

**WORLD BANK GROUP WORK  
IN LOW-INCOME COUNTRIES UNDER STRESS:  
A TASK FORCE REPORT**

September 2002

## ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
CDF	Comprehensive Development Framework
CPIA	Country Policy and Institutional Assessment
DPR	Development Policy Review
ESSD	Environmentally and Socially Sustainable Development Network
ESW	Economic and Sector Work
GNI	Gross National Income
FY	Fiscal Year
IDA	International Development Association
IFC	International Finance Corporation
IGR	Institutional and Governance Review
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
ISA	Independent Service Authority
LICUS	Low-Income Countries Under Stress
MDTF	Multidonor Trust Fund
MIGA	Multilateral Investment Guarantee Agency
NGO	Nongovernmental Organization
OECD-DAC	Development Assistance Committee of the Organization for Economic Co-operation and Development
OED	Operations Evaluation Department
PRSP	Poverty Reduction Strategy Paper
QAG	Quality Assurance Group
SME	Small and Medium Enterprise
UN	United Nations
UNDP	United Nations Development Programme
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations Children's Fund
WBI	World Bank Institute

# WORLD BANK GROUP WORK IN LOW-INCOME COUNTRIES UNDER STRESS

## A TASK FORCE REPORT

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## FOREWORD

In recent years the World Bank Group has rethought its role in supporting country development in low- and middle-income countries. For low-income countries with reasonable policies and institutions, the Bank—in partnership with others—supports country-owned and -prepared poverty reduction strategies. For middle-income countries the Bank has reviewed and reaffirmed its engagement, in the context of the work of the Task Force on Middle-Income Countries. This report, prepared by the Task Force on the Work of the World Bank Group in Low-Income Countries Under Stress, extends this process of rethinking to the minority of low-income countries whose policies and institutions offer limited scope for poverty reduction through donor-supported programs and projects. The analysis and conclusions included in this report, discussed widely throughout the Bank Group and with partners, represent the considered views of the Task Force.

The Task Force was established in November 2001. It was led by Ngozi Okonjo-Iweala and Paul Collier and included the following as members: Sadiq Ahmed, Aysegul Akin-Karasapan, Yaw Ansu, Joseph Badaki, Ian Bannon, Vinay K. Bhargava, James Emery, Elizabeth McAllister, Kathleen B. Mccollom, Oey Astra Meesook, C. Sanjivi Rajasingham, Bernard Sheahan, Lynne D. Sherburne-Benz, Sudhir Shetty, Max Aitken, Nkosana Moyo, Paul J. Siegelbaum, Alice Storch, John E. Todd, Hasan A. Tuluy, Gerald Thomas West, and Kishor Uprety. The Task Force was advised by a Steering Committee comprising Nicholas Stern, Assaad Jabre, Mats Karlsson, Callisto Madavo, Gobind Nankani, Jo Ritzen, Joanne Salop, Anil Sood, and Ko-Yung Tung, under the overall guidance of Shengman Zhang. The Task Force was assisted by Nils Tcheyan, Sri-Ram Aiyer, and Godwin Hlatshwayo. It would particularly like to acknowledge the contributions of Paula Donovan, Katherine Marshall, Jean-Louis Sarbib, Victoria Duncan, and Audrey Kitson-Walters, who guided the administration and logistics of the report; of Patricia N. Rogers and Henry Chase, who edited the report; and of Oscar Bianco, who was responsible for technical assistance and quality control. The Task Force is also grateful to the Executive Directors and the many managers and staff who participated in focus group meetings to debate the main ideas of the report.

# WORLD BANK GROUP WORK IN LOW-INCOME COUNTRIES UNDER STRESS: A TASK FORCE REPORT

## EXECUTIVE SUMMARY

The Task Force on the Work of the World Bank Group in Low-Income Countries Under Stress was created to respond to concerns about how the development community, including the World Bank Group, can best help chronically weak-performing countries get onto a path leading to sustained growth, development, and poverty reduction. The work of the Task Force constitutes a further step in the reappraisal of the Bank's strategy in low- and middle-income countries, the results of which the Development Committee has considered over the past 18 months. It draws on the experience of the global development community in these countries, reflecting the fact that other development partners are often more closely engaged than the Bank. This report summarizes the analysis, findings, and recommendations of the Task Force.

**LICUS Approach.** Low-income countries under stress (LICUS) are characterized by very weak policies, institutions, and governance. Aid does not work well in these environments because governments lack the capacity or inclination to use finance effectively for poverty reduction. Yet neglect of such countries perpetuates poverty and may contribute to the collapse of the state, with adverse regional and even global consequences. The challenge of aid effectiveness in LICUS is thus to use other instruments, supplemented by financial transfers where necessary, to promote change. This report proposes an approach, within the principles of the Comprehensive Development Framework, to facilitate policy and institutional change while improving basic social outcomes by focusing on a few reforms that are feasible in sociopolitical terms, around which capacity building and outcome monitoring can be coordinated. Initial reforms may then reinforce the constituency for change, inducing further reform. The strategy for improving basic social

outcomes is to supplement weak central government delivery by strengthening multiple alternative channels, bearing in mind that the ultimate goal is strengthened and sustainable government capacity to provide services and reduce poverty. The LICUS approach depends on partnership among the relevant agencies. Also, it will require changes in how the World Bank conducts itself and uses its resources.

**LICUS Continuum.** There is no definitive list of LICUS; rather, countries can be ranged along a continuum of policies, governance, and institutions, with some countries more LICUS-like than others. Many countries may pass through a LICUS phase. Nevertheless, there is a consensus for analytic and operational purposes that some countries' policies, institutions, and governance can be defined as exceptionally weak when judged against the criterion of being effective in poverty reduction, especially with respect to the management of economic policy, delivery of social services, and efficacy of government.

**LICUS Typology.** LICUS are highly diverse: no single strategy is appropriate for all of them, nor will all of the Task Force recommendations, or the propositions that underpin them, be universally applicable in each LICUS. For example:

- Several LICUS are “policy-poor” but resource-rich. These countries are most in need of enhanced capacity for public resource management, an issue on which the corporate sector is now sometimes in the lead (for instance, the transparency policy of British Petroleum in Angola, and the efforts by the Diamond Council of Antwerp to curtail traffic in “conflict diamonds”). These LICUS are least in need of finance.

- Several LICUS—such as Haiti—have exceptionally weak government capacity. They are most in need of service delivery channels that do not rely entirely on the capacity of the government. The development of such channels would not only improve service delivery, but also would lighten the load on the government, enabling capacity-building efforts to focus intensively on improving basic government functions such as achieving macroeconomic stability.
- Some LICUS—such as Sierra Leone—have recently emerged from conflict. Historically, finance has not been on a scale commensurate with the high absorptive capacity of these countries, and it has tended to come in too soon and start tapering out just when it should have been accelerating. There is also some indication that in post-conflict environments, even more than elsewhere, social and institutional policies are essential complements to macroeconomic policies.

**A. Engagement in LICUS:  
How and By Whom?**

A key lesson of experience about aid effectiveness is that a country’s capacity to use development finance is related to its policies, institutions, and governance.<sup>1</sup> Where country performance on these matters is satisfactory, financial support can be highly effective in achieving poverty reduction. Reflecting these lessons of experience, IDA and other development assistance has been increasingly concentrated on those low-income countries

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<sup>1</sup> David Dollar and Lant Pritchett, *Assessing Aid: What Works, What Doesn’t, and Why*, World Bank Policy Research Report (New York, Oxford University Press for the World Bank, 1998); and Paul Collier and David Dollar, “Can the World Cut Poverty in Half? How Policy Reform and Effective Aid Can Meet International Development Goals,” *World Development*, 29, pp. 1787-1802, 2001.

with reasonable policies, institutions, and governance. Because LICUS have weak policies, institutions, and governance, development finance provided to them has been largely ineffective, and many donors have disengaged from them.

**Risks of Disengaging.** Although the work of the Task Force reaffirms the lesson that finance should continue to reflect performance, total disengagement from LICUS may have larger implications. Countries abandoned by the international development community show few signs of autonomous recovery, and meanwhile their populations suffer severe deprivation. Such countries are also at risk of “state failure,” with its evident adverse effects, both regional and global. Very weak policies, institutions, and governance lock countries into poverty, economic decline, and dependence on primary commodities—major risk factors in state breakdown.

**Engaging Differently.** The Task Force concluded that, rather than disengaging completely from LICUS, the development community should continue to engage with them, albeit *differently* than with the typical low-income country. Development agencies generally deploy two sets of instruments—finance and knowledge. Knowledge instruments are particularly useful in LICUS, so that the balance between knowledge and finance should be more heavily weighted toward the former, with a more selective content targeted to a broader audience than in other countries. Similarly, donor financial engagement should also be distinctive, with a greater proportion of grants relative to loans.

**B. Engagement: For What and for Whom?**

Donor strategies for LICUS—as for any country—need to be adapted to country conditions along the continuum of policies, governance, and institutions described above. However, as a general matter, the Task Force recommends that such strategies should usually have two objectives: first, substantial and sustained improvement in policies, institutions,

and governance; and second, improvement in the provision of basic social services—health and education. Of course, donors also have these two objectives in other low-income countries. What is different about LICUS is that other objectives may be better put on hold until there is greater capacity to move forward on a broader front. Each objective requires a strategy, and it is at the level of strategy rather than objectives that the proposed LICUS approach becomes more distinctive.

