AFRICAN DEVELOPMENT FUND

STRATEGY FOR ENHANCED ENGAGEMENT IN FRAGILE STATES

OPERATIONS POLICIES AND COMPLIANCE DEPARTMENT
TEMPORARY RELOCATION AGENCY
TUNIS, TUNISIA
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Acronyms and Abbreviations

ACW	Arrears Clearance Window
ADB	African Development Bank
ADF	African Development Fund
ADF-10	Tenth General Replenishment of the African Development Fund
ADF-11	Eleventh General Replenishment of the African Development Fund
AU	African Union
BWIs	Bretton Woods Institutions
CPA	Country Performance Assessment
CPIA	Country Policy and Institutional Assessment
CSP	Country Strategy Paper
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
ESW	Economic and Sector Work
FSF	Fragile State Facility
FSU	Fragile States Unit
GDP	Gross Domestic Product
GEMAP	Governance and Economic Management Assistance Program
HIPC	Heavily Indebted Poor Countries
ICSP	Interim Country Strategy Paper
ICT	Information and Communication Technologies
IFIs	International Financial Institutions
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
LICUS	Low Income Countries Under Stress
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MDTF	Multi-Donor Trust Fund
NEPAD	New Partnership for Africa’s Development
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PCCF	Post Conflict Country Facility
PRSP	Poverty Reduction Strategy Paper
RBM	Results-Based Management
RMC	Regional Member Country
RSP	Regional Strategy Paper
TRM	Transitional Result Matrix
UA	Unit of Account
UN	United Nations
UNECA	United Nations Economic Commission for Africa

Executive summary

1. This paper presents the African Development Bank's strategy for enhancing its engagement in fragile states. The objectives of the strategy are to more effectively assist fragile states to transit out of fragility, help prevent countries at risk of slippage and to assist countries in post-crisis and post-conflict transition move forward towards more stable political and economic development.

2. This strategy is grounded on the OECD-DAC Principles of Good International Engagement in Fragile States and Situations. It has benefited substantially from guidance provided on earlier drafts by the Board of Directors and ADF Deputies.

3. The Bank's enhanced support to fragile states will be implemented through the proposed Fragile States Facility (FSF) that incorporates the existing Post-Conflict Country Facility (PCCF).

4. The amount of resources allocated to the FSF under ADF-11 replenishment is UA 420 million[1], equivalent to 7.5% of total replenishment; the resources are distributed within three pillars:

   - *Pillar I – supplemental financing*: UA 272.4 million, set aside to supplement the PBA-determined country allocation to eligible post-crisis/transition countries in ADF-11 period. Countries accessing supplemental allocations will have to meet tight eligibility criteria, a specific allocation and phasing out mechanism, and monitoring, delivery and exit provisions. Consistent with the ADF-11 operational focus, the supplemental resources allocated to eligible countries will support governance and capacity building and the rehabilitation and reconstruction of basic infrastructure;
   - *Pillar II – arrears clearance*: UA 120.6 million set aside, and combined with the carry-over from the PCCF of UA 102.9 million, leading to total resources of 223.6 million;
   - *Pillar III – targeted support:* UA 27.2 million set aside to provide supplementary targeted support for capacity building and knowledge management, across the full range of fragile countries.

5. To ensure maximum impact, the Bank Group will adapt its business practices and procedures and strengthen its internal capacity, to deliver assistance and measure results in fragile states, while enhancing strategic partnership frameworks with other MDBs, partner agencies and institutions working in fragile states, including the UN, the African Union and other regional organizations.

6. Management will prepare and submit to the Board Committee on Operations and Development Effectiveness (CODE), early 2008, guidelines for operationalizing the Bank's fragile states strategy.

7. The Board of Executive Directors is invited to approve the present strategy.

[1] Pending final confirmation of replenishment figures, and excluding technical gap.

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1. Introduction

1.1 This paper sets out a framework to enhance the Bank's operational engagement in Regional Member Countries that are characterized as fragile.

1.2 The case for an enhanced approach, allowing for an increased and more differentiated engagement, has become clear. The background is essentially two-fold: the Bank has to stay engaged in all its member countries and it needs to enhance its engagement in particular in countries coming out of conflict and crisis. The latter is especially important given the marked progress that has been made in recent years in resolving many long-running and debilitating conflicts and bringing prolonged political crises to an end.

1.3 The possibility of successful turnaround is clearly demonstrated by the experience of such countries as Mozambique and Rwanda, where strong country commitment combined with enhanced and more predictable support from development partners, sustained and accelerated the transition out of fragility. Building on the lessons of the past in order to craft more effective engagement in these countries for the future is thus particularly urgent for the African Development Bank.

1.4 Underpinning the strategy is a move to strengthen incentives for countries to pursue good economic management, thus facilitating their transition out of fragility. This paper incorporates valuable guidance received from the Board of Directors and the ADF Deputies, draws from experience in other organizations and provides additional clarity and detail on specific issues that have been raised on different occasions.

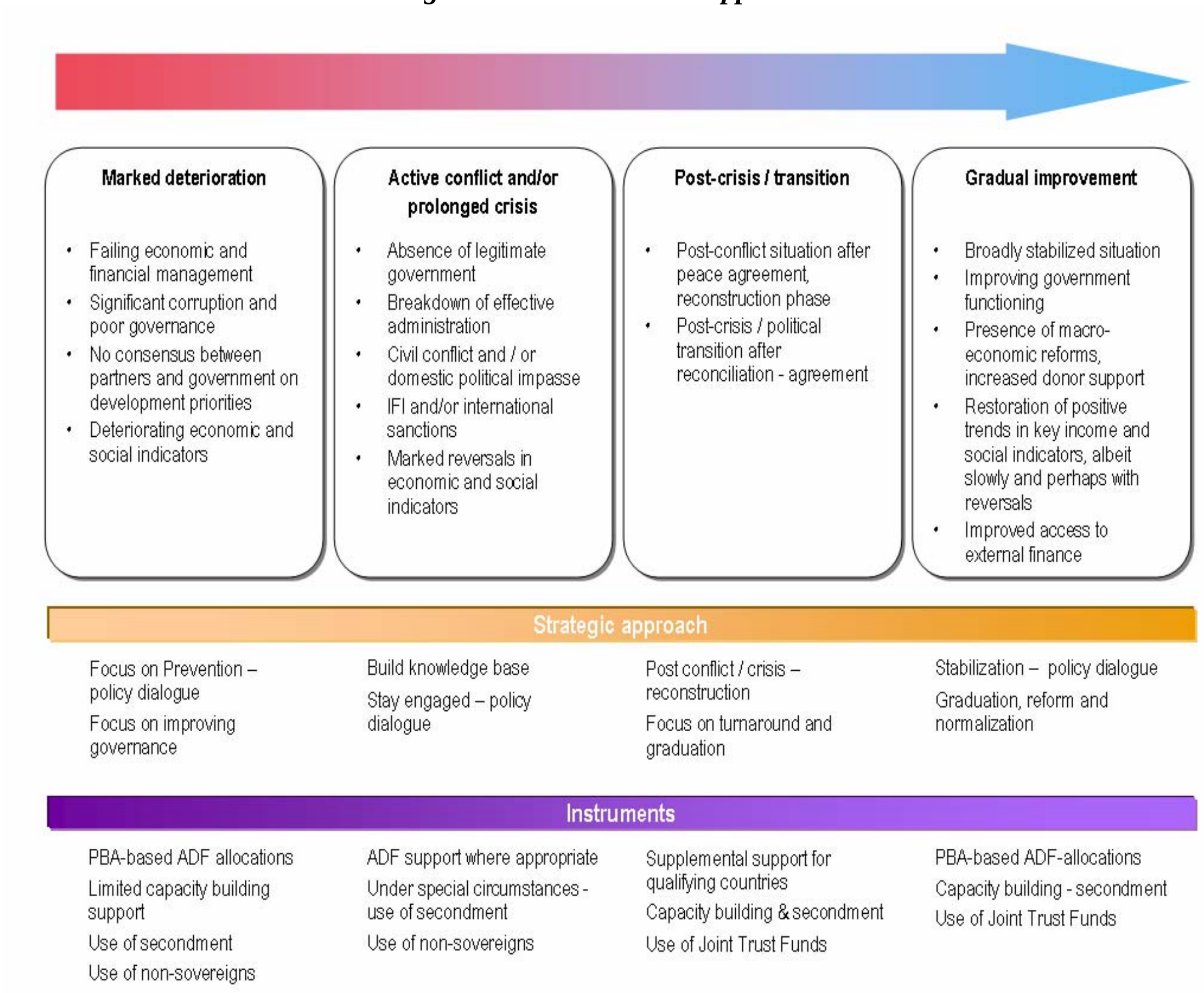
2. Assisting the Continuum of Fragile States

Diversity of fragile state situations

2.1 Fragile state circumstances take different forms in different countries and in the same country at different times. Major differences exist in political and public security environments, institutional capacity and performance, government accountability, and commitment to progress along a credible reform path. These differences have major implications for the scope and nature of engagement by development partners. Experience has shown that a uniform approach to widely differing circumstances on the ground has often failed to produce the desired results, and in many circumstances has precluded forms of selective engagement that could be both justified and effective.

2.2 The figure below illustrates a simplified continuum along which country circumstances typically fall – ranging from marked deterioration in performance, to active conflict, to post-crisis and transition, and finally to gradual improvers. Movement along this continuum is in reality neither automatic nor unidirectional, as countries may stagnate or move back and forth between various fragile situations.

Figure I: The continuum approach



Bank Group's proposed involvement

2.3 The figure above also sets out, in broad terms, avenues through which the Bank may become more effectively engaged on a selective and tailored basis.

- In situations of markedly deteriorating performance, intensified efforts to support government accountability and transparency may contribute to improved capacity.
- In situations of active conflict, viable options are few, but they could include more intensive engagement with non-sovereign actors and selective capacity support.
- States that have clearly emerged from conflict, by contrast, present a strong case for significantly deeper engagement, including through expanded direct investments.
- Finally, states that have moved into a stage of gradual improvement and turnaround can accelerate positive trends through targeted institution and capacity-building support in addition to normal PBA-based allocations.

