AFRICAN DEVELOPMENT
BANK GROUP

STRATEGIC AND OPERATIONAL FRAMEWORK FOR REGIONAL OPERATIONS

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Acknowledgements	This document is the product of a Bank-wide drafting team composed of A. Abou-Zeid, G. Grosso, A. Kamara, G. Manley and S. Pitamber. It was revised with guidance from the Operations Committee (J. Eichenberger, Z. El Bakri, M. Gantsho and L. Kasekende). The drafting team received valuable inputs from staff from across the Bank, including P. Afrika, J. Kanyarubona, G. Mbesherubusa, R. Thomas, I. Van Grunderbeeck and V. Zongo.

Executive Summary

This paper presents the African Development Bank Group's strategic and operational framework for regional operations (ROs). The framework is intended to provide a rigorous but flexible framework to mobilize resources for regional integration in Africa. It is an important building block of the Bank Group's broader strategy to promote regional integration, which includes advisory and analytical services, capacity building for countries and continental and regional organizations and the use of ADB resources where appropriate.

The framework is anchored in the strong consensus that greater regional integration is a key means for Africa to enhance growth and development and address common development challenges such as small, fragmented markets that limit economies of scale, geographic handicaps (landlocked and island states) and high production costs due in part to poor infrastructure. The framework draws on lessons learned from the Bank Group's experience and those of sister institutions. These lessons underline the strong development impact that ROs can have but also point to the need for stronger quality at entry, greater country ownership and reinforced project analysis and implementation frameworks to effectively address the technical and institutional complexities inherent in ROs.

The Bank Group sees the financing of ROs as core element of its development mandate. In response to stakeholder requests, the Bank Group will play a leadership role and support key continental initiatives, particularly the New Partnership for Africa's Development (NEPAD) initiative. This will fill a key void in the international aid architecture; the Bank Group is one of the few institutions focused on financing ROs. Operations will be selective and focus primarily on two areas: (i) infrastructure, particularly transportation but also energy, water and telecommunications; and (ii) promotion of regional public goods (RPGs) where the Bank Group can galvanize regional cooperation to address challenges that cannot be effectively addressed by either private finance or countries acting alone. The Bank Group will also place greater emphasis on partnership, with regional organizations that have the institutional capacity to develop and implement ROs, with bilateral and multilateral donors and with private sector operators. Increased partnership, which can include but must also go beyond co-financing, will allow the Bank Group to better leverage its human and financial resources to develop and implement stronger regional operations.

To deliver on this strategy, Management proposes a revised operational framework based on three pillars:

- Clear *basic eligibility criteria* to ensure that operations are sponsored by an appropriate entity, regional in character and backed by committed sponsors;
- *Prioritization criteria* to channel resources to the highest-quality operations as measured by development impact and alignment with Bank and client strategic objectives;
- A *financing formula* that provides a meaningful link to performance through the use of ADF country allocations to cover part of the cost of each operation and incentives for participation in ROs by leveraging country funds with the ADF regional envelope and ensuring flexibility to accommodate certain special cases.

The Bank Group's support for ROs will be implemented and closely monitored by both sector departments and the Operations Committee. It will include more rigorous management of the existing portfolio and the pipeline of future operations. Management will update the Boards of Directors annually and will prepare an assessment of the framework for the ADF-11 mid-term review, proposing changes as needed.

The Boards of Directors are invited to approve this proposed strategic and operational framework for regional operations.

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Acronyms and Abbreviations

ADB	African Development Bank
ADF	African Development Fund
AFFM	African Fertilizer Financing Mechanism
AICD	African Infrastructure Country Diagnosis
APRM	African Peer Review Mechanism
AU	African Union
AWF	African Water Facility
CAADP	NEPAD Comprehensive African Agriculture Development Plan
CSP	Country Strategy Paper
DAC	Development Assistance Committee (OECD)
ECOWAS	Economic Community of West African States
ENPV	Economic net present value
ESW	Economic and sector work
HIV/AIDS	Human immunodeficiency virus/Acquired immunodeficiency syndrome
ICA	Infrastructure Consortium for Africa
IPPF	Infrastructure Project Preparation Facility
MDGs	Millennium Development Goals
MICs	Middle-income countries
MLTSF	NEPAD Medium- to Long-Term Strategic Framework
MTR	Mid-term review
NEPAD	New Partnership for Africa's Development
NGOs	Non-governmental organizations
OECD	Organization for Economic Co-operation and Development
OPEV	Operations Evaluation Department
PBA	Performance-based allocation
PPPs	Public-private partnerships
RECs	Regional economic communities
RISP	Regional Integration Strategy Paper
RMCs	Regional member countries
ROs	Regional operations
RPG	Regional public goods
STAP	NEPAD Short-term action plan
T & T	Tsetse and trypanosomiasis
UA	Unit of account
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations Children's Fund
US$	United States dollar
WAPP	West African Power Pool

1. Introduction

1.1 This paper presents the African Development Bank Group's strategic and operational framework for regional operations (ROs). This framework addresses concerns raised by Bank Group shareholders and clients about the current framework and is intended to better position the Bank Group as a major contributor to regional integration in Africa. It is important to note that ROs are an essential tool to promote regional integration more broadly, but not the only one at the Bank Group's disposal.

1.2 The Bank Group's broader role in promoting regional integration includes support to the African Union (AU), New Partnership for Africa's Development (NEPAD) and regional economic communities (RECs) in their efforts to achieve deeper integration, particularly through dialogue to promote harmonized regional strategies and policies. The Bank Group provides support and financing for the development of viable regional operations. It acts as an advisor and strategic partner providing vision, leadership, analysis and capacity building on regional issues for regional member countries (RMCs) and continental and regional institutions.

1.3 This paper therefore focuses on the Bank Group's role as a catalytic financier of ROs as one element of the Bank Group's broader strategy to promote regional integration. The Bank Group's forthcoming strategy on support to middle-income countries (MICs) will address more specifically the Bank Group's role in promoting regional integration and ROs in MICs.

2. Rationale and Context

The Case for Regional Integration in Africa

2.1 Africa has the largest number of countries relative to total geographic area of any developing region. On average, each country shares a border with four neighbors. With an average GDP of just US$ 4 billion, African economies are small in absolute terms. Africa's largest economy, South Africa, is only the world's 27th largest. African countries are also heterogeneous in terms of natural resource endowments and levels of development, and many face physical barriers[1] to greater participation in the regional and global economy. About 40 percent of Africa's population is in landlocked countries. The continent is characterized by small national markets, limited opportunities to create economies of scale, and high production costs (exacerbated by under-developed infrastructure) that combine to hinder the development of viable African firms and the expansion of trade, both intra-African and between Africa and the rest of the world. These handicaps make Africa a less attractive destination for foreign and domestic investment.

