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## **IDA16 Mid-Term Review**

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# **PROGRESS REPORT ON IDA SUPPORT TO FRAGILE AND CONFLICT-AFFECTED COUNTRIES**

**IDA Resource Mobilization Department  
Concessional Finance and Global Partnerships**

**October 2012**

## Acronyms and Abbreviations

### Fiscal Year July 1 — June 30

BPs	Bank Procedures	LICUS	Low Income Countries Under Stress
CAR	Central African Republic	MDB	Multilateral Development Bank
CAS	Country Assistance Strategy	MDG	Millennium Development Goal
CCSD	Center for Conflict, Security and Development	MDRI	Multilateral Debt Relief Initiative
CODE	Committee on Development Effectiveness	MDTF	Multi-Donor Trust Fund
CPIA	Country Policy and Institutional Assessment	MIGA	Multilateral Investment Guarantee Agency
CRW	Crisis Response Window	MTR	Mid-Term Review
CSO	Civil Society Organization	OCHA	Office for the Coordination of Humanitarian Affairs
DPL	Development Policy Lending	OECD	Organization for Economic Cooperation and Development
DRC	Democratic Republic of Congo	OP	Operational Policy
DSF	Debt Sustainability Framework	OPCS	Operations Policy and Country Services Vice-Presidency
EU	European Union	PBA	Performance-Based Allocation
FCC	Fragile and Conflict-affected Country	PFM	Public Financial Management
FPA	Fiduciary Principles Accord	PSG	Peace- and State Building Goals
GEMAP	Governance and the Governance and Economic Management Assistance Program	PCPI	Post-Conflict Performance Indicators
HRF	Haiti Reconstruction Fund	PPR	Portfolio Performance Rating
HR	Human Resources	PRSP	Poverty Reduction Strategy Paper
IBRD	International Bank for Reconstruction and Development	SPF	State and-Peace-Building Fund
ID	International Dialogue	UN	United Nations
IDA	International Development Association	UNHCR	UN High Commissioner for Refugees
IDP	Internally Displaced Persons	UNDP	United Nations Development Program
IEG	Independent Evaluation Group	UNMIL	United Nations Mission in Liberia
IFC	International Finance Cooperation	WBG	World Bank Group
ISN	Interim Strategy Note	WDR	World Development Report

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## Executive Summary

i. **Improving the effectiveness of development assistance in Fragile and Conflict-affected Countries (FCCs) is a strategic priority for the World Bank and one of the four special themes identified by International Development Association (IDA) Deputies for the IDA16 Replenishment period.** The World Bank Group has been engaged in global efforts to enhance the effectiveness of development assistance in FCCs, including in the context of the Accra, Monrovia and Busan conferences. In addition to being one of the World Bank Group's six strategic themes announced in 2008, fragility and conflict featured as a special theme in IDA15 and subsequently in IDA16. The 2011 World Development Report (WDR), which served as a comprehensive stocktaking on the challenges faced by FCCs, has called for a paradigm shift in how the development community engages with FCCs. In December 2011, with its endorsement in Busan, the Bank committed itself to delivering on the commitments of the New Deal for Engagement in Fragile States (the "New Deal") and is contributing through the International Dialogue (ID) on Peace-building and State-building.

ii. **As part of the IDA16 policy framework, Management committed to take specific actions to enhance IDA's support to FCCs.** These actions build on measures taken in past IDA replenishments and relate to: (1) strengthening the Bank's operational effectiveness in FCCs; and (2) developing recommendations to simplify and adjust the framework for allocating IDA resources to FCCs. IDA's work in these areas has benefited from the discussions of the IDA16 Working Group on FCCs, which highlighted the importance of considering the heterogeneity and vulnerability of fragility and conflict situations and of aligning the ongoing work with the recommendations of the New Deal.

iii. **The Bank has made progress on the specific IDA16 monitorable actions to strengthen its operational effectiveness in FCCs.** Specifically:

- The *Post-Conflict Performance Indicators (PCPI) Framework* has been thoroughly revised to better capture the challenges and progress in FCCs environments and was applied in FY11 and FY12. The PCPI scores have been publicly disclosed. The Bank is also supporting the development by the g7+ of the state- and peace-building indicators under the New Deal.
- As part of efforts to better *integrate a gender perspective in IDA's work in FCCs*, all FCCs' Country Assistance Strategies (CASs) and Interim Strategy Notes (ISNs) presented to the Board during IDA16 address gender issues and gender background studies and notes are being prepared to inform upcoming CASs and ISNs. At the project level, the share of gender-informed operations has increased significantly in FCCs from 68 percent in FY10 to 83 percent in FY12.
- The *United Nations (UN)-World Bank partnership* has been enhanced, including through activities to facilitate joint work and broader strategic and operational collaboration, addressing implementation challenges, and improved country-level coordination.
- The *Bank's operational policies* relevant for FCCs are being revised as part of the Investment Lending (IL) and modernization reform. The consolidated IL policy proposes a differentiated approach to FCCs with streamlined approval procedures, a wider range of

operational implementation modalities (including UN agencies and Civil Society Organizations (CSOs)), and a more inclusive risk framework that incorporates the risk of inaction.

- Key outcomes from reforms of *Multi Donor Trust Funds* (MTDFs) include strengthened alignment of their mandates with country strategies and the mainstreaming of fragility and conflict in their design. Furthermore, sustained efforts are underway to ensure collaboration with stakeholders on country-specific MDTFs.
- The *procurement policy review* is ongoing and expected to be completed by end 2013. The review will include a differentiated approach reflecting the diversity of borrower capacities, including for FCCs. In the meantime, Management is taking steps to facilitate a greater use of the existing flexibility in current policies.
- The Independent Evaluation Group (IEG) plans to complete the *evaluation of the World Bank Group's work in FCCs* in 2013. An Approach Paper has been prepared following consultations with Management and will be discussed by Committee for Development Effectiveness (CODE) members in Q2 of FY13.

iv. **IDA has made significant efforts to improve portfolio performance in FCCs.** This includes increased staffing for FCCs programs (between FY09-FY11 higher level staff in FCCs increased by 38 percent) and strengthened budgets for the preparation and supervision of operations (since 2007, budget expenditures per dollar of IDA lending in FCCs increased by approximately 20 percent; in FY11, nearly three times as much was spent per dollar of IDA lending in FCCs relative to non-FCCs). These efforts are yielding results. In FY11, the disbursement ratio of the FCC portfolio rose to 25 percent. Furthermore, with the increased use of streamlined procedures in the current operational framework, operations in FCCs are prepared faster and have considerably shortened time periods from approval to first disbursement. The impact of these measures also starts to show in improved project quality. The quality at exit ratings for FCCs projects has improved in recent years. As a result, the performance of the FCCs portfolio in FY11 and FY12 has been on par with the rest of the IDA portfolio. While it is too early to determine whether these trends will be sustained over the medium term, they do demonstrate that targeted efforts to improve aid effectiveness at the project level can have a concrete impact on results even in these challenging environments.

v. **Notwithstanding the above progress, significant challenges remain and the Bank has committed to a broader agenda for change in FCCs in line with the 2011 WDR and the New Deal.** The slow progress of most FCCs towards a sustainable exit from fragility and conflict — and the considerable costs this has for their development outcomes — requires a further shift in both the substance and modes of delivery of assistance to FCCs. This has been reflected in the Bank strategy, *Operationalizing the 2011 World Development Report*, and further enhanced in the Bank's recent *Modernization Paper*. This agenda includes more flexible staffing for FCCs programs to support clients on the ground, more flexible operational processes to better adapt to FCC contexts, and a more integrated World Bank Group approach to enhance employment and private sector development in FCCs. In addition, the Bank established the Global Center for Conflict, Security and Development (CCSD) in July 2011 to lead the implementation of this agenda and provide additional support to country teams to address the drivers of fragility and conflict in FCCs programs. The CCSD is also working with the g7+

group of FCCs (“g7+”) and a wide range of partners to build a global community of practice on fragility and conflict.

vi. **The 2011 WDR, along with recent empirical research, has also implications on financial support to FCCs.** While confirming the centrality of policies and institutions in guiding resource allocation, this research suggests that well targeted and timely external assistance can play an important role in helping countries exit or avoid “fragility traps.” In addition, it finds that building legitimate and lasting institutions requires much longer time frames than previously envisioned, while repeated cycles of violence can prevent countries from exiting fragility traps. In this context, it emphasizes the importance of responding quickly to confidence-building opportunities in FCCs, to generate demonstrative results in the short term, while working to strengthen institutions over the long term. It also recognizes the heterogeneity of FCCs and reinforces the importance of providing tailored assistance in response to new openings in these challenging environments. Finally, recent research suggests that in challenging environments increased attention to project management (from design to implementation and monitoring) can have a positive impact on project outcomes.

vii. **In light of the above, Management has reviewed a comprehensive set of options for strengthening the IDA resource allocation framework for FCCs.** These options can be grouped under four categories: (1) the continued use of the current allocation system; (2) targeted adjustments to the current allocation system; (3) changes in the relationship between allocations and project performance; and (4) changes in the non-performance elements of the allocation formula to reflect: (a) vulnerability or (b) change the weight of the performance exponent in the Performance-Based Allocation (PBA). All options were assessed against a series of considerations including implications on incentives, volatility, responsiveness, and trade-offs. Based on this assessment, this paper presents a subset of options for consideration by IDA Deputies at the IDA 16 Mid-Term Review which could be further discussed in the context of the upcoming IDA17 replenishment discussions. The subset consists of six options included in category (2) and (4,b), specifically:

- **Option 1:** Case-by-case extension of the phase out period from the exceptional allocation regimes for post-conflict and re-engaging countries.
- **Option 2:** Increase of the notional per-capita allocations for post-conflict and re-engaging countries.
- **Option 3:** Increase of the minimum base allocation.
- **Option 4:** Eliminate the remaining MDRI netting out.
- **Option 5:** Provide exceptional allocations to “turn-around” situations.
- **Option 6:** Reduce the country performance rating exponent in the allocation formula.

viii. **Collectively, these measures would represent a significant realignment of IDA’s financial support to FCCs in line with the 2011 WDR and the opportunities represented by the New Deal.** The subset of options presented in this paper are assessed as having the greatest potential for responding to the specific needs of FCCs while preserving the performance orientation of IDA’s allocation system.

- First, they would reduce the volatility in the allocations to FCCs and recognize the long time frames required for establishing legitimate institutions.
- Second, they would enhance IDA's flexibility to provide quick support to turn-around countries (that are not post-conflict or re-engaging) in response to unforeseen opportunities to strengthen coalitions for stability and growth and avoid fragility traps.
- Third, applying these options would enhance the poverty-orientation of the allocation system, while retaining the basic principle of the performance orientation that has been a hallmark of IDA.

ix. **Significant trade-offs would need to be considered in deciding the modalities for providing increased financial support to FCCs and the magnitude of such increased support.** Purely for illustrative purposes, if (among other assumptions) the IDA17 replenishment volume were the same as in IDA16, indicative estimates show that the full implementation of this sub-set of options could increase IDA's support to FCCs in IDA17 by 70 percent relative to what FCCs would receive under the current allocation system (raising their share from 12 percent to 20 percent of the total IDA allocable envelope). However, increasing the financial support to FCCs would lead to a dollar for dollar reduction in the support that IDA can provide to non-FCCs. This would include reducing IDA's financial support to some countries with strong performance that are among the poorest and most vulnerable in IDA's clientele. Consequently, the precise parameters for the increase in support to FCCs will have to consider potential trade-offs which, in turn, will be significantly influenced by the size of the IDA 17 replenishment.

## I. INTRODUCTION

1. **One-and-a half billion people live in areas affected by fragility, conflict and large scale organized criminal violence** — causing human misery and disrupting development. People in Fragile and Conflict-affected Countries (FCCs) are more than twice as likely to be under-nourished than people in other developing countries; more than three times as likely to be unable to send their children to school; twice as likely to see their children die before the age of five; and more than twice as likely to lack clean water.<sup>1</sup> Countries that deteriorate into civil war face, on average, 7 years of conflict and 14 years of recovery, and forego the equivalent of 30 years of economic growth. Poverty rates are, on average, more than 20 percentage points higher in countries where violence is protracted than in other countries.

2. **IDA's work on fragility and conflict is part of a broader agenda for the World Bank and the international donor community.** The World Bank has been engaged in global efforts to enhance the effectiveness of development assistance in FCCs, including in the context of the Accra, Monrovia and Busan conferences. In 2008, fragility and conflict was identified as one of the World Bank Group's six strategic themes, focusing attention on the special problems of countries that are coming out of conflict or are at risk of breakdown.<sup>2</sup> FCCs featured as a special theme in the policy frameworks for IDA15 and subsequently in IDA16. In December 2011, with its endorsement in Busan, the World Bank committed itself to deliver on the commitments of the New Deal for Engagement in Fragile States (the "New Deal") and is contributing through close engagement (in partnership with the United Nations (UN)) with the g7+ group of FCCs (g7+) and participation in the Steering Group of the International Dialogue (ID) on Peace-building and State-building.

3. **The 2011 World Development Report (WDR) on Conflict, Security and Development has called for a paradigm shift on fragility.**<sup>3</sup> As highlighted by the 2011 WDR, FCCs lag significantly behind other developing countries on progress on every UN Millennium Development Goal (MDG). The report served as a valuable stocktaking of the development challenges posed by evolving and repeated criminal, civil and cross-border violence. Countries with weak institutions are more likely to experience these forms of violence and enter fragility traps (cycles of repeated violence and weak institutions). Countries that have successfully broken out of fragility have gone through long and difficult processes of restoring confidence, building inclusive coalitions, delivering early results and sequencing institutional transformations, often over a generation. The 2011 WDR findings call for a paradigm shift in both the operational engagement and financial assistance provided to FCCs, along the following lines: (i) refocusing international assistance on confidence building, through timely and targeted support to build citizen security, justice and jobs; (ii) reforming the donor procedures to respond

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<sup>1</sup> The World Bank and other Multilateral Development Banks (MDBs) define FCCs as: (i) countries with an average Country Policy and Institutional Assessment (CPIA) rating of 3.2 or less (or no CPIA); or (ii) countries that have or have had a peace-keeping or peace-building mission during the past three years. By this definition, 30 IDA countries were considered FCCs in FY12, constituting 37 percent of the number of IDA countries and 15 percent of the population living in IDA countries.

<sup>2</sup> Robert B. Zoellick, *Strategic Directions for the World Bank Group*, February 2008, World Bank.

<sup>3</sup> "World Development Report, Conflict, Security, and Development," 2011, World Bank.

more flexibly to support “turn-around” situations and prevent relapses into violence; and (iii) longer term commitments to build legitimate institutions.

4. **At the 4<sup>th</sup> High-Level Forum on Aid Effectiveness in Busan (2011), a number of countries and international organizations endorsed the New Deal.** This agreement on a new global direction for engagement with FCCs recognizes that, despite the commitments of the Paris Declaration on Aid Effectiveness (2005) and the Accra Agenda for Action (2008), progress towards the MDGs in FCCs has been modest. The members of the ID, comprised of the g7+,<sup>4</sup> development partners, and international organizations, agreed to support five goals — legitimate politics, justice, security, economic foundations and revenues and services — through the following commitments:

- use the Peace-building and State-building Goals (PSGs) to track progress at the global and the country level towards the MDGs;
- focus on new ways to support inclusive country-led and country-owned transitions out of fragility based on: (i) fragility assessments developed by the g7+ with the support of international partners; (ii) a country-led “one vision, one plan”; (iii) a compact between the country and partners to implement the plan; and iv) support of political dialogue and leadership; and
- build mutual trust by providing aid, managing resources more effectively (by enhancing transparency, risk-sharing, using country systems, strengthening capacity and ensuring timely and predictable aid) and aligning these resources for results.

5. **So far, seven self-nominated New Deal pilot countries are committed to field test the New Deal through fragility assessments.**<sup>5</sup> The Bank’s concrete support to these processes include: (i) providing on-call expertise for country-led fragility assessments; (ii) developing a joint national capacity initiative with the United Nations Development Program (UNDP) to support the New Deal agenda in pilot countries; and (iii) connecting g7+ and development partners through a knowledge exchange and learning process on issues of open budgets, innovation in public procurement, and citizen engagement using new technology and open data initiatives.

6. **Within this broader context, as part of the IDA16 replenishment IDA Deputies identified improving effectiveness of development assistance in FCCs as a special theme for IDA16.** They called on IDA to enhance its platform role and catalytic impact. Specifically, IDA Deputies asked Management to implement, monitor and report on eight monitorable actions agreed in the context of the IDA16 Replenishment (a summary is in Annex 1). IDA Deputies requested that an update on progress on these actions be prepared for the IDA16 Mid-Term Review (MTR). This report responds to that request and is structured as follows. Section II reports on the status of seven of the eight monitorable actions agreed in the context of the IDA16

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<sup>4</sup> Established in 2010 in Dili, Timor-Leste, the g7+ comprises: Afghanistan, Burundi, Central African Republic (CAR), Chad, Côte d’Ivoire, Democratic Republic of Congo (DRC), Ethiopia, Guinea, Guinea-Bissau, Haiti, Liberia, Nepal, Papua New Guinea, Sierra Leone, Somalia, Solomon Islands, South Sudan, Timor-Leste and Togo.

<sup>5</sup> Afghanistan, DRC, Liberia, Sierra Leone, Somalia, South Sudan and Timor-Leste.

Replenishment as well as additional ongoing actions related to staffing, nurturing a private sector response and job creation initiatives in FCCs, and means to increase access to global experience. Section III addresses the remaining monitorable action agreed with IDA Deputies. It examines options for simplifying and adjusting the framework for allocating IDA resources to FCCs for discussion by IDA Deputies at the IDA 16 Mid-Term review and in the context of IDA17. Section IV sets out the issues for discussion.

## II. STRENGTHENING IDA'S OPERATIONAL EFFECTIVENESS IN FCCS

7. **The Bank has been stepping up efforts to enhance IDA's operational effectiveness in FCCs.** First, between FY09-FY11, higher level staff (including both locally and internationally recruited staff) in FCCs has increased by 38 percent. In addition, there has been a significant increase in task team leadership and staff support of FCCs projects from regional offices close to FCCs in Abidjan, Accra, Addis-Ababa, Dakar, Delhi, Nairobi, and Sydney. Second, the budget per dollar of IDA lending in FCCs has increased by approximately 20 percent since FY07. In FY11, the Bank spent nearly three times as much per dollar of IDA lending in FCCs in comparison with non-FCCs. A significant portion of that difference is explained by higher supervision budgets for FCC projects (in addition to security costs which are higher in FCCs) to help address implementation challenges in low capacity environments. Third, the introduction of Emergency Recovery Loans (ERLs) in line with OP 8.0, which are widely used across FCCs, has reduced the time between project approval and first disbursement in FCCs. Simpler project designs have also helped substantially increase the FCCs portfolio disbursement ratio which by FY11 rose to 25 percent.

8. **These efforts are beginning to have a positive impact on IDA's portfolio performance in FCCs.** The quality at exit ratings for projects in FCCs have improved and in IDA15 they were on par with the rest of the IDA portfolio.<sup>6</sup> While it is too early to determine whether this trend will be sustained over the medium term, this demonstrates that targeted efforts at the project level can have a concrete impact on results even in these challenging environments. The progress at the portfolio level has been accompanied by progress at the country and institutional level (see Box 1). In addition, a recent independent survey of progress towards meeting the commitments of the Paris Declaration on working differently in FCCs rates the Bank highly in such areas as alignment of aid flows, technical assistance and capacity building, use of country Public Financial Management (PFM) systems and joint country analytic work.<sup>7</sup>

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<sup>6</sup> This outcome reflects the improvement performance of the FCCs portfolio as well as a decline in the performance of the non-FCCs portfolio.