2.4 The Bank's enhanced fragile states framework will be built around three key pillars:

- **Pillar I**: on top of regular PBA-based country allocations, a supplementary financing mechanism to provide incremental resources for enhanced Bank engagement in post-crisis and transition situations. Eligibility criteria, a specific allocation mechanism, and monitoring, delivery and exit provisions are set out.
- **Pillar II**: resources to pursue the Bank's arrears clearance program, which has been managed so far under the PCCF scheme.
- **Pillar III**: a limited pool of additional resources for supplementary targeted support for capacity building, knowledge management, etc. in the full range of fragile countries.

2.5 **A new Fragile States Facility (FSF)**. A single distinct financing vehicle - the "Fragile States Facility" - is proposed to encompass all three channels of enhanced support for fragile states. The new facility will consist of:

- An Enhanced Support Window (ESW), which will cover Pillars I and III.
- An Arrears Clearance Window (ACW), covering Pillar II and providing arrears clearance for FSF eligible countries. This window would perform a similar purpose to the current PCCF, i.e., clearing arrears to the Bank to allow resumption of normal operations and to pave the way to the HIPC process; specific proposals are made that take into account the PCCF past experiences and the emerging practices in comparable institutions.

Box 1: Legal implications of the transformation of the PCCF into the FSF

The PCCF is a *sui generi* trust arrangement governed by general principles of customary law, the terms and conditions of resolution B/BD/2004/13 - F/BD/2004/10 approving the creation of the PCCF (hereafter the "PCCF Resolution") and its own rules and procedures. Such principles and rules do not require obtaining the consent of potential beneficiaries of an arrears clearance program to transform the PCCF into the FSF. On the other hand, the consent of PCCs with vested interest, i.e. for which an arrears clearance program has been approved by the Board of Directors and not yet paid, should be obtained.

In order to transform the PCCF into the FSF, the Board of Directors of the Bank and the Fund should adopt a resolution amending the PCCF Resolution. The amendment would change the name of the PCCF to the Fragile State Facility (FSF), with two sub-facilities: the Enhanced Support Window (ESW) and the Arrears Clearance Window (ACW). The Boards of Directors should also adopt a Resolution amending the Bank Group Post Conflict Assistance Policy Guidelines – Arrears Clearance Framework, in which the role, structure, and resource allocation and funding of the FSF and of each window will be devised following precise criteria given by the Bank and Fund Management, as expressed in this document.

2.6 The key advantages of this approach include:

- Integrate enhanced support for fragile states into a single facility with the resources and instruments to deal effectively with the full range of prospective supplemental fragile state engagements. The benefits would be greater ease of administration, more effective oversight and coordination, and a more seamless sourcing of services and support.

- Strengthen the transparency and performance-basis for allocating regular ADF resources. Regular ADF resources would now be allocated using the PBA system without the need for a "post-conflict enhancement factor".
- Be legally autonomous, and thereby provide greater possibility to use more flexible procedures, in particular for participation in joint trust funds and support for non- and sub- sovereigns. While regular Bank procedures would be used, modifications to accommodate the particular conditions of fragile or post conflict/crisis states would be introduced without needing to amend the overall guidelines of the Bank Group;
- Provide scope for voluntary contributions in addition to the contribution from the ADF. Contributions from other donors could be targeted by country or for general use.
- Make use of an existing framework, the PCCF, while introducing the necessary operational modifications. The policy and legal framework of the PCCF is well established, and would be modified with the addition of a new window.

2.7 **Assistance linked to internationally coordinated strategies.** Effectively addressing the challenges of state fragility requires a clear recognition that peace, security, and economic and social development issues are intertwined. The efforts of the international community to help create a solid basis for durable emergence from conflict or state fragility must therefore be seen as part of a combined and tightly-coordinated program. In this context, the Bank's enhanced engagement with fragile states will be strategically anchored in these efforts, and will be undertaken in close concert with the other relevant parties, including UN agencies, the African Union, and multilateral and bilateral agencies, with clear division of roles and responsibilities.

3. Pillar I: Supplementary Financing for Post-crisis / Transition Countries

3.1 Pillar I provides for substantially enhanced operational support to be provided to a limited number of countries with circumstances characterized as post-crisis / transition[2]. There are particular challenges faced by post-crisis countries working toward successful transition to sustained growth and development, coupled with limitations in the Bank's potential support under its current approach and instruments.

Challenges to effective engagement

3.2 At country level, the key challenges impeding effective engagement in these states are:

- These countries typically have severely degraded institutional and administrative capacity; physical infrastructure is badly deteriorated or non-functioning; and social services are minimal or non-existent in many areas.
- Economic activity has contracted substantially, with per capita GDP well below pre-crisis levels in real terms; human development indicators have typically dropped, even from already low levels.

[2] The "post crisis-countries" in this paper covers countries characterized by OECD/DAC as in post conflict / crises or political transition situations. Other OECD/DAC categories are: deteriorating governance environments, gradual improvement, and prolonged crisis and impasse. OECD: DCD/DAC (2006)62

- Even under optimistic projections available domestic resources are only a fraction of the estimated new investment needed to restore or attain provision of basic services.
- Negative regional spill-over effects are quite often large, with traditional commercial links severed or badly disrupted.
- Dependency on external assistance tends to be heavy, but access to adequate external resources on appropriate terms is still quite limited relative to needs. Aid flows tend to be highly variable and volatile, and in many cases have been interrupted for lengthy periods. Absorptive capacity is a significant challenge.

Limitations of existing approaches

3.3 Limitations to more effective engagement thus far by the multilateral development banks, including the Bank Group, include:

- Resources allocated under performance-based allocation (PBA) system tend to be low relative to needs and legitimate demands.
- The CPIA assessments on which allocations are largely based are only able to capture the very performance deficiencies that result from crisis-driven institutional failure and that require targeted external support. The intended performance focus of the existing PBA mechanism in effect results in low-capacity post-crisis countries competing for limited resources with performing countries in a sharply different set of circumstances. Moreover, because CPIA ratings are retrospective, by design and due to data constraints, they may not adequately capture evidence that a country is actually working to "turn the corner".
- Annual allocations provide, as intended, a regular vehicle for performance assessment; however, they also bring considerable uncertainty for the medium-term budget planning process needed for a well prioritized multi-year recovery and reconstruction effort.
- Arrears to the institutions are typically large relative to prospective new flows, and often long-standing; negotiating a multilateral arrears clearance deal invariably takes considerable time.
- Field presence is at best limited, not well tailored to specific needs and is often lacking entirely.
- Prolonged crisis invariably undermines the knowledge base of the international institutions about this group of countries, making their own reengagement point one of considerable uncertainty.
- Standard operational systems and methods can result in substantial delays in delivering assistance, and may be hampered in adequately monitoring either its quality or effectiveness.

Key elements of the enhanced approach

3.4 The Bank's proposed operational framework for Pillar I builds up from these challenges and AfDB's accumulated experience. Its core components are:

- Engagement triggered by a limited number of indicators intended to demonstrate both particular needs and clear commitment to transition to social stability, reconstruction and renewed development.
- Provision of supplemental resources (i.e., beyond allocations derived from the annual PBA process), primarily for priority infrastructure investments and capacity building.
- Supplemental funding committed up-front for three years, and in line with a country's Debt Sustainability Framework (DSF).
- Funds specifically dedicated for this purpose from the Bank's ADF-11 pool.
- Effective collaboration with partners, including joint engagement wherever possible.
- Potential support for up to 2 ADF cycles, with exit from supplementary financing expected after no more than 6 years.
- Reduction of delivery bottlenecks, and effective monitoring and reporting.

3.5 The Bank will apply a two-stage process in selecting the post-crisis and transition countries eligible to its supplemental operational support.

3.6 **First-Stage Criteria.** The first stage is an assessment of key conditions of peace and security, and of key socio-economic needs indicators.

Box 2: detailed first-stage criteria

Commitment to Consolidate Peace and Security	To demonstrate commitment to consolidating peace and security after crisis or conflict, the country should have: (i) A signed comprehensive and internationally recognized peace agreement or a post-crisis or reconciliation agreement. The presence of such agreements is clear indication that the country has moved out of conflict and is in the process of consolidating its peace situation. International recognition would underpin prospects for supporting the country by other partners and institutions, including the UN Agencies, Funds and Programs. The credibility of signed agreements would also need to be buttressed by an absence of ongoing hostilities of any significance, which is necessary in ensuring that the Bank's program of assistance could be smoothly implemented without being hampered by serious security considerations. Conversely, the absence of formal agreement is indication that the minimum conditions have not been met for substantial Bank Group engagement in the post-crisis or post-conflict transitional country; and (ii) A functioning governmental authority or transitional government broadly acceptable to stakeholders and the international community must also be in place.
Unmet Social and Economic Needs	While all ADF countries are characterized by significant unmet economic and social needs, post-crisis and transitional states that are candidates for supplemental assistance from the Bank are expected to face a uniquely challenging combination of circumstances demonstrated by: (i) Continuing severe economic effects of conflict, as evidenced by a

	contraction of real GDP per capita by 10 percent or more since 1990, which is the base-reference year for the Millennium Development Goals (MDGs). Analysis tends to suggest that countries in Africa where the per capita GDP has contracted by more than 10 percent since 1990 are the furthest from reaching the MDG goals; and (ii) Extremely low levels of human development, as indicated by ranking in the bottom quintile of the UN Human Development Index.

3.7 **Second Stage Criteria.** Countries considered to satisfy these first-stage criteria would then be assessed relative to a simple filter intended to capture a country's commitment to a sound program to improve macroeconomic conditions and pursue sound debt policy, sound financial management practices and transparency of public accounts.