2.2 There is a strong consensus that one of the best ways to address these constraints is through greater regional and continental economic integration. This vision of an integrated Africa is reflected in the NEPAD initiative, a broadly accepted continental framework for cooperation. Creating physical links, coordinating the use of shared natural resources and harmonizing policies must be a key strategy for making Africa more competitive and increasing opportunities for growth, trade, private sector development and job creation. However, economic growth is not the only thing at stake. Regional integration is also essential to deal effectively with disease, climate change, conflict and technological advancement, for example. These are challenges that don't confine themselves to national borders; they are regional, continental and even global in scope. Collective approaches are required to tackle these issues and ensure that Africa's development is sustainable.

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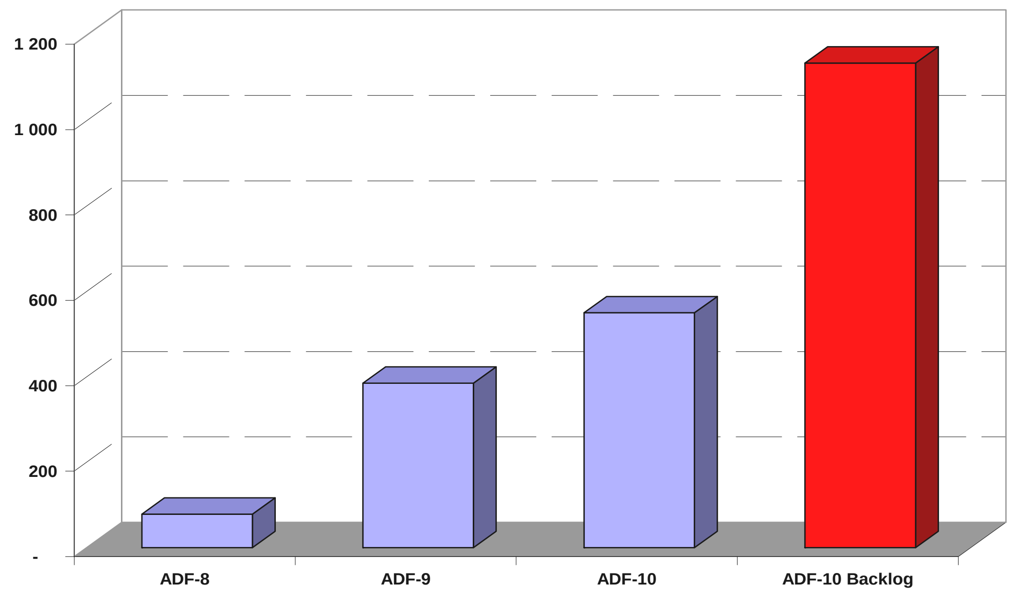
[1] Of Africa's 53 countries, 15 are landlocked (28%) and another three, including the Democratic Republic of Congo, are nearly landlocked, with extremely limited access to the sea. Africa also includes 5 "water-locked" island nations.

The Bank Group's Work on Regional Operations

2.3 The Bank Group's RMCs increasingly recognize the value of regional solutions to their development challenges and of projects that promote regional integration. In response to strong client demand for regional operations, the Bank Group has responded by earmarking a growing proportion of ADF replenishment resources for ROs. Starting from 5% under ADF-8, the RO envelope rose to 10% during ADF-9 and now stands at 15% under ADF-10. Demand for ROs continues to grow, and has outstripped the resources for ADF-eligible countries. The backlog of unfinanced requests at the close of ADF-10 period is expected to be UA 1.1 billion. The current pipeline of regional projects, including the backlog and projects that could be developed over the next three years, amounts to UA 2.4 billion.

Figure I: ADF Support to Regional Operations
(UA millions)



Source: Bank Group

2.4 From 1996 to 2006, the Bank Group financed 134 ROs amounting to nearly UA 1.2 billion. The Bank Group's RO work has been strongly concentrated on the infrastructure sector, with roughly 50% of the Bank Group's financing going primarily towards regional transportation and energy projects. Bank Group regional operations have also supported objectives in other areas, including: private sector and trade development, increasing regional agricultural productivity and food security, efficient management of shared natural resources (i.e., forests and water), environmental conservation, prevention of communicable diseases, and greater policy harmonization to promote common development objectives. ROs have been concentrated primarily in West Africa (40%) but with sizeable portfolios also in East Africa (18%) and Southern Africa (12%) as well as pan-African and multiregional operations (26%).[2] Annex 1 provides further details on Bank Group lending for ROs over the last decade.

Lessons Learned

2.5 A number of key lessons emerge from both the Bank Group's own experience with ROs and those of other multilateral institutions.[3] Generally, regional operations have the potential for creating significant benefits and a number of regional operations have successfully achieved

[2] Based on the 5 regions identified under the Lagos Plan of Action. The 8 AU-recognized RECs demonstrate significant overlaps that complicate regional analysis.

[3] In addition to external documents, these lessons draw on a January 2007 preliminary analysis of regional project completion reports by the Operations Evaluation Department (OPEV).

project objectives and results. One of the key findings of recent evaluations is that economic returns on ROs can be higher than national operations because ROs often create significant economies of scale and lead to the rationalization of production or open entirely new productive opportunities that cannot be achieved by a single country. In addition, ROs are proving to be successful in addressing inherently regional development challenges (i.e., communicable diseases, environmental preservation) where national programs have not fully achieved objectives.

2.6 However, developing and implementing regional operations involves significant additional challenges compared to standard country operations that are primarily related to the technical complexity of the operations themselves and the additional coordination and financing challenges inherent in multi-country operations. As a result, preparation and supervision of regional projects on average costs 1.5 times that of national projects. More specific lessons emphasize the need for:

- ***Joint ownership by participating countries.*** A strong country and regional political commitment is critical to the success of the RO. In many cases this will require significant policy dialogue with national and regional actors to ensure agreement upfront from all stakeholders.
- ***Policy harmonization.*** In addition to ownership, general or sector policy harmonization is often critical to achieving the benefits of ROs. Differences in legal, procurement and financial frameworks across countries can render project implementation more cumbersome. Certain ROs will require sector policy harmonization and reforms in order to achieve project outcomes. This is particularly critical in regional infrastructure investments where differences in agricultural, water, energy, telecommunications and customs policies can create delays or significantly reduce anticipated project benefits. Sector policy harmonization problems are in some cases compounded by the lack of sufficient upstream economic and sector work (ESW) to draw on.
- ***Capable regional project management structures.*** The structures put in place to manage ROs have in some cases lacked the necessary capacity and/or mandate to be effective. It is imperative that implementation units, with responsibility for execution, monitoring and reporting, have appropriate human and financial resources as well as a clear mandate and operational scope, particularly relative to relevant national agencies where there may be overlap. RECs may act as appropriate regional project management structures provided they have the required institutional and technical capacity. The Bank Group must also be prepared to allocate more resources to supervising and facilitating implementation of ROs.
- ***Enhanced project analysis.*** Economic and risk analysis of complex regional projects has not always been sufficiently rigorous. Projected economic benefits may be overestimated.[4] Key technical, financial, environmental or coordination risks may be overlooked or insufficiently mitigated leading to considerable project delays or failure. Reinforced project analysis teams are needed to identify and plan for risks and ensure higher quality at entry.
- ***Co-financing arrangements.*** The financing needs for regional infrastructure alone are huge. Equally demanding are the analytical and implementation capacity requirements to effectively develop ROs. This underlines the need to build partnerships with bilateral and multilateral development agencies as well as the private sector to leverage the Bank's financial resources, expertise and institutional capacity. The evidence suggests that co-financed ROs are more likely to achieve their development objectives.