### ***1. Strategy for Improving Policies, Institutions, and Governance***

The international development community has tried for years to help improve policies, institutions, and governance in LICUS. A key instrument has been conditional aid, but in LICUS there has usually been too little ownership of reform for this strategy to be effective. The approach proposed by the Task Force, which draws on the lessons of experience from donors that have been most closely engaged in these countries, is that the international development community should play an indirect but catalytic role in helping to build ownership for reform in LICUS, supplementing the sometimes weak government role.

***“Zero-Generation” Reforms.*** The first stage would be to identify—in consultation with domestic stakeholders—a highly focused reform agenda. This would consist of two or three reforms that are important in economic terms and likely to result in a rapid and substantial payoff, but that are also feasible in sociopolitical terms, tending to unite a broad coalition for reform. To identify such a reform agenda, conventional economic analysis would need to be supplemented by sociopolitical analysis. Of course, the lesson that reform agendas should be focused and prioritized applies in all countries, but the approach needs to be taken further in LICUS than in other countries: although more is wrong in LICUS, there tends to be less capacity and appetite for change.

***Champions of Reform.*** The second stage in the catalytic role is for the donor community to use its instruments to facilitate the society’s capacity for change around this limited reform agenda. Engagement with society needs to be taken further in LICUS than in other countries: reform is less likely to be an autonomous initiative of the government. If one reform is to lead to another, it is important that early reform efforts be demonstrably successful. Simple measurement systems need to be established that can rapidly track the effects of the initial reforms. Beyond this, donors would work strategically to build capacity in those areas inside and outside of government that are potential parts of a coalition for the reform agenda. This might include setting up think-tanks and twinning key organizations, such as small business or women’s associations, with counterparts in other countries that have successfully implemented the same reforms. There is also scope to identify and use diaspora talent to reduce capacity bottlenecks, especially in post-conflict situations, and to train young talent in organizations critical for reform. Again, in all of this work, participation by domestic stakeholders is essential for building ownership.

### ***2. Strategy for Improving the Provision of Basic Social Services***

The appropriate strategy in most low-income countries is to increase funding for government provision of basic services while at the same time helping to improve government delivery mechanisms. However, this strategy is not a realistic way to improve basic health and education outcomes in most LICUS because conventional channels of government provision of basic social services are highly unsatisfactory. Attempting to increase the flow of finance through these channels is unlikely to be effective, and there is little immediate prospect of significant institutional improvement. Yet the people living in LICUS desperately need basic social services.

***Supplementing Government Provision.*** The rationale for the involvement of the international development community follows from its commitment to the attainment of the

### **Box ES1. Innovations in Service Provision: Independent Service Authorities**

A possible model for financing basic services in LICUS is an independent service authority (ISA), which would:

- be largely autonomous from government, with transparency, financial accountability, and intensive donor scrutiny of performance;
- have appropriate incentives;
- be a wholesaler, contracting with multiple channels for retail provision—private, nongovernmental organization (NGO), local government—with performance at the retail level properly monitored so that cost-effectiveness could be compared;
- finance both capital and recurrent costs as necessary, financing a flow of services rather than pump-priming projects;
- coordinate donor efforts in basic service provision, functioning like a multidonor trust fund;
- ensure that extra donor resources would be matched by extra government financing rather than offset by reduced government spending; and
- be a transitional body, serving while governance is weak, and subject to a sunset provision.

All of these features are found separately in existing institutions, and social funds already incorporate most of them as an instrument. ISAs can be and should be specifically tailored for the distinctive problems of each LICUS.

Millennium Development Goals. The populations of LICUS have the smallest prospect of adequate service provision. In respect of health, this situation also implies risks for neighboring countries. The improvement of basic services will sometimes have to wait for substantial improvement in policies, institutions, and governance. However, sometimes it will be possible to supplement government provision with other channels, albeit designed so that in the longer term they can contribute to government capacity. One end of the range of options is to make more use of the existing partial solutions for specific concerns, such as vaccination, through agencies such as the Red Cross or Red Crescent. At the other end of the range, the Task Force suggests the piloting of independent service authorities (see Box ES1). In between are options such as social funds, which have a range of designs and features.

#### ***Transition to Government Service Provision.***

Experience has shown that LICUS tend to suffer continued failure of basic service provisions. Donor-financed provision, properly organized, owned by the society, integrated at the local level, and approved by the central authority, can

be a transitional solution. Social funds and independent service authorities work with government at the local level, can include government representation in their governance structures, and should be designed so that the basic services they finance are gradually incorporated into the government. They build long-term capacity in the form of trained service delivery staff and—by showing households what provision they should expect—they build demand.

### **C. Implications for the World Bank Group**

What would be the implications of this proposed approach for the World Bank Group? In some LICUS, the Bank Group is already implementing a strategy close to the one set out above. In others it is not. These differences go far beyond what is appropriate for customization to country conditions and the fact that LICUS and other countries need a continuum of solutions to match the continuum of problems they face. Indeed, what most clearly emerges from the Task Force analysis of the Bank's role is the need for a more balanced approach to



LICUS country programs, underpinned by enhanced institutional support and Management attention. To this end, this section sets out a proposed strategy Management may adopt.

### **1. Management Attention**

Most LICUS have typically not received much Senior Management attention—in part because they receive little lending, which often provides the context for Management engagement. There also has been little investment in economic and sector work (ESW), so that World Bank Group knowledge of these countries is often seriously deficient. To redress this, the Task Force recommends increased managerial attention to LICUS as follows.

**Going Forward.** Going forward, for each LICUS, Management may require that a country strategy document of the Country Assistance Strategy or Transitional Support Strategy type, modified as appropriate, be developed—or if one exists, that it be kept up to date. These documents will set out the challenges on the ground, partner programs, and Bank Group plans for capacity building, support for service delivery, and financial and knowledge transfers where appropriate. The underlying strategies will be knowledge-intensive rather than finance-intensive, looking to facilitate reform through greater sociopolitical awareness and scaling up of capacity-building activities. For some LICUS, the Bank may have ongoing dialogue on Poverty Reduction Strategy Papers (PRSPs), interim PRSPs, and the Heavily Indebted Poor Countries Initiative. The recommended approach offers an additional entry point to complement these processes. Where the Bank has ongoing strategies under implementation, the LICUS approach would provide an additional perspective to be taken into account.

### **2. Instruments**

Existing Bank Group instruments are appropriate for LICUS. However, as in any country, they will need to be tailored to individual country needs and challenges,

reflecting especially the continuum of challenges and issues that each LICUS faces.

**Knowledge and Capacity-Building Instruments.** Knowledge and capacity building are key elements of Bank Group strategies in LICUS countries. Existing ESW products—such as the Country Economic Memorandum or Development Policy Review, and the Institutional and Governance Review—could contribute in these areas. To build the capacity to monitor the outcomes of reforms, Poverty Assessments would also be useful. Complementing these diagnostic activities, Bank Group strategies in LICUS could also include highly selective capacity-building support targeted to critical public and/or private sector reform or change-agent entities. For example, a major effort at strengthening the local press may be particularly valuable in LICUS. The Global Distance Learning Network and the Global Development Network can be used to share knowledge and build communities of practice; and the IFC has capacity-building programs to help small businesses to organize more effectively and become agents for change, and to help nongovernmental organizations to commercialize their service delivery. Where called for, it may also be effective to place Bank staff in LICUS, providing direct assistance and advice to the government. There is presently some demand for this, with financing from bilaterals and other multilaterals. Although the Bank Group need not be in the lead in capacity-building efforts, and would work with bilateral and multilateral partners, universities, and foundations to try new ideas or systematize ongoing ones that work, its capacity-building engagement must be more intensive—and extensive—than in the past if the development community is to achieve sustained impact in LICUS.

**Financial Instruments.** Concessional lending is an important vehicle of development assistance to low-income countries that have adequate policies, institutions, and governance. IDA's performance-based allocation system is applicable to LICUS. The allocation of any IDA grants will, of course, need to fit within the agreed use of grants, as introduced under the

IDA13 replenishment for the period covering July 1, 2002-June 30, 2005. Since grant allocations will be part of IDA's overall performance-based allocations, the access to IDA grants by most LICUS will be restricted by their poor policies, institutions, and governance.

### **3. Partnerships**

Partnership with other agencies is central to Bank Group activities, particularly in LICUS, where environments are extremely difficult and donor coordination, including pursuit of a shared strategy, is critical. Sometimes other development agencies are more heavily engaged in LICUS than the Bank, and may have a comparative advantage in terms of a better knowledge of the country conditions and greater ability to work with the civil society on the ground. However, the Bank can bring as its comparative advantage intellectual and analytic strength, making for more effective partnerships in support of LICUS.

#### ***Cooperation, Collaboration, Coordination.***

Cooperation is already ongoing with a task force of the Development Assistance Committee of the Organization for Economic Co-operation and Development looking at the issues of LICUS, and agreement has been reached with the United Nations Development Programme for joint piloting of the LICUS approach in a few countries. The collaboration could include, among other things, joint work on the sociopolitical analysis that underpins the identification of the reform agenda, and capacity-building efforts. There has also been discussion of the scope for closer cooperation with the IMF. Similarly, Bank Group involvement in LICUS will need to be coordinated with the regional development banks; just as financial support for low-income countries has become increasingly coordinated across the development banks, so knowledge services need to be coordinated. Finally, for historical and other reasons, many bilateral agencies and other external parties, such as the European Union, have special knowledge of particular LICUS, which the Bank Group can draw on to supplement its own work.