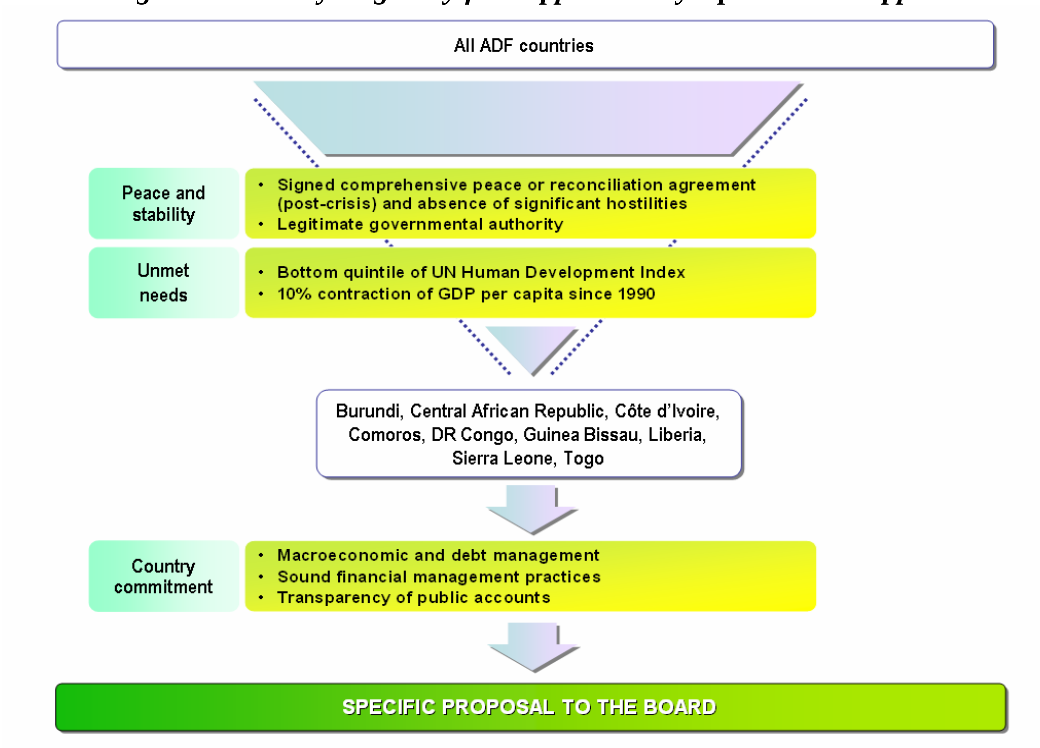
Box 3: detailed second-stage criteria

Improving Macroeconomic Conditions and Pursuit of Sound Debt Policy	The Bank will assess a country's program to improve its macroeconomic performance and debt management policy. Such an assessment is critical in the context of countries which emerge from crisis or conflict with unstable macroeconomic conditions, including high domestic inflation and unsustainable debt. The assessment will be done in close collaboration with other partners, including the Bretton Woods Institutions. It will be based on dialogue with the relevant country authorities and stakeholders, on the basis of which agreement will be reached on key performance benchmarks used to guide engagement and assess the country's progress over the medium term.
Sound Financial Management Practices	The Bank will assess a country's commitment to pursue sound public financial management practices, which are important dimensions of improving good governance and in re-establishing the enabling environment for private sector activities in post-crisis and post-conflict transitional countries. The Bank will assess this commitment based on progress made by a country in reforming its public expenditure management system, seriously addressing corruption and reviving or strengthening its revenue mobilization institutions.
Transparency of Public Accounts	The Bank will further monitor the transparency of public accounts in all post-crisis, post-conflict transitional countries eligible for supplementary funding, through regular reporting or publishing of government revenues and expenditures, external debt obligations and new borrowings.

3.8 **Specific Proposals to Board**. Management will prepare and submit to the Board specific proposals for each country potentially eligible for supplemental funding.

3.9 In the context of this exercise, the Bank's preliminary assessments indicate that nine countries might at present pass the first stage bar. Illustration is given in figure 2 below.

Figure 2: Country Eligibility for Supplementary Operational Support



Allocation of supplementary operational support

3.10 **Guiding principles.** The proposed resource allocation mechanism aims to satisfy the following basic criteria:

- Expand the Bank's allocated resources and operations in eligible countries to support recovery and transition;
- Scale resources appropriately relative to the size of the economy and its development circumstances;
- Provide a transparent and predictable process to determine individual country allocations that is perceived as equitable relative to resources similarly provided to other recipients; and
- Make resources available with high degree of certainty for a multi-year period.

3.11 **Support for performance.** The proposed mechanism for supplementary resource allocation is in synch with the ADF cycle. The mechanism for allocation of these resources for the upcoming ADF period is anchored in a country's performance under the previous ADF period. Specific country allocations are calculated as follows:

- Set as a baseline, or "anchor", the average of the two highest calculated allocations under the previous ADF period[3]. These allocations: i) capture the relative size and economic development differences between individual countries; ii) reflect the best

[3] Calculated excluding any resources provided through the Post-Conflict Enhancement Factor (PCEF) and the UA 5 million minimum

available recent measures of performance, through the CPIA[4]; and iii) do not reflect any prior judgment about post-conflict funding needs.

- Given the pool of resources made available for ADF-11, the supplemental amount to be provided under this approach is equivalent to ~2.17 times this baseline allocation[5]. Thus, a country whose average "highest 2 years" allocation for the ADF-10 period was UA10 million would be eligible for supplemental funding of UA 21.7 million.

3.12 The basic performance-driven allocation will continue to be provided, under ADF-11, in addition to any supplemental allocation. Thus, for example, a country whose average "highest 2 years" allocation for the ADF-10 period was as above, and whose ADF-11 allocation is set at UA15 million, would have a total pool of available resources of UA 36.7 million over the upcoming three year period.

3.13 **Floors and caps.** Given the wide range in population size of potentially eligible countries, a single country could potentially receive under this approach a supplemental allocation that is very large in absolute terms. With the competing demands for and constraints upon the limited pool from which these supplemental funds would be constituted, there is a real risk that large-country allocations would crowd-out resource availability for smaller eligible countries. Similarly, some minimal level of supplemental funding would be necessary to ensure meaningful additionality. Consequently, a minimum supplemental allocation of UA10 million and a maximum of UA60 million are set.

3.14 If additional countries become eligible, separate proposals will be presented to the Board with respect to their financing.

Performance Monitoring and Exit

3.15 **End-of-cycle assessment with six-year limit.** There would be a limit of six years — two ADF funding cycles — on access to supplementary operational support. The base period for enhanced support is 3 years. Continuation of support after the first 3-year period would require (in addition to funding availability under the AD-12 replenishment), satisfactory performance during the first cycle as determined by formal review, on a case-by-case basis, and the approval by the Board of Directors. Assessment will be based on the achievements made by the country with respect to commitments and benchmarks agreed with the Bank at entry point, and set out in the country programming document. The normal PBA process under ADF-11 will also contribute an on-going performance assessment that will feed into the end-of-cycle assessment.

3.16 **Performance benchmarks.** Performance benchmarks will aim at being few, simple, monitorable, and country specific, taking into account identified constraints on the ground. While the benchmarks will be tailor-made to country situations and therefore will vary across countries, they are expected to include economic governance, especially in strengthening public financial management, as is the case in Liberia under the GEMAP – Governance and Economic Management Assistance Program. Others would include transparency in public financial and debt management policy, implementation of a plan to normalize relationships with other partners, particularly the MDBs, commitment to

[4] The CPIA does not capture some dimensions of fragile state performance such as security, nor does it reflect rapid or discontinuous changes in performance such as a peace settlement. The MDB Working Group, in which the Bank is actively participating, is further exploring the development of performance measures that could better underpin allocations decisions for enhanced support to post-conflict/crisis countries. Pending the development of such an indicator, the CPIA remains as the best available, simplest and most transparent single measure.

[5] A detailed explanation of the calculation of the top-up factor is provided in Annex VII

execute a sound arrears clearance program, and the satisfactory implementation of a medium-term, growth-oriented macroeconomic reform program.

3.17 **Premature exit from Pillar I.** While the basic presumption would be that supplemental funding would be assured for a full three year period, a significant departure from the agreed basis for supplemental support -- such as a breakdown in agreed political arrangements or public security, or accumulation of new debt on inappropriate terms -- would trigger a rapid review that could result in premature exit from the supplemental program. Any such exit decision would be submitted to the Board for review and approval. The expectation would be that if early exit were approved for a country, any un-obligated Pillar I fund for this country would be returned to the general ADF resource pool.

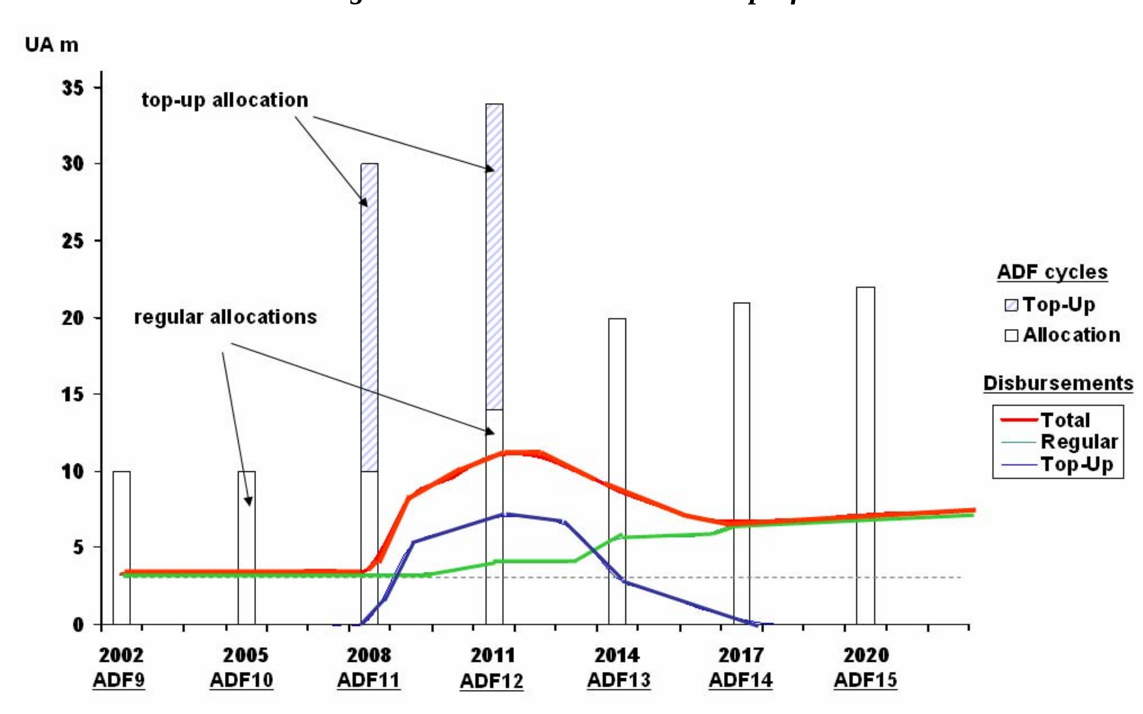
3.18 **Disbursement profile.** In administering the supplementary allocations, due attention will be paid to the profile of support, particularly as countries approach full reliance on regular ADF resources. The disbursement curve is expected to avoid potentially disruptive drop-off of support, due to:

- Front-loading the enhanced support at the beginning of the lending cycles;
- Spreading disbursement flows over multiple years (in particular, project portfolio and disbursement profile will be programmed in a manner that could ensure a smooth transition at the end of the supplemental funding); and
- The effect of normal PBA allocations, which will increase as a result of better country performance.

3.19 Illustrative phasing[6] is presented in figure 3.

[6] Key assumptions used in the illustration: initial PBA of UA10m, moving up to UA14m after 1st three-year enhanced support, then UA20m at the end of the 6 years, and growing at the rate of 5% per replenishment thereafter (improvement of country performance). Average disbursement period for projects: 6 years. Financing under enhanced contribution front-loaded at 1st three-year cycle, further front-loaded at 2nd three-year cycle once absorptive capacity is built up.

Figure 3: illustrative disbursement profile



Focal Areas of Support

3.20 **Strategic priorities.** Consistent with the ADF-11 operational priorities[7], the Bank's support in post-conflict / transition countries will focus on rehabilitation / reconstruction of basic infrastructure and governance / capacity building, where its intervention is expected to generate the highest impact. Leadership in other critical areas, such as peace and security, will be left to other partners.

3.21 **Infrastructure**. With respect to infrastructure, the Bank will determine the specific areas (in transport, water supply and sanitation, energy and power, ICT) on the basis of country demand; an overall plan will be developed, in conjunction with other partners.

3.22 **Governance / Capacity building**. Capacity building would aim at addressing weaknesses in state administration and accountability and economic management. Programs would seek to address the drivers of conflict to prevent its re-emergence and address the impact of conflict on a regional basis. The Bank will, in particular, provide support for programs of economic and structural reforms, including budget support where conditions are appropriate. Specific attention will be paid to the challenges of resource-rich fragile states, lack of transparency, and corruption as contributors to state fragility.

3.23 **Regional approach.** As spill-over effects from fragile states are substantial in Africa, the Bank would take a regional approach in providing support for post-conflict and transition counties. Strengthening regional integration and investing in cross-border infrastructure will create positive synergies and have stabilizing effects on sub-regions.

3.24 **Mainstreaming cross-cutting issues**. The Bank will mainstream cross-cutting issues into its enhanced engagement. In particular, the Bank will seek to ensure that the programs its supports will help address the impact of conflict and crisis on women and other vulnerable groups and the gender-related obstacles that prohibit women from

[7] See African Development Fund, ADF-11 Deputies Report, December 2007

participating fully in the development process; the environmental challenges attending to a rapid building up of infrastructure and economic activity; and communicable disease problems exacerbated by conflict.

4. Pillar II: Arrears Clearance

4.1 Supplementary operational support needs to be closely coordinated with arrears clearance operations to ensure the highest impact in the countries concerned. In order to maximize synergies, the arrear clearance activities – currently managed under the PCCF scheme – will be folded into Pillar II of the Fragile States Facility, the Arrears Clearance Window (ACW).

Lessons Learnt From PCCF Operations

4.2 The Post-Conflict Country Facility (PCCF) was established in July 2004 to assist post-conflict countries to clear their arrears with the Bank Group. Thus far, assistance has been provided through the PCCF mechanism to Burundi (Oct. 2004), the Republic of Congo (Dec. 2004), Central African Republic (Dec. 2006), Liberia and Comoros (Dec. 2007). The five successful arrears clearance operations to date provide useful experience to inform future operations.

- Application of a case-by-case approach has been both necessary and appropriate given the differences in economic and financial circumstances.
- Flexibility on cut-off dates and burden sharing has contributed to achieving the PCCF's core objective, but has also produced wide variations in the application of the originally established norms for cut-off dates and burden-sharing (a three-way burden sharing arrangement was initially devised, in which an eligible country was expected to repay up to 1/3 of its arrears, the country's development partners to assist in clearing at least 1/3, while the remaining 1/3 would be cleared by the PCCF. In practice, a tailor-made approach has largely prevailed).
- Close coordination with bilateral and multilateral Donors has been critical.
- Transactions costs -- particularly with respect to negotiations and delays in reaching final agreement -- have been greater than anticipated.
- Arrears clearance has trigged net positive resource transfers, as intended.
- All countries have quickly reached the HIPC decision point after arrears clearance).

Box 4: Burundi's Successful Transition from Arrears Clearance to HIPCs Program

Experience to date reaffirm the importance of a dedicated and adequately resourced PCCF arrears clearance mechanism that could effectively assist countries in economic and financial crisis and those in transition to reengage with the Bank, thus enabling them gain access to new inflows of much need resources, including those from HIPCs and the Multilateral Debt Relief Initiative (MDRI), to finance their socio-economic recovery programs. Burundi, the first beneficiary of the PCCF, for instance, received support for arrears clearance from the Bank, the World Bank and the IMF in 2004, which enabled the country to gain access to its HIPC program in September 2005 worth US$ 826 million in December 2004 Net Present Value (NPV) terms. The Bank contributed US$149.4 million or US$ 226.01 million to Burundi's HIPC program. The country has made commendable progress in implementing its HIPC program and is targeted to qualify for deeper debt relief under the Multilateral Debt Relief Initiative (MDRI) in early 2008.

Proposed reforms

4.3 As the PCCF is folded into an Arrears Clearance Window within the Fragile States Facility, Management proposes to strengthen the Bank's arrears clearance programs by introducing changes that take into account the lessons learnt over the past in the following three areas:

- **Eligibility** to Arrears Clearance Window:
    - o Management proposes access to the ACW for eligible countries to FSF's Pillar I. Thus, eligible countries will meet the two-stage criteria set out under pillar I of the FSF, including having established coordinated re-engagement programs with other partners[8].
    - o The countries must also:
        - Have respected the Bank Group's preferred credit status by servicing new maturities on all outstanding Bank Group loans or at least to the same relative level of the debt service paid to other IFIs; and
        - Be eligible for HIPC debt relief, but not yet at the decision point of the program.
- **Two-tier burden sharing**: To minimize the time and resources spent in pre-arrears clearance negotiations and ensure a more equitable cost-sharing arrangement, Management proposes that arrears clearance under the FSF be based on a two-tier system that eliminates bilateral donor contributions rather than the three-tier arrangement applicable in the PCCF. The proposed two-tier system will ensure that countries continue to meet up to a maximum of a third of their arrears clearance obligations while the ACW of the FSF takes up a minimum of 2/3. Under this approach, it will be also possible for other donors to make contribution towards the country portion of the burden share on a voluntary basis.
- **Quantitative assessment of country's ability to pay**: The actual share of a country's contribution to its arrears clearance program will be based on a quantitative assessment of its ability to pay. This will ensure a consistent and transparent determination of the country share. The methodology is detailed in Annex V.
- **Possibility for operational support to precede arrears clearance**: Operational support through the enhanced mechanism (i.e., supplemental resources) would be allowed to precede arrears clearance, on an exceptional basis, when countries show firm commitment vis-à-vis debt regularization. In any such situation, the approval of the Board of Directors, based on the case presented by Management, will be sought. New commitments from the PBA-derived base allocation would be made consistent with the Bank's current policy.

[8] The PCCF guidelines required potentially eligible countries to have been designated as "post-conflict" applying the established criteria used by the Bank to define PCC. Such countries must also be potentially eligible for HIPC but not yet qualified for debt relief under the initiative.

Box 5: Addressing Moral Hazard

The exceptional case for the provision of supplemental support to a country prior to the completion of the process for debt regularization raises the question of moral hazard, by which the Bank's actions could lessen the incentive for debtors to meet their obligations to the Bank Group. This risk is expected to be adequately mitigated, as follows.

First, access to the Enhanced Support Window (as well as access to arrears clearance support as at present) will be limited by the eligibility criteria and performance benchmarks, including sound macroeconomic and debt management practices.

Second, the basis for continued access to the supplementary financing (i.e. for a second 3-year cycle) includes specifically agreed performance elements. In particular, active participation of the country in the arrears clearance process would be viewed as part of the country's commitment to economic governance. The program being supported by the Bank Group in conjunction with the Bretton Woods Institutions and the international community will provide clear incentives for the country to pursue a policy path that includes clearance of arrears to the Bank Group. The linkage is hence through the program itself, which would provide an explicit path to debt regularization, and be part of the performance benchmarking.

The proposed provision to fragile states of ESW financing before arrears clearance will necessitate the approval by the Boards of Directors, on a case by case basis, of waivers to the Revised policy on loan arrears recovery dated March 1997 (the "Sanctions Policy"), which contains a general prohibition to identify, appraise, approve or disburse new projects or programs in countries which are in arrears.