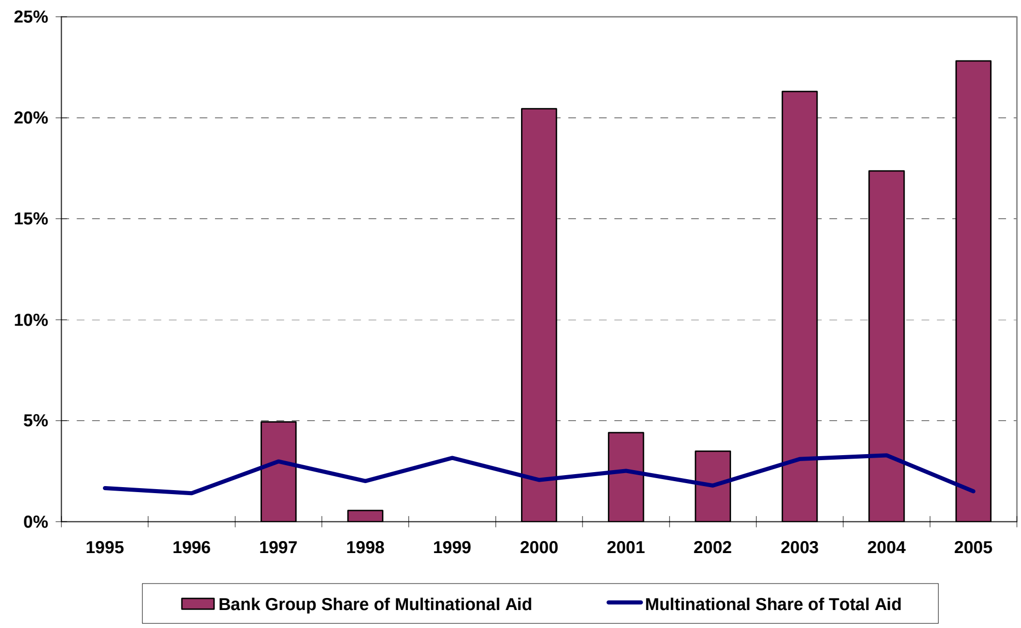
[4] Examples include unrealistic assumptions for increases in traffic flow from transportation infrastructure projects or in agricultural production from irrigation.

3. Strategic Orientations

3.1 In light of the importance of regional integration for Africa and in response to strong RMC demand, the Bank Group is committed to playing a greater role in ROs as one of the pillars of its broader strategy to promote regional integration. The Bank Group sees promotion of deeper regional integration as a key area of its mandate, anchored in initiatives such as NEPAD, the Comprehensive African Agriculture Development Plan (CAADP/NEPAD), the African Peer Review Mechanism (APRM), the Infrastructure Consortium for Africa (ICA), the African Water Facility (AWF), and the African Fertilizer Financing Mechanism (AFFM). The Bank must scale up delivery, building on its accumulated experience to ensure greater selectivity and higher quality operations, stronger and deeper partnerships and greater financial leverage from private and public sources.

3.2 The case for deeper Bank engagement in regional operations is reinforced by the Bank Group's positioning within the current aid architecture. Most aid (71%) is channeled through bilateral sources that generally have not given a high priority to regional projects. Over the past 10 years, average annual aid for regional projects has accounted for less than 3% of total aid to Africa. The Bank Group has emerged as the one of the lead financiers of ROs in Africa, primarily through the ADF window, accounting for nearly a quarter of all regional investments in Africa in 2005.

Figure 2: Aid for Regional Operations in Africa
(Percent)



Source: OECD DAC database

3.3 The Bank Group is well positioned to fill the gap in donor support for ROs. In 2006, the Bank created a department dedicated to NEPAD, regional integration and trade whose strategy is to become both a center of excellence and reference on African regional integration for external partners and a focal point within the Bank for mainstreaming this issue in regional and country dialogue and strategy. With sovereign and non-sovereign operations under the same roof, and both concessional and non-concessional instruments at its disposal, the Bank is ideally positioned to support public-private partnerships and work across the full spectrum of African countries: from middle-income countries to more fragile states.

3.4 While regional integration is a multidisciplinary issue and covers a wide range of sectors, the Bank Group will be appropriately selective in its operations, focusing on areas where it can best deliver on its mandate and demonstrate superior results. The Bank Group's regional operational focus will primarily be on infrastructure and regional public goods (RPGs). The Bank has a strong track record in regional infrastructure. Based on the 2007 OPEV review of regional project completion reports, the percentage of infrastructure projects with an overall satisfactory performance rating was 67% compared to 38% for other sectors.

Infrastructure

3.5 Inadequate infrastructure significantly increases the costs of doing business for firms in Africa and makes potential investments unattractive. It can constitute a major obstacle to effective provision of essential social services; and, it impedes the development of domestic competitiveness both at home and abroad. Recent studies suggest that indirect costs, including basic services such as power and water, are significantly higher in Africa than in other developing regions.[5] Internal transport costs are estimated at nearly twice the levels of other developing regions. Africa's needs in regional infrastructure are huge. It is estimated that US$ 24 billion is needed to fund projects already identified that would fill Africa's infrastructure gaps in transport, energy and telecommunications. Better infrastructure will improve the delivery of basic services, increase economic efficiency across all sectors creating better prospects for job creation and private sector development and investment in order to sustain the higher and more broad-based growth needed for greater impact on poverty. This strategic focus builds on the Bank's long experience in infrastructure and growing focus on infrastructure in its national operations. It will also back the Bank Group's efforts to deliver on a number of continental infrastructure initiatives where it has been asked to play a leading role. These initiatives include NEPAD, the Infrastructure Consortium for Africa (ICA), and the African Water Facility (AWF).

Box 1: The Bank and Regional Infrastructure - The West African Power Pool (WAPP)

WAPP Electricity Interconnection Project

Participating countries: Ghana, Togo and Benin

ADF Financing: UA 32.2 million loan

Status: Approved in 2007, expected completion in 2010

The West African Power Pool (WAPP) is an ambitious regional program to create an integrated electricity market in the ECOWAS sub-region through the interconnection of individual national electricity grids. The overall goals are to lower the price of electricity and improve system reliability through interconnection, economies of scale and leveraging the most efficient regional production sources (i.e., hydro and gas). The Bank has been involved in the development and financing of both studies and infrastructure for the WAPP since the 1990s. One of these projects was the Nigeria-Benin interconnection project that the Bank Group supported through a UA 12.5 million loan in 2002.