<sup>7</sup> See World Bank, 2011, "The World Bank and Aid Effectiveness: Performance to Date and Agenda Ahead", and Ishihara, 2012, "Identifying Aid Effectiveness Challenges in Fragile and Conflict-Affected States" Policy Research Working Paper 6037, for specific discussion on aid effectiveness issues in FCCs.

### **Box 1: Progress in FCCs performance**

**While development in FCCs is challenging, performance is improving with successes at both the country and institutional level.** Eight of the 10 countries with the largest CPIA score improvement over the past 5 years were FCCs. When countries build resilience and reduce fragility, they can achieve impressive growth; Laos, Cambodia, Uzbekistan and Vietnam have had average economic growth rates of 4 to 7 percent since they exited the list of FCCs. This could further fuel exceptional development gains as evidenced in the case of Vietnam where the poverty headcount ratio decreased from 64 percent in 1993 to 17 percent in 2008. This effect, however, is not universal. Djibouti, The Gambia, Niger and Tajikistan recently exited the FCCs group but have experienced lower economic growth and the 2011 WDR points out slow progress in reforms.

**Progress can be mixed within countries, with successes concentrated in individual projects.** For example, coordinated international actions in Liberia through innovative IDA financed projects such as building roads with the UN and the Governance and Economic Management Assistance Program (GEMAP) have built the foundation for the gradual, continuing progress seen in the country. Likewise, the National Solidarity Program (NSP) in Afghanistan has provided small grants to meet the needs of communities through Community Development Councils in 29,000 rural communities that foster participatory decision making and accountability in the use of small grants providing basic services and infrastructure. The 2011 WDR (Overview Feature 5 and Chapter 6, Feature 6) further discusses the conditions and contributions of successes of programs like NSP, “Roads with United Nations Mission in Liberia (UNMIL)” and GEMAP.

9. **However, the slow progress of most FCCs towards a sustainable exit from fragility and conflict — and the considerable costs this has for their development outcomes — requires a further shift in the way assistance is delivered to FCCs.** Country programs need to do more to ensure that they address the key drivers of fragility and conflict together with client governments and key stakeholders. Stronger partnerships are required to draw on the comparative advantages of a wider range of international and local actors in addressing the complex issues of citizen security, justice and jobs. More operational flexibility and greater local capacity are needed to respond to the volatility and risk inherent in FCC contexts. Bringing the right staff skills in a sustainable and cost effective model to operate in these challenging environments remains an important issue for the Bank as well as all international actors.

10. **In response to these challenges, the Bank has committed to a broader agenda for change in FCCs in line with the New Deal.** This has been reflected in the Bank’s *Operationalizing the 2011 World Development Report*, and further enhanced in the Bank’s recent *Modernization Paper*.<sup>8</sup> This agenda includes measures to enhance financing modalities to respond to the volatility in FCCs, more flexible staffing for FCC programs to enhance support to clients on the ground, more flexible operational processes to better adapt to FCC contexts, and a more integrated World Bank Group approach to enhancing employment and private sector development in FCCs. In addition, the Bank established the Global Center for Conflict, Security and Development (CCSD) in July 2011 to lead the implementation of this agenda and provide additional support to country teams to address the drivers of fragility and conflict in FCCs programs. The CCSD is also working with the g7+ and a wide range of development partners to build a global community of practice on fragility and conflict. Sub-sections A to G describe progress on the actions to strengthen IDA’s operational support to FCCs agreed with IDA

<sup>8</sup> See “Operationalizing the 2011 World Development Report: Conflict, Security and Development,” DC2011-0003, April 4, 2011, and “Update on the Bank’s Business Modernization: Results, Openness, and Accountability Spring 2012,” DC2012-0005, April 11, 2012.

Deputies in the context of the IDA16 discussions. Sub-section H describes the progress on the additional actions envisaged under the broader modernization agenda.

#### **A. PCPI Revision, Testing and Disclosure and Mechanisms to Monitor Progress in FCCs**

**11. The Post-Conflict Performance Indicators (PCPI) framework has been thoroughly revised and the new framework was finalized, tested and implemented in FY11.** The new framework and criteria have been applied in the FY11 and FY12 PCPI exercises. The new criteria were informed by recommendations of an external panel that reviewed the contents of the previous criteria and insights from the 2011 WDR.<sup>9</sup> Changes included:

- **Content.** The indicators were reorganized in four clusters to clarify and simplify their content (Economic Management and Structural Policies; Social Inclusion and Human Development; Governance; and Post-Conflict Risk). The first three clusters are used to assess re-engaging countries, while all four are used to assess post-conflict countries.
- **Links to the Country Policy and Institutional Assessment (CPIA).** A more explicit link between CPIA and PCPI was introduced.
- **Process.** The PCPI process has been modified to increase its alignment with the CPIA process, in particular regarding the internal review process and consultations with country authorities.<sup>10</sup>

**12. Disclosure of PCPI Country Scores.** In June 2011, for the first time (and according to the timetable set in the IDA16 Report), the FY11 PCPI scores for the post-conflict and re-engaging countries were publicly disclosed in the external website of the World Bank. Likewise, PCPI scores for 2012 have been disclosed this year.<sup>11</sup> Two elements of the PCPI are not disclosed: the write-ups that provide the rationale for the ratings and the sub-ratings that are combined to determine scores of some of the criteria.

**13. To better monitor progress in FCCs, the World Bank, together with the UN and the Organization for Economic Cooperation and Development (OECD), is supporting the development of the state- and peace-building indicators through the ID working group on indicators under the New Deal implementation** (see Section I). Support for this process has included Bank technical expertise, contracting of experts to provide inputs and consolidate the process, financing g7+ participation in meetings of the ID, and substantive contributions to the dialogue with the g7+. Piloting for fragility assessments, including identification of country-owned indicators used to monitor progress, is currently underway in DRC, Liberia, Sierra Leone, South Sudan and Timor-Leste. Reports from these pilots were presented at the UN General Assembly meetings in September 2012. Afghanistan and Somalia are queued to follow with piloting informed by lessons learned out of the first five pilots. Out of those experiences, an

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<sup>9</sup> See the IDA 2009 report “Post Conflict Performance Indicators: Recommendations of External Panel Review and Next Steps.”

<sup>10</sup> Consultations with country authorities are also combined with consultations with other partners (e.g., UN on security issues).

<sup>11</sup> See <http://www.worldbank.org/ida/ISAI-2011.html>

inductive process in the fall of 2012 will identify shared indicators that can be used as a basis for global indicators on peace- and state-building.

## **B. Integration of a Gender Perspective in IDA's Support to FCCs**

14. **A corporate commitment was made to strengthen efforts to integrate a gender perspective in IDA's support to FCCs.** In line with this commitments, all Country Assistance Strategies (CASs) and Interim Strategy Notes (ISNs) presented to the Board in FY12, including for FCCs, specifically address gender issues.<sup>12</sup> Several of these are informed by gender studies and/or portfolio reviews of ongoing projects to identify current gaps as well as lessons learnt. Promoting gender equality is usually addressed either as a cross cutting theme for the respective strategies (Nepal, Afghanistan as a special dimension of the cross-cutting filter on conflict and transition), or through mainstreaming into programs (Haiti). Gender background studies and background notes are being prepared to inform the ongoing preparation of the Angola, Burundi, Central African Republic (CAR), Guinea-Bissau, Liberia, DRC, and Timor-Leste CASs, and for the South Sudan and Sudan ISNs.<sup>13</sup> Gender-informed monitoring and evaluation are included directly in the results framework and/or at the project level.

15. **Increasingly, operations in FCCs are gender informed.** Between FY10 and FY12, the share of gender-informed operations in FCCs rose from 68 percent to 83 percent. Indeed, the share of gender-informed operations in FCCs has been at least as high as the Bank average for non-FCCs. In Sub-Saharan Africa, which accounts for half of operations in FCCs, 86 percent of projects in FY12 were gender-informed, with 15 operations including gender analysis or consultations, 14 including specific actions which are expected to narrow gender disparities, and 17 also including gender-specific monitoring and evaluation. The report "Accelerating Progress on Gender Mainstreaming and Gender-Related MDGs" prepared for the IDA16 MTR presents further information on this action, including examples of ongoing operations that address gender issues in FCCs.

## **C. Implementation of UN-World Bank Partnership Agreements**

16. **IDA has extensive partnerships across a range of bilateral, UN agencies, multilateral and civil society stakeholders in its efforts to improve the effectiveness of development assistance in FCCs.** Current partnership efforts with the UN build on the 2008 UN-World Bank Partnership Framework for Crisis and Post-Crisis Situations. The Bank and the UN are committed to enhance cooperation, particularly at the field level, and are working together to align their cooperation with country leadership through the New Deal.

17. **Progress in the UN-World Bank partnership can be noted through the following specific institutional measures:**

- **Resources to strengthen UN-World Bank partnership.** In 2010, a UN-World Bank Partnership Trust Fund (TF) was established with funding from the Swiss Government. Its

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<sup>12</sup> ISNs submitted to the Board in FY12 include those for Nepal, Haiti, Togo and Afghanistan.

<sup>13</sup> All have tentative Board dates in FY13.

objectives are to promote dialogue on strategic, policy and operational issues; improve alignment of UN and Bank programs and resources; and promote a culture of collaboration and communication. Since 2011, the TF has supported a range of initiatives, including:

- the exchange of staff members between the UN and the Bank to facilitate headquarters support to partnership initiatives;
  - provision of country-level grants to facilitate dialogue and joint work, and establish foundations for broader strategic and operational collaboration between the UN and the Bank. These include support for the CAR, DRC and Guinea-Bissau.<sup>14</sup>
  - organization of a broad review of UN-World Bank partnership efforts to date, with the aim of identifying progress achieved to date, as well as challenges and priorities for strengthening collaboration;
  - development of targeted training and knowledge/learning activities to promote greater understanding and interaction between the two institutions, and to develop a shared repository of best practices and lessons learned;
  - development of instruments and guidance to strengthen interoperability and systematize collaboration at different levels.
- **Addressing implementation challenges.** In 2008, the Bank and 11 UN agencies, funds, and programs signed a Fiduciary Principles Accord (FPA), creating a new model for cooperation and fiduciary assurance that is centered on shared principles.<sup>15</sup> A review is currently being undertaken (with completion expected in second half of 2012) to improve its applicability. The review of the FPA is also expected to open space for a broader discussion of how the Bank and UN can collaborate to address operational challenges to implementation in FCCs contexts, including through increased interoperability, common approaches to risk management, and development of instruments for combined operations.
  - **Improving country-level coordination of responses in crisis and post-conflict situations.** The results on the ground of such coordination (with the UN and other organizations such as the European Union (EU) and the African Union) include the following:
    - joint UN/WB/EU country needs assessments in Libya (2011) and Yemen (2012) have facilitated strategic alignment of Bank and UN efforts against critical national transition priorities.
    - in South Sudan, the Bank and the UN are exploring how to jointly strengthen local governance mechanisms and promote local economic recovery.

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<sup>14</sup> Specifically: (i) joint UN-WB analytical work and coordination in CAR to strengthen the Government's national development strategy and ability to implement it; (ii) support for the joint development of a Peace Consolidation Program for western areas of DRC; and (iii) joint development of a capacity strengthening strategy in Guinea-Bissau to support the Government in identifying and prioritizing institutional reforms and capacity development priorities in key sectors.

<sup>15</sup> The FPA was designed to address exceptional circumstances, envisioned under the Policy for Rapid Response to Crisis and Emergencies (OP 8.00). It reflects a shared WB/UN approach to fiduciary issues permitting each to rely on its own fiduciary systems when executing activities financed under Multi-Donor Trust Funds (MDTFs) administered by the other.

- the Bank and the UN are also exploring modalities for improving coordination in the allocation of funding from their dedicated mechanisms to address urgent post-conflict and peace-building needs (including the State and-Peace-Building Fund (SPF) and the UN Peace-building Fund).
- the Bank, with resources from the Crisis Response Window (CRW), has supported the expansion of UN High Commissioner for Refugees' (UNHCR) ongoing program of health and nutrition service delivery to targeted refugee camps in the Horn of Africa.<sup>16</sup>
- **Expanding sectoral and thematic collaboration.** The Bank is expanding its collaboration with the UN on key research, knowledge, learning and policy initiatives:
  - in the area of economic recovery, the Bank is launching a new platform for supporting job creation policy development and country level operations.
  - through its Program on Forced Displacement, the Bank is strengthening partnerships with key UN entities to improve predictability of responses for the reintegration of Internally Displaced Persons (IDPs) and refugees.<sup>17</sup>
  - in the area of security and justice, the Bank is developing, together with the UN Department of Peacekeeping Operations and UNDP, a security sector expenditure review toolkit for the analysis of financial management, financial oversight and expenditure policy issues in the security sector.<sup>18</sup>
- **Deepening dialogue on partnership and peace-building issues.** The Bank actively participates in the country-specific configurations of the Peace-building Commission and the Senior Peace-building Group.

#### **D. Review of the Operational Policy on Development Cooperation and Conflict**

18. **As part of the IDA16 discussions, Management agreed that the relevant operational policies (OPs), bank procedures (BPs) and staff guidance be updated.** Specifically, references in the Operational Policy on Development Cooperation and Conflict (OP/BP 2.30) were to be updated to emphasize: (i) the support for preventive action, peace-building and institutional strengthening in FCCs; and (ii) the importance of partnerships with international organizations working on political, security and justice issues in FCCs with explicit reference to be made to the UN-World Bank Partnership Framework.

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<sup>16</sup> This innovative operation, part of the World Bank response to the Horn of Africa drought, allowed the provision of support to Somali refugees in Ethiopia and Kenya.

<sup>17</sup> Including the UNHCR, UNDP, Office for the Coordination of Humanitarian Affairs (OCHA) and the Special Representative of the UN Secretary General on IDPs.

<sup>18</sup> The toolkit is being jointly developed by the Bank, the United Nations Department of Peace Keeping Operations Office of Rule of Law and Security Institutions with each partner relying on their respective competences and experiences. In particular, the Bank's involvement in this initiative will be in accordance with its development mandate under its Articles of Agreement and its legal and policy framework including the 1991 Guidance on Military Expenditures and the 2007 Legal Opinion on Bank Involvement in Peace-Building, Security, and Relief.

19. **The updating of specific OPs and BPs has now been superseded by a much broader process of revising the entire Operational Manual (OM).**<sup>19</sup> The goal of the OM reform is to simplify the Bank's maze of operational policies by creating an accessible and well-organized compilation of policies, procedures, and guidelines that is user-friendly. The new OM architecture is organized around four "pillars" covering each major Bank instrument (Advisory and Analytical Activities, Investment Lending, Program-for-Results Financing and Development Policy Loans). Cutting across those four pillars will be a client engagement "beam" intended to cover the basic parameters of how the Bank engages with country clients and partners. The new "beam" will have a separate category for engagement in FCCs which will consolidate and revise existing OPs and BPs scattered across different sections of the current OM, including OPs/BPs 2.30, 7.30 and parts OP 8.0, all of which set out the parameters for working in FCCs. As a result, the updates of OP 2.30 set out in the IDA16 policy framework will be incorporated into the new FCCs country engagement beam as part of the overall revision of the OM scheduled in this fiscal year.

20. **In addition, Management has proposed a significant revision of operational policy to streamline procedures for the preparation and implementation of investment lending (IL) in FCCs as part of the IL reform.** While the current OP 8.0 sets out simplified and expedited procedures for preparing and implementing investment operations in response to emergencies and crises (referred to as Emergency Recovery Loans), the IL reform proposes to extend these exceptional procedures to investment lending in all FCCs in recognition of the systematic weaknesses in institutional capacity and the need to respond more quickly and flexibly in FCCs. In addition, the IL reform explicitly incorporates an analysis of the "risks of inaction" into the existing risk framework to recognize the potential long term costs of countries facing fragility traps. These policy reforms set out a differentiated approach to investment lending in FCCs recognizing the need to work differently in these environments, building on the existing Bank experience responding to emergencies and crises where there are similar challenges associated with urgent needs, weak institutional capacity and high risks.

#### **E. Evaluation of IDA's Work in FCCs during 2012-2013**

21. **Building on recent Country Program Evaluations for Nepal, Liberia, Afghanistan, and Timor-Leste, the Independent Evaluation Group (IEG) has initiated the evaluation of World Bank Group's support to FCCs.** The evaluation will be the first one to focus on FCCs since the 2006/2007 evaluation of the Low Income Countries Under Stress (LICUS) initiative.<sup>20</sup> It will examine the impact of some of the major reforms that the Bank has put in place including on Human Resources (HR) incentives and operational policy. The review provides an opportunity to revisit the issue of results and risk management, and to offer new insights on the balance between risk and results in FCCs. The IEG team is meeting with a wide range of stakeholders for varied perspectives on the scope of the evaluation, some of the common issues

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<sup>19</sup> The reform of the Operations Policy Manual and associated Investment Lending Policy were discussed in April 2011 in the CODE. See "The Bank's Operational Policy Manual (OM): Issues and Prospects for Reform" (CODE2011-0024) and "Investment Lending (IL) Policy Reform: Fixing the IL Policy Maze" (CODE2011-0025).

<sup>20</sup> "Engaging with Fragile States: An IEG Review of World Bank Support to Low-Income Countries Under Stress" Independent Evaluation Group, 2006, World Bank, Washington DC.

faced by Bank staff in FCCs that are not adequately captured by current evaluation methodologies, and an improved evaluative framework for FCCs. An Approach Paper has been prepared following consultations with Management and will be discussed by CODE members in Q2 of FY13. IEG is expected to complete the evaluation by September 2013.

## **F. Collaboration on Multi-Donor Trust Funds**

**22. Implementation of Multi-Donor Trust Funds (MDTFs) is an integral aspect of IDA's engagement in FCCs.** MDTFs, in particular, have allowed for a broader Bank participation in politically sensitive contexts and in crises and emergencies. The synergies offered by the MDTFs with IDA's core products and services have enhanced the flexibility and timeliness of financing, including for countries in arrears. During the period July 2009 to June 2012, MDTFs disbursed US\$3.6 billion to IDA-eligible FCCs, of which US\$2.2 billion went to Afghanistan.

**23. The Bank is committed to improve the functioning of TFs (including MDTFs) in FCCs.** These efforts are part of an ongoing broad TF reform process including a series of evaluations and reforms, many of which are in progress, focusing on issues ranging from accreditation of staff to manage TFs to integration of TFs with Bank's operational and management systems. In addition, in 2010 the Bank commissioned a strategic review of MDTFs in FCCs, which, among others, raised the need to mainstream MDTFs into Bank processes.<sup>21</sup> Key outcomes of these efforts to date include:

- **Strengthened alignment of TFs with country strategies.** Progress has been made in enhancing the strategic alignment of TFs with CASs/ISNs and sector strategies. This will not only ensure a better alignment with the Bank's engagement in FCCs but will strengthen collaboration with development partners on the ground. All regions now include TFs in country portfolio reviews in order to ensure alignment with CASs/ISNs, portfolio indicators and performance. All IDA16 CASs/ISNs have included mapping donor activities. Also, in April 2012 the Bank updated its CAS guidelines to include revised guidance on integrating TFs in CAS products. The Africa region, in particular, has made much progress in ensuring that MDTFs support activities around the same strategic pillars.
- **Mainstreaming of fragility and conflict in TF design.** Five country-level MDTFs have been established since the onset of the IDA16 discussions.<sup>22</sup> Conflict sensitivity and adaptation to fragile environments have been addressed in all of them by introducing a broad menu of financing options, including budget support and capacity building; establishing the financing priorities by the client governments; adapting to context (e.g., simplification of disbursement categories); and alignment of non-contributors' bilateral assistance to allow for better coordination and implementation.