### **4. Administrative Budget and Human Resources**

On the basis of its findings, the Task Force recommends that Management devote more resources to work on LICUS. The administrative budget will need to provide appropriate funding for maintaining the knowledge base, strategic readiness, and capacity-building support in addition to any financial support the Bank Group will provide. At the same time, high-quality staff and managerial resources will be essential to manage the many nuanced and challenging issues in LICUS that require outside-the-box thinking, while operating within the constraints of the Bank's mandate and operational policies.

***Administrative Budget.*** A review of last year's budget allocation indicates that, except in few cases, resources may be more an issue of better expenditure composition than of greater budget allocation. Management should ensure that a more appropriate composition (and, for a few countries, level) of the administrative budget for LICUS is part and parcel of the scaling up that the Bank is pursuing in the area of knowledge activities for the low-income countries. In the IFC, there may be need for a top-up for work on LICUS countries, even within the context of the "frontier strategy," to compensate for the high-cost, high-risk, and low-financial-reward environment of LICUS.

***Incentives and Guidance for Staff.*** Staff resources, institutional support, and incentives for LICUS work need also be strengthened. To a large extent, the increase in Management attention will automatically improve incentives, by raising the profile of LICUS work. But other steps, including additional incentives, will also be needed to encourage staff to undertake LICUS assignments. It will also be important to ensure that the Bank has an appropriate overall skills mix to address LICUS issues. There is also a need to further clarify and disseminate the Bank's operational policies, procedures, and best practices for LICUS work.

# WORLD BANK GROUP WORK IN LOW-INCOME COUNTRIES UNDER STRESS: A TASK FORCE REPORT

## I. INTRODUCTION

The Task Force on the Work of the World Bank Group in Low-Income Countries Under Stress was created to respond to concerns about how the development community, in particular the World Bank Group, can best help chronically weak-performing countries get onto a path leading to sustained growth, development, and poverty reduction. It constitutes a further step in the reappraisal of the Bank's strategy in low- and middle-income countries, the results of which the Development Committee has considered over the past 18 months. It draws on the experience of the global development community in these countries, reflecting the fact that other development partners are often more closely engaged than the Bank.<sup>1</sup> This report summarizes the analysis, findings, and recommendations of the Task Force.

**LICUS Approach.** Low-income countries under stress (LICUS) are characterized by very weak policies, institutions, and governance. Aid does not work well in these environments because governments lack the capacity or inclination to use finance effectively for poverty reduction. Yet neglect of such countries perpetuates poverty in some of the world's poorest countries and may contribute to the collapse of the state, with adverse regional and even global consequences. The challenge of aid effectiveness in LICUS is thus to use other instruments, supplemented by financial transfers where necessary, to promote change. This report

proposes an approach, within the principles of the Comprehensive Development Framework, to facilitate policy and institutional change while improving basic social outcomes by focusing on a few reforms that are feasible in sociopolitical terms, around which capacity building and outcome monitoring can be coordinated. Initial reforms may then reinforce the constituency for change, inducing further reform. The strategy for improving basic social outcomes is to supplement weak central government delivery of social services by strengthening multiple alternative channels. The LICUS approach depends on partnership among the relevant agencies. Also, it will require changes in how the World Bank conducts itself and uses its resources.

**Organization of This Report.** Following this introductory chapter, this report is organized into five chapters covering various aspects of the Task Force's analysis and recommendations. Chapter II summarizes the Task Force's analysis of poor-performing countries. Chapter III contains the Task Force's analysis and recommendations on donor strategies in LICUS. (Key analytic propositions are summarized in Annex 1.) Chapter IV addresses the catalytic role of donors. Chapter V addresses the delivery of basic social services in LICUS. Chapter VI sets out the implications for the World Bank Group.

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<sup>1</sup> The Task Force has been liaising with the Development Assistance Committee of the Organization for Economic Co-operation and Development (OECD-DAC) in its own work on similar issues. The Task Force has also consulted with the African Development Bank, the European Union, the International Monetary Fund, and the United Nations Development Programme, among others.



## II. ANALYSIS OF POOR-PERFORMING COUNTRIES

This report defines poor performance in terms of policies, institutions, and governance. Although policies, institutions, and governance do not mechanistically determine social and economic outcomes, they are fairly directly under the control of government and they affect the efficacy of donor assistance.

### A. Definitions and Characteristics

The suitability of policies and institutions for development is a matter of judgment. Even where judgments agree, performance is a multi-faceted continuum. Hence, any classification of a group of countries as poor performers is inexact at the margin, and there is not a natural cut-off. Specific criteria for identifying LICUS have been developed, recognizing that no set of criteria can be definitive. The advantages of specific criteria are that they focus attention on characteristics rather than on countries, while at the same time generating illustrative examples that enable concrete analysis. From the Bank's operational perspective, the key issue is whether normal lending instruments can be used successfully. For most low-income countries, concessional lending to the government is an effective way of reducing poverty. This report is concerned with the minority of countries for which such lending is likely to be much less effective, and may even be counterproductive. While the report proposes a strategy for a "typical" LICUS country, with the lessons of experience drawn from a group of countries, this should be understood as a strategy appropriate for one end of a spectrum. Actual country strategies will be blends between this approach and conventional engagement, according to where along the spectrum a country lies. Furthermore, since persistently poorly performing countries often differ greatly one from another, and LICUS status is fluid over time, an appropriate strategy has to be

tailored to the specific characteristics of each country.

**LICUS Data.** For analytic purposes, the Task Force has designated states whose per-capita incomes fall below the IDA operational cut-off (GNI of \$875 in 2001) and which combine poor policy performance or low service delivery capacity with a lack of responsiveness to their citizens, as LICUS. Indicators, including the Bank's own Country Policy and Institutional Assessment (CPIA), were developed for policy management capacity, service delivery capacity, and influence of citizens on government. These indicators were applied to 2000 and 2001 data, and then were re-applied to 2001 data recalibrated with a slightly revised definition of service delivery capacity. A country was counted as scoring low on each indicator if it was in the bottom one-third of the 80 countries that met the income criterion. A country was classified as a low-income poor performer if it scored in the bottom one-third on either policy management or service delivery *and* on responsiveness to its citizens. Countries that ranked in the bottom one-third of all three categories were considered "core" LICUS. Finally, a small set of countries was classified as LICUS solely on the basis of low CPIA scores for 2001.<sup>2</sup> The result is a snapshot of about 30 states (about three-fifths of which are core LICUS) whose difficult country circumstances furnish examples against which to measure the success or failure of different types of engagement by the international community. It is important to see these countries as illustrating a set of conditions, rather than as constituting a definitive "list." The Bank's concern is how to address a complex syndrome, not a set of specific countries, but for ease of presentation, this report uses the term LICUS.

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<sup>2</sup> The quintile ranking of all IDA countries according to CPIA criteria is available at <http://www.worldbank.org/ida/idalloc.htm>.

**LICUS CPIA.** Taken as a group, the illustrative countries exhibit a tenuous grip on economic policy management, an unfriendly environment for private sector activity, exclusive rather than inclusive social policies, and high levels of corruption, opacity, and arbitrariness in public sector decisionmaking. For every one of the 20 CPIA indicators, the mean score of the group of nonperformers is less than 3, on a scale of 1 to 6. Independent indicators present a similar image of public sector performance in these countries. On average, then, nonperformers are lagging in multiple ways, each of which alone severely handicaps development. Reform is needed in all dimensions, government capacity to reform is limited, and government willingness to reform has been low.

**LICUS Variation.** There is enormous variation within the group. The Task Force considered various subgroups for which distinctive strategies are likely to be appropriate. One subcategory is of countries that are resource-rich but “policy-poor.” A second is of countries with exceptionally weak government capacity. A third is of countries where the objectives of the government are assessed by the international development community to be seriously misaligned with the need for poverty reduction. A fourth subcategory is of countries where Bank engagement is circumscribed by the authorizing environment of key partners. A fifth subcategory is of countries that are recently emerging from conflict. Finally, a sixth subcategory includes a few countries that are in the early stages of a domestically generated reform process. These varying characteristics should give rise to distinctive strategies and tactics (in post-conflict situations, for example, it is particularly important to take a pragmatic, often second- or third-best, approach to developing economic instruments and to policymaking).

## **B. Bank Group Experience with Poor-Performing Countries**

The Bank Group is currently active in about two-thirds of the countries considered by the Task Force in its analysis of LICUS issues,

either implementing a lending program or conducting economic and sector work (ESW) and providing advisory services. Like other donors, the Bank aims through these activities to promote good policies and to contribute to development. The LICUS are often formidably difficult environments in which to achieve these goals.

**Budget Allocation Formula.** Since LICUS have greater need for policy improvement than other countries, it would be desirable if the Bank’s ESW for them was both more extensive and of higher quality than for other countries. However, the Task Force found that the Bank’s internal budget allocation formula (as developed by the Bank’s Corporate Resource Management Group) for funding the administrative costs of ESW penalizes countries with a low CPIA. While it is not mandatory for Regional vice presidents to implement this formula for budget allocations, in practice they either choose to follow it or use their own criteria that nevertheless closely conform to it. The evidence for this is that the Corporate Resource Management Group allocation formula explains 86 percent of the variation in country administrative budgets.