4.4 The Bank will ensure that its arrears clearance programs are tightly coordinated with the arrears clearance operations of other International Financial Institutions (IFIs), in particular the World Bank and the IMF. Tight coordination is essential particularly to determine appropriate cut-off dates and ensure that arrears are cleared simultaneously in countries with arrears to the Bank and other IFIs. Under a recent agreement with the World Bank and IMF, the Bank will be directly engaged in the debt sustainability framework.

5. Pillar III: Targeted Support

5.1 While supplementary operational support would be made available only to a sub-set of eligible post-crisis and transition countries, pillar III provides dedicated resources to enhance the Bank's engagement in other fragile situations (*see* Figure I page 2) through a set of targeted interventions and instruments. In particular,

- For countries moving towards more fragility, with a risk of drifting to conflict or crisis, intensified provision of policy advice and efforts to strengthen institutional and administrative capacity could contribute materially to stabilizing deteriorating situations and help prevent conflict.
- For countries in conflict or crisis, targeted interventions aiming at anchoring reforms and improving performance in these cases can make an important contribution to effective use of ADF resources accessed on a normal PBA-basis.

5.2 Pillar III offers a limited pool of dedicated supplemental resources available to provide incremental support in areas that cannot be adequately addressed through traditional projects and instruments. Such resources would finance:

- **Secondments for capacity-building.** Fragile states commonly suffer from particularly weak state capacity and accountability. The challenge is especially daunting for core institutions of economic and financial management and administration. In such circumstances, regular technical assistance operations leave gaps in terms of timeliness and targeting. Secondment of seasoned professionals would help fill such critical gaps at the senior executive level, building leadership capacity on a targeted basis and helping to develop senior civil servant capacity in management and implementation of reforms.

- **Small grants to non-sovereigns for service delivery.** With weak state institutions for delivery of critical services, non-state (“non-sovereign”) entities, such as international procurement or auditing firms, may be the best or only avenue to address critical service gaps in fragile state situations.
- **Knowledge-building and dialogue.** Economic and sector work (ESW) needs to be produced in order to support knowledge enhancement: in particular, analysis of the impediments to change, the dynamics in government, state-building and the potential drivers of reforms. This knowledge is important to get the reform agenda for fragile states right in specific country contexts and to underpin productive dialogue. The Bank will also seek to develop early warning tools about the sources of fragility and develop appropriate response options for the state, in conjunction with NEPAD, African Research Institutions, and external researchers (in cooperation with ECON).

6. Proposed Financing Approach

6.1 Effective implementation of the proposed revised approach will require additional resources on an enlarged scale and a dedicated mechanism to deliver them for the intended purpose. This section summarizes the major financial components of the approach presented, and outlines the proposed financing mechanism.

Financing needs and sources

6.2 The amount of resources provided to the FSF by the ADF will be determined in each replenishment cycle. Under the ADF-11 replenishment, the FSF is allocated 7.5% the total ADF-11 resource level of UA 5.6 Billion[9], or UA 420.3 million. The resources are distributed as follows within the three windows (see detailed rationale in Annex VI).

- UA 272.4 million for supplemental operational support in post-crisis/transition countries.
- UA 120.6 million for the ACW, which will be combined with the carry over of UA 102.9 million from the PCCF. Total resources in the ACW will therefore be UA 223.6 million for ADF-11 period.
- UA 27.2 million to finance targeted support for capacity building, knowledge management cross the full range of fragile states.

Additional sources of funds

6.3 The funding provided under ADF-11 may be supplemented by additional voluntary contributions from ADF donors beyond basic ADF-11 commitments and direct contributions from non-traditional sources, including non-ADF-members, particularly to finance any additional countries as may become eligible.

[9] Excluding technical gap. Pending confirmation of final replenishment figures.

7. Partnership and Complementarity in Implementing the Strategy

Principles

7.1 The proposed strategy is grounded on the OECD-DAC Principles for Good International Engagement in Fragile States and situations, which aim to complement the commitments, set out in the 2005 Paris Declaration on Aid Effectiveness (Annex III).

7.2 Work by the OECD-DAC reflects the significant increase internationally in the interest in fragile states, and in developing more effective approaches to assist them. Relevant UN-bodies and Multilateral Development Banks, including the Bank, have been active participants in this process. A key element of this framework is agreement on appropriate division of labor in country contexts. The Bank will contribute to the development of such strategic frameworks in fragile states, identifying critical gaps and ensuring complementarity and tailor-made approaches in the way it operates on the ground. Such donor coordination will be linked to a comprehensive and agreed reform-agenda, which will be sequenced in relation to key priorities, each donor concentrating on areas where it has strength and where it could make an impact. Joint operations or co-financing arrangements with other partners will be used strategically. These approaches will have to adapt to the changing environment on the ground. The proposals outlined in this paper are aimed at enabling the Bank to do so, to adapt its operational strategy to local needs, to act faster, more flexibly, and in closer partnership with others.

Support for integrated peace-building strategies

7.3 The Bank's support would be part of an integrated peace-building approach that would address the political, security and development issues in fragile states. As the mandate of the Bank along with other MDBs does not extend to all of these areas, the Bank would work in partnership and coordination with all relevant bilateral and multilateral actors on the ground. Talks will be held in particular with the United Nations Development Program (UNDP), the UNDP Bureau for Crisis Prevention and Recovery, and the United Nations Children Fund (UNICEF). The UNDP and the World Bank are developing a joint work plan on state building in fragile states, including country level work and lessons learning. The Bank Group will engage in these discussions.

Collaboration with other African institutions

7.4 African institutions are taking on an increasingly important role, both in relation to policy and security in fragile states in Africa. The African Union, Economic Commission for Africa (ECA), the New Economic Partnership for Africa's Development (NEPAD) and the regional institutions are important partners for the Bank. This collaboration will be even more critical in countries in fragile situations, in conflict and crisis prevention, during crisis, and when countries are transiting out of conflict and crisis. The Bank will work closely with all African partners in relation to state fragility, including through the recently developed Early Warning System (EWS). As sub-regional spill-over effects are key concerns in this regard, close coordination and cooperation between African institutions to address these concerns from both security, political and development perspectives are critical.

Collaboration with MDBs

7.5 The Bank will enhance its collaboration with other IFIs, particularly the World Bank and the IMF in the implementation of the strategy, including the provision of arrears clearance and debt relief to eligible countries. This collaboration is essential in moving forward the fragile states agenda, sharing lessons and experiences learnt and in creating the required synergy for operating in such countries. The Bank will collaborate with other MDBs in harmonizing its operational approaches in fragile states, including undertaking joint debt sustainability frameworks, economic and sector works, and preparation of joint programming strategies. In this regard, the Bank is an active member of the MDB Working Group (WG) on "fragile states and weakly performing countries" that was set up in March 2007 and tasked to come up with common definitions and operating principles for engaging collaboratively in fragile states, explore possibilities for building partnerships with donors, including the UN Agencies and regional organizations and agree on procedures that could ensure the effective design and implementation of MDBs responses in fragile states[10].

7.6 The first Report of the WG[11] was endorsed by the six MDB Heads during the October 2007 World Bank - IMF Spring Meetings. The report identified strengthening national ownership or recovery and reform, building capacity and accountability in national institutions, and contributing to peace-building through economic and social programs as the goals of MDB assistance in fragile situations. The Report further identified the guiding principles, operational approaches and implementation arrangement that should be pursues in order to achieve the goals of MDB assistance in fragile states.

8. Reforms to Improve Impact

Adapting programming tools to country circumstances

8.1 The Bank program of assistance will be differentiated to meet the specific circumstances in each country and will be governed by a Board-approved programming document in the form of a Country Dialogue paper, Interim or full Country Strategy Paper, Joint Assistance Strategy or Country Briefs (Details are provided in Annex IV). Management and Country Teams will select the appropriate programming instrument to use based on country specific circumstances.

Improving delivery

8.2 For the Bank to provide more timely and effective support in the especially challenging circumstances in fragile states, it will have to address a number of operational constraints.

8.3 A number of important steps are already underway Bank-wide as part of the ongoing institutional reforms that are expected to strengthen the Bank's delivery performance in fragile states (as well as other RMCs). These include:

- Significant streamlining of business processes, particularly with respect to the project development and review process, that will reduce internal processing delays and improve focus, quality at entry, and performance monitorability.

[10] MDBs participating in this WG are: the African Development Bank, Asian Development Bank, Inter-American Development Bank, European Bank for Reconstruction and Development, the World Bank and the IMF
[11] MDB Working Group on Fragile States and Weakly Performing Countries "Towards a More Harmonized Approach to MDB Engagement in Fragile Situations" Washington D.C., Oct. 2007.

- Introducing more flexible waivers on a case-by-case basis, allowing for up to 100% Bank financing of operations in fragile states including for recurrent expenditures, taxes, and local costs.
- Strengthening the focus on results and allowing for more flexible treatment of different country contexts and circumstances in country programming documents;
- Country teams are now central to strategy development and operational delivery, and explicitly accountable for effective results on the ground. Significantly more Bank staff are now on the front line of operations.
- Strengthening the operations complexes and field offices of the Bank through enhanced recruitment.
- Delegating authority downward and outward to the field offices; reduced delays and greater staff level initiative in solving problems are expected.
- Restructuring the Procurement and Financial Management Unit and revising internal procedures in order to substantially improve oversight and quality control, and ensure that unnecessary and unreasonable procurement delays are eliminated.
- Invigorating the Bank's Partnership Unit with the objective of streamlining the quality of relationship with external partners, build innovative new partnerships, and ensure more effective use of the special purpose resources entrusted to the Bank.

8.4 Beyond these steps, which promise to improve operational performance Bank-wide, the Bank will take additional initiatives specific to improving results and performance in the context of fragile states, including:

- The adoption of a series of specific rapid-response procedures to speed up disbursement and procurement activities, as set out in Annex II would be utilized on the basis of case-by-case approval by the Board.
- Explicit benchmark and monitoring of all procurement and disbursement activities in recipient countries to eliminate unnecessary delays.