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<sup>21</sup> "Flexibility in the Face of Fragility: Programmatic Multi-Donor Trust Funds in Fragile and Conflict Affected Situations," July 2010.

<sup>22</sup> The Haiti Reconstruction Fund, the Liberia Integrated Public Financial Management Reform Fund, the Nepal Financial Management Support Fund, the Somalia PSD Re-engagement Phase II fund, and the Yemen Household Budget Survey 2010 Fund.

24. **At the country level, sustained efforts are underway to ensure collaboration with stakeholders on country-specific MDTFs.** These engagements have brought to light several lessons. They have revealed the changing international development context within which MDTFs operate (see Box 2 for the cases of Afghanistan and Pakistan).<sup>23</sup> They have also stressed the potential for significant reputational risk (and reward) for the Bank in administering strategic, high visibility MDTFs in FCCs. This is partly the reflection of donor expectations for a rapid roll-out of activities, smoother donor coordination, and intensive and MDTF-tailored results reporting. Finally, as illustrated by the Haiti Reconstruction Fund (HRF), participation of partners and clients in the design of MDTFs (and subsequent operations) strengthens knowledge sharing among stakeholders.<sup>24</sup>

25. **Reporting on results will continue to improve with the full integration of TFs into the Bank business process.** Within the newly established MDTFs outlined above, many partner entities are responsible for the monitoring and evaluation of financed activities. However, a uniform set of reporting and results measurement systems have been agreed to reduce the transaction costs to governments while supporting measures aimed at aid effectiveness and better coordination. Going forward, the Bank is taking steps to fully integrate TFs into the Bank's results agenda.

### **Box 2: Reviews of MDTFs in Afghanistan and Pakistan**

CCSD staff engaged actively with partners in evaluating MDTFs active in Afghanistan and Pakistan.

- In Afghanistan, MDTF donors had requested an external review of the Afghanistan Reconstruction Trust Fund (ARTF) ahead of the July 2012 Tokyo Conference. In particular, ARTF donors wanted a review of the ARTF's strategic position in the context of the changing needs that the Afghan transition implies and specific follow-on recommendations. The review confirmed that the ARTF is "fit for purpose" having adapted its governance arrangements that set clear performance benchmarks and establish a predictable three-year financing strategy. The key risks highlighted in the review are the increased uncertainty, reduced implementation options, and uneven government capacity to implement the upcoming transition period. Looking ahead, the review recommends that the ARTF play a key role in supporting a focus on operations and maintenance within the recurrent cost window. In addition, the evaluation recommended a strengthened communication of monitoring and evaluation and results.
- In Pakistan, the MDTF established in 2010 for the border areas of Khyber-Pakhtunkhwa, FATA and Balochistan has worked closely with donors and government officials to align delivery expectations in light of global MDTF experiences, review performance to date and consider opportunities and risks for the future. A recent workshop with donors and the government in Islamabad highlighted the role that MDTFs could play in establishing long-term institution-building systems for service delivery in line with the WDR framework as well as providing a platform for strategic dialogue on development issues.

Both the ARTF and the Pakistan MDTF team are working to develop peace-building-focused results frameworks as a response to stakeholder expectations for closer alignment to conflict reduction and peace building goals.

<sup>23</sup> Pakistan is not in the harmonized list of FCCs, however, the MDTF in the border areas offers lessons on the usefulness of MDTFs for focusing strategic dialogue and donor coordination in challenging environments.

<sup>24</sup> In the case of the HRF, there are official observers representing Haitian civil society, local government, private sector, diaspora, and international NGOs. Project documentation and materials are extensively distributed in English, French and Creole. However, more work remains in sharing the implications of different governance structures on implementation.

## **G. Review of Procurement, Fiduciary and Legal Inputs in FCCs**

26. **The Bank's procurement policies and procedures were originally shaped by the nascent practices for large-scale, stand-alone infrastructure investments.** Over the years, the Bank has periodically updated its policies and procedures, as laid out in the "Procurement and Consultant Guidelines" applicable to the Bank's borrowers, as well as OP/BP 11.00 on Procurement. Such periodic updates over the years embody significant cumulative changes including in transparency of bidding processes, enhanced business opportunities, and access to information. However, experience shows that the complexity of the procurement processes limits their positive impact in fragile environments that lack procurement capacity and sound institutional, legal and governance systems. During the last update, which took place in January 2011, Management agreed with the Board of Directors to undertake a review of the Bank's current approach to procurement under Bank-financed operations, the first such review since the Bank's founding.

27. **The Board recently approved the Procurement Policies and Procedures: Policy Review, Approach Paper** (March 2012). The paper is expected to examine the Bank's work with FCCs which "frequently calls for a differentiated strategy geared toward simplification and adaptation to their respective capacities and circumstances". The "one size fits all" approach to all categories of procurement and situations does not reflect the diversity of borrower capacities and is expected to be discontinued. This approach aims to address procurement capacity building support, risk taking, the consideration of new specific policy provisions as well as expand opportunities for harmonization to cover partnerships and co-financing mechanisms, Recipient-Executed TFs, and the involvement of other development institutions such as UN agencies and global funds in Bank-financed operations in FCCs. A staged approach will be used in carrying out the policy review to conduct a comprehensive fact-finding exercise and allow time for extensive consultations with stakeholders. The FCC Implementation Support Team will actively participate in this exercise to bring in the diversity of experience from FCCs. The review will be carried out in two phases and completed by end of 2013 culminating in a revised statement of operational policies and procedures.

28. **In parallel, Bank Management is taking steps to strengthen and streamline internal procedures to discharge the Bank's fiduciary mandate.** Corruption constitutes a significant development challenge in FCCs: according to a variety of indices, about half of the 40 most corrupt countries are FCCs. The recent GAC update also notes that "corruption between opportunistic criminals and corrupt elites magnify the state-building and capacity challenges" in FCCs.<sup>25</sup> The Bank is striving to prevent fraud and corruption in projects in FCCs while at the same time it is making — where warranted — greater use of the flexibility provided by the revised Procurement and Selection of Consultants Guidelines of January 2011. Guidance notes on Procurement and Financial Management in FCCs have been issued to help World Bank staff support the implementation of procurement in Bank supported operations in FCCs. In particular, the Procurement note analyses changes incorporated into the revised Guidelines that can help facilitate work in FCCs; a template for carrying out a procurement capacity assessment; advice on how to assess the prevailing market conditions, competitiveness and logistical infrastructure in the country; how to provide local contractors and suppliers with basic training on public

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<sup>25</sup> Strengthening World Bank Engagement on Governance and Anti-Corruption, Companion Pieces, Page 52.

procurement procedures; and how to finance secondhand goods. Designated procurement staff has been established in each region to provide procurement support on emergency and rapid response situations. The Guidance Note on financial management (FM) in FCCs indicates how to simplify and standardize FM interventions, conduct longer-term operations in low-capacity and inaccessible environments, how to respond appropriately, using streamlined FM procedures and processes, and how to build in sustainable institutional reforms and capacity building for reliable FM arrangements, systems, and internal controls in client governments to start laying the foundations for the future.

29. **The Legal Note and Guidance on Bank Involvement in the Criminal Justice Sector forms an element of the Bank's efforts to operationalize the 2011 WDR.** They support the Bank's goals of strengthening its approach to criminal justice interventions and are intended to cover all Bank and Bank-supported activities. Guidance for Bank staff is provided on how to analyze whether an intervention is appropriate for the Bank to engage in, how to assess the risks involved, and how to develop a risk-taking and management strategy.

#### **H. Additional Measures Envisaged under the Modernization Agenda**

30. **Staffing.** The Bank is building on improvements in both financial and career development incentives to attract qualified staff to work on FCCs.<sup>26</sup> Financial benefits exclusive to staff working in FCCs were approved in May 2008, including an Assignment Premium Bonus, a Fragile States Premium, and Rest and Recuperation. Non financial incentives have also been improved through recognition of the challenges and risks of working in these environments. Moving forward, the Bank is proposing further measures in two broad areas: (i) enhancing the career path for staff working in FCCs through mechanisms such as priority placements following successful assignments, creating career advancements opportunities for FCCs staff, and better accommodating family issues for staff in FCCs; and (ii) diversifying and expanding the recruitment pool for professional staff, through increased use of qualified locally recruited staff both within countries but also within/across regions, using international staff, including those in non-FCC settings, more strategically to leverage local and regional staff, and building up the cadre of FCCs staff through flexible term arrangements and tapping into the young professionals program as feasible.

31. **Operational processes.** Recognizing that the constraints on working effectively in FCCs are often rooted as much in behavior and practice as in policy, Operations Policy and Country Services Vice-Presidency (OPCS) and the CCSD are working to support FCCs country teams in making full use of the flexibility embedded in the existing policy framework. A set of pilot countries has been identified among FCCs to incorporate greater flexibility into the implementation of existing fiduciary policies. The dedicated Implementation Support Team for FCCs based in Nairobi is also tasked with providing on the ground clinics, guidance and mentoring for local staff to disseminate "best fit" implementation solutions across FCCs programs and to promote a more feasible response to risks in FCCs environments.

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<sup>26</sup> "Strengthening the World Bank's Rapid Response and Long Term Engagement in Fragile States," March 30, 2007.

32. **Employment and Private Sector Development.** Together with International Finance Cooperation (IFC) and Multilateral Investment Guarantee Agency (MIGA), the Bank is developing a joint approach to address the issue of employment in FCCs. This includes “quick-win” public and community-based employment, infrastructure investments to open up new markets, and concomitant Bank and IFC investments and MIGA facilities to nurture a private sector response. The Bank Group is advancing cross-institutional research on private sector development in FCCs, and will support new instruments to operationalize this body of knowledge. Five knowledge products jointly sponsored by the World Bank and IFC are underway including those on the potential contribution of private sector institutions to resilience against violence and conflict; private sector responses to violence and crime; early foreign and large-scale investments; small entrepreneurs; and investment climate reforms in FCCs. The World Bank Group and participating institutions have set up a Global Facility for Employment Creation in FCCs to formulate a coordinated response to the challenge of creating jobs in fragile environments.<sup>27</sup> The IFC’s focus is on the creation of an enabling environment for investments, promotion of transformative industries, and addressing the key obstacles to growth and employment creation including access to power, SME growth, agriculture and food security. MIGA is in the process of establishing a trust fund for FCCs that would receive donor support to cover a first-loss facility and mobilize private reinsurance capacity.

33. **Knowledge and Learning.** To ensure that the Bank remains an intellectual leader in the area of fragility and conflict, it will continue its focused program of research, knowledge, and learning. In order to create a worldwide community of practice on the prevention of fragility, conflict and violence, connect knowledge across contexts and disciplines, and share emerging ideas and innovations to advance best practices in the field, the Bank has set up a Hive — a knowledge-sharing platform — connecting practitioners, researchers, policymakers and organizations working on these issues around the world. It is expected that the platform will strengthen relationships and knowledge-sharing between “hard-to-reach” groups like grassroots leaders and local government officials, and experts working within Non-Governmental Organizations, think tanks, and the private sector.

34. **The CCSD leads the implementation of a new model of engagement for better results in FCCs.** The CCSD is leading the implementation of Bank-wide policy and practice changes to integrate the lessons of the 2011 WDR. At the same time, the CCSD facilitates rapid deployment of staff, financing and knowledge to FCC country teams as needed. With 20 professional staff in Nairobi and 15 in Washington, the CCSD is already providing strategy and implementation support to 15 FCC priority programs across Bank regions. The thrust of this support is to ensure that Bank strategies and programs address sources of fragility, conflict and violence; and programs are designed and implemented in a flexible way, adapted to local realities while reinforcing long term capabilities of governments and encouraging partnerships with bilateral and multilateral organizations.

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<sup>27</sup> These include the African Development Bank (AfDB), the International Labor Office (ILO), the United Nations Development Program (UNDP), the United Nations Economic Commission for Africa (UNECA), and the United Nations Peace Building Support Office (PBSO).

### III. SIMPLIFYING AND ADJUSTING THE ALLOCATION FRAMEWORK FOR FCCS

35. **IDA's financial support to FCCs has expanded significantly in recent replenishments.** IDA commitments to FCCs over the period IDA11 through IDA15 amount to US\$22.0 billion (US\$16.5 billion in disbursements).<sup>28</sup> Such a level of support was possible thanks, among others, to enhancements to the resource allocation framework that led to an average growth rate of commitments to FCCs of 45 percent per replenishment period. Beyond this support, IDA has also provided support to FCCs in the form of HIPC Initiative and MDRI debt relief as well as increased concessionality in its financing through the provision of grants. Finally, FCCs have also benefited from significant Trust Fund (TF) support delivered through the SPF and through MDTFs.<sup>29</sup> In particular, MDTFs' disbursements to FCCs during IDA15 amounted to US\$2.7 billion, equivalent to 57 percent of IDA's disbursements to these countries.

36. **As part of the IDA 16 discussions, Management committed to develop, by the IDA16 MTR, proposals to simplify and adjust the framework for allocating resources to FCCs.** Deputies urged Management to draw out the implications of the findings of the 2011 WDR in terms of support to FCCs. They requested that specific proposals regarding IDA's support to these countries be developed for consideration at the IDA16 MTR. This section reviews IDA's current allocation framework for FCCs and explores different options for simplifying and adjusting the allocation framework which could be further discussed in the context of the upcoming IDA17 Replenishment discussions.

#### A. IDA Allocations for FCCs: Current Policy

37. **FCCs constitute a heterogeneous group.**<sup>30</sup> As described in the 2011 WDR, the challenges faced by FCCs vary widely, including by types of violence faced, composition of the economy (natural resource dependence), and other stresses (linked to ethnicity and identity, horizontal inequalities and neighborhood/regional effects, among many others). From the perspective of IDA financing, this heterogeneity can be illustrated along several dimensions, including:

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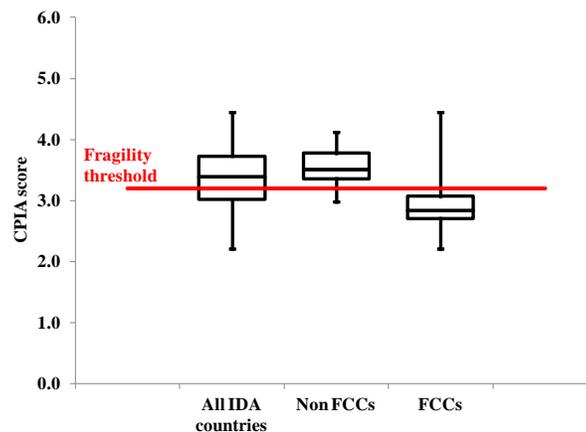
<sup>28</sup> This includes resources provided through: (i) the regular PBA system, (ii) the exceptional regimes for post-conflict and re-engaging countries, (iii) pre-arrears clearance grants, (iv) exceptional support for the clearance of arrears, and (v) exceptional support for crisis impact mitigation.

<sup>29</sup> SPF commitments as at end-August 2012 amounted to US\$117 million, of which 78 percent were for FCCs. Established with a US\$100 million IBRD contribution, the SPF succeeded the Low-Income Countries Under Stress (LICUS) TF and the Post-Conflict Fund as the Bank's primary multi-country TF for addressing the state fragility and conflict. The SPF finances activities that cannot easily be funded under regular IDA or IBRD operations: small-scale pilot projects that, if successful, can be scaled up by regular IDA funding; the continuation of well-performing projects responding to critical needs for which other sources of financing are inadequate; and discrete, complementary activities that are managed programmatically with IDA-financed activities but have a higher level of risk than the IDA activities. For details see: "Refining the Approach to Below-the-Line Grant Making: A Consolidated Report on the World Bank's Grant-Making Facilities," IDA/SecM2012-0226, May 2012.

<sup>30</sup> Due to the use of a harmonized average CPIA, a number of countries with a World Bank CPIA rating of 3.2 or less have been excluded from the FY12 FCCs list (Cameroon, Djibouti, Mauritania, Pakistan and São Tomé and Príncipe).

- **Performance** (measured by the CPIA — see Chart 1). Largely by definition, most FCCs fall at the lower end of the performance spectrum. Nevertheless, reflecting the inclusion of peace-keeping and political missions in the FCCs definition, this group also includes a number of countries with high CPIA scores.
- **Income** (measured by the GNI per-capita). Most FCCs have GNI per-capita levels below the IDA operational cutoff. At the same time, several of them are among the IDA-eligible countries with the highest per-capita incomes (with income levels several times the IDA operational cutoff).
- **Human development** (measured by the non-income Human Development Index-HDI). Close to 50 percent of the FCCs have an HDI score lower than the average for countries in the Low Human Development group. About 20 percent of the FCCs in the sample, however, have an HDI score in excess of the average for countries in the Medium Human Development group.
- **Financing status.** A number of FCCs are eligible for blend IBRD/IDA financing and, reflecting their economic circumstances and broader financing options, some of them are on the path towards graduation to International Bank for Reconstruction and Development (IBRD)-only status. The FCCs group also includes four countries (Myanmar, Somalia, Sudan and Zimbabwe) that are inactive due to arrears to IDA and/or IBRD.
- **Degree of conflict.** Civil wars with annual battle-deaths over 1,000 are typically considered to be "major civil wars". In addition to major conflicts, FCCs often face challenges from small-scale/minor violence or low intensity but protracted conflict below this threshold, as well as violence between non-state actors, ethnic groups, perpetrated by armed actors against unarmed civilians (which would not be defined as battle-deaths) or through high homicides associated with organized criminal activities. This suggests a wide spectrum of challenges associated with violence in these countries.<sup>31</sup>

**Chart 1: CPIA Distribution (boxplot) in IDA Countries**



**Notes:**

1/ Excludes inactive countries (Myanmar, Somalia, Sudan and Zimbabwe) and Tuvalu.

<sup>31</sup> See the WDR 2011 for an extensive discussion on the heterogeneity and evolving nature of the violence encountered in fragile situations.