In 2007, the Bank Group provided UA 32.2 million to finance the next phase in WAPP interconnection, linking Benin with Togo and Ghana. In addition to lowering costs by nearly 30%, the project is expect to significantly increase electricity access rates, reduce the number of power failures and cut power rationing, particularly during drought years for countries dependent on hydropower. The project is aligned with regional and continental strategies: it was included in the ECOWAS energy master plan and was a NEPAD priority project with a grant from the NEPAD-IPPF used to finance the feasibility studies. The Bank Group was the lead financier, providing 45% of total project costs, with co-financing for the project provided by the World Bank, the Islamic Development Bank and the West African Development Bank.

The Bank Group will continue to support the WAPP during the ADF-11 period with several interconnection projects in the pipeline.

[5] See for example: Center for Global Development, "Business Environment and Comparative Advantage in Africa: Evidence from the Investment Climate Data", 2005

3.6 The Bank Group will play a proactive role in shaping Africa's regional infrastructure development plans. Two important studies are currently being carried out in parallel by the Bank Group and the World Bank. They are the Medium- to Long-Term Strategic Framework Study (MLTSF) and the African Infrastructure Country Diagnosis (AICD). The overall objective of these exercises is to anchor Africa's infrastructure development agenda in a broadly supported action plan, developed in cooperation with the African Union Commission and the NEPAD Secretariat, and based on country and sub-regions' strategies and plans. The Bank Group has also put in place the NEPAD Infrastructure Project Preparation Facility (IPPF), which provides funds to develop bankable regional infrastructure projects that may then be financed by the Bank, other donors or private investors. It is leading a "tunnel of funds" approach in order to foster better cooperation between donors and investors and optimize the use of available resources.

Box 2: The Bank and Regional Infrastructure - Linking Post-Conflict States

The Kicukiro-Kirundo Road Project

Participating countries: Rwanda and Burundi

ADF Financing: UA 30.2 million grant

Status: Approved in 2006, expected completion in 2008

Rwanda and Burundi are landlocked countries gradually emerging from a decade of political instability that led to the deterioration of transport infrastructure. Reconstruction efforts to improve economic prospects depend to a large extent on establishing trade with regional partners and the outside world. Roads are the principal mode of transport covering about 90% of distribution needs: foodstuffs and agricultural products, industrial and capital goods, etc.

The Kicukiru-Kirundo Road project will facilitate and enhance trade between the two countries and with the outside world and reduce transport time and costs by building an all-weather permanent 97 km road link that will also open up regions with a high agro-pastoral potential via 149 km of feeder roads. The project will also build technical and operational capacities of national authorities and border services.

The Bank Group has partnered with the Arab Bank for Economic Development in Africa, the OPEC Fund and the Saudi Fund for Development to leverage its own funds and co-finance the project, which amount to UA 53 million. It draws on lessons learned from Bank interventions in both countries as well as from those of other donors in the road sub-sector, particularly the involvement of beneficiaries and civil society in project design and project sustainability.

3.7 The Bank Group will maximize synergies between its public sector activities and its private sector window for greater impact. Although private investment in infrastructure in Africa is on the rise, it has been relatively limited compared to other regions and overall needs. Private investment has been narrowly focused in terms of sector (i.e., primarily telecommunications, ports, power generation and rail) and project type (i.e., greenfield projects mostly, as well as concession/management contracts). In some sectors, such as power and water, private sector involvement has not met expectations and proven to be unsustainable for a variety of reasons including deficient regulatory and legal frameworks, poor financial performance leading to underinvestment and inappropriate risk-sharing arrangements.

3.8 The Bank Group strategy to support increased mobilization of private investments for RO in infrastructure will draw on these lessons. Specifically, the Bank will: (i) prepare a detailed strategy and action plan for public-private partnerships (PPPs); (ii) systematically review prospects, obstacles and prerequisites for private investment in ROs; (iii) explore and promote adequate mechanisms and frameworks for corporate governance of government-owned infrastructure utilities, often an important player in ROs; (iv) continue to support capacity building of government agencies, including those responsible for establishing and monitoring legal and regulatory frameworks; (v) strengthen coordination, consultation and knowledge exchange with other key donors; and (vi) mobilize donor funds and guarantees, including from emerging donors such as China, India, and Islamic banks, in support of PPPs.

3.9 Funding for regional projects may also include studies necessary to support regional infrastructure integration, and capacity building activities for the executing agencies in charge of implementing projects, including RECs and other regional institutions. It may also finance selected policy-related programs that promote regional integration, better governance and harmonization of regulatory frameworks that provide the "soft" infrastructure to accompany physical investments.

Regional Public Goods

3.10 There is broad agreement that international financial institutions have a key role in the promotion of RPGs. Deeper engagement in this area must be one of the key objectives of the Bank Group's regional operations. The importance and special challenges of public goods have received increased attention recently, particularly with the acceleration of globalization and the recognition that many economic and social challenges can only be addressed through international cooperation.

3.11 Public goods are those whose benefits can be enjoyed by one party without (or hardly) reducing their availability to others. In addition, it is difficult or prohibitively expensive to exclude others from these benefits. They are therefore non-rival and non-excludable.[6] Regional public goods create positive spill-over effects (i.e., promotion of positive externalities or mitigation of negative ones) for countries belonging to a geographical region. RPGs may yield direct utility. In many cases, however, the RPG itself does not generate direct revenues and has an indirect positive influence on the revenue generation capacity of other social and economic activities in the region.

3.12 Because of these features, RPGs are generally not produced spontaneously by market mechanisms nor, often, will individual states or countries finance RPGs on their own. In many cases if one regional partner does not participate, sufficient financing will not be forthcoming and the regional objective will not be achieved. There is therefore a need for collective action and coordination to promote RPGs. As a continental institution, the Bank Group should play a constructive role in forging a regional consensus for collective action to promote RPGs; and it should be positioned to bring appropriately catalytic financing to bear. Specific criteria to guide the Bank's interventions in support of RPGs are more fully developed below (*see* 4.14).

Partnerships

3.13 The Bank Group will increasingly work in partnership with others, both clients and like-minded donors. This will include country and regional dialogue and cooperation on regional integration and the identification, development and implementation of ROs. In some cases this will involve ad hoc multinational partnerships to develop and execute specific operations. In other cases, it will involve existing continental and regional bodies, including NEPAD, RECs or other regional organizations. Partnerships will be privileged with regional organizations that have the demonstrated backing of their member countries and the required institutional capacity. The Bank Group's own capacity building efforts should contribute to stronger RECs and regional institutions over time.