8.5 The Bank will explore additional possible steps in a few areas, and will engage the Board in discussions on the following:

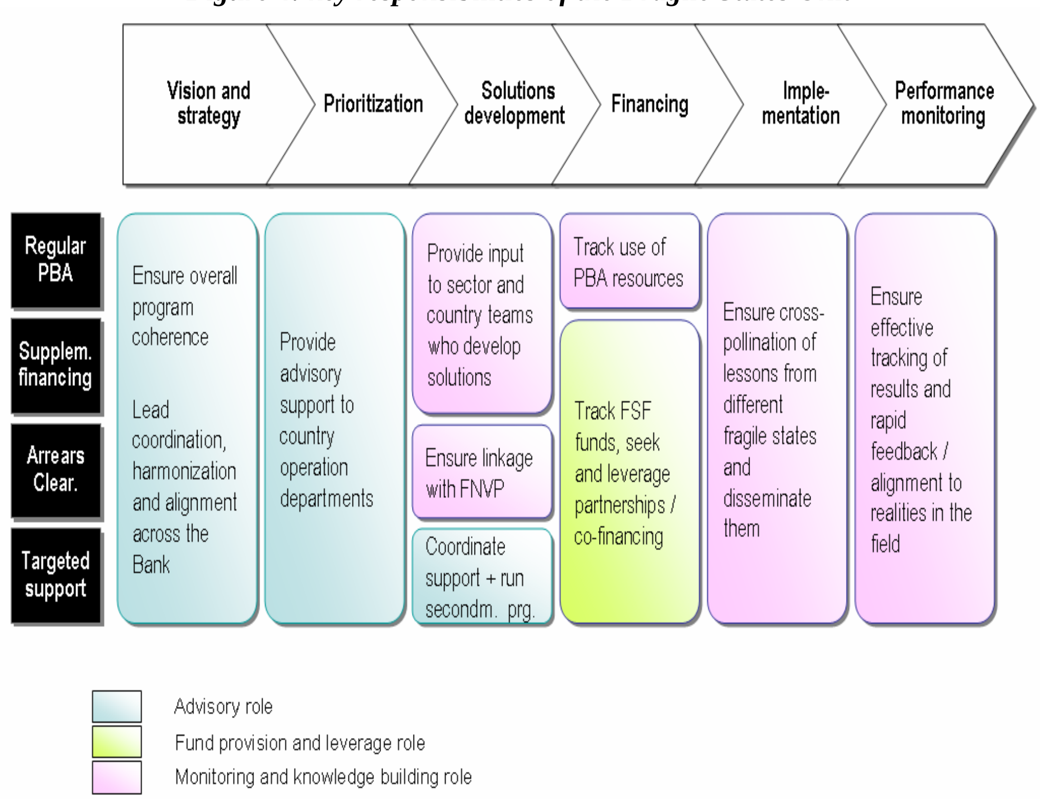
- Possible increase of the threshold for grants in the area of capacity-building above the current range of 20 - 50 %, on a case-by-case basis.
- Bank participation in joint trust fund financing, such as through Multi-Donor Trust Funds (MDTFs) involving pooling of funds by partners. This would provide an important new instrument for partnership in fragile situations.
- Ways to facilitate the use of non-sovereigns and sub-sovereigns in Bank operations.

8.6 The Bank-wide steps already underway coupled with specific additional initiatives as outlined above are expected to improve substantially the Bank's capacity to deliver and effectively monitor an intensified operational program in selected countries.

Internal administrative arrangements: creation of a dedicated Unit

8.7 The proposed enhanced support through secondments, small grants, and knowledge-building will be centrally managed within a "Fragile States Unit" hosted by the Vice-Presidency Operations II (OSVP). Figure 4 below presents the roles and responsibilities of the Fragile States Unit.

Figure 4: key responsibilities of the Fragile States Unit



8.8 The key roles and responsibilities of this new unit would be:

- Administrative oversight of the FSF.
- Ensure program coherence, rapid response capacity, and a short feedback loop for learning and adaptation.
- Facilitate the coordination, harmonization and alignment of Bank's work with that of other international organizations and agencies working in fragile states.
- Actively contribute to the preparation and the dissemination of policies, guidelines and procedures on selected operational issues required for the rigorous implementation of the Bank's program of assistance to fragile states.
- Collaborate with Regional Departments and the Office of the Chief Economist in the preparation and dissemination of Bank's Economic and Sector Work.
- Provide supplementary and advisory support to regional and sector departments working in fragile states, particularly with respect to the preparation of country programming documents and in the design and implementation of programs and projects (the operations will be implemented by the various operational complexes).
- Run the secondment program and facilitate learning among the roster of secondees to build delivery capacity.
- Help implement the arrears clearance program of the Bank in close coordination with regional departments and FNVP.

8.9 Field presence is essential for operating effectively in fragile states, including strengthening field-based donor coordination and harmonization. It is particularly important that the Bank has field presence in fragile states that are coming out of crisis or conflict and are eligible to supplementary funding. The implementation of the strategy will imply the establishment of a few additional field offices. For failed states or countries in severe conflict, field presence is not envisioned, and some existing regional offices could effectively substitute for country offices. In cases where it is operationally difficult to establish field offices, particularly in states just emerging from conflict, the Bank can second liaison officers to work with ministries of finance, economic planning and sectors, or with field-officers of other IFIs, pending the establishment of a country office.

8.10 The implementation of the Bank's strategy on fragile states will mainly be undertaken by its Operation Complexes, Regional Departments and field offices. The role of the FSU will be to facilitate this implementation. Accordingly, the staffing requirements of the Unit are expected to be modest and include:

- The Unit's coordinator, who will head the Unit and be the Bank-wide focal point on all interactions and operations in Fragile States,
- A lead macroeconomist and a political scientist / governance expert, who will be responsible for the technical work of the Unit, including assisting Regional Departments (RD) in the preparation of country programming documents and in the prioritizing and following up on the implementation of programs and projects, providing intellectual leadership on ESW and undertaking dialogue with beneficiaries of the FSF.
- A financial analyst, who will provide support to arrears clearance operations and to operationalizing targeted capacity building and secondment of professional staff.
- Two support staff to provide secretarial and administrative support.

8.11 Besides the staffing requirement of the FSU, effective implementation of Bank's strategy in fragile states will require motivated staff in the Bank's Operations Complexes, Regional Departments and field offices. Accordingly, the Bank, in June 2007, prepared a staffing policy which increased incentives for international staff posted to hardship areas, including fragile states. These incentive-based staffing policies are expected to be implemented in line with the practices of comparable MDBs.

Budget Implications

8.12 Efficient implementation of the Bank's strategy for enhanced engagement in fragile states as outlined in the ADF-11 Deputies Report will have short and medium-term budgetary implications for the Bank. Short-term implications stem mainly from the four professional and two support positions required for the FSU, which are incorporated into the 2008 budget. Over the medium-term, the Bank would establish additional field presence in fragile states. The budget for such offices and other outlays required for implementing the strategy will be prepared as the need arises through the normal budgetary process, starting in 2009.

9. Results Monitoring & Evaluation

9.1 Closely monitoring results is critical in assessing whether the Bank's programs for supporting fragile states are on course to achieve the desired results.

9.2 Monitoring the implementation of the entire strategy will be done in the context of the attached result log-frame (Annex VII). The log-frame matrix summarizes the impact, outcomes and output expected to be achieved, as well as the beneficiaries of this FS initiative. The log-frame will be used to track progress and results achieved under the three-pillars of the Bank's, as well as the necessary organizational arrangement. The proposed benchmarks and targets will be further elaborated with country teams and development partners as soon as the FS strategy is approved by the Board of Executive Directors.

9.3 Consistent with the ADF-II policy orientation, Management will provide the Board of Executive Directors with periodic status reports regarding the implementation of the Bank's fragile states strategy and the up-to-date utilization of resources from all the three windows of the FSF.

9.4 In addition, Management will bring to the Board of Executive Directors any specific proposal on engagements, which will create further opportunities to inform the Board on progress.

10. Recommendation

10.1 This Bank's strategy on fragile states is expected to allow the Bank Group to respond in a more efficient, effective and timely manner to the needs of fragile states and propose a set of solutions to some of their pressing problems.

10.2 Management will embark on preparing the required operational guidelines for implementing the Bank's fragile states strategy for consideration by the Board Committee on Operations and Development Effectiveness (CODE), early in 2008. These include guidelines on the Fragile States Facility, including its legal framework, secondment of professional staff to needy countries, and Bank's participation in Multi-Donor Trust Funds (MDTF).

10.3 The Board of Executive Directors is invited to approve the present strategy.

International Response to Governance Weaknesses in a Post-Conflict Transition

Close donor coordination and collaboration, in a deteriorating governance environment resulted in the establishment of Governance and Economic Management Assistance Program (GEMAP) between the National Transitional Government of Liberia and its key development partners - EC, ECOWAS, UN, US, World Bank and IMF. The GEMAP provides a strong platform for public financial management underpinned by international technical assistance, backed by Security Council resolution. It has seen considerable improvements in public financial management and accountability, budgeting and expenditure management, procurement and concession practices, combating corruption, capacity development and donor coordination. Notably, government revenues have increased significantly due to enhanced control mechanisms, improved financial practices and strengthened tax administration. **GEMAP is a ground-breaking example of strong donor coordination in a deteriorating governance environment.** Results achieved include the following:

Securing Liberia's Revenue Base. Government has undertaken a wide range of measures, including: a Memorandum of Understanding signed in June 2006 between key revenue generating State Owned Enterprises (SOEs) and commercial banks currently operating in Liberia. All revenues and fees of SOEs are now openly monitored in a specified number of accounts, to ensure that these revenues are not misused as in the past. Further, Internationally Recruited Experts (IREs) have been seconded to key ministries and other public agencies with co-signing authority to establish transparent financial management systems and to report openly on SOE operations, revenues and spending. The government has also strengthened revenue administration, which resulted in a significant increase in revenue since early 2006.