38. **IDA's financial support to FCCs has been enhanced over time to address this heterogeneity.** Because the challenges and opportunities for engagement vary so widely within FCCs, the Bank's response must be tailored to the specific circumstances of different categories of FCCs. The IDA current allocation to a specific FCC is determined under one of the following two regimes:

- **The regular Performance-Based Allocation (PBA) system**, under which the key factor determining a country's allocation is its performance (measured by the CPIA and Portfolio Performance Rating — PPR).<sup>32</sup> As part of this system, each country receives a fixed minimum allocation, set at SDR3 million per year during IDA16. The regular PBA system directs more resources to better performers. This effect also applies to FCCs with strong performance. The inclusion of the fixed minimum allocation benefits small states, several of which are in the FCCs group.
- **Exceptional allocation regimes**, which have been created for clearly identifiable categories of countries with particularly high needs. Exceptional regimes for post-conflict and re-engaging countries were established in IDA13 and IDA14, respectively.<sup>33</sup> These exceptional regimes were enhanced during IDA15 and IDA 16, among others, by linking the size of the exceptional allocations to the size of the replenishments and extending the duration of the phase-out periods.<sup>34</sup> The introduction of these regimes recognized these countries' exceptional needs, their challenges and the fact that they have not had an opportunity to fully rebuild their institutional and policy environment. These regimes have allowed the eligible countries to benefit from allocations several times higher than those they would have received under the regular PBA system. Currently 7 out of the 30 IDA-eligible FCCs benefit from these exceptional allocation regimes.<sup>35</sup>

39. **Reflecting these enhancements, IDA's financial support to FCCs more than quadrupled from IDA11 to IDA15** (see Chart 2). The total IDA commitments to FCCs increased significantly from US\$1.5 billion in IDA11 to US\$6.6 billion in IDA15. Most of this increase has been channeled to post-conflict and re-engaging countries through the exceptional allocation regimes. IDA's financial support to FCCs during IDA16 is expected to reach a level similar to that for IDA15 with the inclusion of the special allocation for Haiti from the CRW. As a share of total IDA commitments, commitments to FCCs increased from 8 percent in IDA11 to 15 percent in IDA15, peaking at 21 percent in IDA13. The share of IDA resources for FCCs fluctuates because the composition of the FCCs group changes over time, either because of country exits (i.e., when they exceed the 3.2 CPIA cutoff like Nigeria did in FY11), or because of the entry of inactive countries (like Afghanistan, DRC, Liberia, Côte d'Ivoire and Togo) over

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<sup>32</sup> For a detailed discussion of the regular PBA system see Annex 2.

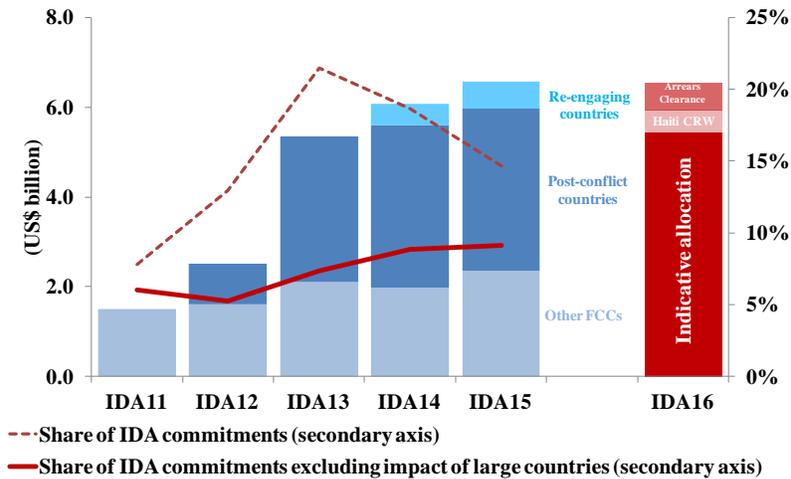
<sup>33</sup> For a detailed discussion of these exceptional allocation regimes see Annex 3.

<sup>34</sup> These extensions reflected analytical work that pointed to the desirability of providing exceptional levels support to these countries over a longer period of time to avoid disruptions in country programs. See World Bank (2003). "Breaking the Conflict Trap: Civil War and Development Policy" and World Bank (2011), "World Development Report on Conflict, Security and Development."

<sup>35</sup> Afghanistan, Burundi, DRC, Côte d'Ivoire and Liberia under the exceptional regime for post-conflict countries and CAR and Togo under the exceptional regime for re-engaging countries. During IDA16 Haiti is benefiting from an exceptional allocation under the CRW.

the past decade. The peak of IDA support to FCCs in IDA13 thus reflects the entry of several large countries (Afghanistan and DRC) just before IDA13 and the subsequent decline reflects the exit of Nigeria, Niger and Cameroon. Controlling for these factors, the share of commitments to FCCs shows a steady increase between IDA12 (5.3 percent) and IDA15 (9.1 percent).

**Chart 2: IDA commitments to FCCs over the period IDA11-IDA15**  
(US\$ billion, unless otherwise indicated)



Sources: World Bank Business Warehouse

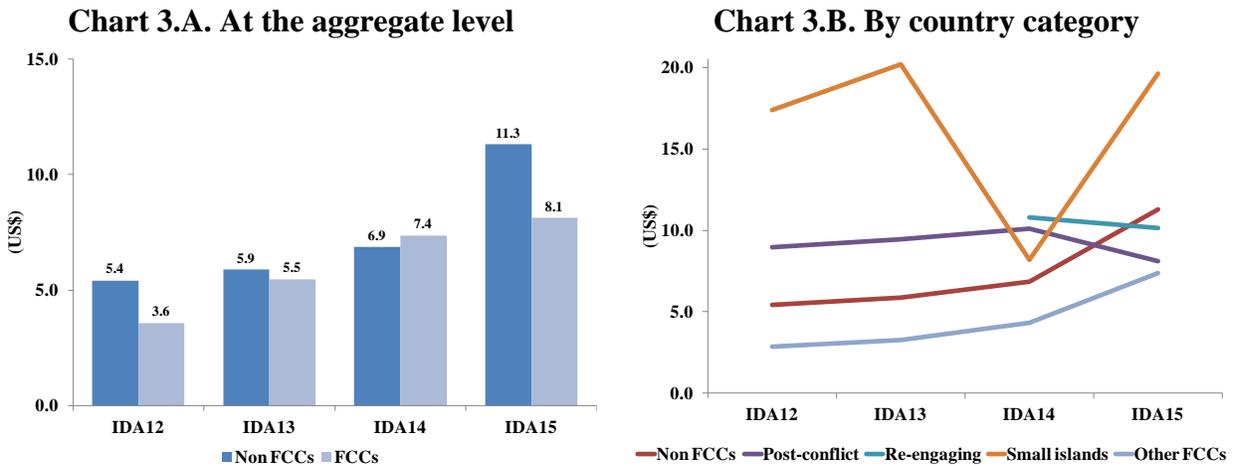
**Notes:**

1/ Figures for post-conflict and re-engaging countries include the exceptional arrears clearance support provided in IDA14 and pilot CRW support in IDA15

40. **While overall allocations to FCCs have increased steadily in recent replenishments, the per-capita support to FCCs relative to non-FCCs decreased in IDA15** (see Chart 3.A). Per-capita commitments to FCCs have steadily increased over the last replenishments reaching US\$8.1 in IDA15, more than double the US\$3.6 level in IDA12. In IDA14, IDA’s support to FCCs in per capita terms exceeded that to non-FCCs. However, per capita commitments to FCCs in IDA15 were about 30 percent lower than those for non-FCCs. This was primarily due to the phase out of some FCCs from these exceptional regimes to the regular PBA system. The evolution of per-capita allocations to FCCs (see Chart 3.B) reflects the following trends:

- Until IDA14, post-conflict and re-engaging countries had significantly higher per-capita commitments than most other countries (non-FCCs and FCCs). In IDA15, the per capita commitments to these countries dropped below those to non-FCCs, reflecting the phase out from the exceptional allocation regimes to the regular PBA system.
- The small islands have high per-capita commitments as a result of the fixed minimum base allocation.
- For the remaining FCCs, per-capita commitments increased from US\$2.9 in IDA12 to US\$7.4 in IDA15. Yet, reflecting these countries’ relative performance, their per-capita commitments were about a third lower than those of non-FCCs.

**Chart 3: Average IDA per-capita commitments to FCCs over the period IDA12-IDA15**



Sources: World Bank Business Warehouse database and Global Development Finance.

**Notes:**

1/ Figures for Non-FCCs exclude Iraq (who had access to IDA in IDA14 on an exceptional basis) and India and Pakistan (for which IDA allocations are capped at 11 percent and 7 percent of the IDA allocable envelope, respectively).

2/ Figures for post-conflict and re-engaging countries include the exceptional arrears clearance support provided in IDA14 and pilot CRW support in IDA15.

41. **Barring any adjustment to the current allocation framework, the allocations to FCCs would decrease in future replenishments.** Under the current allocation framework IDA allocations to FCCs in IDA17 would decrease by about 15 percent relative to IDA16 (assuming the same replenishment volumes as in IDA16).<sup>36</sup> As a share of total allocations, allocations to FCCs as a group would decline from 14 percent in IDA16 to 12 percent in IDA17. This decline, which reflects mainly the phasing out from the exceptional allocation regimes to the regular PBA system, is expected to continue in later replenishments.<sup>37</sup>

42. **FCCs have also benefited from IDA support beyond the regular PBA system and the exceptional allocation regimes** (see Annex 4). Important additional mechanisms that have benefited FCCs include: (i) debt relief; (ii) exceptional support prior and for the clearance of arrears; and (iii) exceptional support to mitigate the impact of crises and natural disasters.<sup>38</sup> In all, these mechanisms have allowed FCCs to benefit from about US\$4.0 billion in additional resources in recent replenishments. Beyond this additional support, most FCCs have benefited from an increased grant element in IDA’s financing since they have qualified for the provision of IDA grants. During IDA15, 73 percent of IDA’s commitments to FCCs were delivered as grants (compared to 68 percent of grant financing to FCCs during IDA14). As a result, the average

<sup>36</sup> Refers to resources allocated through the PBA system (i.e., regular PBA system, and exceptional allocations for post-conflict and re-engaging countries) plus IDA16 CRW support for Haiti.

<sup>37</sup> Increases in the IDA16 per-capita allocation level relative to the IDA15 per-capita commitment level (presented in Charts 2 and 3) are explained, among others, by changes in the: (i) composition of the group of active FCCs (IDA16 figures assume the re-activation of some of the currently inactive FCCs); (ii) size of the IDA allocable envelope; and (iii) parameters underlying the country allocations.

<sup>38</sup> To date, FCCs have benefited from: 20 percent of the debt relief committed by the Bank in the context of the HIPC Initiative and Multilateral Debt Relief Initiative (MDRI), 100 percent of the support provided through pre-arrears clearance grants and the systematic approach to arrears clearance, 30 percent of the support provided through the pilot CRW and 67 percent of the support provided through the IDA16 financing for the CRW.

grant element of IDA financing to FCCs during the IDA15 period reached about 90 percent. In addition, several FCCs have benefitted from financing from the IDA Regional Program. Finally, the introduction of additional instruments for crisis and emergency response has provided further flexibility, speed and effectiveness in IDA's support, including to FCCs. These include: (i) the 2007 revision of the World Bank's policies and procedures relating to crises and emergencies; (ii) the adoption of the IDA16 CRW, following its piloting in IDA15; and (iii) the adoption of the Immediate Response Mechanism (IRM) in December 2011.

43. **While the above mechanisms have made IDA much more responsive, IDA does not have a vehicle to provide rapid support to new opportunities in turn-around situations.** These are countries not explicitly defined as post-conflict or re-engaging which experience unforeseen openings for significant policy and institutional changes. These countries are often characterized by low level cycles of violence and/or partial state collapse, the impact of which on human resilience and development outcomes can be just as devastating as all-out war, as shown in the 2011 WDR. The 2011 WDR also emphasizes that there are "transition moments" that constitute critical opportunities for building coalitions to strengthen stability and resilience and avoid the cyclical relapse into violence and fragility; it urges international donors to find mechanisms for quick and decisive support to help governments and stakeholders make the most of these opportunities.

## **B. Options for Simplifying and Adjusting the Allocation Framework for FCCs**

44. **IDA's reliance on its PBA system is a core IDA strength firmly grounded on evidence that good policies and institutions matter for aid effectiveness.** Though there remains academic debate on the issue, comprehensive studies confirm the continued relevance of this basic foundation of the PBA. At the same time, the 2011 WDR and recent research has added new dimensions to the understanding of aid effectiveness in the FCCs context. In particular:

- A recent analysis found that factors beyond the quality of policies and institutions (e.g., project design and investment in project implementation and monitoring) have also a significant positive impact on project outcomes.<sup>39</sup> The recent improvements in IDA's portfolio in FCCs support these findings (as detailed in Section 2 above).
- Another strand of research highlights the phenomenon of "fragility traps."<sup>40</sup> The proponents of this concept argue that well-targeted and delivered aid resources, especially those that are directed to tackle the very roots of fragility, can play an important role in

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<sup>39</sup> See "Good Countries or Good Projects? Macro and Micro Correlates of World Bank Project Performance" by C Denizer, D Kaufmann and A Kraay, 2011.

<sup>40</sup> A fragility trap is defined as a sustained equilibrium of low growth and poor governance shaped by weak policies and institutions. See "Avoiding the Fragility Trap in Africa," by Noro Aina Andrimihaja, Matthias Cinyabuguma and Shanta Devarajan, World Bank Policy Research Working Paper No 5884 (November 2011) and *The Bottom Billion: Why the Poorest Countries Are Failing and What We Can Do About It* by Paul Collier (Oxford: Oxford University Press, 2007). This research agenda is ongoing and though the concept of fragility traps is generally well accepted, there remains much debate over the dynamics by which external assistance can help countries exit or avoid such traps.

helping switch countries out of fragility traps into a more positive equilibrium of strengthening institutions and higher growth.<sup>41</sup>

- Research commissioned for the 2011 WDR demonstrates that the timeline for emerging out of fragility traps, even among the most successful reformers, is far longer than initially envisioned. This research estimates such timeframes at between 20 and 36 years.

45. **While reaffirming the relevance of the PBA, this research suggests that well targeted and timely external assistance can play an important role in helping FCCs exit or avoid fragility traps.** It finds that much longer time frames may be required to build legitimate and lasting institutions, while repeated cycles of violence can prevent FCCs from leaving fragility traps. In this context, it makes a case for sustained and enhanced external assistance to FCCs, emphasizing the importance of responding quickly to confidence-building opportunities (including at the project level) to generate demonstrative results in the short term, while working to strengthen institutions in the long term. It also recognizes the heterogeneity of FCCs and therefore supports the appropriateness of IDA's targeted approach to providing resources in response to new openings in these challenging environments.

46. **As per the IDA16 commitment, and in light of this recent evidence, Management has considered a comprehensive set of options for simplifying and adjusting the framework for resource allocation to FCCs.** This work has benefited from informal discussions and feedback from the IDA 16 Working Group on Fragile States. The options assessed can be grouped in the following four categories:

- **Category 1.** *No modification of the current allocation system.* Under this approach, the current allocation system would remain unchanged and, everything else equal, the allocation to FCCs is expected to decline reflecting the phasing out from exceptional allocations of post-conflict and reengaging countries.
- **Category 2.** *Targeted adjustments to the current allocation system.* This approach builds on the current allocation framework. Under this approach, increased support to FCCs would rely on the implementation of specific actions aimed at enhancing the strengths of the current allocation system and addressing its drawbacks. The options considered in this category are:
  - the extension of the phase out period from the exceptional allocation regimes for post-conflict and re-engaging countries;
  - increasing the notional per-capita allocations for post-conflict and re-engaging countries;
  - increasing the minimum base allocation;
  - the elimination of the remaining MDRI netting out; and
  - the provision of exceptional allocations to “turn-around” situations.

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<sup>41</sup> Andrimihaja, Cinyabuguma and Devarajan (2011) present econometric evidence showing that aid to fragile states in Africa has been more productive than aid in Africa generally, though given the very low level of this assistance, it has so far been insufficient to reach threshold levels that would help countries break out of fragility traps.

- **Category 3.** *Change the relationship between allocations and project performance.* Options in this category aim to rebalance the incentives in the allocation system to reward strong project performance. The two possibilities considered are:
  - a portfolio approach, by which the weight of portfolio performance in the allocation formula would be increased; and
  - a project approach, by which additional financing could be targeted to well performing projects.
- **Category 4.** *Change the non-performance elements in the allocation formula.* Options in this category aim to capture more broadly in the allocation system elements of equity (by compensating countries for structural vulnerabilities) and relative poverty. The two possibilities considered are:
  - inclusion of structural vulnerability in the allocation formula; and
  - modification of the allocation formula so as to direct more resources to countries with *higher* relative poverty.

47. **These options have been assessed against a framework consisting of principles, criteria (considering factors such as incentives, volatility) and possible trade-offs.** Annex 5 presents the details of this framework and Annex 6 presents the assessment of the options above under this framework. As detailed in Annex 6, all of the considered options present attractive features as well as drawbacks. Below is a summary of some of the pros and cons of the 4 categories of options.

- **Category 1 (no modification)**
  - Pros. Leaving the current allocation system unchanged would result, over time, in an increased performance orientation as countries exit the exceptional allocation regimes. It would not lead to reductions in allocations to non-FCCs, many of which remain among the poorest and most vulnerable of IDA clients, which might result from changes to the current allocation framework.
  - Cons. FCCs would face reduced allocations from IDA at a time when the international community and the Bank have emphasized the importance of enhancing support to FCCs and have shown concrete results in improving the effectiveness of IDA resources to FCCs. Any increases in the IDA's envelope would have only modest benefits for FCCs and would go mostly to non-FCCs.
- **Category 2 (targeted adjustments)**
  - Pros. Options in this category would enhance the support to FCCs while preserving the fundamental structure, incentives and principles of the current allocation system. Four of the measures in this category enhance elements of the current allocation framework, one measure (eliminating the MDRI netting out) significantly reduces the complexity of the system, and one measure aims to increase flexibility to respond rapidly to changing country needs and circumstances. These adjustments would align the Bank's financial support with the current understanding of fragility and conflict and provides increased flexibility to respond to the need for longer timeframes required for countries to exit out of fragility traps and to the heterogeneity of FCCs situations in addressing fragility traps.

- Cons. As the targeted adjustments are based on and add to the current allocation system, this approach does not significantly reduce the perceived complexity of the allocation system.
- **Category 3 (changing allocations to reward project performance)**
  - Pros. Options in this category would reward a proven track record of project implementation, thus building on the recent progress in FCCs portfolio performance and aligning the allocation system with recent research on the importance of project-level variables in enhancing aid effectiveness. They would also help increase the attention to project-level results and to their monitoring and evaluation framework.
  - Cons. The time lag between project implementation and evaluation could create a disconnect between allocations and the conditions that brought about project success. In addition, the options in this category would increase the volatility of IDA's financial support to FCCs and non-FCCs and may alter incentives towards easier but less critical areas of project focus.
- **Category 4 (changing allocations to reflect non-performance elements)**
  - Pros. The option of including vulnerability in the PBA would allow the system to provide greater support to vulnerable countries. The option of changing the relative weight of poverty in the PBA would increase the poverty-orientation of the allocation system, while providing incentives for improving performance for countries *at the lower end of the performance spectrum*, all of which are FCCs.
  - Cons. The inclusion of vulnerability indicators in the PBA would pose implementation challenges linked to data availability and responsiveness to actions by recipient countries. In addition, it would lead to significant reductions in allocations for some FCCs. The option of decreasing the performance exponent in the allocation formula would lead to a reduced *overall* performance orientation of the system.