3.14 The Bank Group will increasingly look to develop partnerships to finance ROs, including with bilateral and multilateral partners and private investors. This will be a key strategy for leveraging Bank Group resources. Since 2003, the World Bank has placed greater emphasis on regional operations and is now a key player. Collaboration with the World Bank on

[6] Non-rivalry: Consumption of the good by one party does not reduce the amount available for others to consume. Non-excludability: Once provided to one party, public goods are available to all at no additional cost.

regional integration is already bearing fruit and will be reinforced in the future through joint sector and project work, policy harmonization, increased staff contact and joint retreats. Concrete examples of collaboration to date include the East Africa Transport and Trade Facilitation project, the West Africa Power Pool and the Eastern Africa Submarine Cable System. There is also a strong pipeline of co-financed projects, including the Inga I and II Rehabilitation project.

3.15 The Bank Group has demonstrated its ability to build productive partnerships in ROs with a wide variety of development actors, including sub-regional development banks, UN agencies and bilateral donors. One example is the Mano River Basin HIV/AIDS Mitigation Project, which has diminished the spread of HIV/ AIDS in Guinea, Sierra Leone, Liberia and Côte d'Ivoire by addressing the disease along cross-border corridors of refugee movement, enhancing the institutional capacity of participating countries and raising awareness at all levels.

Box 3: The Mano River Basin HIV/AIDS Mitigation Project

The Mano River Basin HIV/AIDS Mitigation Project has developed an innovative partnership and cooperation mechanism. The Global Fund has been one of the major co-financiers and has supported the project from the design stage. Furthermore, UNFPA has been brought on board to coordinate the implementation of the activities in the four countries, through a decentralized mechanism. In each country a number of NGOs selected by the countries and other UN bodies (i.e., UNICEF and UNHCR) are in charge of implementing the activities on the ground. The arrangement has been very effective in delivery of resources to the beneficiaries as well as implementing the activities in a timely and efficient manner. As a result, the project has managed to accelerate progress to meet the MDG on HIV/AIDS at a regional level.

4. Operational Framework

4.1 In order to deliver on this strategy, the Bank Group's proposed operational framework will provide a rigorous but flexible tool to support regional integration through regional investments. It has been conceived in light of the lessons learned and the strategic orientations going forward. It is based on the following core elements:

- Basic eligibility requirements to ensure that operations are driven by regional development needs and demonstrably strong country commitment.
- Prioritization criteria that direct resources to projects with the greatest impact on development in Africa and that are closely aligned with the continental and regional development agenda as well as the Bank Group's own strategy.
- Financing modalities to reinforce the link with country performance and commitment, while providing sufficient flexibility and incentives.

Basic Eligibility Criteria

4.2 Regional projects must satisfy the basic requirements for all Bank Group operations (i.e., technical and economic viability, environmental standards, implementation capacity, etc.). In addition, to be considered for financing under this framework, regional projects must satisfy the following basic eligibility criteria:

- ***Project sponsors.*** Eligible entities will include: (i) governments and government entities of eligible RMCs; (ii) regional or sub-regional intergovernmental bodies and other intergovernmental vehicles; (iii) special purpose vehicles created to facilitate public investment in non-sovereign entities or PPPs; and (iv) operations sponsored by other multilateral or bilateral agencies on a case-by-case basis.

- ***Regional character.*** The operation must involve costs and/or benefits in at least two participating countries and require the involvement of all participating countries to achieve its objectives. The operation should clearly contribute to regional economic integration and/or the provision of regional public goods.

- ***Commitment.*** The project must have strong ownership by project sponsors at the country and regional level. Evidence of such commitment could include an intergovernmental or REC agreement or memorandum of understanding (already existing or under preparation).

Project Selection and Prioritization

4.3 In light of the strong demand for ROs and the limited pool of resources available, ROs will be selected and prioritized based on objective, measurable criteria. Eligible ROs will be assessed against two dimensions: (i) development impact; and (ii) strategic alignment.

- ***Development impact.*** Projects that demonstrate the greatest development impact will be given priority. Development impact will be measured by the project's contribution to: economic growth; regional integration and the provision of RPGs. Contribution to regional economic growth will be measured by a relevant indicator of economic value added. [7] The project's impact on regional integration will be measured by its contribution to regional infrastructure, common natural resource management and regional policy harmonization (i.e., movement of goods, services and factors of production, fiscal and economic management, sector and social policies, etc.).

- ***Strategic alignment.*** Preference will be given to regional projects that are strongly aligned with continental and regional objectives (i.e., ROs identified as priority operations under NEPAD[8] or REC regional integration plans) and the Bank Group's strategic orientations with respect to: (i) selectivity and sector focus; and (ii) harmonization and partnership. Priority sectors will include infrastructure, continent-wide and broadly defined, as well as other sectors identified in country or regional strategy papers. Selectivity will be reinforced by favoring projects that have already been identified as continental priorities and larger projects that best leverage the Bank Group's staff capacity and reduce unit transaction costs. Harmonization and partnership will be encouraged by giving preference to co-financing arrangements that promote donor coordination and leverage the Bank's own resources by mobilizing additional funds, including from sister institutions or the private sector.

Financing Guidelines

4.4 As a general rule, the participating country will be expected to finance its portion of the total project costs, and all participating countries are expected to share costs. An allocation of the project costs will be agreed upon during project preparation. Bank Group resources will be made available to the participating country according to the terms and conditions of the borrowing window to which it has access as set out in the relevant Bank Group policies and guidelines. Depending on the nature of the RO, the Fund may require a joint / several guarantee from participating RMCs.

ADB countries

4.5 In line with current Bank Group lending rules, ADB-only countries (category C) will finance 100% of project costs attributed to them through the ADB window or with resources from another source. Management recognizes the risk that ADB-only countries may not have the same incentives as ADF-only countries to participate in ROs. In the near term, to minimize

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[7] Whenever possible the economic net present value (ENPV) should be used as the proxy for contribution to economic growth. Another generally accepted indicator may be used for projects that do not lend themselves to ENPV analysis.

[8] For instance, the NEPAD Short-Term Action Plan (STAP) or the Medium and Long-Term Strategic Framework (MLTSF), the CAADP or projects identified in the NEPAD Spatial Development Program.

this risk and encourage ADB-only countries to participate in ROs, the Bank Group will make efforts to identify sources of concessional financing. In some cases, the MIC Trust Fund may provide grant resources to develop ROs. Management is exploring other options for promoting regional integration generally and providing incentives to participate in ROs specifically in MICs. The forthcoming MIC strategy will provide proposals.

ADF countries

4.6 For ADF countries involved in ROs, a meaningful link to performance can be achieved through the use of ADF country allocations to cover part of the cost of each operation, while also increasing incentives for participation in ROs by augmenting available country funds with the ADF regional envelope. The Financing Policy Guidelines of the prevailing ADF cycle will apply to all ADF-eligible participating countries.

- ***Country contributions:*** ADF-eligible countries (categories A and B)[9] will generally be expected to utilize a portion of their PBA-derived country allocations to cover one-third of the project costs attributed to them.