Improving Budgeting and Expenditure Management. The Liberia government has strengthened its commitment control system, reinforcing the role of the Cash Management Committee, which now ensures that expenditure are consistent with funds available. As a result, government has implemented a cash-based balanced budget and no new arrears have been accumulated. The government has also taken initial steps to develop a multi-year fiscal framework to guide spending agencies in expenditure planning. To further increase transparency, the government produced an Annual Fiscal Report 2005/2006 that was sent to the Parliament and widely published in local papers. Also, the budget FY 07 and first quarter fiscal report have been posted on the Ministry of Finance's website and publication of monthly revenue outturns has begun. Publication of monthly expenditure outturns is expected to commence shortly.

Improving Procurement Practices and Granting of Concessions. Government in early 2006 activated the Public Procurement and Concessions Commission to implement the Public Procurement and Concessions Act and to continue the independent review of all contracts and concessions entered into by the NTGL. The government reviewed and nullified all forestry concessions, with a view to re-awarding through transparent competition. Government has also subscribed to the EITI and has started work on implementing the Kimberley Process..

Combating Corruption. The Governance Reform Commission recently finalized an anti-corruption strategy and is now preparing legislation for the creation of an independent anti-corruption agency.

Supporting Key Institutions of Government and **Capacity Building**. Several key ministries and other public agencies have benefited from support provided by Internationally Recruited Experts, management studies/reviews of several key public agencies have been sponsored by various donors, experts have been providing support to the rebuilding of financial systems and processes and structured training sessions.

Annex II
Rapid Response Procedures: Possible Template for Pillar I-eligible Countries

The template of rapid response procedures is building on the new procedures approved by the World Bank, "Strengthening the World Bank's Rapid Response and Long Term engagement in Fragile States" and "Toward a New Framework for Rapid Response to Crises and Emergencies", on January 12, 2007. These new procedures are largely applicable to Fragile States, with the appropriate management and oversight. Management will take the decision on their application on a case-by case basis.

The Rapid response-procedures would be applied only to the countries eligible for Pillar I, and be <u>subject to ex-ante approval by the Board on a case by case basis</u>.

To ensure the Bank's ability to speed up ***disbursement,*** it could:

- provide for a quick-disbursing component designed to finance (or re-finance) a positive list of goods that have been identified as necessary
- permit the Bank to finance up to 100 percent of the expenditures needed to meet the development objectives, including recurrent expenditures, local costs, and taxes;

In Procurement, a more rapid response could include:[1]

- the use of rapid procurement methods (direct contracting or simple shopping) for the procurement of services of qualified multilateral agencies/programs and/or suppliers (for goods) and civil works contractors already mobilized and working in emergency areas (for works);
- use of third party, independent procurement agencies;
- sole sourcing of consulting firms already working in the area and which have a proven track record in the provision of technical assistance;
- extension of contracts issued under existing projects for similar activities through increase in their corresponding contract amounts;
- where alternative arrangements are not available, the use of Force Account for delivery of services; and
- the use of NCB, accelerated bidding and streamlined procedures and application of provisions on elimination, as necessary, of bid securities.

<u>*Ex-post controls:*</u> The risks associated with the need for much greater speed early on, such as listed above, will be balanced by more careful and intensified supervision later in the operation, including additional *ex post* reviews, audits by international firms and other measures, and application of appropriate remedies. There will be regular reporting to the Board in this regard.

Annex III

OECD/ DAC Principles of Good International Engagement in Fragile States

A durable exit from poverty and insecurity for the world's most fragile states will need to be driven by their own leadership and people. International engagement will not by itself put an end to state fragility, but adoption of the following shared Principles can help maximize the positive impact of engagement and minimize unintended harm.

1. **Take context as the starting point.** It is essential for international actors to understand the specific context in each country, and develop a shared view of the strategic response that is required. It is particularly important to recognize the difference constraints of capacity, political will and legitimacy, and the difference between: i) post-conflict/crisis or political transition situations; ii) deteriorated governance environments; iii) gradual improvement, and iv) prolonged crisis or impasses.

2. **Do no harm.** International intervention can inadvertently create societal divisions and worsen corruption and abuse, if they are not based on strong conflict and governance analysis, and designed with appropriate safeguards.

3. **Focus on state building as the central objective.** States are fragile when structure lack political will and/or capacity to provide the basic functions needed for poverty reduction, development and to safeguard the security and human rights of their populations.

4. **Prioritize prevention.** Action today can reduce fragility, lower the risk of future conflict and other types of crises, and contribute to long-term global development and security. International actors must be prepared to take rapid action where the risk of global conflict and instability is higher.

5. **Recognize the links between political, security and development objectives.** The challenges faced by fragile states are multi-dimensional. The political, security, economic and social spheres are interdependent. Importantly, there may be tensions and trade-offs between objectives, particularly in the short-term, which must be addressed when reaching consensus on strategy and priorities.

6. **Promote non-discrimination as a basis for inclusive and stable societies.** Real or perceived discrimination is associated with fragility and conflict, and can lead to service delivery failures. Measures to promote the voices and participation of women, youth, minorities and others excluded groups should be included in state-building and service delivery strategies from the outset.

7. **Align with local priorities in different ways in different contexts.** Where governments demonstrate political will to foster development, but lack capacity, international actors should seek to align assistance behind government strategies. Where capacity is limited, the use of alternative aid instruments – such as international compacts or multi-donor trust funds-can facilitate shared priorities and responsibility.

8. **Agree on practical coordination mechanisms between international actors.** Where possible, it is important to work together on upstream analysis; joint assessment; shared strategic; and coordination of political engagement. Practical initiative can take the form of joint donor strategies, agreed division of labor among donors, delegated co-operation arrangement, multi-donor trust funds and common reporting and financial requirements.

9. **Act fast... but stay engaged long enough to give success a chance.** Assistance to fragile states must be flexile enough to take advantage of windows of opportunities and respond to changing conditions.

10. **Avoid pockets of exclusion.** International actors need to address the problem of aid orphans – where there are no significant political barriers to engagement, but few international actors are engaged and aid volumes are low.

Choice of the programming instruments

Building on the role of the Bank in different types of fragile situations, an instrument is needed to both ensure a necessary knowledge base on the situations in all countries on the African continent, provide the basis for intensified dialogue with countries, as well as devising appropriate measures to address their situation. Crafting the most appropriate support for fragile states will be anchored in available strategic tools.

- Interim or full Country Strategy Paper (CSP): for countries that have prepared interim or full Poverty Reduction Strategy Programs (PRSPs); and

- A new document, the Country Brief (CB) that replaces the Country Dialogue Paper (CDP). The CB is particularly appropriate in the very early stages of post-crisis or conflict.

Purpose of the Country Brief

The intention behind the Country Briefs in relation to fragile states is to have a speedy vehicle when no other programming instrument is available, in order to provide the basis on which operations can be financed from the FSF.

Outline of the Country Brief

The Country Briefs will be flexible, and will differ when covering a country where Bank-operations will not be proposed and when used as a programming instrument, both with regard to accessing FSF-resources and the use of the instruments anchored in the Fragile States Strategy. All country briefs, regardless - should be brief, 10 pages at the maximum. An indicative, proposed outline is given below:

- Background:
  - Outline of the situation in the country, and recent developments
  - Short discussion of Bank engagement in the country
  - Role of the donor community and the IFIs: possible Strategic Framework at country level
  - Reason for CB at this stage (case for arrears clearance, enhancing dialogue etc)

- Assessment of country eligibility & resource allocation:
  - Eligibility related to peace and stability & unmet needs (HDI & contraction of GDP)
  - Report from dialogue mission & outline of proposed key benchmarks of economic governance and country commitment to these benchmarks
  - Proposed allocation of topping up FSF-resources for the country concerned

- Proposed use of Bank instruments:
  - Assessment of country needs with regard to sectors, other donors' interventions, and on that basis, proposed Bank support
  - Proposed operational cooperation with other donors
  - Proposed use of Secondment modality

- Monitoring of country performance:
  - Proposed Bank monitoring measures and benchmarks
  - Coordination with the IMF and the World Bank on monitoring economic governance

The principles governing PCCF Burden sharing arrangements favored a case by case approach to allow flexibilities in determining a country's level of contribution to its arrears clearance operation. On the basis of a review of experience to date under the PCCF, Management committed to develop a more systematic and quantitative methodology to assess country ability to pay.

This annex proposes a revised approach to arrears clearance burden sharing and, specifically, to the assessment of country capacity to pay.

Indicators

Raw capacity to pay: ADB arrears / Government Revenues

- Arrears clearance operations pave the way to debt relief (HIPC, MDRI, Paris Club and non-Paris Club cancellations) where an agreed share of the country's debt will be forgiven. Other preferred creditors are also implementing arrears clearance strategies, in close coordination with the Bank.
- "ADB arrears" captures the amount which must be financed, while "Government Revenues" captures the financial resources potentially available for that purpose.

Ability to generate financial resources: Current Account / GDP

- This indicator captures the country's present ability to generate foreign exchange resources; it does not depend on the performance of the revenue collection systems in place.

Spending prioritization: GDP / Capita

- The size and depth of the poverty challenge also needs to be recognized in considering the range of options available to meet debt and debt service obligations.
- GDP/capita is the most commonly available aggregate to measure that need.

Source of Data

Data was gathered from the Bank's Data Platform as follows:

- Common source, to avoid methodological discrepancies
- Time series of year of arrears clearance to ensure comparability

Composite score computation

- Thresholds are set for each indicator, to introduce a point system (see table)
- For each country, points are attributed for each indicator and summed
- The aggregate score determines the range of country contribution

Range of Country Contributions

- Country contributions are set in ranges to allow additional flexibility when exceptional circumstances grant it, while satisfying the comparable treatment requirement for countries with common characteristics.

Nota: Under this approach, it will be also possible for other donors to make contribution towards the country portion of the burden share on a voluntary basis.