### C. Options for Consideration

48. **Based on a detailed analysis, this paper identifies a subset of options that are assessed as having the greatest potential to respond to the specific needs of FCCs.** The subset of options follows the findings of the 2011 WDR, including with respect to the heterogeneity of FCCs, volatility of IDA allocations, expectations of the long timeframes of reform, and the changes needed to enhance aid effectiveness in FCCs. As such, it recognizes the importance of responding quickly to confidence-building opportunities while working to strengthen legitimate institutions in FCCs. In addition, and building on the implementation experience of the current framework, the options recognize the importance of tailored responses to new openings in these challenging environments. Furthermore, the options aim to direct more resources to the poorest countries given that a number of IDA countries, including some FCCs, currently have high GNI per-capita levels. The increased poverty-orientation of the allocation system would be achieved while simultaneously strengthening the incentives for performance for countries at the lower end of the performance spectrum — all of which are FCCs. Specific options are:

- **Option 1.** *Case-by-case extension of the phase out period from the exceptional allocation regimes for post-conflict and re-engaging countries for the duration of IDA17.* The 2011 WDR found that recovery from conflict can take up over 30 years and that the path out of fragility for even the most successful countries can take a similar timeframe. In light of this, it would be appropriate to consider extending exceptional support for post-conflict and re-engaging countries beyond existing phase out periods. A case-by-case extension of the phase out period for countries currently under these exceptional regimes would recognize the diversity across FCCs in the progress of their transitions. Such extension could be based on the criteria agreed in the context of the IDA16 discussions.<sup>42</sup> In the context of IDA16, five countries — Afghanistan, Burundi, CAR, DRC and Togo — met the criteria for extending the phase out period through the end of the IDA16 period.
- **Option 2.** *Increasing the notional per-capita allocations for post-conflict and re-engaging countries.* When the framework for exceptional allocations was introduced in IDA13 the upper bound of the notional per capita allocations was set at US\$20. That level was reduced to US\$17 in IDA14, when the amount of resources available for exceptional allocations became linked to the overall size of the replenishment. This reduction was due to the increase in eligible countries, which had led to a reduction of available resources for countries under the regular PBA system. The effective upper bound for the IDA16 period for post-conflict countries, which takes account of the adjustments for replenishment size, is US\$24 per capita. In line with the findings of the 2011 WDR regarding the protracted nature of fragility and conflict and the need for substantial resources over long periods of time, the upper bound for notional allocations to post-conflict countries could be increased. An increase to US\$34 would increase the effective average level of per capita support to post-conflict countries from US\$12.5 in IDA16 up to US\$19.0 in IDA17 (and from US\$9.5 up to US\$13.5 for re-engaging countries).<sup>43, 44</sup> The adjustment would also increase the share of IDA resources used for exceptional allocations from 7.5 percent in IDA 16 to 11.2 percent in IDA17, assuming the replenishment volumes remain the same as in IDA16.<sup>45</sup>
- **Option 3.** *Increase the minimum base allocation from SDR3.0 million to SDR4.0 million per year.* This adjustment aims at addressing the small states' vulnerability to economic shocks and natural disasters. It recognizes that, despite its recent increase, the minimum base allocation remains insufficient to maintain an effective country program. This increase would have a significant impact for small states — several of which are FCCs —

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<sup>42</sup> The eligibility criteria for the case by case extension agreed in the context of IDA16 are: (i) limited economic status and financing options, measured by GNI per capita that is less than the IDA operational cutoff or lack of access to IBRD financing; (ii) the presence of clear factors slowing down the transition, most notably a resurgence or continuation of conflict in parts of the country, as measured by the presence of UN Security Council mandates for peace-keeping forces (with the exclusion of border monitoring missions); and (iii) IDA portfolio performance rating, averaging, over the last three years, at least 3.0. The decision rule was to extend the country's phase out period if it meets criterion: (i) and at least one of the two criteria (ii) or (iii).

<sup>43</sup> For re-engaging countries, the IDA16 figure excludes the IDA16 CRW support to Haiti.

<sup>44</sup> As a result of this adjustment, the per-capita support to FCCs as a group (including the IDA16 CRW support to Haiti) would increase from US\$15 in IDA16 to US\$17 in IDA17.

<sup>45</sup> As a result of this adjustment, the share of IDA resources to FCCs as a group (including the IDA16 CRW support to Haiti) would increase from 14 percent in IDA16 to 16 percent in IDA17.

by ensuring a minimum “lifeline” without significantly impacting the overall performance orientation of the system or significantly changing the allocations for other countries.

- **Option 4.** *Elimination of the remaining MDRI netting out.*<sup>46</sup> This option will simplify the current allocation system and increase resources for some FCCs. It recognizes that, despite the capping agreed in IDA16, the remaining MDRI netting out still leads to significant allocation declines for some MDRI recipients. It also recognizes that several among the countries most affected by MDRI netting out are FCCs. Finally, this option would address the dilution of incentives to performance that some countries — including some FCCs — could experience as a result of its application.<sup>47</sup> This option would have a significant impact on allocations to the countries adversely affected by MDRI netting out without significantly impacting the allocations to other countries.
- **Option 5.** *Provision of exceptional allocations to “turn-around” situations.* Under this option, IDA could provide exceptional support to turn-around countries, i.e., countries not explicitly defined as post-conflict or re-engaging but that are undergoing unforeseen openings for significant policy and institutional changes. Such countries are generally characterized by low intensity but often protracted cycles of violence and/or partial collapse of the state, the impact of which on human resilience and development outcomes can be just as devastating as all-out war. This option therefore recognizes the importance of responding quickly and decisively with international support to openings that enable policy and institutional reforms to build resilience and avoid fragility traps. In principle, the exceptional turnaround regime could use the same principles and criteria for assessing performance and allocation used under the exceptional allocation regimes for post-conflict and re-engaging countries. At the same time, this regime could draw on the work being undertaken as part of the New Deal, including fragility assessments and the development of peace building and state building indicators. Based on the IDA Deputies’ feedback, the elements in Annex 7 could be further refined for consideration of such an exceptional regime in the context of the IDA17 Replenishment discussions.
- **Option 6.** *Reduce the exponent of the country performance rating in the allocation formula from 5 to 4.* This measure is motivated by two objectives. First, it would make IDA’s overall allocation system more poverty oriented.<sup>48</sup> Currently there are several IDA countries with GNI per-capita levels above the IDA operational cutoff. These countries are receiving more support on a per capita basis than the other IDA countries —

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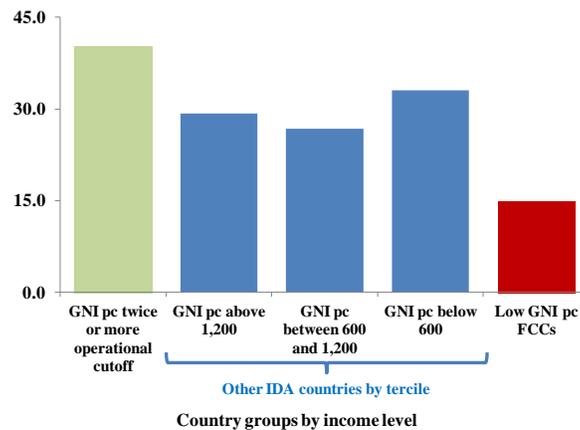
<sup>46</sup> Countries benefiting from debt relief under the MDRI are subject to reductions in IDA allocations through the MDRI netting out mechanism. For further details on the impact of the MDRI netting out see “Implementation Experience of Capping MDRI Netting out in IDA16,” September 2012.

<sup>47</sup> A key incentive in the allocation system is the increase of allocations that would follow improved performance. In the case of MDRI recipients for which the capping on MDRI netting out is binding, the netting out could offset the performance increase that could result from improved performance. See “Implementation Experience of Capping MDRI Netting out in IDA16,” Op.Cit.

<sup>48</sup> A similar effect could be achieved by changing the GNI per-capita exponent in the allocation formula. Given the interactions of the different variables (population, GNI per capita and CPR) this option would, however, not have a uniform effect on FCCs. It also has some unintended consequences, including that it would increase volatility, and a bigger impact on the performance orientation of the system, and negatively impact several countries with already small allocations. See Annex 8 for a detailed discussion on the benefits and shortcomings of both options.

in particular FCCs — as they tend to have stronger performance (see Chart 4) and have access to broader financing options, reflecting their improved economic circumstances. Second, it would increase the level of financial support to FCCs, most of which have GNI per-capita levels significantly below the operational cutoff. In addition, it has the advantage of providing larger relative incentives for performance for countries at the lower end of the performance spectrum — most of which are FCCs with low per capita support from IDA (see Chart 5). Overall, as detailed in Annex 8, this change allows for a greater poverty-orientation of the allocation system and enhanced financial support to FCCs, while retaining the principle of performance orientation in the system and reducing the volatility of allocations due to country income changes.

**Chart 4: Per-capita allocations by income groups**

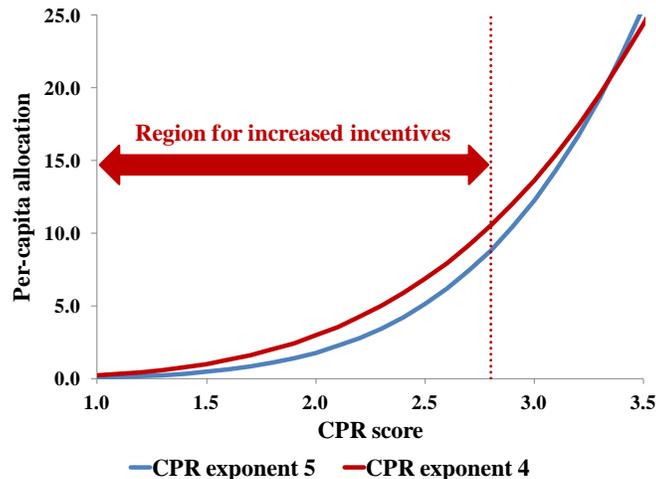


Sources: Global Development Finance and staff estimates

Notes:

- 1/ Exclude India and Pakistan (for which IDA allocations are capped), inactive countries and countries under the small islands exception.
- 2/ Countries in the low GNI pc FCCs category exclude FCCs with GNI per-capita levels twice the operational cutoff or higher.

**Chart 5: Allocation curve: impact of changing the CPR exponent from 5 to 4**



Sources: Staff estimates

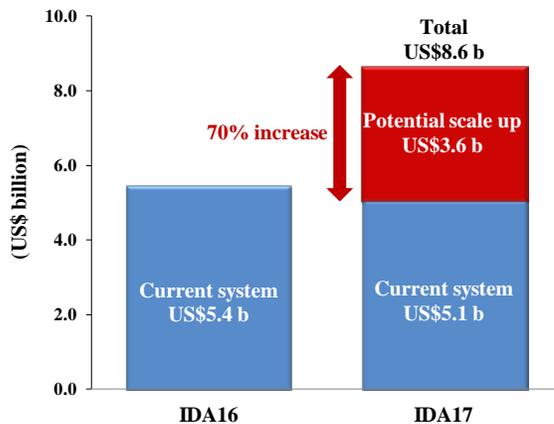
Notes:

- 1/ Allocation curves estimated based on the FY11 CPIA, PPR, GNI per-capita and population for countries whose allocations are determined under the regular PBA system.

49. **The full application of the above options would lead to a step change in IDA’s support to FCCs across a number of dimensions.** First, assuming (among others) the IDA17 replenishment volume is the same as in IDA16, indicative estimates show that their full application would increase IDA’s financial support to FCCs during IDA17 by about 70 percent or about US\$3.6 billion over what they would receive under the current allocation system (see Chart 6). As a result of this scaling up, IDA’s allocations to FCCs: (i) would increase from US\$5.4 billion in IDA16 to US\$8.6 billion in IDA17; (ii) as a share of total IDA allocations, would increase from 14 percent in IDA16 to 20 percent in IDA17; and (iii) in per-capita terms, would increase from US\$13 during IDA16 to US\$21 in IDA17.<sup>49</sup> The increased resources to FCCs would capture improvements in IDA’s FCC portfolio performance resulting from the Bank’s modernization agenda to strength its effectiveness in FCCs. Second, the application of these options would reduce the volatility in FCCs allocations and recognize the longer time frames required for the strengthening of legitimate institutions as documented in the 2011 WDR. Third, it would enhance IDA’s flexibility to provide quick support to turn-around situations in response to unforeseen opportunities to strengthen coalitions for stability and growth and avoid fragility traps. Finally, these options would enhance the poverty-orientation of the allocation system, while retaining the basic principle of performance orientation that has been a hallmark of IDA.

50. **Collectively, these changes would represent a realignment of IDA’s financial support to FCCs to respond to the lessons of the 2011 WDR and to the opportunities represented by the New Deal.** With increased — and more flexible — resources in the context of continued incentives to reward good performance, IDA would enhance its support to FCCs in their efforts to bridge the still considerable distance towards achieving the MDGs, particularly in the face of potentially increasing pressures related to the sluggish global economic recovery.

**Chart 6: Impact of options on overall allocations to FCCs**

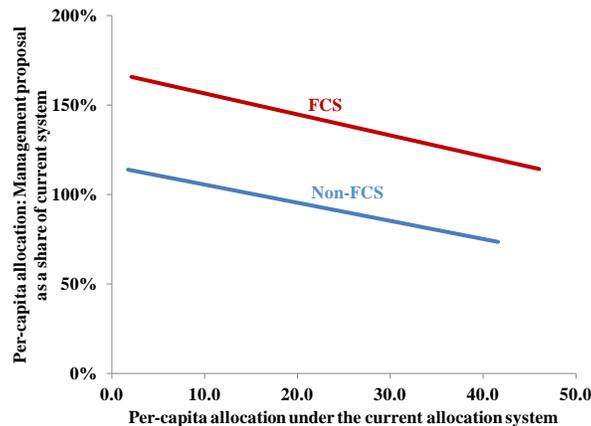


Total impact		3,593
<b>1) Targeted adjustments</b>		<b>3,112</b>
2.a. Extend phase out		492
2.b. Increase notional allocations		1,910
2.c. Increase base allocation		80
2.d. Eliminate MDRI netting-out		49
2.e. "Turn around" support		579
<b>2) Change CPR exponent</b>		<b>481</b>

Sources: Staff estimates

<sup>49</sup> This change refers to the resources channeled through the PBA system (including exceptional allocations for post-conflict and re-engaging countries). As such, the IDA16 figures in this paragraph exclude the IDA 16 CRW support to Haiti and any possible support for the clearance of arrears under the systematic approach for arrears clearance.

**Chart 7: Impact of options on per-capita allocations at the country level**



51. **The decision on whether, and by how much, to increase the financial support to FCCs would need to take into account different trade-offs.** All other things equal, increasing the support to FCCs would lead to a dollar for dollar reduction in IDA’s support to non-FCCs. Since, under the current allocation system, FCCs would receive 12 percent of the IDA17 allocations, that dollar shift reflects a much larger increase in the percentage of commitments to FCCs than it does as a percentage decrease to non-FCCs — a 70 percent increase to FCCs reflects a 9 percent decrease to non-FCCs. This shift from non-FCCs would mean a reduction of IDA’s program in countries with strong policies and institutions and a strong record of project implementation, some of which are among the poorest and most vulnerable in IDA’s clientele. At the regional level, the Africa and the Latin America and the Caribbean regions would experience increases in their share of IDA support while the other regions would experience small decreases. Consequently, the precise modalities for increasing the support to FCCs and the magnitude of such increase will have to consider several factors, including trade-offs and the size of the replenishment. In addition, the decision will need to strike a balance between a rule-based approach and the flexibility that would be desirable to respond decisively to windows of opportunity that could arise in the FCCs context.

#### **IV. ISSUES FOR DISCUSSION**

52. **Staff would welcome the Deputies’ views on:**

- the Bank’s efforts to improve the operational effectiveness in fragile states, including the implementation of actions agreed in the context of the IDA16 Replenishment.
- the sub-set of options indentified for simplifying and adjusting the framework for allocating resources to FCCs.
- the need to take into account potential trade-offs and the size of the replenishment.

**Annex 1: IDA 16 Monitorable Actions - Status of implementation**

	<b>Actions</b>	<b>Status</b>
<b>Completed Actions</b>		
A	Examine the operational implications of the 2011 WDR, including with respect to the heterogeneity of fragility and conflict, approaches to fragile situations and for conflict prevention, volatility of IDA allocations, etc. Based on these findings, develop, by the IDA 16 MTR, proposals including to simplify and adjust the framework for allocating resources to FCCs.	Completed. See Section III
B	Complete the revision and testing of the PCPI criteria, and publicly disclose the country scores in June 2011 before the start of IDA 16. Develop specific mechanisms to monitor efforts in the broader set of fragile and conflict affected countries in cooperation with other agencies and bilateral partners.	Completed See Section II A
C	Strengthen efforts to integrate a gender perspective in IDA's support to FCCs.	Completed and Ongoing See Section II B
<b>Actions in Progress</b>		
D	Develop plans for enhanced implementation of UN-World Bank Partnership Agreements in a few pilot countries.	Ongoing See Section II C
E	Revise the World Bank's Operational Policy on Development Cooperation and Conflict (OP/PB 2.30) by the end of 2011, and include partnership agreements.	Ongoing See Section II D
F	Complete evaluation of IDA's work in fragile and conflict affected countries during 2012-2013.	Ongoing See Section II E
<b>Continuing Actions (In progress now and beyond IDA 16)</b>		
G	Strengthen collaboration with partners on MDTFs administered by the World Bank, develop a reform plan in response to the MDTF evaluations, and report on progress at the IDA16 MTR.	Continuing See Section II F
H	Provide a review of procurement, fiduciary and legal inputs in FCCs to speed up implementation in FCCs.	Continuing See Section II G

## Annex 2: The PBA system

1. **The regular PBA allocation formula determines a country’s allocation based on its performance, as measured by the Country Performance Rating (CPR), and its needs, as measured by population size and GNI per capita. The specification of the allocation formula is the following:**

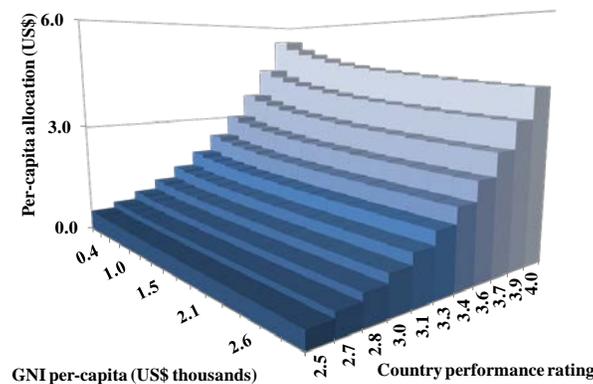
$$\text{Allocation Country}_i = \text{Base allocation} + \text{PBA}_i$$

Where:

- The base allocation amounts to SDR3 million per year
- $$\text{PBA}_i = \frac{(\text{CPR}_i)^5 * \text{Pop}_i * (\text{GNIpc}_i)^{-0.125}}{\sum_i [(\text{CPR}_i)^5 * \text{Pop}_i * (\text{GNIpc}_i)^{-0.125}]} * \text{Annual allocable envelope}$$
- $$\text{CPR}_i = 0.24 * \text{CPIA}_{A-C}_i + 0.68 * \text{CPIA}_D_i + 0.08 * \text{PPR}_i$$
- CPR is the Country Performance Rating
- Pop is the country’s population
- GNIpc is the country’s population
- CPIA<sub>A-C</sub> is the average rating for CPIA clusters A to C
- CPIA<sub>D</sub> is the rating for CPIA cluster D
- PPR is the country Portfolio Performance Rating

2. **The chart below provides a visual representation of the regular PBA allocation formula.** The functional specification of the formula makes that allocations increase steeply with better performance and they decrease much less steeply with higher GNI per-capita levels.

**Annex 2. Chart 1: Illustration of the regular PBA allocation formula**



3. **The formula is applied in six steps to determine the country-by-country allocation of IDA resources and IDA’s terms of support (i.e., credits, grants, or a mix):**

- **Step One:** Determine gross allocations using the regular PBA formula. The PBA formula is used to determine the gross IDA allocations at the country level.
- **Step Two:** Determine grant eligibility on the basis of debt distress ratings.
  - IBRD/IDA blend countries and gap countries are not eligible for grants.<sup>50</sup>

<sup>50</sup> Gap countries are IDA-eligible countries whose per capita incomes have been above IDA’s operational cutoff for more than two consecutive years but are not creditworthy for IBRD lending. In FY13 such countries included Angola, Bhutan, Congo Republic, Djibouti, Guyana, Honduras, Kosovo, Moldova and Timor-Leste.