- ***Regional Envelope:*** The remaining two-thirds will come from the ADF regional envelope. This arrangement promotes country ownership and commitment, while providing very substantial financial incentives to participate in regional projects.

4.7 To accommodate the specific constraints faced by small countries, a ceiling of 10% on the amount of drawdown on individual ADF country allocations will be applied to countries with relatively small ADF allocations (UA 20 million or less). Allocated costs in excess of this ceiling will be covered by the ADF regional envelope. This is a cumulative ceiling for the entire ADF replenishment period.

4.8 As an illustration of this mechanism, consider the following example, involving two ADF countries, the first one with a small allocation of UA 15 million, and the second with a larger allocation of UA 100 million. These countries undertake a UA 50 million RO, for which UA 20 million can be apportioned to the small country and UA 30 million to the larger one.

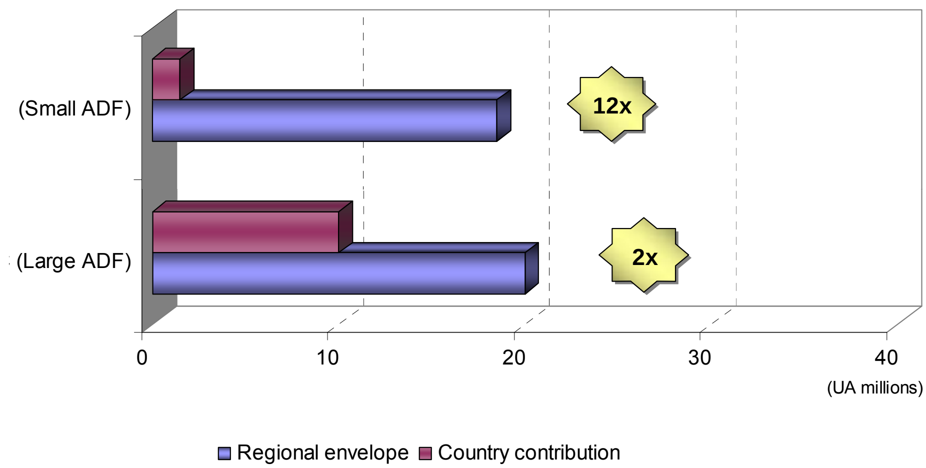
- The small country's use of its PBA would be capped at UA 1.5 million (applying the 10% cap) with the remaining UA 18.5 million covered by the ADF regional envelope.

- The larger country's use of its PBA would be UA 10 million (i.e. one third of allocated costs), with the remaining UA 20 million covered by the ADF regional envelope.

4.9 As shown in Figure 3 below, this financing mechanism creates significant leverage for ADF countries as an incentive to participate in ROs.

[9] Category A countries are only eligible for the ADF window. Category B countries have access to both the ADF and ADB window. Category C countries are only eligible for the ADB window.

Figure 3: Leverage from RO Financing Mechanism
(UA millions)



Source: Bank Group

4.10 It is important to note the cumulative character of the cap for small countries. Once the cap is reached, if a small country participates in additional ROs during the same replenishment period, it will not be required to use its country allocation. This increases the opportunities for leveraging country allocations and creates an additional incentive for countries to participate in multiple regional integration operations.

4.11 For other countries that participate in multiple operations or other special cases that may arise, exceptions to the cost-sharing formula may be proposed on a case-by-case basis and subject to Board approval.

Regional Organizations

4.12 While regional organizations are eligible to draw on ADF loan resources to finance multinational operations, all such loans will be guaranteed by their ADF-eligible member states. In circumstances where a guarantee cannot be legally provided, grant funding may be provided, on a case by case basis, subject to Board approval.

Countries Under Sanctions

4.13 The Bank Group's Policy on Loan Arrears Recovery will apply to all ROs. Some high priority ROs may require the participation of countries that are currently under Bank Group sanctions for loan arrears. In such cases, one of the other participating countries or a regional organization can take on the financial and implementation responsibilities of the country under sanctions.

The Case of Regional Public Goods

4.14 Operations in support of regional public goods involving multiple countries and / or RECs may be proposed on a selective basis. Such support would be provided on a case-by-case basis, including potentially through grants and without cost-sharing. The final financing arrangement will be subject to Board approval.

4.15 To ensure consistency, the definition below will be systematically used to assess whether a project can be considered a RPG:

A project can be considered an RPG if it satisfies the following three conditions:

Public dimension: the good is of broad public interest and benefit; a public / governmental entity in each participating country is typically responsible for the regulatory / policy context for the good to be produced and takes part in its production.

Regional dimension: the public good can only be effectively produced if every country involved participates and supports, **and** the development impact to be achieved through countries' cooperation is **demonstrably superior to** what each country could have achieved individually.

Bank's role: financing targets the **initial stage** of the processes for generating the public good, and aims at **correcting disincentives** that prevent the RPG from emerging or progressing toward the stage of production, such as *lack of coordination*, a*version to risk, free-rider problem.* As such, the project clearly provides support to the countries to address the obstacles that have prevented collaboration, **up to the point** where benefits materialize (or at least become evident) and cooperation becomes sustainable.

4.16 Examples of regional public goods include:

- Facilitation mechanisms (i.e., cooperative frameworks) for cross-border trade and transport networks, telecommunications, power grids and data transmission;
- Financial market regulation issues;
- Legal frameworks;
- Environmental management issues including pollution, management of natural reserves and scientific research on issues of ecological zones management;
- Public health issues including management of infectious disease and basic research on diseases endemic to a particular region;
- Agricultural research and extension.

Table 1: Summary of the financing modalities

Infrastructure	
Beneficiary	**Financing modalities**
ADB country	Loan on ADB terms. Country (and other financiers) finances 100% of project costs attributed to it.
ADF country (PBA>20m)	Loan or Grant, as per DSF. Country finances 1/3 of project costs attributed to it; regional envelope covers 2/3.
ADF country (PBA<20m)	Loan or Grant, as per DSF. Country finances 1/3 or less of project costs, subject to a ceiling of 10% on the amount of drawdown on the allocation, cumulative for the entire ADF replenishment period. Regional envelope covers the rest.
Regional organization	Loan, guaranteed by ADF-eligible member states. Regional organization finances 1/3 of project costs, regional envelope covers 2/3. In circumstances where a guarantee cannot be legally provided, ADF grant funding may be provided, subject to Board approval.
Country under sanction	One of the other participating countries or a regional organization can take on the financial and implementation responsibilities of the country under sanctions.
Special cases	For other countries that participate in multiple operations or other special cases that may arise, exceptions may be granted on a case-by-case basis and subject to Board approval.
Regional Public Goods	
Beneficiary	**Financing modalities**
Countries / RECs	Project to comply with RPG definition. Support provided on a case by case basis, including as a possibility through grants and without cost-sharing. Final financing arrangement subject to Board approval.

5. Implementation

Quality at Entry

5.1 In order to promote development effectiveness, the Bank will focus on improving the quality of ROs at entry through the following measures.