**Budget Allocation Formula Implication.** The implication of this allocation of the administrative budget is that the greater is the need for policy reform, the less are the resources devoted to economic and sectoral analysis. The lower amount of ESW for LICUS is reflected in a lack of the Bank’s standard diagnostic products. About one-third of the LICUS have Poverty Assessments. No LICUS has a full set of the five standard ESW products: Country Economic Memorandum, Public Expenditure Review, Country Procurement Assessment Report, Country Financial Accountability Assessment, and Poverty Assessment (although the great majority of Bank clients also lack at least one of these products). One LICUS has four of them and eight have three of them. Not only is the quantity of ESW lower for the LICUS, but the quality of the work also seems to be lower. Quality Assurance Group (QAG) ratings for ESW in LICUS found that 35 percent of it is unsatisfactory—around double that for

ESW on other countries (although to date QAG has sampled relatively few ESW products for LICUS). Several factors may contribute to the lower quality of ESW on LICUS, including difficulties with data—an often intractable problem in some of these countries. There is also the problem of inadequate incentives for staff working in such difficult circumstances. Work on LICUS often presents fewer opportunities for promotion: in the focus groups conducted as part of the Task Force, it was suggested that the perception of fewer opportunities for advancement tended to limit the applicant pool for LICUS, producing a vicious circle. Thus to date, the Bank has provided less ESW and ESW of lower quality; and this work has been carried out by staff with inadequate incentives and recognition of the difficult circumstances in which they work. All of this occurs in countries that arguably are in greatest need of well-presented advice. Despite the relative weakness of the Bank's diagnostic work on LICUS, about two-thirds of the countries have either a fairly recent Country Assistance Strategy (CAS) or a Transitional Support Strategy. Slightly fewer have Poverty Reduction Strategy Papers (PRSPs) or interim PRSPs. (Almost all of the countries are eligible for the IMF's Poverty Reduction and Growth Facility, and about one-third currently have arrangements under that facility.) Of the seven countries with no recent strategy document, three have old CASs, ranging from 4-9 years old, while the remaining four have had no strategy document for almost a decade.

**Conditionality.** Conditionality can sometimes play a useful role in the reform process. However, one of the core messages from *Assessing Aid*,<sup>3</sup> supported by *Aid and Reform in Africa*,<sup>4</sup> is that conditionality is least effective in achieving sustained reform in those countries where the government is least committed to

reform. Conditionality works best when a reform program initiated by the government is already under way. *Assessing Aid* cautions against justifying projects in the absence of government commitment by hopes that they will provide donors with leverage for policy change. Conditionality is not likely to be effective in inducing sustained reform in LICUS, so that projects with an unsatisfactory performance cannot be justified indirectly by an appeal to their wider role as inducements for reform. Further, there is disturbing new evidence that aid to LICUS might worsen governance. Specifically, where government ownership of reform is lacking, aid appears to increase corruption significantly.<sup>5</sup>

**Failure of Donor Strategies.** Whether because of shortcomings of ESW and conditionality, or for other reasons, the Bank's objective of promoting policy reform has rarely been achieved to any substantial extent in LICUS environments. By definition, the current LICUS have poor policies and institutions. More disturbing, most current LICUS also had poor policies and institutions a decade ago. Donor efforts in these countries have not succeeded in inducing significant sustained change in spite of the long period in which they could take effect. Further, few of the countries that met the LICUS criteria 10 years ago have elevated themselves from that environment. Hence, donor strategy toward LICUS as a group has had a low rate of success. This may simply reflect the fact that donor objectives cannot usually be realized in these environments. However, it provides grounds for trying the different approaches proposed in this report.

**Bank LICUS Portfolio.** As of November 2001, the World Bank had a portfolio of 168 investment projects in the LICUS, for total commitments of \$4.4 billion, of which about one-third was for the core LICUS.

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<sup>3</sup> David Dollar and Lant Pritchett, *Assessing Aid: What Works, What Doesn't, and Why*, World Bank Policy Research Report (New York, Oxford University Press for the World Bank, 1998).

<sup>4</sup> Shantayanan Devarajan, David Dollar, and Torgny Holmgren, *Aid and Reform in Africa* (Washington, D.C.: World Bank, 2001).

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<sup>5</sup> Stephen Knack, "Aid Dependence and the Quality of Governance: Cross-Country Empirical Tests," *Southern Journal of Economics* 68(2): 310-29, 2001; and his subsequent work with the Development Research Group for the World Bank.

Implementation of some of these projects had started before countries deteriorated into LICUS status. Overall, LICUS have had considerably less Bank investment than other low-income countries. In eight LICUS, the Bank is “inactive” because arrears to the Bank totaling \$1.2 billion have triggered nonaccrual status, rendering them ineligible for new lending. Some 80 percent of LICUS have been classified as severely indebted by the Global Development Finance criteria, and slightly more than one-half of these countries fall under the Heavily Indebted Poor Countries initiative. The modest level of existing investment lending to LICUS is itself a recognition of the impediments to successful project implementation in these environments; indeed, it is well established that the absorptive capacity for aid is usually much lower in poor policy environments.

**OED and QAG Ratings.** Ratings by the Bank’s Operations Evaluation Department (OED) and QAG show that projects in the LICUS sample have a consistently poorer record compared with other countries. Although overall project performance has improved substantially over the past few years, the risk of a LICUS project being rated unsatisfactory remains twice that of projects in non-LICUS countries (see Table 1). QAG and OED ratings at entry, supervision, and exit show even larger disparities, which warrant further discussion. To some extent differences in OED exit scores reflect the higher risk levels associated with LICUS project environments. But the entry and supervision differentials also suggest that the weak LICUS implementation environment was not sufficiently taken into account in the project design and supervision plan.

**Undisbursed Commitments.** All of the 168 active projects in LICUS have some funds undisbursed. There is a high likelihood that some 30 percent of these projects will exit the portfolio with unsatisfactory outcomes. Projects in the core LICUS are encountering particularly severe problems. Even for this narrower group, the Bank currently has commitments of \$1.5

**Table 1. Percentage of Projects Unsatisfactory or at Risk**

	1990-1994	1995-1998	1999-2001	Activ portfolio
LICUS	48	40	37	29
Other countries	26	21	18	12

Source: Data prepared for the Task Force.

billion in investment projects, with about \$890 million undisbursed. Substantial levels of undisbursed funds indicate that absorptive capacity is low, translating into slow resource transfer. In most LICUS, the ratio of disbursements to undisbursed balances is in the range of 14-17 percent, compared to 23 percent for IDA as a whole.

**Poverty-Efficient Allocations.** The Bank’s aggregate analysis of the returns to aid suggests that some LICUS are receiving too much aid from the international development community as a whole, relative to other developing countries. At the same time, other countries, particularly those emerging from conflict, may be receiving too little.<sup>6</sup> For the core LICUS for which there exists a reliable database (about two-thirds of the group), total net aid flows in 1999 were 34 percent in excess of the “poverty-efficient” allocation. That is, given the overall amount of aid being deployed, poverty could have been reduced more if around one-third of the aid funds allocated to LICUS had instead been allocated to other low-income countries that would have been able to use these resources more effectively.<sup>7</sup> Finally, projects with low disbursement rates and a high probability of failure are not even helpful for the development of LICUS since they tend to build up debts that are not likely to be serviced.

<sup>6</sup> Paul Collier and David Dollar, “Aid Allocation and Poverty Reduction,” *European Economic Review*, Vol. 45, pp. 1-26.

<sup>7</sup> Further, there is some evidence that this aggregate analysis exaggerates the return to aid in most LICUS environments because, as analysis undertaken for the Task Force suggests, there are limits to the ability to restore the returns to aid by reducing its volume.



**Post-Conflict Countries.** The Bank has a post-conflict framework in place and growing experience in and knowledge of such environments. Post-conflict situations, for example, are an important exception to the low absorptive capacity of aid in LICUS environments. Recent work suggests that during the first decade following conflict, absorptive capacity may be as much as double that of normal low-income countries, with the peak absorptive capacity being in the middle of the decade.<sup>8</sup> Actual aid disbursements to post-conflict countries often do not reflect these needs and absorptive capacity, however. Aid flows are too small, and arrive in a rush in the first few years of peace, tapering out just as they should be accelerating.

**International Finance Corporation.** IFC experience in LICUS yields a somewhat different picture. Over the past decade, IFC has made investments in about two-thirds of the LICUS and is currently active in slightly fewer of them, although less than a half-dozen countries account for three-quarters of all investment, both by number of projects and by value. Resource extraction (oil, gas, and mining) accounts for nearly two-thirds of IFC investment (by value) and 10 percent of the total number of IFC projects in the LICUS. These larger projects typically support their own infrastructure and may be somewhat insulated, such that they can operate in weak regulatory environments. The remaining IFC projects are mainly in the social sectors and in agriculture. This composition of the IFC portfolio is distinctive: in non-LICUS, the IFC usually has a substantial share of its portfolio in the financial and infrastructure sectors.