- Eligibility for grants for the remaining countries is based on debt distress ratings as assessed under the joint Bank-Fund Debt Sustainability Framework (DSF) for Low-Income Countries.<sup>51</sup> Debt-distress risk classifications are mapped as per the system below to determine the terms of assistance (i.e., grant and credit mix):

**Annex 2. Table 1. Risk of Debt Distress and Share of Grants in IDA Financing**

Debt distress risk	Grant and credit assignment
Low	100 percent credits
Moderate	50 percent credits, 50 percent grants
High or in debt distress	100 percent grants

- **Step Three:** Apply volume discounts on grants.  
Grant allocations are subject to a 20 percent reduction in volume.<sup>52</sup> This reduction is aimed at achieving two distinct objectives. First, an incentive-related discount of 13 percent is applied to help maintain the strength of IDA’s incentive system in light of increased grant levels. Second, a charges-related discount of 7 percent is applied to help finance foregone charge income on IDA grants. The incentive-related discount is not applied to countries benefitting from exceptional post-conflict allocations.
- **Step Four:** Redistribute resources from volume discounts on grants.  
The resources from volume discounts on grants are re-injected into the IDA pool and redistributed among eligible countries. Specifically:
  - The resources from the incentive-related discount are redistributed to all IDA-only countries, excluding gap countries and those benefitting from exceptional post-conflict allocations.<sup>53</sup> Terms of such reallocation are in accordance with countries’ risk of debt distress. Amounts are allocated to eligible countries in accordance with the regular PBA allocation formula. For those countries receiving part or the totality of such additional resources as grants, no further volume discounting will take place.
  - The resources from the charges-related discount are made available on hard terms to blend countries with the exception of the small states. Annual hard-term allocations are distributed among eligible countries in proportion to their share of gross allocations.<sup>54</sup>
- **Step Five:** Apply the MDRI “Netting-Out” to eligible countries.

<sup>51</sup> When DSAs are unavailable, grant eligibility still relies on the ‘static’ pillar of the grant allocation framework—which involves a “static” comparison between the latest available external debt indicators and the applicable external debt thresholds under the DSF.

<sup>52</sup> See “*Debt Sustainability and Financing Terms in IDA14: Further Considerations on Issues and Options*,” IDA/SecM2004-0779, December 2004.

<sup>53</sup> The treatment for post-conflict countries reflects the fact that this share of volume discount is not deducted from their allocation as described in the previous section.

<sup>54</sup> For details, refer to IDA (2005), “*Implementation Note: Lending at “Hard Terms” in IDA14*.” April 2005, and IDA (2011) “Additions to IDA Resources: Sixteenth Replenishment,” March 2011.

For MDRI recipient countries, annual MDRI debt relief is deducted from the allocation amounts they would otherwise receive from steps one through four above. In IDA16, the MDRI netting out is limited to 1/3 of a country's gross allocation.

- **Step Six:** Distribute MDRI-related compensatory resources to all IDA-only countries. Donor resources provided to IDA to compensate for debt service forgone as a result of the MDRI are reallocated to all IDA-only, non-gap, countries. The compensatory resources are distributed to countries in accordance with the PBA allocation formula. For those countries receiving part or whole of such additional resources as grants, no further volume discounting will take place.

4. **It is important to note that Steps 2 to 4 are applied only to IDA-only countries.** All blend and gap countries receive their respective allocations in the form of credits, irrespective of their risk of debt-distress. Step 5 is applicable to MDRI-eligible countries only. Step 6 is applicable to all IDA-only countries. Steps 4 and 6 do not apply to countries whose allocations were independently determined or to inactive countries.

5. **While the bulk of IDA resources are allocated using the regular PBA allocation formula, there are five exceptions:** (i) allocations to blend countries with large populations are capped (caps for India and Pakistan are set at 11 percent and 7 percent, respectively); (ii) exceptional allocations are provided to post conflict and re-engaging countries; (iii) exceptional allocations are for the funding of arrears clearance operations under the Systematic Approach for Arrears Clearance; (iv) special allocations for regional projects; and (v) exceptional allocations under the CRW. Details on the exceptional allocations for post-conflict and re-engaging countries are provided in Annex 3. For further details on the remaining exceptions please refer to the IDA16 document on the PBA system.<sup>55</sup>

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<sup>55</sup> IDA (2010) "IDA's Performance Based Allocation System: Review of the Current System and Key Issues for IDA16," May 2010.

### **Annex 3: Exceptional allocation regimes for post-conflict and re-engaging countries**

1. **This annex is organized in three sections.** First, it presents the historical evolution of IDA's allocation modalities to post-conflict and re-engaging countries. Second, it details the mechanics of these exceptional allocation regimes, as agreed under IDA16. Finally, it evaluates the impact these exceptional regimes have had in terms of increased support to these countries.<sup>56</sup>

#### **Evolution of the exceptional allocation regimes for post-conflict and re-engaging countries**

- Pre IDA12
  - Exceptional allocations case-by-case. This approach was criticized on the grounds of lack of predictability, equity of treatment and the possible inclusion of political considerations as part of the allocation process.<sup>57</sup>
- IDA12
  - Exceptional allocation regime for post-conflict countries introduced on pilot basis.
- IDA13<sup>58</sup>
  - Exceptional allocation regime for post-conflict countries formally introduced.
  - Exceptional post-conflict allocations limited to three years plus a transition period of up to two years. During this transition period exceptional allocations would phase out to the levels determined under the regular PBA system.
  - Maximum notional per-capita allocations based on performance as measured by the PCPI. Upper bound for countries with a PCPI rating close to 5.0 set at US\$20. Upper bound for countries with a PCPI rating close to 2.0 set at US\$4.<sup>59, 60</sup>
  - During IDA13 MTR, the duration of exceptional post-conflict allocations is extended to four years plus a phase out period of three years.

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<sup>56</sup> This assessment is based on counterfactual scenarios that apply retrospectively the IDA16 allocation mechanism with and without exceptional allocations for post-conflict and re-engaging countries.

<sup>57</sup> See: "Adapting IDA's Performance-Based Allocations to Post-Conflict Countries", May 2001.

<sup>58</sup> Source: Annex 2 in IDA13 final replenishment report.

<sup>59</sup> In several respects, the PCPI covers the same areas as the CPIA, although the expected performance is less ambitious. In addition, the PCPI measures progress in areas critical for transition processes not captured in the CPIA—security, demobilization and reintegration of ex-combatants, political and reconciliation processes, and reintegration of displaced populations.

<sup>60</sup> These maximum notional per-capita allocations are lower than originally proposed by staff. In the original staff proposal, the maximum notional per-capita allocations ranged from US\$5 to US\$30. See: IDA (2001), "Adapting IDA's Performance Based Allocation to Post-conflict countries," IDA 13, May 2001.

- IDA14
  - Mapping of PCPI ratings versus maximum notional per-capita allocations modified as follows:

**Annex 3. Table 1. Notional Per-Capita Allocation per PCPI Score**

<b>PCPI score</b>	<b>Allocation Maximum (US\$ per capita per annum)</b>
2.0 to 2.5	3.4
2.5 to 3.0	6.0
3.0 to 3.5	8.5
3.5 to 4.0	11.9
4.0 to 4.5	14.4
4.5 to 5.0	17.0

- Introduction of exceptional allocation regime for re-engaging countries. Allocations under this regime lower than the one for post-conflict countries.
  - Exceptional allocations for re-engaging countries limited for a period of up to three years.
- 
- IDA15
    - Duration of the phase-out period for exceptional allocations for post-conflict countries extended to six years.
    - Duration of exceptional allocations for re-engaging countries set at five years, of which three correspond to the phase-out period.
    - Allocations under the exceptional regime for re-engaging countries determined based on the maximum notional per-capita allocations for post-conflict countries (half the amount for each PCPI rating range).<sup>61</sup>
- 
- IDA16
    - Phase-out period for exceptional post-conflict and re-engaging allocation regimes extended for the duration of IDA16 on a case-by-case basis.
    - Extension based on the following criteria: (i) limited economic status and financing options, measured by GNI per-capita lower than the IDA operational cutoff or lack of access to IBRD financing; (ii) presence of clear factors slowing down the transition, most notably a resurgence or continuation of conflict in parts of the country, measured by the presence of UN Security Council mandates for peace-keeping forces (with the exclusion of border monitoring missions); and (iii) PPR, averaged over the last three years, of at least 3.0.

<sup>61</sup> Source: IDA (2007), “Operational Approaches and Financing in Fragile States, IDA 15,” June 2007.

- Decision rule was:
  - Phase out period not extended if the country does not meet i),
  - Phase out period extended if the country meets (i) and at least one among (ii) or (iii).

### **Mechanics of exceptional allocations for post-conflict and re-engaging countries**

#### **2. Allocations under the exceptional post-conflict regime are determined as follows:**

- **Step 1:** Determine the regular allocation under the PBA system.
- **Step 2:** Calculate the notional post-conflict envelope

The notional post-conflict envelope is the sum across countries of the notional post-conflict country allocations. The notional post-conflict country allocation is the notional per capita country allocation times the population. The notional per capita country allocation is determined based on the IDA14 PCPI mapping (see previous section).

- **Step 3:** Determine the post-conflict allocation for each country  
This step uses a modified PBA formula that is applied to the notional post-conflict envelope (determined under step 2). In the modified PBA formula the PCPI replaces the CPIA in determining the CPR and the exponent of the CPR is reduced from 5 to 2.
- **Step 4:** Apply a phase-out for countries in the phase-out period  
The phase-out formula reduces the allocation of such countries by 1/7 in each of the phase-out period. The phasing out supports a smooth transition to the regular PBA system.<sup>62</sup>

#### **3. Allocations under the exceptional regime for re-engaging countries are determined following similar steps, but the notional per capita allocation is half of that for post-conflict countries with a PCPI score in the same range.**

### **Impact of the IDA16 framework for exceptional allocation regimes**

**4. The impact of the IDA16 framework for exceptional allocation regimes is assessed in terms of its capacity to direct increased resources to eligible countries.** Such capacity is estimated as the difference between two scenarios. Under the first scenario, the IDA16 framework for exceptional allocation regimes is applied retrospectively to past replenishments (IDA 15, IDA14 and IDA13). Under the second scenario, the IDA16 regular PBA system is applied to past replenishments (i.e., allocations to post-conflict and re-engaging countries are determined using the regular PBA system).

**5. The assessed impact is presented in Charts 1 and 2 below.** Charts 1.A. and 1.B. present the results of the simulations under both scenarios for post-conflict and re-engaging countries, respectively. Chart 2 presents the difference in the average per-capita allocations

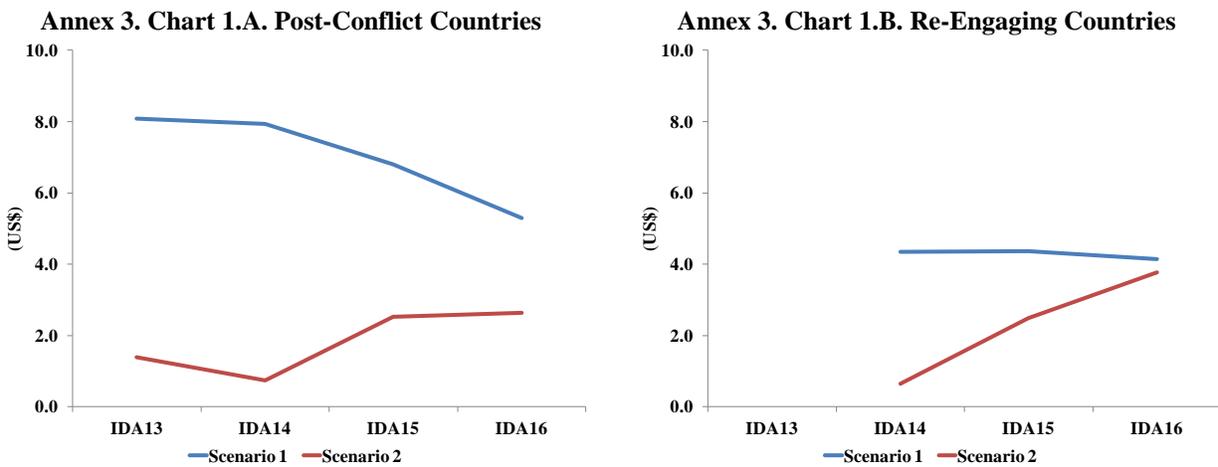
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<sup>62</sup> This assumes the phase out period of 6 years agreed in IDA15. If the phase period is extended beyond the regular 7 years, the approach should be modified accordingly.

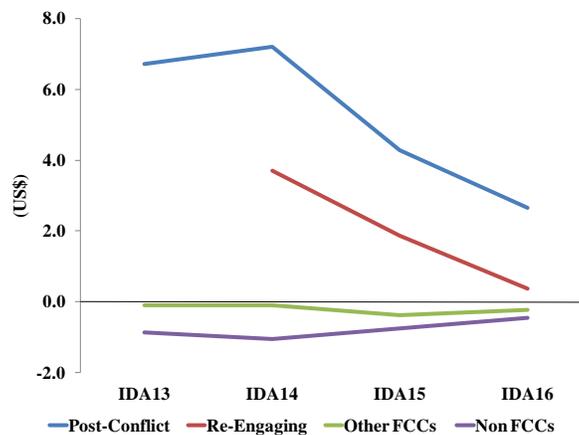
under both scenarios for all categories of countries (post-conflict, re-engaging, other FCCs and non-FCCs). A positive value in Chart 2 indicates a Scenario 1 allocation higher than that under Scenario 2.

6. **Post conflict and re-engaging countries would benefit from higher allocation under Scenario 1 than under Scenario 2.** For post conflict countries, at its peak, the IDA16 exceptional allocation regime would have channeled more than 5 times more resources than the regular PBA system. In the case of re-engaging countries, the IDA16 exceptional allocation regime would have resulted in allocations 5 times larger than the regular PBA system (yet about half the ones granted under the exceptional post-conflict regime). The impact of the exceptional allocation regimes, however, fades away as countries advance in the phase out period. In addition, as illustrated in Chart 2, the increased allocations for post-conflict and re-engaging countries would have been provided at little cost for other countries (FCCs and non-FCCs).

**Annex 3. Chart 1. Per-Capita Allocations to Post-Conflict and Re-Engaging Countries**



**Annex 3. Chart 2. Change in Per-Capita Allocations by Country Category (Scenario 1 versus Scenario 2)**



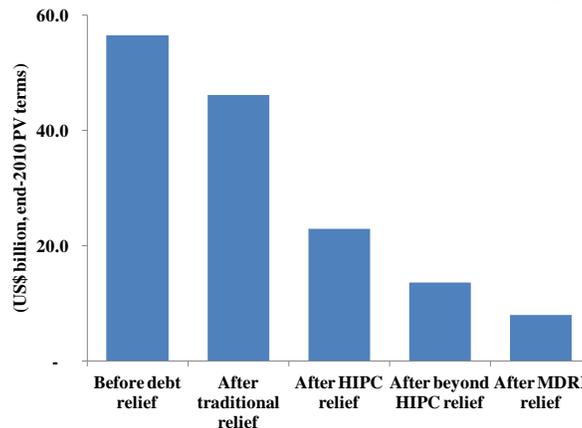
#### **Annex 4: Support to FCCs beyond the allocations under the regular PBA system and the exceptional allocation regimes**

1. **Several FCCs have benefited from financial support beyond that provided under the regular PBA system and the exceptional allocation regimes.** Key additional mechanisms for enhanced financial support to FCCs include: (i) debt relief; (ii) exceptional support to countries in their re-engagement efforts; and (iii) exceptional support to mitigate the impact of crises and natural disasters. In all, these mechanisms have allowed FCCs to benefit from about US\$4.0 billion in additional resources in recent replenishments.

#### **Debt relief**

2. **Debt relief under the HIPC Initiative and the MDRI has substantially lowered the debt burden of eligible FCCs.** Seventeen FCCs have been grandfathered for HIPC eligibility. Of these, 14 have reached the HIPC Initiative decision point. Debt relief under the HIPC initiative and the MDRI, together with that under traditional debt relief mechanisms and debt relief beyond HIPC from Paris Club creditors, is estimated to reduce the debt burden of the 14 post-decision point FCCs by about 90 percent relative to pre-decision point levels (Chart 1).

**Annex 4. Chart 1. Post Decision Point FCCs Debt Stock by Debt Relief Stages**



Source: 2011 HIPC Initiative and MDRI Progress Report

3. **IDA's committed debt relief under the HIPC Initiative and MDRI to the 14 post-decision point FCCs amounts to US\$6.7 billion in end-2010 present value (PV) terms.** Of this amount, US\$4.4 billion in PV terms had been delivered by end-September 2012 (i.e., about 2/3). The provision of debt relief under these two initiatives is estimated to have lowered the debt service payments from the 14 post-decision point FCCs to IDA by about US\$1.8 billion over the period IDA12 through IDA15.<sup>63</sup>

<sup>63</sup> This amount excludes the relief provided through the exceptional support for the clearance of arrears, which is discussed in detail later in the annex.

4. **More FCCs will benefit from debt relief from IDA as they move forward in the HIPC process.**

#### **Exceptional support to countries in their re-engagement efforts**

5. **IDA's support in the context of a country's re-engagement follows a sequence of steps rooted in the Bank's legal and policy framework:**

- **before the beginning of the re-engagement process**, the World Bank can typically provide support through TFs' resources.
- **once a country is on the path towards re-engagement**, IDA can provide pre-arrears clearance grants. The framework for the provision of such grants was introduced in IDA12 and a number of enhancements were introduced in IDA15.<sup>64</sup>
- **at the time of the clearance of arrears**, IDA can provide exceptional support to re-engaging countries through the Systematic Approach to arrears clearance introduced in IDA15.<sup>65</sup> The provision of such support is ring-fenced to countries in arrears to the Bank as of end-2006 that are grandfathered for eligibility under the HIPC Initiative.

6. **So far, the experience with pre-arrears clearance grants and arrears clearance support has been positive.** Afghanistan, DRC, Liberia and Côte d'Ivoire benefitted from pre-arrears clearance grants in the amount of US\$0.3 billion.<sup>66</sup> To date, IDA has provided US\$0.8 billion under the systematic approach for arrears clearance to Liberia, Côte d'Ivoire and Togo.<sup>67</sup> In recognition of their success, these two instruments have been confirmed in IDA16 and will play a crucial role if and when the remaining inactive countries make credible progress towards re-engagement.

#### **Exceptional support for crisis mitigation**

7. **IDA has been involved in different aspect of crises response since its establishment.** This included the provision of additional resources to assist in the recovery efforts. During IDA15 FCCs have benefitted from US\$620 million in additional support for crisis response (of which US\$420 million were provided through the Pilot CRW). Furthermore, Haiti has benefitted from an exceptional allocation of US\$500 million from the IDA16 CRW.

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<sup>64</sup> These enhancements included the possibility to provide grants to: i) countries where the clearance of arrears is delayed for reasons unrelated to their track record; and ii) re-engaging countries. See IDA (2007) "Further elaboration of a Systematic Approach to Arrears Clearance."

