own institution. This helps to foster a healthy working relationship between the Bank and its clients.

Despite the huge financing requirements, the absorptive capacity of fragile states tends to be low. Strengthening their absorptive capacity is therefore a key priority. Development partners sometimes impose a wide range of disbursement and reporting procedures, taxing already weak government institutional capacity. Harmonization and simplification of such procedures will increase aid absorptive capacity. Furthermore, care needs to be taken to ensure that aid does not

lead to the setting up of a large institutional structure, in parallel with the existing government structure. Such parallel structures result in duplication and weaken government capacity to manage the development process. The “cherry picking” of the best local brains from government and tertiary institutions further weakens domestic capacity.

The Fragile State Facility allocates funds to beneficiary countries partly on the basis of the performance-based allocation (PBA) system. Fragile states are also eligible for financing under the African Development Fund where funding decisions are based exclusively on the PBA system. However, the PBA formula does not fully capture the extent of vulnerability and the underlying structural conditions of fragile states. As a result, resources allocated under the PBA system tend to be low relative to needs. The PBA system awards more funds to countries with a good policy environment (as captured by the Country Policy and Institutional Assessment (CPIA) Index). However, this implicitly penalizes countries for being fragile as a poor policy environment is itself often a defining feature of state fragility. Moreover, because CPIA ratings are retrospective, they may not adequately capture recent developments in a country. The backward-looking feature of the PBA system further penalizes fragility and takes away the opportunity of using aid to improve stability and the policy environment. These limitations have led to a growing debate on the need to revisit the PBA formula to take into account considerations of the underlying structural conditions and vulnerability of countries.

#### **4. Going Forward**

A growing body of experience and lessons on fragile states is being accumulated within the Bank and outside. It would be useful to document and analyze such experiences and lessons in the form of policy briefs, working papers, scholarly articles, and other knowledge products. Furthermore, research and analytical work is needed on a range of critical issues for fragile states. Development partners have pursued a wide range of policies and practices in fragile states whose relative efficacy remains a matter of speculation. There is little knowledge about what works and what does not and many questions remain unanswered. What type of aid suits fragile states? Is budgetary support appropriate in the face of weak institutions for accountability and transparency? In what circumstances has aid been effectively utilized? What has been the impact of aid on macroeconomic stability? Finally, is the PBA an appropriate framework for resource allocation?

Strategic partnerships will need to be nurtured at the local, regional and international levels. At the local and regional levels, such partnerships would enhance the participation of local, national and regional institutions and stakeholders in the development process. At the international level, such partnerships can improve coordination of development assistance, thereby avoiding duplication and waste. It would also reduce the transactions costs that aid recipients face in dealing with a multiplicity of donor conditions.



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