**IFC Performance in LICUS.** On a portfolio basis, IFC investments in LICUS generally perform as well as those in other countries. This conclusion is based on the degree of IFC loss reserves, historic write-offs, default rates, various equity investment measures, and the evaluations of projects by the Operations

Evaluation Group. This result is consistent across most investment types—equity and straight loans, African Enterprise Fund investments supporting Small and Medium Enterprises (SMEs), and Small Enterprise Fund investments. The one exception is equity returns to resource-extracting investments, where IFC’s LICUS investment performance has been substandard. On an average project basis, LICUS investments are more likely to be poorly performing, but this is because of the higher proportion of investments that are small (such as the African Enterprise Fund and the Small Enterprise Fund), which have historically shown poorer investment performance in all environments. Normalized for the class of investment, IFC projects do not perform more poorly in LICUS. Perhaps surprisingly in view of this finding, MIGA has only very limited exposure in LICUS.

**IFC Nonlending Services.** The investment activity of IFC in LICUS is complemented by its nonlending services. It has important advisory, investment promotion, capacity-building, and technical assistance activities in LICUS. The SME group is beginning to undertake capacity-building, knowledge sharing, and other activities with the smaller enterprises that predominate in these countries.

**Implications of IFC’s Results.** There are implications of IFC’s performance in LICUS.

- First, it might suggest that Bank Group efforts in LICUS should be rebalanced toward the private sector and IFC. Though the good performance of IFC projects is not necessarily indicative of the overall investment climate in LICUS, it does demonstrate that, through private sector support, some opportunities exist in LICUS to contribute to economic growth.
- Second, concerns about the possible detrimental effects of resource extraction industries on governance and conflict might suggest greater caution, a concern fully recognized within IFC. In the key area of revenue management, IFC’s Sustainability initiative sets out its approach to help deal

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<sup>8</sup> Paul Collier and Anke Hoeffler, “Aid, Policy and Growth in Post-Conflict Countries,” processed paper, Development Research Group, World Bank, 2002.

with this issue in the projects it supports.<sup>9</sup> IFC also makes strenuous efforts to harness the potential of these large projects for improving the investment climate for local firms.

- Third, large-scale projects can spill over to SME activities, empower citizens with increased scrutiny of public expenditures, and demonstrate viable economic opportunities to potential investors, thus providing an important development role for IFC.

### C. Preliminary Diagnosis

To date, donor nonlending engagement with LICUS has been insufficiently effective in inducing change. Donor resource flows to the public sector have had a high rate of failure, suggesting that they should either be redesigned or reduced. Private capital flows have gone predominantly into resource extraction activities that face higher risks in countries with poor governance.

**Policy Reform Record.** The record of Bank (and other donor) involvement in inducing policy reform in LICUS contrasts with the considerable progress on clarifying and improving the process for engaging with most of its clients. In the past decade, the normal donor-government relationship has been recast as that of partnership, with the government taking the leadership role. This is the underlying philosophy of the Comprehensive Development Framework and is embedded in the PRSP process. This approach is a reaction to a prior model of engagement-policy conditionality in which the government was seen as part of the problem, making the aid relationship intrinsically confrontational. While conditionality has not been abandoned, it is now set within a context of cooperation.

**Partnerships.** While country-led partnership is typically the right model, it is difficult to apply in LICUS. Two characteristics of core LICUS

governments severely constrain the strategic options for donors. First, they exhibit a severe lack of capacity. Achievements in college education are one measure of this. Among the nine LICUS with data in 1995, enrollment in college education amounted to only 2.5 percent of the age-appropriate population, compared to 12.2 percent in a sample of 43 better-performing poor countries for which there are data.<sup>10</sup> Second, in many LICUS, the financial interests of political decisionmakers are less likely to be aligned with reforms that increase transparency and accountability in government decisionmaking. Improved service delivery and a stable regulatory environment are less likely than in better-performing countries to offer decisionmakers political or personal advantage. This is especially so in countries where governments capture resources from a few easily controlled sources, such as oil. However, it is also the case in countries where a leadership's grip on power depends on the disbursement of patronage benefits to key supporters and on the use of government powers—fiscal, regulatory, and police—to control opponents.

**LICUS Governance.** A key characteristic of LICUS is that they fail to meet the most basic governance requirements for development. As a consequence, the logic underlying traditional donor emphases on providing resources for government to implement socially valuable programs breaks down. Circumventing (and ultimately removing) the governance obstacles to development is therefore a key element in development support strategies toward LICUS. This has already been recognized in some country strategies. Box 1 shows the importance attributed to governance concerns in the Bank's programs in Cambodia, Papua New Guinea, and Sierra Leone.

**LICUS Capacity.** Given the dearth of capacity, aid goals in these countries must be correspondingly modest, at least in the short and medium term. The government as a whole is not

<sup>9</sup> *Revenue Management and Distribution in IFC Projects*, <http://ifcnet.ifc.org/corprelations/main/Q-A/>

<sup>10</sup> Because of limited data availability the sample included countries with per capita incomes under \$2,000.

### **Box 1. Importance of Governance Reforms**

*Cambodia.* In Cambodia, allegations of corruption are widespread, land and property rights are uncertain, and the regulatory framework is weak and unpredictable. As the 2000 CAS notes, “Cambodia’s institutions of governance are still weak. This issue overshadows almost all of Cambodia’s development problems.” The 2000 CAS proposes an integrated package of measures to strengthen the capacity and accountability of public administration and build a credible legal and judicial framework that safeguards basic human and property rights; and it notes that “Cambodia has committed itself to ... making steady progress in institutional capacity-building, governance, and anti-corruption measures.”

*Papua New Guinea.* Despite natural wealth and high levels of external assistance, inadequate management has prevented Papua New Guinea from registering sustained poverty reduction and economic growth. The main objective of the 1999 CAS is to assist “in improving the foundation for a capable state that can be responsive to its people by addressing human and economic development challenges in a transparent and accountable manner.” Poor service delivery is reflected in falling health indicators and slow progress in education. “The need to focus on governance issues is overwhelming. ... Poor service delivery is not due to a lack of government financial resources, but is a direct result of public sector mismanagement, poor accountability mechanisms and unwillingness to make service delivery a priority in practice.”

*Sierra Leone.* The democratic, decentralized system that existed at Sierra Leone’s independence was progressively dismantled, culminating in a highly centralized regime that did away with local government and imposed one-party rule in 1978. The concentration of power and resources in the capital disenfranchised the population and deprived the rural population of infrastructure, education, and health care. Against this domestic backdrop, attacks by the Revolutionary United Front from Liberia started sporadically in 1991 and quickly spread throughout the countryside, igniting a conflict that lasted for a decade. In January 2002, all parties to the conflict issued a Declaration of End of War. By this juncture, state institutions were near collapse and most managerial, professional, and technical personnel had left the country. To lay the foundation for sustained recovery and growth, the 2002 Transitional Support Strategy for Sierra Leone focuses on governance. It targets institutional reform and capacity building down to the district level, with a heavy emphasis on enhancing participation and community-driven development activities. It also aims to accelerate economic growth and expand poor people’s access to basic social services, infrastructure, markets, and assets.

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*Sources: Cambodia Country Assistance Strategy, World Bank, 2000; Papua New Guinea Country Assistance Strategy, World Bank, 1999; Transitional Support Strategy: Sierra Leone, World Bank, 2002.*

in a position to lead a process of reform, although there are often reformers within government. Further, the central government spending ministries are usually not able to use aid effectively for poverty reduction. If large resources are channeled to the government using existing modalities, the likely effect may be to worsen governance, exacerbating the core problem. It is because the government can neither lead reform nor deploy aid resources effectively that partnership is so problematic.

**LICUS Ownership.** As noted, LICUS are unsuited to the normal country-led partnership

model. Further, because the LICUS governments have atypically low ownership of the reform process, these are also precisely the environments in which conditionality is least effective in achieving sustained reform.

**Turning Points?** In such circumstances, lending based on hopes of policy improvement tends to lead to poor results. Donor agencies have been overly keen to believe that minor events in LICUS constitute “turning points.” Sometimes turning points are genuine. Afghanistan and Sierra Leone provide current examples of large crises that may well pave the way for viable reform. In these post-crisis

countries there is an urgent challenge to strengthen the government. *Aid and Reform in Africa* suggested that this is the stage at which aid for reform—that is, conditionality—is useful. However, radical change such as has occurred in Afghanistan and Sierra Leone is infrequent. In 1991-98, only Ethiopia and Uganda were clear cases of sustained turnaround, although many claims of LICUS turnaround were made to the boards of donor agencies in support of increased resource flows.

***Aid Should Follow Reform.*** Excessive lending in LICUS worsens corruption, accumulates indebtedness, and makes it harder for aid to play the important role of reinforcing reform once it is already under way. It is notable that the countries in which aid has recently played a major role in reinforcing reform—Ethiopia, Ghana, Uganda, and Vietnam—all started reform from a base of low aid, so that it was feasible for donors to increase aid substantially as reforms progressed. Thus, the presumption should be that significantly increased aid flows through current modalities should *follow* reform. The size of the flow should reflect the attained level of policy rather than “reward” change or anticipate further change. The few exceptions to this should be because change is sufficiently far-reaching as to be incontrovertible.

***Default Option.*** Because in LICUS neither of the donor community’s models of engagement—country-led partnership and conditionality—is likely to be effective as currently practiced, the default option is to conclude donors are impotent against poverty. The advantage of this option is that it does not waste resources that could be used effectively to reduce poverty elsewhere. However, the default option cannot be accepted unless all credible avenues of aid effectiveness have been explored. LICUS account for nearly 500 million people, including around 200 million people living in extreme poverty. The decision to deny resources is only legitimate if it is well-founded on a solid investigation of other options.