<sup>65</sup> See IDA (2007) Op. Cit..The experience in Liberia led to the introduction of this approach in recognition that traditional mechanisms for supporting the clearance of arrears would be insufficient to support the eligible countries. All of the eligible countries had arrears in amounts that were several times higher than their potential IDA allocation. For instance, Liberia had arrears to the Bank that were 14 times the size of its IDA allocation and also had limited access to domestic and donor resources with which to support the clearance of arrears.

<sup>66</sup> DRC received US\$50 million in 2001, Afghanistan received US\$100 million in 2002, Liberia received US\$46.5 million in 2006 and Côte d'Ivoire received US\$120 million.

<sup>67</sup> Based on an assessment of the country's payment capacity, IDA provided exceptional support for the full cost of the clearance of arrears in the case of Liberia (US\$378 million) and Togo (US\$143 million) and for half of the cost of the clearance of arrears in the case of Côte d'Ivoire (US\$273 million).

8. **Beyond the above additional support, most FCCs have benefited from an increased grant element in IDA's financing thanks to the provision of IDA grants.** During IDA15, IDA's support to FCCs was delivered primarily through grants.<sup>68</sup> IDA grants to FCCs during IDA15 amounted to US\$4.8 billion, or 73 percent of the total IDA commitments to these countries. This compares with 68 percent of grant financing to FCCs during IDA14. Thirty eight IDA-eligible countries were considered FCCs at some point during the IDA15 period. Of these countries: (i) 27 benefitted from IDA grants while in the FCCs category (including 20 for which 100 percent of IDA's commitments were on grant terms), (ii) 4 did not receive IDA commitments, and (iii) 7 received IDA commitments on credit terms. As a result of the above, the average grant element of IDA financing to FCCs during the IDA15 period reached about 90 percent, compared to about 60 percent for countries that receive all of IDA financing in regular credit terms.

9. **Finally, several FCCs have benefitted from financing from the IDA Regional Program for investments in high-potential regional projects.** Total IDA lending to DRC, for example, increased from US\$917 million in IDA14 to US\$1,074 million in IDA15, due to additional financing from IDA's regional program for two transformative regional projects, namely the South African Power Market Program, which promotes regional integration of power systems for the transmission of clean and renewable energy, and the Regional and Domestic Markets Development Project that aims to increase the output of the hydropower plants at Inga through the rehabilitation of existing generation facilities.

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<sup>68</sup> Starting in IDA14, grants were allocated to proactively mitigate the risks of debt distress revealed by the DSF. See Annex 2 for further details.

## **Annex 5: Framework for assessing the considered options**

1. **From IDA's inception, the demand for resources has outstripped supply.** Hence the need for principles and criteria that determine eligibility for access to IDA resources, the level and terms of IDA's financial support to eligible countries and graduation from IDA eligibility at the appropriate time. This paper deals with IDA's system for allocating its limited resources among the eligible countries. The challenge with this system is to ensure that the underlying principles and criteria accurately reflect IDA's over-arching objective of meeting the needs of the world's poor and adequately address the heterogeneity of country situations, in particular that of FCCs.

2. **Below are the set of principles, criteria and tradeoffs that staff considered** while evaluating different options for simplifying and adjusting the FCCs allocation framework presented in this paper.

- **Principles**

- **Effectiveness.** The allocation system should direct resources to countries where they are likely to achieve more results. IDA's allocation system is based on the premise that IDA resources are more effective in better managed countries.
- **Rules-based.** The allocation system should be based on clear rules to avoid arbitrariness and the inclusion of considerations other than those agreed with stakeholders in the allocation process.
- **Transparency.** The rules of the allocation system should be transparent. Stakeholders should be able to understand the reasons underpinning changes in IDA allocations.

- **Criteria**

- **Incentives.** Incentives in the allocation system should be aligned towards increasing the effectiveness in the use of IDA resources. The incentives embedded in a given allocation system have been measured by its performance orientation (i.e., the extent to which more resources are allocated to better managed countries, as measured by the CPIA).
- **Volatility.** Refers to the extent to which allocations vary over time (due to factors within the control of country authorities or outside their control). The volatility of a given allocation system has been measured by its coefficient of variation.
- **Responsiveness.** Refers to the speed at which the allocation system is able to respond to changes in a country's situation. This criteria looks to the extent to which a given allocation system creates a link between improvements (deteriorations) in the country's capacity to use the resources effectively and its allocations. The degree of responsiveness of a given allocation system has been measured by the lags in the variables used to determine a country's allocation, the paucity of such variables and their capacity to reflect changes on the ground.
- **Smoothness.** Refers to the extent to which allocations are subject to threshold effects.

- **Complexity.** Refers to the extent to which the allocation system includes carve outs and exceptions to the regular system that could add to the perception of complexity.
- **Tradeoffs.** In assessing the options for simplifying and adjusting the allocation framework, staff has considered tradeoffs at the following levels: incentives, regions and countries.

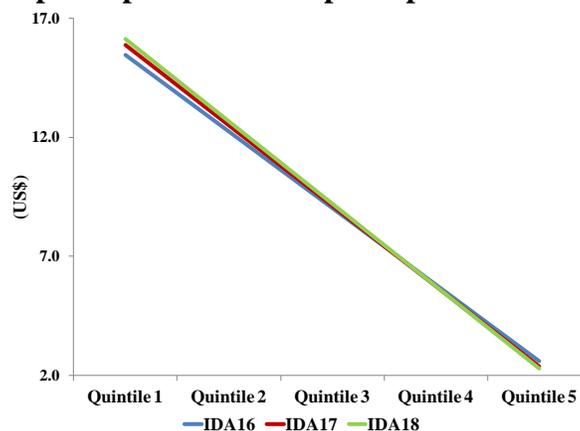
## Annex 6: Assessment of the options

1. **This annex presents the staff’s assessment of the options for simplifying and adjusting the framework for resource allocation to FCCs.** First, the annex presents an assessment of the current allocation system reflecting the criteria outlined in Annex 5. Then, the annex presents the assessment of the different options presented in Section III.B of this document (grouped by categories) relative to the current allocation system.

### The current allocation system

2. **Performance orientation.** The current allocation system has a strong performance orientation: for IDA16, it is expected to allocate 6.6 times more resources to countries in the top performance quintile than to those in the lowest quintile (see Chart 1). The performance orientation of the current allocation system is expected to increase in future replenishments as, barring any change to the system, this ratio is expected to increase to 7.3 and 7.8 in IDA17 and IDA18, respectively. The increase of the performance orientation of the system is explained by the phasing out of countries from the exceptional allocation regimes to the regular PBA system.

**Chart 1. Current allocation system. Performance orientation in future replenishments (Annual per-capita allocation per replenishment period)**



Note.

1/ Excludes India and Pakistan for which allocations are capped.

2/ The lines in the chart are the trend lines for the actual performance orientation curves.

Trend lines are shown to facilitate the visual analysis.

3. **Volatility.** The median coefficient of variation of IDA allocations for the period FY84 to FY12 is estimated at 0.42. Over the same period, FCCs have experienced higher volatility than non-FCCs (0.57 compared to 0.36). It is important to mention, however, that concomitant with the introduction of the exceptional allocation regimes, the allocations for post-conflict and re-engaging countries have experienced reduced volatility (the median coefficient of variation is estimated at 0.49 for the period FY03 to FY12 compared to 0.63 for the entire period of analysis).<sup>69</sup>

<sup>69</sup> Earlier analysis has found that, at the donor level, IDA is less volatile than other development resources providers, both in terms of commitment and disbursement. Estimates performed by staff have also found that the volatility of IDA commitments and disbursements are much higher than that of IDA allocations, indicating

4. **Responsiveness.** The parameters used to determine a country's allocation have a one-year lag (i.e., FY13 allocation determined on the basis of 2011 population, GNI, CPIA/PCPI and PPR). Furthermore, the CPIA and PCPI scores reflect policy actions taking place during the year for which the assessment is performed. In that sense, the current allocation system provides a strong link between changes in a country's policy environment (as defined in the system) and IDA's response in terms of allocations.

5. **Smoothness.** The current allocation system presents threshold effects associated to the inclusion of: (i) two exceptional regimes (for post-conflict and re-engaging countries); (ii) a minimum base allocation; and (iii) capped allocations to India and Pakistan. The impact of these threshold effects is limited by the inclusion of phasing out periods as part of the exceptional allocation regimes.

6. **Complexity.** The perceived complexity of the current allocation system is related to the inclusion of: (i) two exceptional regimes (for post-conflict and re-engaging countries); (ii) a minimum base allocation; (iii) a discount on the grant portion of a country's allocation; (iv) the MDRI netting out; and (v) the redistribution of grant discounts and MDRI-compensatory resources.

#### **Category 1. No modification to the current allocation system**

7. **This option has a limited impact on the overall allocations to FCCs.** This is because, in general, FCCs have lower performance relative to non-FCCs. It also reflects rigidities in the framework for exceptional allocations to post-conflict and re-engaging countries: in line with the current methodology, the notional per-capita allocations to these countries are determined using a conversion table that is adjusted only for the size of the allocable envelope.<sup>70</sup>

8. **In terms of the principles and criteria set out in Annex 5, this option would have:**

- the same characteristics as the current allocation system with the exception of performance orientation; and
- regarding performance orientation, if driven by possible graduations, this option would result in an increased performance orientation of the current allocation system. The reason for the increased performance orientation is that most of the resources made available by the possible graduations would be channeled through the regular PBA system (as opposed to exceptional allocation regimes) due to the rigidities mentioned in the paragraph above.

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most of the challenges for minimizing volatility of IDA assistance in FCCs is in project delivery and implementation.

<sup>70</sup> Thus, under the assumption of no increase in the allocable envelope (i.e., if this option is driven by possible country graduations), the IDA notional per-capita allocation to post-conflict and re-engaging countries would not be affected.

## **Category 2. Targeted adjustments to the current allocation system**

9. **The adjustments under this category build on the implementation experience of the current allocation framework.** They aim at enhancing its strengths and addressing its weaknesses in responding to fragility. In particular, they recognize:

- the important role that exceptional allocation regimes have played in addressing the heterogeneity of FCCs;
- that countries undergoing “turn around” situations (that are not post-conflict or re-engaging) face equally challenging circumstances and that additional financial support could help avoid a fragility trap (as pointed out in the 2011 WDR).

10. **The introduction of exceptional turn around allocations, a key adjustments in this category, could help align the Bank’s financial support with the New Deal** and reflect the Bank’s commitment for helping countries make progress on peace-building and state-building goals.

11. **In terms of the criteria set out in Annex 5, the adjustments would most notably:**

- increase the level of support to FCCs significantly and for a prolonged period of time;
- slightly decrease the performance orientation of the allocation system, as more resources would be channeled to FCCs which — in general — have lower performance than non-FCCs;
- the smoothness of the current system would be adversely affected by the introduction of additional threshold effects associated to the new exceptional regime for turnaround situations; and
- regarding the complexity of the current allocation system: it would be reduced by the elimination of MDRI netting out but the introduction of a new exceptional allocation regime would have the opposite effect.

## **Category 3. Change the relationship between allocations and project performance**

### *Portfolio approach*<sup>71</sup>

12. **Unless the weight of the PPR is increased drastically (beyond 33 percent), the magnitude of the impact of this option on the overall allocations to FCCs would be modest compared to other options** (in particular Category 2). Furthermore, under this option the impact on allocations to FCCs is mixed with about one third of the FCCs experiencing allocation reductions.

13. **In terms of the criteria set out in Annex 5, this option would lead to:**

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<sup>71</sup> Under this approach, the weight of the PPR in the allocation formula would be increased.

- a decreased performance orientation of the allocation system. Depending on the weight given to the PPR, the reduction in the performance orientation could be higher than under category 2.
- increased allocation volatility since the historical standard deviation of the PPR is 3 times that of CPIA scores (5 times for changes in scores).
- reduced complexity and increased smoothness of the allocation system if coupled with the elimination of exceptional allocation regimes.

14. **While redistributive issues at the regional level are limited, the impact at the country level is significant.** As mentioned before, more FCCs would experience allocation increases than decreases under this option. However, some FCCs (and non-FCCs) with already small allocations would be affected by allocation reductions. There would also be significant redistributions within non-FCCs.

*Project approach*<sup>72</sup>

15. **The impact of this option in terms of volumes, performance orientation and other criteria is difficult to assess at this point.** Staff estimates (based on IEG project performance ratings) suggest that the increase in allocations to FCCs would be modest compared to other options.

16. **In terms of the criteria set out in Annex 5, this option would:**

- increase significantly the complexity of the allocation system due to the project-based nature of the approach;
- reduce the responsiveness of the allocation system: due to delays in project evaluation allocations would be slow in responding to developments on the ground. This would increase the possibility of disconnect of the allocation response and the circumstances which brought about success of the project;<sup>73</sup>
- increase allocation volatility, reflecting the volatility in project performance and the capacity of countries — including FCCs — of sustaining strong project performance.

17. **Beyond the above criteria, this option presents some attractive features.** For example, it would increase attention to project-level results and to their monitoring and evaluation framework. It would also create incentives for the development and implementation of projects that can achieve demonstrable results.

18. **On the other hand, multiple issues complicate the implementation and operationalization of this option.** These include issues of:

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<sup>72</sup> Under this approach, increased financial support would be linked to project-specific performance. A proposal under this approach is presented in Alan Gelb :How Can Donors Create Incentives for Results and Flexibility for Fragile States? A Proposal for IDA,” Center for Global Development, Working Paper 227, October 2010.

<sup>73</sup> This could be somewhat overcome if, for example, the evaluation process could be expedited to provide for a short independent feedback loop.

- equity of treatment: not all IDA projects receive a similar level of scrutiny during evaluations;
- incentives: it may be necessary to adjust the premium modality by instrument and/or sector to create the right incentive system (success rates of Development Policy Lending (DPL) and roads/infrastructure projects are likely to be higher than success rates of PFM reform or extractive industry reforms). If this element is not factored in, countries undertaking difficult reforms could be penalized or a bias against undertaking difficult reforms could be created;
- calibration: inadequate calibration could lead to equity of treatment issues (if resources are insufficient to provide similar treatment to all successful projects) or issues around idle resources (if the resources are excessive);
- Some of these problems could be somewhat overcome by new mechanisms, for example, IEG could expedite rating of projects which are rated high in ICRs.

#### **Category 4. Change the non-performance elements in the allocation formula**

##### *Inclusion of structural vulnerability in the allocation formula<sup>74</sup>*

19. **This option aims at making IDA allocations reactive to a country's structural handicaps to growth, in particular economic vulnerability and lack of human capital.** It also aims at addressing criticisms to the current allocation system related to the exceptions to the regular allocation formula (i.e., the inclusion of a minimum base allocation, exceptional allocation regimes for post-conflict and re-engaging countries, and caps for some blend countries with large populations). Proponents of this approach argue that the introduction of these elements could provide a simplified and uniform allocation formula that could accommodate the heterogeneity of IDA-countries.

20. **Depending on the functional specification of the revised allocation formula, this option could have a significant impact on allocations to FCCs as a group.** It would be important to mention, however, that the impact at the country level is mixed. Some FCCs could experience significant allocation increases, while others (including countries that currently have small allocations) would experience significant allocation reductions. Specifically, post-conflict and re-engaging countries as well as some small islands would be affected by the removal of the exceptions to the current allocation formula.<sup>75</sup>

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<sup>74</sup> A recent proposal on how to include structural vulnerability in the allocation formula is presented in Patrick Guillaumont "How to take into account vulnerability in aid allocation criteria and lack of human capital as well: improving the performance based allocation," Fondation pour les études et recherches sur le développement international, Working Paper 13, October 2010. A detailed discussion of the impact in the case of IDA of including structural vulnerability in the allocation formula is in "IDA's Performance Based Allocation System: Review of the Current System and Key Issues for IDA16," May 2010.

<sup>75</sup> It should be mentioned that, while one of the intentions of the proponents of this approach is the removal of the exceptions to the rule, they do not argue for removing the caps on allocations to populous blend countries. This is because by eliminating this last exception would shift significant resources to India and Pakistan to the detriment of other countries, including FCCs.

21. **In terms of the criteria set out in Annex 5, this option would:**

- have significant implications in the performance orientation of the allocation system. Specifically, as the weight of vulnerability in the allocation formula increases, the overall performance orientation in the allocation system decreases. Furthermore, for some specifications, not only the relationship between allocations and performance is diluted but also a non-monotonous relationship emerges in the analysis per performance quintile. This is the case, in particular, when the population exponent in the allocation formula is modified to eliminate the minimum base allocation;
- lead to an increased smoothness and reduced complexity of the allocation framework due to the elimination of some of the exception to the current allocation formula. However, as pointed out earlier, the proponents of this approach do not argue for their full elimination (specifically, the caps for populous blend countries are not eliminated);
- lead to a less responsive allocation system reflecting mainly two data issues: i) some of the data used in the indexes capturing economic vulnerability has significant lags; and ii) the indexes are available only every 3 years, which limits the variations in allocations during these years.

22. **Moreover, the use of the proposed vulnerability indexes in the allocation formula presents some additional shortcomings.** In particular, the inclusion of structural vulnerability in the allocation formula would reduce the responsiveness of allocations to actions by country authorities and create allocation premia for some categories for countries. Specifically:

- per the design of the indexes, less populous countries are considered more vulnerable and would be deemed to receive a higher allocation--thus creating an allocation premium for less populous countries.
- remoteness is defined as the minimum average distance for a given country to reach a “significant fraction” of the world markets (arbitrarily set at 50 percent).<sup>76</sup> Unless there is a drastic change in the economic importance of world markets, the indicator will show little change over time--thus introducing rigidity in the allocation system.
- the share of the population in low elevated coastal zones is also an indicator that may not change significantly over time.

23. **This option would also lead to significant redistributive issues at the regional level.** Depending on the functional specification, the share of IDA resources to Africa would increase significantly to the detriment, mostly of South Asia and East Asia.

24. **Finally, it could be argued that the inclusion of structural vulnerability in the allocation formula would result in double counting of some variables.** For example, population is one of the variables used to construct the EVI, but is also one of the variables in the

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<sup>76</sup> As a side note, the only criterion used to define remoteness is geographical distance without any reference to transport connectivity or trade costs, perhaps a more relevant criterion. In addition, this criterion does not consider that a country may be favored by having a big market as a neighbor, e.g., Botswana. In addition, landlocked countries are penalized with low scores in the EVI. Yet being a landlocked low-income country is a great disadvantage as it is widely recognized.

current allocation framework. Also, it could be argued that the structural bottlenecks to growth are already part of the allocation process through the impact of such factors in the GNI per-capita.

*Modification of the allocation formula to direct more resources to poorer countries*

25. **This option aims at increasing the level of support to poorer countries.** As discussed in Annex 8, the current allocation formula provides for achieving this objective: (i) reducing the exponent of the CPR (Option 1); or (ii) reducing the exponent of the GNI per-capita (Option 2). For the reasons presented in Annex 8, the discussion below focuses on Option 1.

26. **The impact of this option in directing additional resources to FCCs would be more significant than the options under Category 1 and 3.** Depending on the size of the reduction of the CPR exponent in the allocation formula, the impact could be more significant than the options under Category 2.

27. **In terms of the criteria set out in Annex 5, this option would:**

- reduce the overall performance orientation of the system, but incentives for performance for FCCs (which are at the lower end of the performance spectrum) would increase; and
- reduce the volatility of allocations by reducing the impact of CPR fluctuations.