Table: Ranges of Country Contribution and comparison with PCCF operations

	Country	Year	ADB Arrears/Gov Revenue	Current Account Balance	GDP/capita
	Raw Data				
PCCF operations	Burundi	2004	15%	-8.1%	87.83
PCCF operations	Congo, Rep.	2004	11%	2.0%	1317.06
PCCF operations	Central Afr. Rep.	2006	15%	-3.8%	349.14
PCCF operations	Comoros	2007	33%	-3.7%	521.09
PCCF operations	Liberia	2007	170%	-24.3%	195.30
ADF11	Cote d'Ivoire	2007	13%	2.6%	1013.57
ADF11	Togo	2007	4%	-6.4%	364.37

	Conversion to point system					Aggregate Score	Country Contrib.	Burden under PCCF
PCCF operations	Burundi	2004	2	3	3	**8**	1 to 11%	30%
PCCF operations	Congo, Rep.	2004	1	1	1	**3**	22 to 33%	35%
PCCF operations	Central Afr. Rep.	2006	2	3	3	**8**	1 to 11%	1%
PCCF operations	Comoros	2007	3	3	3	**9**	1 to 11%	1%
PCCF operations	Liberia	2007	3	3	3	**9**	1 to 11%	1%
ADF11	Cote d'Ivoire	2007	1	1	1	**3**	**22 to 33%**	
ADF11	Togo	2007	1	3	3	**7**	**11 to 22%**	

CONVERSION MATRICES

	ADB Arrears/Gov Revenue	Current Account Balance	GDP/capita
1	<15%	positive	>1000
2	15 to 25%	-	600 to 1000
3	>25%	negative	<600

Total Points	Country Contrib.
3	22 to 33%
4	22 to 33%
5	11 to 22%
6	11 to 22%
7	11 to 22%
8	1 to 11%
9	1 to 11%

The amounts available during the ADF-11 cycle are determined as follows:

1. Amount earmarked for the FSF:

- 7.5% of the total replenishment (excluding technical gap) of UA 5.6 billion[12],
- i.e. UA 420.3 million

2. Amount necessary to clear arrears during ADF-11

- Countries expected to be cleared during the period: Cote d'Ivoire and Togo
- Expected amount of ADF resources needed: UA 223.6 million, based on the following hypotheses:
    - Côte d'Ivoire: cut-off date April 2007, FSF burden share: 66.7%
    - Togo: cut-off date December 2008, FSF burden share: 85.0%

3. ACW (FSF Pillar II)

- Doted with UA 223.6 million in accordance with the needs assessed above:
    - including ADF resources carried over from the PCCF: UA 102.9 million;
    - and new resources: UA 120.6 million

4. ESW (FSF Pillars I and III)

- UA 299.7 million, i.e. UA 420.3 million – UA 120.6 million
- Pillar III represents 10% of Pillar I, leading to:
    - Pillar I: UA 272.4 million
    - Pillar III: UA 27.2 million

5. Calculation of the top-up factor

Country	"High 2" ADF10 alloc. w/o PCEF	"High 2" ADF10 alloc. w/o PCEF & 5m	10m floor / 60m cap applies?	Floor / Cap value	Top-Up Alloc. Pillar I
	(UA Mln)	(UA Mln)	(yes / no)	(UA m)	(UA m)
Burundi	28,45	23.45	no		51.00
CAR	11,03	6.03	no		13.12
Comoros	5,49	0.49	yes	10.00	10.00
Congo DRC	198,78	193.78	yes	60.00	60.00
Cote D'Ivoire	28,33	23.33	no		50.75
Guinea Bissau	7,05	2.05	yes	10.00	10.00
Liberia	11,62	6.62	no		14.39
Sierra Leone	26,75	21.75	no		47.31
Togo	12,30	7.30	no		15.89
Total		**284.81**			**272.45**

Top-up factor (excl floor and cap countries) **2.174838**

[12] Estimate, pending confirmation of final amounts; excluding technical gap.

OBJECTIVES	EXPECTED IMPACT & RESULTS	REACH	PERF. INDICATORS (MEANS OF VERIFICATION-)	BANK'S INDICATIVE TARGET & TIMEFRAME	ASSUMPTIONS, RISKS &BANK MITIGATION MEASURES
STRATEGIC GOAL **To restore stability and foster socio-economic recovery and development in targeted fragile states**	**Long-Term Impact** Improved human development as well as governance and accountability	**Beneficiaries** Population of the targeted FS Population of countries and regions neighboring FS Global community	**Indicators** 1. Improved Human Development Index (HDI) 2. Improved Country Policy and Institutional Assessment (CPIA) in FS **Source of Data**: International development partners and Bank's annual reports on FS	1. The average HDI value of beneficiary countries rises to 0.5 by the end of 2010 and to 0.57 by the end of 2013 (i.e. the average of Low income countries: 0.57 in 2005) 2. The average CPIA score of the beneficiary countries rises to 2.9 by the end of 2010 and to 3.2 by the end of 2013.	**Assumptions**: 1. Bank quickly develops its own internal institutional capacity for working in FS 2. Bank establishes strong strategic and co-financing partnership arrangements with other multilateral & bilateral development institutions as well as Non-sovereign actors
FINAL OBJECTIVE OF THE INITIATIVE **Increased number of FS transitioning out of "fragile situations"**	**Final Results of the Initiative** Increased number of FS stabilized	**Beneficiaries** Targeted FS Victims and casualties of FS Neighboring countries Global community	**Indicators** Amount of target FS using Pillar I resources assessed as satisfactory **Source of Data**: Bank's annual report's on FS	Three by the end of 2010 and an additional five by the end of 2013	

OBJECTIVES	EXPECTED IMPACT & RESULTS	REACH	PERF. INDICATORS (MEANS OF VERIFICATION-)	BANK'S INDICATIVE TARGET & TIMEFRAME	ASSUMPTIONS, RISKS &BANK MITIGATION MEASURES
INTERMEDIATE OUTCOME **Pillar I:** 1. Enhanced governance 2. Strengthened economic recovery 3. Improved social recovery **Pillar II:** Debt sustainability is enhanced	**Intermediate Results of the initiative** **Pillar I:** 1. Rebuild public financial management and public administration 2. Rebuild & rehabilitated domestic infrastructure, including cross boarder infrastructure 3. Improved social inclusion and equity **Pillar II:** Reduced debt for FS	**Beneficiaries** Citizens in targeted FS Women and other vulnerable groups Neighboring RMCs	**Indicators of Medium-Term Outcomes & Data Sources:** **Pillar I:** 1. Improved Public Sector Management and Institutions cluster of the Country Policy and Institutional Assessment (CPIA) in FS 2. Increased infrastructure investment in targeted FS 3. Improved Social Inclusion & Equity cluster of the Country Policy and Institutional Assessment (CPIA) in FS **Pillar II:** Increased number of FS benefiting from HIPC and MDRI initiatives **Source of Data**: 1. FS Government s statistics, international development partners, CPIA	**Bank's Indicative Target** **Pillar I:** 1. The average CPIA score of the targeted nine countries in Public Sector Management and Institutions cluster rises from 2.68 in 2006 to 2.9 by the end of 2010 and to 3.2 by the end of 2013. 2. 20% increase by the end of 2010 and 40% increase by the end of 2013 compared to 2007 level 3. The average CPIA score of Social Inclusion & Equity cluster rises from 2.64 in 2006, to 2.9 by the end of 2010 and to 3.2 by the end of 2013 **Pillar II:** Number of FS reaching decision or completion point of HIPCs reach 4 by end of 2010 and to 8 by end 2013	**Risks:** 1. Risks of conflict resumption 2. Long time required to achieve successful turnaround in fragile states 3. Slippages in government implementation because of weak institutions capacity 4. Difficulties that the Bank might encounter in working with other organizations

OBJECTIVES	EXPECTED IMPACT & RESULTS	REACH	PERF. INDICATORS (MEANS OF VERIFICATION-)	BANK'S INDICATIVE TARGET & TIMEFRAME	ASSUMPTIONS, RISKS &BANK MITIGATION MEASURES
IINPUTS AND PROGRAM ACTIVITIES **Pillar I:** 1. Provide additional financial resource on a timely basis to FS **Pillar II:** Set up arrears Clearance Programme **Pillar III:** Increased capacity for service delivery through targeted support	**Short-term results and Immediate Outputs of the project** **Pillar I:** Increased disbursement to targeted FS **Pillar II:** Arrears cleared in targeted FS **Pillar III:** Increased support to service delivery, including through non-sovereign actors	**Beneficiaries** Targeted FS Non-sovereign actors AfDB	**Indicators of immediate outputs** **Pillar I:** Increased disbursement of projects/programs under Pillars I **Pillar II:** Number of countries for which arrears have been cleared **Pillar III:** Increased disbursement for services delivery **Source of Data**: AFDB disbursement and annual reports	**Bank's Indicative Target** 50% of ADF 11 allocation to FS disbursed by the end of 2010 and 100% by the end of 2013 Two countries by end of 2010 and an additional two by end 2013 50% of targeted support disbursed by the end of 2010 and 70% disbursed by end of 2013	**Mitigating Measures**: 1. Bank monitor closely and collaborates with country authorities and development partners to manage post-conflict risks 2. Strengthening internal capacity of the Bank, including that of the newly created FSU 3. Developing and deploying additional financial and programming instruments suitable to the special needs of fragile states 4. Increased and effective field presence, in the most marginalized fragile states
BANK INSTITUTIONAL APPROACHES **Increased institutional capacity of the bank to work on FS**	**Short-term results and Immediate Outputs of the project** 1. Fragile State Unit (FSU) operationalized 2. Guidelines on Secondment and MDTF established 3. Partnerships & cooperation with other organizations (multilateral, bilateral and Non-sovereign actors) enhanced	**Beneficiaries** Targeted FS Multilateral and bilateral donors Non-sovereign actors The Bank's Group team working on Fragile States	**Indicators** 1. FS team operational 2. Guidelines for secondment and for MDTF prepared 3. Number of joint assessments as well as co-financed projects **Sources of Data**: AfDB internal documents	**Bank's Indicative Target** 1. FS Team operational by mid-2008 2. Guidelines for FSF, secondment and for MDTF approved by Executive Board of Directors by end 2008. 3. Three joint assessments and 10% of projects co-financed by the end of 2010, and an additional four joint assessments and 50% of the projects co-financed by the end of 2013.	