***Adverse Externalities.*** Globalization is increasingly linking all countries. No country is so naturally disconnected from the rest of the world that it can safely be left to collapse. Poor-performing countries inflict adverse externalities on their region and globally: health breakdowns in one country inflict costs across the region, for example. When the economy of one country performs badly, the performance of neighboring economies is adversely affected. If a country is in conflict, as many LICUS are, growth slows elsewhere in the region. Finally, at the global level, terrorism, drug trafficking, and environmental degradation are all associated with state failure.

### III. DONOR STRATEGY FOR DEVELOPMENT IN LICUS

Given the problems of the development community's engagement with LICUS, it is appropriate to propose a more promising basis for engagement. This chapter describes how donors might best use their instruments of knowledge transfer and financial transfer to assist LICUS, and in particular how such an engagement would differ from that applied in other low-income countries. It proposes that donor engagement with LICUS would focus on enhancing the capacity of the society for change, and fostering the provision of basic social services to poor people.

**Assessment Features.** To assess how knowledge and financial transfers to LICUS would differ from those to better-performing low-income countries, this report focuses on four features that make LICUS distinctive—low CPIA scores, poor governance, proneness to conflict, and a low capacity for change—each of which has implications for the content of policy advice and for donor resource transfers. The assessments are presented as 22 propositions: 12 concern knowledge transfers where there is most scope for enhanced donor activity, 9 concern financial transfers, and 1 overarching proposition concerns the balance between the two types of activity.

#### A. Knowledge Transfer

##### 1. Implications of Low CPIA Scores

The most evident way in which LICUS are systematically distinctive is that they have much lower CPIA scores than other low-income countries. If, therefore, there is some generally efficient sequence to reform, LICUS are distinctive because they are at an earlier stage of that sequence. That is, they should be fixing things that other low-income countries have already fixed.

**Quick Pay-Offs.** There is no single path of reform along which countries should progress, but some sequences are likely to be more efficient than others. A common dictum that has

some empirical support is that macroeconomic stability is needed before most other reforms. However, many LICUS have already made some progress in this respect, at least as regards inflation. The median inflation rate for LICUS in 1999 was only 9 percent. There is some evidence that there is little pay-off to bringing inflation below 8 percent, so that in some LICUS there may not be opportunities for *quick and visible* macroeconomic reforms. However, some structural reforms are likely to have quick pay-offs that do not depend on other reforms; and there are reforms that enable growth without investment. For example, the regulation of prices and activities, combined with very poor transport and communications, means that most LICUS have considerable unutilized production. Reforms such as deregulation should therefore take priority over investment and its financing. Other aspects of sequencing arise because some reforms are dependent on previous actions—for example, until the courts work, banks cannot use assets as collateral. Finally, some reforms become more difficult once other reforms occur. For example, a civil service may be both too large and inadequately paid. If pay levels are raised before staffing is reduced, staffing reductions become more difficult.

##### *Proposition 1.*

*Priorities for reform should be based on the identification of likely large and quick pay-offs and should respect logical sequencing.*

**Address Worst First.** As noted, inflation management in most LICUS is in some sense better than other areas of policy. There is some evidence that it is desirable, other things equal, to fix the worst policies first. There are sufficient time series data on the CPIA to permit its disaggregation into macro, structural, and social components. When this disaggregation is included in the regression analysis linking economic performance to the CPIA, it shows that greater dispersion of the components contributes significantly to poor performance.

*Proposition 2.*

*Prioritize reform in whichever broad component of the CPIA—macro, structural, or social—is worst.*

## **2. Implications of Poor Governance and Opportunism**

LICUS typically have weak government performance and high levels of opportunistic behavior in both the public and the private sectors, especially in natural resource extraction activities. This has implications for prioritization, both for the Bank and for IFC.

*Proposition 3.*

*Prioritize improvements in governance, reduce dependence on natural resource extraction, and intensify scrutiny of the uses—including the distribution and management—of natural resource rents.*

**Rely on Private Sector.** Because LICUS have atypically low government absorptive capacity for resources, there should be atypical reliance on the private sector. Similarly, the boundary between public and private activities should atypically favor private activity where possible.

*Proposition 4.*

*Prioritize policies that matter for private economic activity—for instance, macro and deregulation.*

*Proposition 5.*

*Increasing tax revenue is normally not a priority.*

*Proposition 6.*

*Governments should be encouraged to use nongovernmental channels for a range of services that would normally be more appropriately provided by government.*

**Target Weaknesses.** However, a preference for the private sector should recognize that LICUS societies can be highly opportunistic. Government often fails to set a tone of good practice, and the unpredictability of most LICUS economies reduces the incentive to invest in a good reputation. The high degree of

opportunism is both a constraint and a target for improvement.

*Proposition 7.*

*Strengthen the agencies that can potentially contain opportunism, such as the police and the courts.*

*Proposition 8.*

*Strengthen the professions to improve conduct; for example, get teachers to turn up for school.*

## **3. Implications of a High Risk of Conflict**

LICUS are significantly more prone to large-scale and violent civil conflict than other low-income countries. Hence, policies for conflict prevention are a greater priority in LICUS than elsewhere. Poor economic performance is itself a risk factor, but aid as conventionally delivered is ineffective in improving economic performance in LICUS until policy and institutions have been reformed. A further important risk factor is dependence on primary commodities. This may be amenable to risk management even in the absence of more wide-ranging policy and institutional reform. International companies, including the banks that finance natural resource activities, have a critical role to play in promoting increased transparency and pressing for improved governance of natural resource rents.

*Proposition 9.*

*To reduce the risk of conflict, it is important to improve the national and international governance of revenue from primary commodities, and to diversify the economy away from primary commodities.*

**Post-Conflict Priorities.** For many LICUS that have already experienced conflict, there is a high risk of repetition, so that conflict prevention is even more important than it would otherwise be. Further, there are some distinctive features of post-conflict societies that warrant distinctive priorities. Distinguishing between three broad categories of policy—social, structural, and macro—there is some evidence that in post-conflict societies, social policies are relatively more important and macroeconomic policies relatively less important than in other

LICUS situations.<sup>11</sup> The post-conflict period can also be a opportunity for reform: policy improvement is typically more rapid.

*Proposition 10.*

*In post-conflict societies the pace of economic policy reform can be significantly faster than elsewhere, and social policies may be relatively more important than macroeconomic policies.*

#### **4. Implications of a Low Capacity for Change**

The final characteristic that is distinctive about LICUS is that they have an atypically limited ability to change. Governments are usually more resistant to change, and there is less societal capacity for change.

*Proposition 11.*

*Choose reforms that meet the least resistance and that offer quick pay-offs to groups that are potential constituencies for further reforms. Avoid reforms that divide, or are opposed by, such constituencies.*

**Working Against the Grain.** If there is a low capacity for change, it is important to be highly selective in priorities, for only a few changes can initially be accomplished, and attempts to move on a broad front may simply dissipate the change effort and overwhelm the country's absorptive capacity. This implication is perhaps the most difficult for donor agencies to incorporate into knowledge transfer activities, because it runs counter to their norm: they are constructed so as to be comprehensive, because aid programs are generally more effective if macro, structural, and social reforms move broadly in step. Moreover, donor agencies are subject to the natural tendencies of bureaucratic politics, in which each "fiefdom" argues for the priority of its own specialty, with the result that country programs tend to be comprehensive. Selectivity in knowledge transfer thus requires donor agencies to work against their natural grain, but this is vital in LICUS.

*Proposition 12.*

*Donor agencies need to make special procedural efforts to be more selective in their knowledge transfer to LICUS. Programs should focus on two or three things that best meet the preceding criteria.*

## **B. Financial Transfers**

### **1. Implications of Low CPIA Scores**

As was discussed above, aid to most LICUS has been excessive, and aid to post-conflict countries has been insufficient. Both the micro evidence on project performance and the macro evidence on the returns to aid bear this out. The long-standing evidence that conditionality is ineffective in LICUS and the new evidence that aid tends to worsen corruption in LICUS both reinforce this conclusion.

*Proposition 13.*

*Ensure that total net financial transfers to LICUS are appropriate relative to governance capacity, post-conflict status, and the levels of transfers to other low-income countries.*

**Grant Use.** Even with greater caution in managing financial transfers, LICUS will remain high risk environments for projects, and financial transfers to them may in the end increase their indebtedness without yielding development results. In this regard, some grant use may be advantageous. Clearly, however, a donor strategy of extending grants to poor performers but loans to good performers has a dangerous potential to reward poor performance, and raises issues of equity. Thus, financial transfers to LICUS countries should take account of the overall approach to the provision of grants, and should be set out in that framework.

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<sup>11</sup> Paul Collier and Anke Hoeffler, "Aid, Policy and Growth in Post-Conflict Countries," op. cit.