28. **Redistributional issues at the regional level are limited.** At the country level, this option would benefit a significant number of FCCs. This would be done at the expense of a number of IDA-eligible countries, for most of which the relative cost would be relatively low (i.e., for most of the countries affected under this option, the allocation reductions would be small relative to their allocations under the current system).

## **Annex 7: Exceptional allocation regime for “turn around” situations (preliminary elements)**

1. **The exceptional allocations regimes have been a useful tool for engaging with post-conflict and re-engaging countries.** They allowed the provision of timely assistance above and beyond that that would be provided under the regular PBA system for select countries in particularly challenging circumstances. Allocations under these regimes have been granted within a framework of clearly defined criteria for eligibility (see bullets below) as well as duration, graduation and level of support (as described in Annex 2).

- Eligibility under the exceptional post-conflict regime (PCR) is limited to countries experiencing a recent conflict with high intensity measured across one of the following: (i) casualties (direct or indirect), (ii) displacement (internal or refugees), or (iii) physical destruction.<sup>77</sup>
- Eligibility under the exceptional re-engaging regime (RER) is limited to countries experiencing all of the following: (i) evidence of partial collapse of the state (but ineligibility for PC allocations), (ii) existence of a strong transition plan with concerted donor support, and (iii) disengagement from IDA and accumulation of arrears.<sup>78</sup>
- Additionally, eligibility under both exceptional regimes include a temporal component, defined by Operational Policy 2.30 as reduction of conflict, expectation of continued stability, presence of an effective government counterpart and evidence of strong international cooperation.

2. **These exceptional regimes have allowed an adequate response in many FCCs, but not all.** Countries undergoing turnarounds (“transition moments” as defined by the 2011 WDR) also face challenging circumstances where additional resources could help avoid a fragility trap.<sup>79</sup> However, countries that have not experienced extensive violence or accumulated significant arrears yet have experienced low intensity but protracted conflict or partial collapse of the state and have developed a strong transition plan with extensive international support while demonstrating a commitment to stability and reduction of conflict, and do not have a vehicle for accessing exceptional allocations.

3. **The provision of exceptional allocations to “turn-around” situations reflects the evolution of IDA responsiveness to the FCCs’ special needs.** This is consistent with an evolving understanding of fragility and conflict, beyond civil war and the conflict/post-conflict paradigm, but reflecting the unique challenges faced by individual countries. It is also timely, reflecting the World Bank’s endorsement of the New Deal and commitment to help developing

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<sup>77</sup> Eligible countries are: (i) countries that suffered from a severe and long-lasting conflict which has led to the inactivity of the borrower for an extended period, or at least a substantial decline in the level of external assistance, including from IDA; (ii) countries that experienced a short but highly intensive conflict leading to a disruption of IDA involvement; or (iii) new sovereign states emerging through a violent break-up of a former sovereign entity. See "Additions to IDA Resources: Thirteenth Replenishment," September 2002.

<sup>78</sup> See "Additions to IDA Resources: Fourteen Replenishment," March 2005.

<sup>79</sup> See Chapter 2 of the 2011 WDR and Andrimihaja, Cinyabuguma and Devarajan, 2012 “Avoiding the Fragility Trap in Africa” World Bank Policy Research Paper 5884.

countries make progress on peace-building and state-building goals as important preconditions for development. Also, the exceptional allocations for turn-around situations could finance countries committed to avoid conflict, providing exceptional allocations to countries that have identified drivers of fragility and conflict and are taking steps to build resilience and avoid fragility traps.

#### **Preliminary building blocks for an exceptional turn-around regime**

##### **4. A viable exceptional turnaround regime (TAR) should:**

- use the same principle of criteria, signals and commitment and performance mechanisms that have made the PCR and RER successful tools for selective engagement (i.e., have allowed to discriminate perennial poor performers with some track-record in tackling fragility against countries making determined efforts to emerge from fragility); and
- eliminate restrictions that preclude access to other FCCs strongly committed to reform, but that have not necessarily experienced major conflict or significant arrears.

##### *Eligibility*

**5. Eligibility criteria for the TAR would allow countries that have experienced partial collapse of the state** (as evidenced by a fragility assessment) **and/or significant violence to apply for exceptional allocations.** Signals which are used in the PCR and RER would be employed to demonstrate commitment to reform and transition out of fragility (see Table 1 below), including: evidence of recent reduction of conflict and commitment to stability,<sup>80</sup> expectation of stability from the international community, and strong international support for a strong and inclusive national plan for turnaround/transition.<sup>81, 82</sup>

**6. These signaling mechanisms** (fragility assessments, national dialogues or other inclusive planning processes, identification of indicators to track peace-building and state-building progress, compacts with donors and other partners) **would give an indication of the level of commitment of the country to reform and transition out of fragility.** External support from

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<sup>80</sup> Examples of reduction of conflict and commitment to stability could include reduction in the actual incidence of violence (measured in violent deaths, including battle deaths, intentional homicides, civilian deaths and/or violence by non-state actors, or destruction), demonstrable and voluntary returns of displaced persons or other efforts to avoid violence, including truth and/or reconciliation campaigns, signing of ceasefire or other peace agreements, security sector reforms and commitment to demobilization, disarmament and reintegration programs.

<sup>81</sup> Expectations and support from the international community could be demonstrated through donor conferences, alignment of a PCNA to the national plan and/or New Deal compacts between the country and donors. A compact is defined as a “partnership agreement between a country (government, private sector, civil society, etc) and its partners on how to exit fragility and achieve the five Peacebuilding and Statebuilding Goals” (New Deal document).

<sup>82</sup> An inclusive national transition plan would reflect a nationally owned process of widespread consultation, through national dialogues, stakeholder consultation and an inclusive political process – “a country led assessment involving key national stakeholders and non-state actors on the causes and features of fragility and sources of resilience....” (New Deal document).

the international community and internal support in the form of national dialogue and consultations would provide additional evidence of the government’s commitment to transition.

*Duration/Graduation*

7. **Paths out of conflict vary significantly by country, suggesting that not all countries can follow a transition period (as evidenced in the case of PCR and RER).**<sup>83</sup> Thus, unlike the PCR and RER, the TAR may not involve a “phase-out” period. Rather, because the TAR is intended to provide financial support to a national plan following out of a national dialogue process and associated with a particular transition moment, the length of the TAR could be set at 2 years from the outset. If the process of transition is successful (as demonstrated through tracking of indicators associated with peace-building and state-building goals and the PCPI) and the country undertakes new fragility assessments/consultations to develop a new transition plan, the country could apply for further 2 years of TAR. Countries that have not demonstrated progress on peace-building and state-building goals would not be eligible to re-apply for a TAR until conditions change and a new assessment is undertaken.

8. **Re-application would increase flexibility of IDA in responding to changing conditions in FCCs** (rather than blanket phase-outs) and allow alignment of the TAR to national strategic planning, including Transition Results Frameworks associated with Post-Conflict/Post-Disaster Needs Assessments (PCNAs/PDNAs) or Joint Assessment Missions (JAMs), CASs/ISNs or Poverty Reduction Strategies (PRSPs).

*Level of support*

9. **Allocations under the TAR could be set at a level similar to the RER.** Also, incentives could be aligned for countries to demonstrate progress on the PCPI to be eligible for re-application to the TA.

**Annex 7. Table 1. Exceptional turnaround allocations. Possible parameters**

Regime 1/	Allocation level	Duration/Graduation	Criteria
Post-conflict	notional per-capita allocations	4 years plus 6 of phase out	<ul style="list-style-type: none"> <li>Recent conflict with high intensity as measured by: casualties, displacement, or destruction, and</li> <li>Reduction of conflict, expectation of stability, effective government counterpart, concerted international support of strong plan</li> </ul>
Re-engaging	1/2 of post-conflict	2 years plus 3 of phase out	<ul style="list-style-type: none"> <li>Previous partial collapse of state</li> <li>Strong plan with concerted international support, and</li> <li>Disengagement from Bank and accumulation of arrears</li> </ul>
Turnaround	1/2 of post-conflict  Inverted on PCPI	2 years plus possibility to re-apply if strong evidence of transition	<ul style="list-style-type: none"> <li>Evidence of fragility/partial collapse of state and/or</li> <li>Significant damage, death or destruction, and</li> <li>Reduction of conflict, commitment to and expectation of stability, concerted international support for strong country owned (inclusive) plan</li> </ul>

Notes: 1/ Countries unwilling to undertake a fragility assessment that do not reduce conflict, demonstrate a strong commitment to stability and develop a strong inclusive plan with concerted international support would continue under the regular PBA system.

<sup>83</sup> See "IDA’s Performance Based Allocation System: Review of the Current System and Key Issues for IDA16," May 2010.

## Annex 8: Modifying the allocation formula to direct more resources to poorer countries

1. **This option aims at increasing the level of support to countries with higher relative poverty** (i.e., countries with lower GNI per-capita). The current allocation formula provides for two main possibilities for doing so: (i) reducing the exponent of the CPR (Option 1); or (ii) reducing the exponent of the GNI per-capita (Option 2). To determine which of these options to retain, staff simulated their impact on the allocations for countries currently under the regular PBA system. The results indicate that, on balance, Option 1 is superior to Option 2. This assessment is based on considerations regarding the redirecting of resources to countries with low GNI per-capita, volatility, incentives, volumes and impact at the country level. Below are the details of the assessment.

- **Redirecting resources to countries with low GNI per-capita.** Both options redirect resources to countries with lower GNI per-capita (see Chart 1). This redirecting is unambiguous under Option 2, less so under Option 1. In particular, it should be mentioned that under Option 1 some countries with low GNI per-capita and strong performance could experience allocation reductions.

### Annex 8. Chart 1. Impact on per-capita allocations by income level

Chart 1.A. Option 1

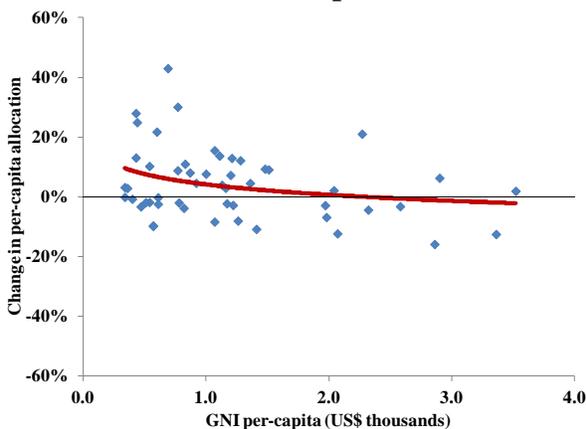
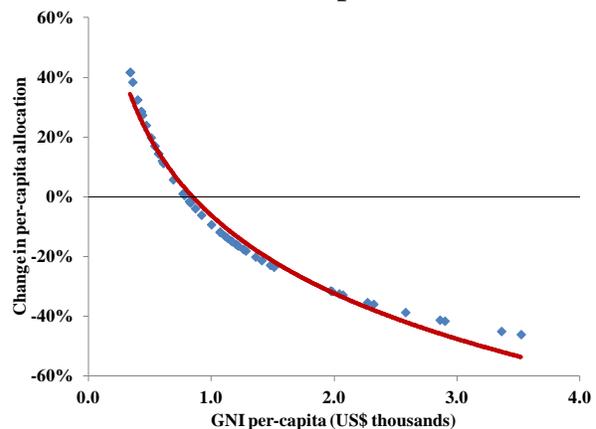


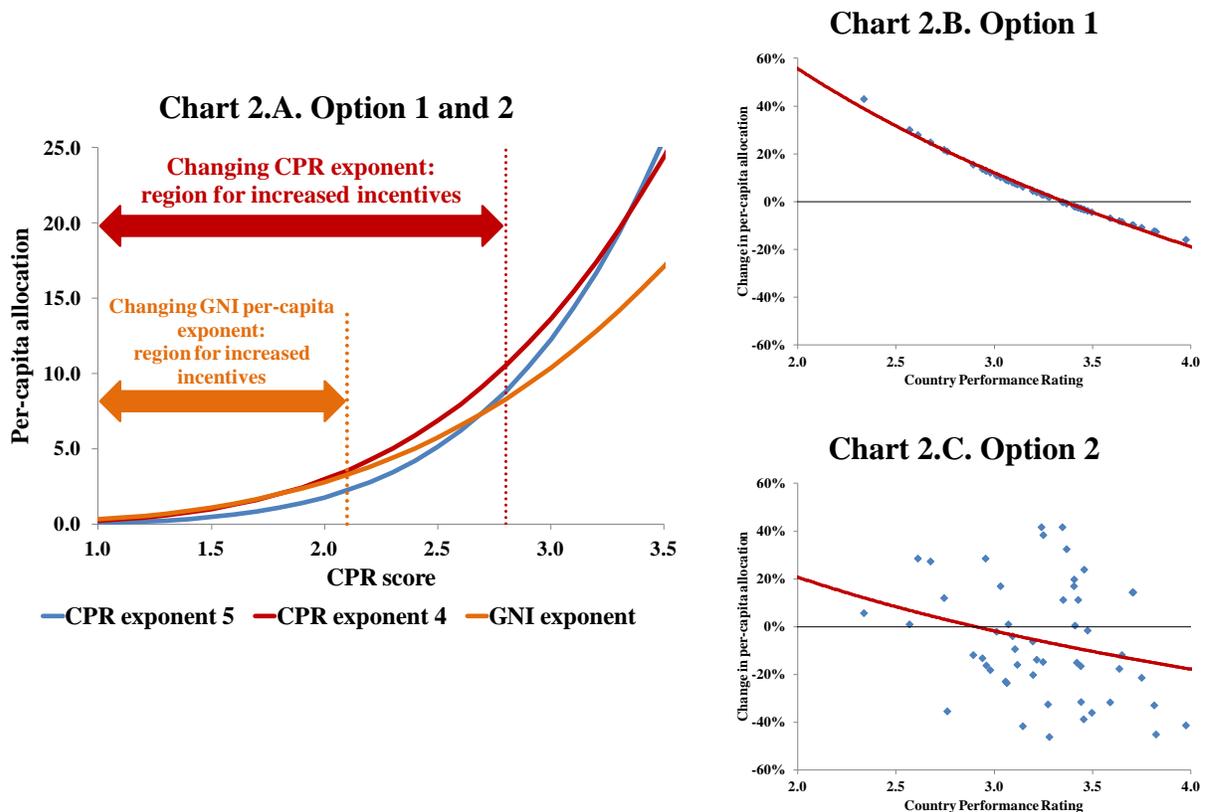
Chart 1.B. Option 2



- **Volatility of allocations.** Option 1 would reduce the overall allocation volatility as, ceteris paribus, a lowering of the CPR exponent would reduce the impact of CPR fluctuations. On the other hand, Option 2 would increase overall allocation volatility as, ceteris paribus, lowering the (negative) GNI per-capita exponent would amplify the impact of its fluctuations. The impact on volatility is evident in the simulations: per-capita allocations under Options 1 and 2 have an estimated coefficient of variation of 0.38 and 0.52, respectively. This compares to 0.47 with the current allocation formula. Reducing the impact of income fluctuations on allocations seems particularly relevant for FCCs as these countries tend to exhibit high income volatility. In addition, lower allocation volatility for a country or group of countries would also lead to lower allocation volatility for the remaining countries.

- Incentives in the allocation system.** Both options: (i) increase the incentives for performance for countries at the lower end of the performance spectrum, and (ii) lead to a reduction in the overall performance orientation of the allocation system. Under Option 2, however, the reduction in the performance orientation of the system is larger and the increased incentives for performance reach fewer countries than under Option 1. Also, the generation of increased incentives under Option 2 is more ambiguous than under Option 1. These points are illustrated in Chart 2.A. in terms of per-capita allocations and charts 2.B. and 2.C. in terms of changes in per-capita allocations.

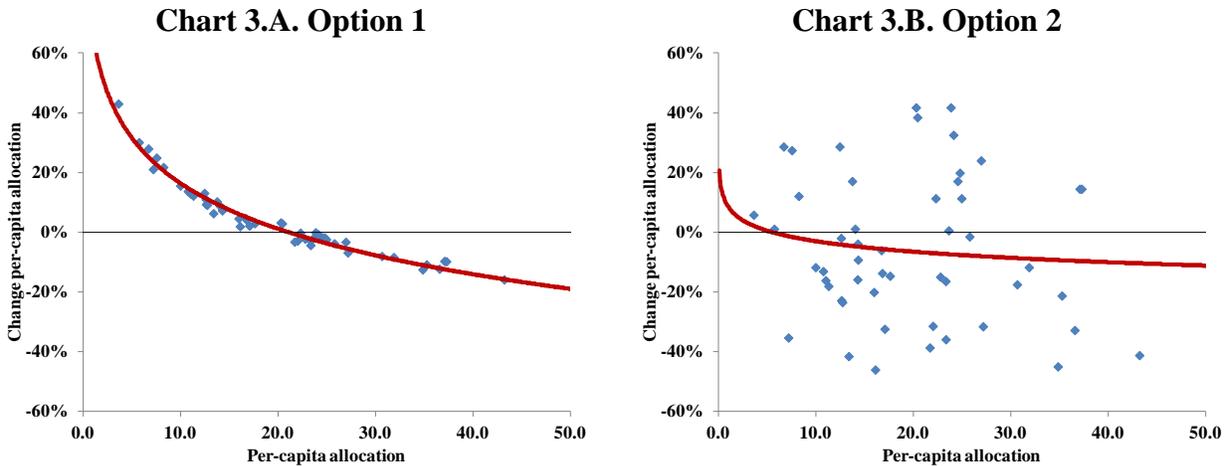
**Chart 2. Impact on the performance orientation of the allocation system**



- Volume.** The volume of resource transfers under Option 2 is estimated to be almost 3 times higher than that under Option 1.
- Impact on country allocations.** Under Option 1, more countries would benefit of allocation increases (28 compared to 20) at the expense of reductions for fewer countries (24 compared to 32). In addition, countries benefiting (being affected) by allocation increases (reductions) under Option 1 are countries that currently have low (high) allocations (see Chart 3). Such pattern is much less obvious under Option 2. Also, it is important to mention that the change in country allocation has a larger dispersion under Option 2 than under Option 1. Indeed, under Option 1, changes in per-capita allocations range from -16 percent to +43 percent; this compares to changes from -46 percent to +42 percent under Option 2. Thus: (i) Option 1 benefits more countries at a lower relative

cost for the affected ones; and (ii) Option 2 benefits less countries at the expense of more countries and with potentially a larger relative impact on some of these.

### Chart 3. Impact on country allocations



#### In summary:

- Option 1 leads to the lowest reduction in the performance orientation of the system. It increases unambiguously the incentives for performance at the lower end of the performance spectrum. This option would also reduce the volatility of allocations by reducing the impact of CPR fluctuations. In addition, relative to Option 2, Option 1 benefits more countries at the expense of fewer countries and with a lower relative cost for the affected ones. It should be mentioned, however, that under Option 1 some countries with low GNI per-capita and strong performance would experience allocation reductions.
- Option 2 leads to a more unambiguous redirecting of resources towards countries with lower GNI per-capita levels. It is also the option leading to the higher volume of transfers from higher to lower income countries.<sup>84</sup> This option, however, would lead to increased volatility in allocation by amplifying the impact of income fluctuations.

Thus, reducing the country performance rating exponent provides a better balance between increasing financial support to FCCs, maintaining the performance orientation in the system, reducing volatility and limiting the impact on the affected countries.

<sup>84</sup> A circumstance in which absorptive capacity could become a binding constraint. A consideration that needs to be taken into account particularly in the context of FCCs.