- ***Regional Strategies to Build Early Ownership.*** The Bank will work proactively with its RMCs to think regionally in developing poverty reduction strategies and identify regional solutions to common challenges. Ensuring ownership among regional and national stakeholders is essential for successful implementation of ROs. Regional integration and regional operations will be emphasized in country dialogue. This will be reflected in Regional Integration Strategy Papers (RISPs) and individual Country Strategy Papers (CSPs). A RISP for Southern Africa was approved in 2004, and others will be developed in the future. CSPs will also specifically address regional integration and spell out the Bank's strategy for supporting the country's integration efforts in partnership with other donors. CSPs and/or RISPs backed by relevant analytical work will increasingly be a first step in the process of identifying suitable ROs and building the political support and engagement necessary for successful project implementation.
- ***Rigorous Prioritization of ROs.*** Each sector department or sector vice presidency will review its pipeline of ROs under preparation semi-annually. Based on the latest information, each sector department will produce a list of priority operations for preparation including the status of operations already in the pipeline as well as new

operations proposed for preparation[10]. Following the sector review, the Operations Committee will consolidate sector reports and prioritize ROs across the Bank based on the eligibility and prioritization criteria. This will be done at an early stage to facilitate the preparation of annual regional operations programs that are appropriately selective and strategic.

- ***Quality Assurance for Project Preparation.*** ROs will be prepared and submitted for Board approval according to the same procedures for national projects. ROs will therefore follow the normal internal review and quality assurance process. Due to their technical and institutional complexity, ROs do require a reinforced preparation approach. They will generally demand more time and resources, including a larger project team, more and longer evaluation missions and/or greater use of consultants for technical expertise. This will be taken into account explicitly in annual business planning and budgeting. The NEPAD-IPPF will be an important tool for financing rigorous upstream project analysis.

5.2 As with all projects, each regional project proposal will incorporate a results measurement framework, including specific targets and measurable indicators. Solid baseline studies and data collection will be explicitly required and, where appropriate, funded in new regional projects. OPEV will also be involved in quality assurance under the Bank's new business processes.

Monitoring and Evaluation

5.3 The Bank Group will actively monitor the results generated by the ROs portfolio and draw on lessons learned to refine its regional approach through regular evaluation and reporting.

- ***Operations Committee regional portfolio review.*** The Operations Committee will be responsible for monitoring the use of the ADF regional envelope, including the availability of grant and loan resources to finance planned operations. This will include making recommendations about those operations that should be considered for full financing under the regional envelope as RPGs. The Operations Committee will also look at regional breakdown of the pipeline and seek to promote appropriate balance.[11] The overarching objective, however, will be to prepare the most effective projects with the highest anticipated impact, which will be achieved through broad consultation of internal and external stakeholders.

- ***Board reporting.*** Every year, Management will prepare a brief Board information note to provide an update on the use of Bank Group funds for RO and the status of the portfolio of regional operations.

- ***ADF-11 Mid-Term Review (MTR).*** An independent analysis will be prepared for the ADF-11 MTR to assess the effectiveness of the framework. Furthermore, the Bank Group will reinforce its results measurement and development impact mechanism through an analysis of completed ROs that will be prepared for the ADF-11 MTR.

Results Framework

5.4 The Bank's work on ROs is expected to contribute to the achievement of the objectives set out in the Bank's two-tier results measurement framework, including country outcomes and institutional targets (i.e., quality at entry, supervision, evaluation, harmonization, etc.). The framework for country outcomes includes indicators on African trade performance, including intra-African trade, to measure the Bank's contribution to greater regional integration. In addition to the institutional objectives in the results framework, table 2 below provides specific indicators and targets for the Bank's institutional effectiveness on ROs that are in line with and will contribute to the Bank's global results measurement framework.

[10] A concept note will prepared for all new ROs and will serve as the basis for judging the project.
[11] Regional balance is inherently difficult to define because operations may not fit neatly into existing regional groups.

Table 2: Institutional Effectiveness –Regional Operations during ADF-11

Indicator	Baseline Year	Target Year	Baseline Value	Target Value
% of RMCs with ADB regional integration strategy*	2007	2009	26	50
% of ROs in NEPAD/REC regional integration plans	2005-07	2008-09	57	67
% of co-financed ROs	2005-07	2008-09	48	66

** As reflected in either the CSP or RISP.*

6. Current Pipeline of Regional Operations

6.1 The current pipeline of ROs includes roughly 60 operations amounting to UA 2.4 billion. (See also Annex 2). It reflects the strategic priorities outlined in section 3:

- ***Focus on Infrastructure and RPGs.*** Roughly two thirds (66%) of the RO pipeline consists of infrastructure operations, including transportation, energy, water and telecommunications. The remaining operations are primarily focused on promoting RPGs including environmental protection and natural resource management and communicable disease control and eradication.
- ***Larger average size of operations.*** The average size of operations in the pipeline is UA 41.5 million, compared to UA 8.6 million for the current portfolio. This represents a significant increase and should enable better use the Bank Group's human resources and limit transaction costs for clients.
- ***More partnership and co-financing.*** Roughly two thirds (66%) of the ROs in the current pipeline are planned as co-financing arrangements. This is also a significant increase compared to the current portfolio and provides opportunities for leveraging the Bank Group's funds with those of other donors and private sector operators, and reinforcing harmonization efforts. The majority of the operations, including roughly 80% of infrastructure operations, have been identified as priority ROs within the NEPAD framework, including the CAADP.
- ***Greater regional balance.*** The RO pipeline is broadly balanced across the West (21%), East (20%), Center (16%) and South (12%). There is larger proportion of continental and multiregional operations due to a number of significant operations that span several regional groups. The North region is the only region without a significant pipeline of operations, primarily because the region is composed on ADB-only countries.[12]

7. Conclusion and Recommendations

7.1 In response to increased RMC demand, the Bank Group has earmarked a growing pool of ADF resources to support regional operations. The Bank Group needs a rigorous and flexible framework to finance regional operations as a key element of its broader strategy to support regional integration. This paper presents Management's proposal to provide such a framework for operations that involve ADF-eligible countries. Forthcoming policy documents on regional integration and support to MICs will deal with the important questions of broader Bank Group support for regional integration and the Bank Group's catalytic role in ADB-only countries.

7.2 The proposed strategic and operational framework will enhance the focus of the Bank Group's operations by emphasizing regional infrastructure and RPGs. The quality of its ROs will be improved by explicit prioritization criteria that direct resources to the strongest

[12] The Bank Group is working proactively to develop ROs in the North region, for example regarding climate change adaptation.

projects, those with the greatest development impact and strongest strategic alignment. Country ownership, a critical success factor, will be enhanced by establishing a strong link to the existing PBA system through use of ADF country allocations from all participating ADF-eligible RMCs. In recognition of the technical and institutional complexities of ROs, the implementation and monitoring mechanism will be reinforced through stronger project preparation teams and a semi-annual monitoring framework.