*Proposition 14.*

*There are advantages to providing financial transfers to LICUS through grants rather than loans, but transfers should be consistent with the overall framework for the provision of grants, and with equity of support to other clients.*

## **2. Implications of Poor Governance and Opportunism**

In LICUS, IFC has not faced the same problem of poor project performance in its loans to the private sector as the Bank has in lending to the public sector. A large share of IFC's funding is for resource extraction, which in the absence of appropriate project screening, structuring, and supervision and a reasonable governance environment, can increase the risk of poor governance and conflict. In such environments, IFC can add value by bringing to bear industry best-practice to ensure a broader development impact from the project and by helping to ensure appropriate revenue distribution and management in coordination with the Bank and the IMF. This would improve the economic well-being of all stakeholders.

*Proposition 15.*

*Channel finance to the private sector (but finance resource extraction only where the probability of resources being used well is reasonable).*

### **Meeting Basic Health and Education Needs.**

Because government functions less well in LICUS than in other societies, the social services normally provided by government to poor people—basic health care and primary education—are particularly inadequate. Donors should focus their efforts on meeting these health and education needs, using where appropriate the greater flexibility provided by grants to fund nongovernmental and local government channels of service provision.

*Proposition 16.*

*Refocus aid programs toward health and education, using as appropriate local government and nongovernmental channels of delivery.*

**Accountability.** However, nongovernmental channels are not a panacea. LICUS societies display a high level of opportunism, and many groups that might deliver services—for example, nongovernmental organizations (NGOs) and faith-based organizations—are not normally subject to evaluation and accountability norms.

*Proposition 17.*

*Place greater stress on accountability and scrutiny in all donor activities.*

## **3. Implications of Proneness to Conflict**

Typically, aid to post-conflict societies is abundant in the early post-conflict years, when the country is still the center of international attention, but then declines as attention fades. Evidence on aid effectiveness in post-conflict environments suggests that capacity to absorb aid productively is limited in the first three or four years after a conflict, but then goes through a phase of being productive. In effect, there is a preparatory phase in which absorptive capacity is itself recovering.

*Proposition 18.*

*While donor commitments to aid in post-conflict situations are helpful if made at an early stage, it should be accepted that actual disbursements may need to be atypically slow.*

**Restoring Order.** Post-conflict countries typically have a pressing need to restore order. The international community can play an important part in this through financing reform of the services and entities that provide domestic order and security for citizens.



*Proposition 19.*

*The restoration of order through reform of the services entities that provide domestic order and security for citizens is a good early use for donor finance in post-conflict societies.*

***Absence of Aid-Conflict Link.*** It is sometimes argued that aid provides an inadvertent incentive for conflict, by providing resources whose acquisition is contested. The evidence suggests that there is no systematic *direct* effect of aid on either the risk of conflict or on the duration of ongoing conflicts.<sup>12</sup> Any systematic effects of aid work via their effects on development.

*Proposition 20.*

*Unless aid is effective in development it is unlikely to be effective in reducing conflict. Conversely, if it is effective in development, it is unlikely to have adverse effects on conflict.*

#### ***4. Implications of a Low Capacity for Change***

The overriding need for change in LICUS, combined with the extreme difficulty in inducing it, suggests that donor financing should be directed to this purpose. This was the underlying rationale for conditional lending. A more effective deployment of finance for the same purpose might be to enhance the capacity for change. Think tanks and institutional twinning arrangements are examples of capacity building that are not massively expensive, but may build the foundations for sustainable change. The other deployments of finance—to the private sector, and for nongovernmental and local government delivery of health and education services—also sometimes have the potential to enhance the capacity for change.

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<sup>12</sup> Paul Collier and Anke Hoeffler, “Aid, Policy and Peace,” 2002, *Journal of Defense Economics and Peace* (forthcoming).

*Proposition 21.*

*Use grants to build capacity for change in both government and society.*

### **C. Strategic Balance and Nuance**

The final proposition concerns the balance between the two types of resource transfers to low-income countries, knowledge and finance. To date, donors have usually provided these two resources in broadly fixed proportions. For example, the Bank allocates its administrative budget for nonlending services using a formula that closely corresponds to the formula that IDA uses to allocate its financial transfers. If donor agencies were commercial enterprises, this correspondence would be appropriate: nonlending services (unless themselves marketed commercially) would be there to support the lending services. However, donor engagement with LICUS is motivated by a noncommercial concern to reduce poverty by promoting development. Thus, maintaining broadly fixed proportions between knowledge transfers and financial transfers reduces effectiveness in attaining the overall objective, because LICUS have an atypically high need for knowledge transfers, while having an atypically low capacity to absorb financial transfers. Hence, the overarching lesson for donor strategy toward development in LICUS is that of rebalancing.

*Proposition 22.*

*More donor resources should be devoted to knowledge transfer activities—capacity building and advice—relative to financial transfers.*

***Categorizing LICUS.*** The application of the broad strategy for LICUS—serving as a catalyst and delivering services using grant finance and knowledge transfers—would vary by country. However, the six categories of LICUS can guide the application of a country-specific strategy (bearing in mind that the same country can fall into several categories).

- **“Policy-Poor” but Resource-Rich.** These countries are most in need of enhanced capacity for public resource management. IFC and MIGA are well placed to bring the private corporations that participate in natural resource extraction more fully into the agenda of improving governance. (Examples of a sense of corporate responsibility include the Chad-Cameroon pipeline, the transparency policy of British Petroleum in Angola, and the efforts by the Diamond Council of Antwerp to curtail “conflict diamonds.”) Conversely, this group of LICUS is least in need of finance to government. A small amount of grants well-targeted to civil society may, however, be an important part of a catalytic strategy, strengthening the capacity of society to scrutinize the use of national resources.
- **Exceptionally Weak Government Capacity.** These countries are most in need of service delivery channels that do not rely on the central government. This approach would both improve service delivery and lighten the load on central government, enabling capacity-building efforts to focus intensively on improving basic government functions such as the courts, security, and macroeconomic stability.
- **Government/Donor Lack of Consensus.** Donors already curtail finance to governments with which they cannot reach agreement on the basic development strategy for the country. There may, however, be opportunities to channel finance to nongovernmental recipients to facilitate change and improve service provision.
- **Limitations on Engagement.** The Bank and other development agencies face various limitations on engagement with a few LICUS governments, for example, because of United Nations or other agency policies. In such situations, no development agency should act unilaterally: there is a need for coordinated assessments of the appropriate timing of reengagement. Nevertheless, in working with regional organizations and lead donors, reengagement can in some cases be facilitated through a few confidence-building, knowledge, or capacity-enhancement activities.
- **Turnaround Countries.** A few LICUS appear to be turning around, whether because of political changes ushering in a phase of strong policy reform, or because of the end of civil wars. Donor strategy toward countries clearly in the process of reform is least in need of rethinking. There may, however, be opportunities for supplementing current strategy by greater emphasis on strengthening the capacity of the society—not just of the government—for change, as proposed in the overall LICUS strategy.

#### IV. CATALYTIC ROLE OF DONORS

Although national policies and institutional frameworks are critical to sustainable development, some aspects of society can function and change without direct reliance on government. Further, societal change tends over time to induce governmental change. Thus, an indirect approach to development through societal change potentially offers an avenue for donor engagement in LICUS. Promoting development-inducing change through engagement with society as well as with government is not as participatory with government as a normal partnership, but neither is it as confrontational as conditionality.

***Donor Catalytic Role Components.*** A donor catalytic role has two components, a development strategy that identifies the reforms that are of sufficient priority to be “zero generation” reforms, and a strategy for deploying knowledge and financial instruments to promote the adoption of the development strategy.

##### **A. Identifying an Appropriate Development Strategy**

Donors are more effective as catalysts for change if they have some notion of the appropriate first steps in a development strategy for the country. The first 12 propositions set out in Chapter III are criteria for an initial development strategy for a LICUS—the zero generation reforms; but proposition 12 urges the importance of selectivity: only a few reforms can reasonably be considered as being zero generation. What those reforms are will vary among LICUS. Even in any particular LICUS, it is unlikely that there are more than two or three reforms that satisfy all criteria. To identify a sensible agenda for zero generation reforms requires both economic knowledge of development processes, and sociopolitical knowledge of interest groups and beliefs. In practice the choice of an appropriate strategy is likely to involve trade-offs between economic

and sociopolitical criteria. For example, trade liberalization may have a substantial overall pay-off but may divide the business community into winners and losers. Deregulation of SMEs may have a smaller pay-off but may bring widespread benefits to a group with the potential to influence other policies. These choices are matters of judgment rather than of doctrine. Ultimately, of course, they are choices for societies rather than for donors. However, in the special circumstances of LICUS, where channels for broad participation and local capacity for policy analysis are limited, there is an atypical need for leadership on the part of the development agencies. Hence, the agencies themselves need to form a view.

***Sociopolitical Analysis.*** Sociopolitical analysis can be used to help identify the reforms that are feasible and the best ways to promote them. The Bank does not normally undertake sociopolitical analysis (but see Box 2 for some modest exceptions). In most non-LICUS societies it is not necessary for the Bank to do so; an accomplished government does such analysis itself as a matter of course. Additionally, most governments in low-income countries are now attempting to build consensus for reforms through participatory processes that guide the preparation of the PRSP. However, LICUS governments usually lack either motivation or capacity to do sociopolitical analysis of reform, and are unwilling to mount genuinely participatory processes for consensus building. In these circumstances, while rudimentary forms of the PRSP process may still be possible, it is important for donors to undertake such analysis—or acquire it from other development agencies or institutions in the academic and policy community. The Bank (and other donor agencies) may not need an extensive capacity to generate such knowledge if it is being produced by others, merely a capacity to absorb it; for the Bank, this focus on comparative advantage may imply training country managers to be effective *consumers* of such analysis.