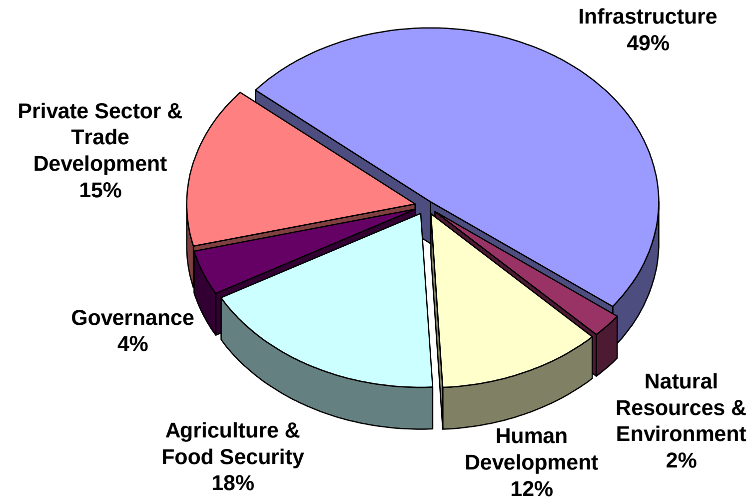
7.3 The Boards of Directors of the Bank Group are invited to approve the proposed strategic and operational framework for financing regional operations.

Annex 1: Summary of Regional Operations (1996-2006)

Sector Distribution
(UA millions)

Category	Amount
Infrastructure[1]	567.5
Natural Resources & Environment	23.2
Human Development	134.6
Agriculture & Food Security	204.9
Governance	50.5
Private Sector & Trade Development	171.7
Total	**1,152.5**

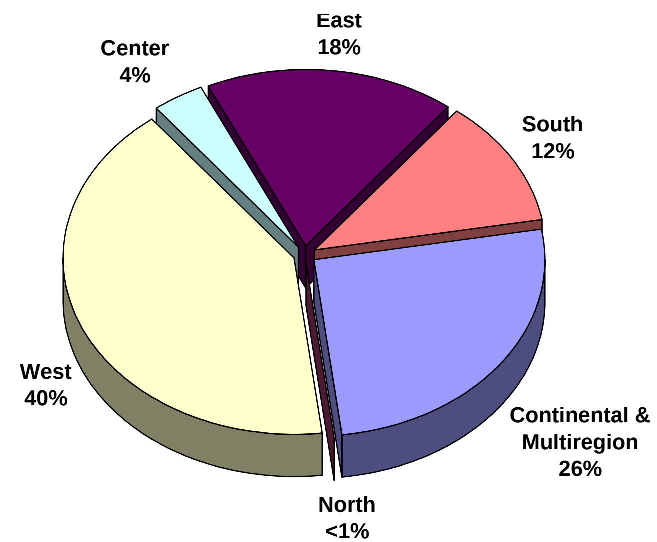
[1] Infrastructure includes transportation, energy, water and telecommunications.



Regional Distribution
(UA millions)

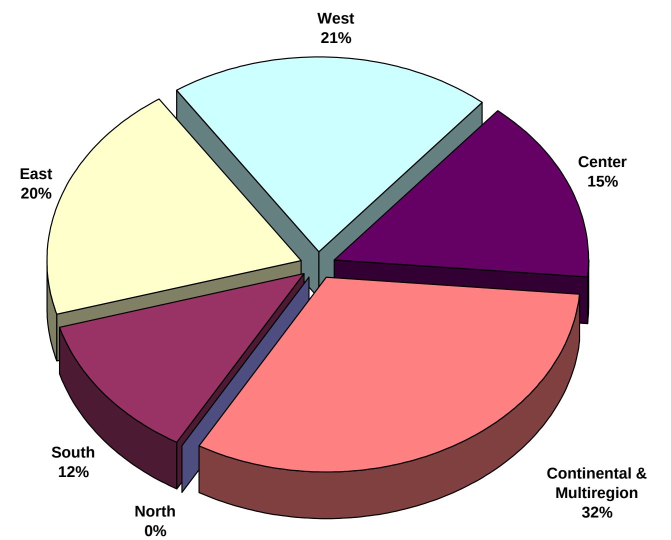
Category	Amount
Continental & Multiregion[2]	296.4
North	0.1
West	478.1
Center	41.9
East	203.0
South	133.0
Total	**1,152.5**

[2] Also includes investments in PPP initiatives.

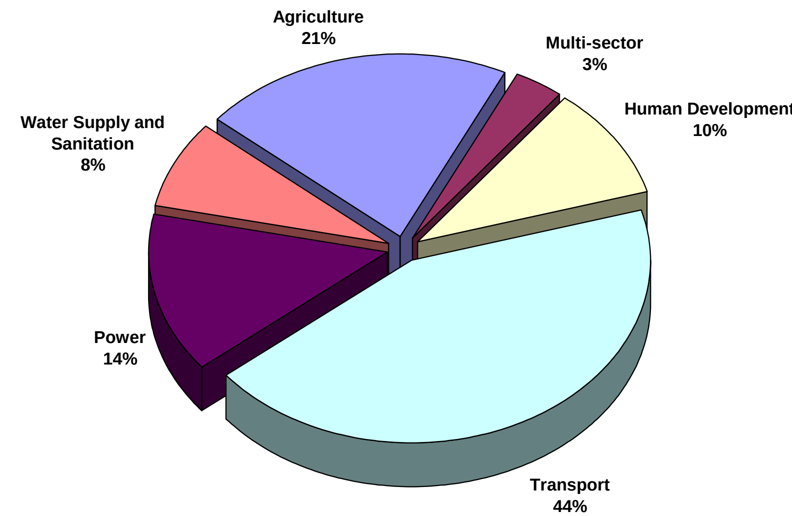


Annex 2: Pipeline of Regional Operations (2008-2010)

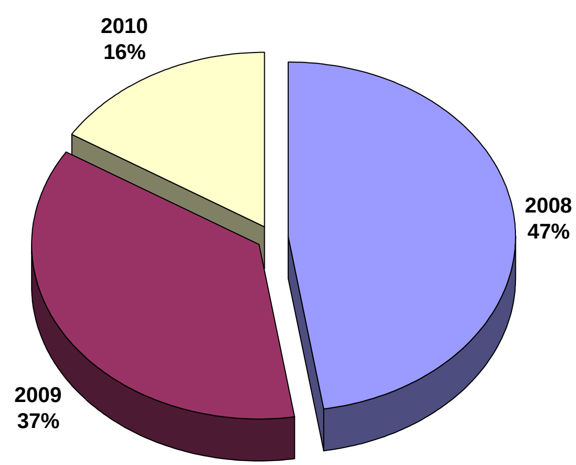
Regional Distribution



Sector Distribution



Distribution by Year



Average Project Size *(UA millions)*