### **Box 2. Sociopolitical Analysis and Reform**

In Niger trade unions were opposed to reforms. With government support, the Bank helped to negotiate a place at the table for the unions and a clear stake in the outcomes of the privatization program. An impediment to privatization in Malta was the unwillingness of the main opposition party and the affiliated trade union to let more than 40 percent of state-owned enterprises be sold. Identifying the issues enabled negotiations that led to consensus for privatization, through employee ownership of up to 20 percent of the entities to be privatized. One lesson of this experience is that external actors can facilitate negotiations, and make concessions to key stakeholders more palatable.

**Identifying Interest Groups.** Reforms are highly contextual to country, sector, issue, time, project, and the prevailing enabling international environment. Each individual reform in each country brings with it a different set of supporters and opponents and a different social and cultural context. For example, unions may be opponents of economic reform yet support health or education reform within the same country. Sociopolitical analysis first identifies influential interest groups and then gathers information on how each group is organized, who its leaders are, and what their beliefs and sources of information are. This information can then be used to analyze the effect of proposed reforms on each of these groups and a group's likely response to them. (Given the information and capacity level of even influential groups in LICUS, the actual effect of a reform would not necessarily predict the group's reaction to it.) If a reform—no matter how desirable—is sufficiently detrimental to the true interests of powerful groups that they are likely to block it, there is little point in donors investing much effort in promoting it. But if some groups oppose a reform because they don't understand it, sociopolitical analysis can help identify the misperceptions so they can be addressed, as well as supporting groups that could potentially be strengthened and brought together.

**Sensitive Information.** Sociopolitical information can be just as sensitive as financial information. For example, simply identifying reformers or champions can reduce their influence if they are seen as “puppets” of the outside world. Alternatively, the support of the international community can increase the influence of the reformer. It is easier to manage these inherent risks by building knowledge of the subtleties and nuances of the cultural, social, or political setting; hence, the need for integration of these skills in the Bank's operations in LICUS countries. Without it, attempts to promote change in LICUS are likely to continue to be frustrated.

### **B. Promoting Capacity for Change**

Once the donor community arrives at a development strategy, its second, and more important, role is to facilitate its adoption. This is decidedly not a simple matter of donor advocacy. If change is to be sustained, it must come predominantly from within. Change will occur when among the many people in the country who are disadvantaged by the status quo, groups emerge that diagnose problems, design a strategy for change, and win sufficient support to get these designs implemented. This requires three things: access to information, capacity for analysis and strategy design, and access to decisionmakers. An effective donor change strategy transfers knowledge and finance in ways that help to satisfy these three conditions: A donor needs to know what “zero generation” development strategy is likely to be appropriate not primarily in order to explicitly advocate that strategy, but to target information and capacity building in the appropriate context and to the appropriate audience.

#### **1. Communicating a Reform Strategy**

Implicit in the process of reform is the need for people to engage in new behaviors, which may be at odds with long-standing patterns of behavior. For example, when large, inefficient, state-owned enterprises are privatized, many employees lose their jobs. Employees' willingness to retrain for another job in the newly privatized company, or the labor union's

acceptance of its stake in the reform and its new role in a market-driven economy, influence the eventual success of privatization. Understanding reform from the perspective of those who are directly affected by it is key. Thus, decisions made about reform—what factors are addressed and how reforms are to be developed, tested, launched, and sustained—center on stakeholders' needs.<sup>13</sup>

**Communications Criteria.** It is useful to disaggregate the communication about a reform into five management decisions: Which *audiences* need to be reached? What change in *behavior* is required? What *messages* would be appropriate? Which *channels* of communication would be most effective? How will the process be *monitored and evaluated*?

## 2. Provision of Information

Considerable recent evidence suggests that the effects of even highly successful reforms are not sufficiently dramatic as to be directly apparent. For example, in Uganda, after eight years of rapid and distributionally neutral growth in which poverty declined by around 40 percent, focus groups reported that “the poor had got poorer.” Thus, the effects of reforms cannot be left to speak for themselves. In Uganda, one of the vital ingredients that sustained the reform program was the availability of objective and reliable data on trends in poverty. These data were publicized through the media, so that gradually people came to perceive the reforms as having been successful. If a 40 percent reduction in poverty can be misperceived, the potential for failing to notice early success in LICUS reforms is surely even more considerable.

**Prioritizing Data Acquisition.** Economic data are usually very poor in LICUS, and data collection is expensive. Thus data collection should focus on the few zero generation reforms that donors are targeting as policy priorities. If,

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<sup>13</sup> Daniel Kaufman, “Listening to Stakeholders’ Views about Their Development Challenges and World Bank Instruments,” Harvard University and the World Bank, 1997.

for example, the first necessary reform is a reduction in inflation, it is important to have a reliable consumer price index. This in turn will require a household expenditure survey or some simpler measurement vehicle that targets relevant data. If the first reform is aimed at reviving the rural market economy, then measures of geographic price dispersion are useful to monitor market integration. If deregulation of SMEs is a priority reform, then a baseline survey of how SMEs are affected by regulations and regulators would be useful.

**Provision of Secondary Information.** The world is awash with secondary information, but LICUS societies often do not have access to it. The ability to access secondary information can be enhanced by equipping those groups identified as important in the change process with the basic technology and training needed to use the Internet. The media are key disseminators of information within the society, but in LICUS, journalists typically lack understanding of economic issues. They are an obvious target group for intensive and sustained training.

**Role of ESW.** Participatory ESW can be an important means of transmitting information and building consensus.<sup>14</sup> The Bank’s ESW, which incorporates considerable secondary information, has traditionally been pitched at a narrow audience of government technocrats. Generally, the Bank now aims to provide information and analysis for a broader audience, but in LICUS—where societal change is the objective—it is especially important that the audience be conceived more broadly, and in consequence, the style of presentation should be made more accessible.

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<sup>14</sup> Recent evaluations, such as the QAG assessment of FY01 ESW, have found that analytic and advisory work is becoming increasingly participatory; 40 percent of the QAG sample for FY01 was identified as “strongly participatory,” compared to about 30 percent in FY00. Strongly participatory ESW achieved higher ratings on dimensions of overall quality, likely impact, and dissemination. See *Quality of ESW in FY01: A QAG Assessment* (CODE2002-0015), March 27, 2002.

### 3. *Enhancing Analytic Capability of Key Groups*

In most LICUS, key groups lack a capability for policy analysis, and the society lacks such independent and trusted sources of authority as think tanks. The analytic capability of key groups can be enhanced by providing overseas training for some of their members, who will in turn provide in-country training, and by twinning groups with counterpart groups abroad. Think tanks can also be established and funded through intermediaries, such as the African Capacity Building Foundation; and university-based economists can learn from colleagues in more successful countries in the region through institutions such as the African Economic Research Consortium. This alone, however, does not constitute a LICUS-focused capacity-building strategy. LICUS societies need earmarked grants to encourage participation as well as a prior stage of academic training in universities outside the LICUS.

### 4. *Projects as Demonstrations*

Piloting is a particularly appropriate role for projects in LICUS: pilot schemes are less likely to be blocked by groups opposing reform and, if shown to be successful, can reassure groups whose opposition is based on false expectations. For a project to be an effective pilot it has to work well. This is likely to require additional resources in LICUS, since projects in such an environment have a disturbingly high failure rate, and QAG evaluations show that they have poorer than average design and supervision components. Moreover, for a project to be an effective pilot it has to be evaluated in a way that convinces the pertinent audience (an audience that is likely to extend beyond the government). An ex ante identification of the target audience is the first step in convincing that audience. Indeed, the need to convince a particular audience should determine the choice of the project, rather than a prior choice of project determine the appropriate audience. Building in audience-pertinent monitoring increases the costs of the project, but the costs

are justified because the audience *is* the project's rationale.

### C. **Risks in Donor Catalytic Role**

An explicit strategy to promote change carries two risks: activities may be insufficiently monitorable, and they may take the donor institution beyond its mandate. Each of these risks is real, but can be managed.

- **Monitoring.** Some activities in support of change are in principle too amorphous for performance to be judged. In such a case, donor management would not be able to fulfill its fiduciary responsibility. Any strategy for change needs to be formulated with sufficient precision that it is capable of being assessed ex ante, approved by Management, supervised during implementation, and evaluated ex post, in the same manner as an investment project. Evaluation cannot be based solely on whether change has occurred, although that is evidently highly pertinent. Change in LICUS is infrequent and tends to come in a cascade. Change activities thus need to be set out using the “logical framework” approach that facilitates subsequent evaluation, so that a failure to secure change can be attributable either to an avoidable failure in the activity, or to a risk factor that was accepted ex ante.
- **Mandate.** The second risk is that donor actions may be seen as illegitimate interventions in domestic politics. Some donor agencies have a wider mandate than others; the European Union, for example, through the Cotonou Convention, has a mutual framework for addressing governance issues. Quite explicitly, the Bank does not have a mandate to be a political actor. This risk can be managed in three complementary ways. First, analysis, as opposed to interventions, can legitimately be sociopolitical. In such analysis, the Bank would simply identify the audiences that would be pertinent for each possible reform, and assess the likely acceptability of particular possible reforms. Second, the

Bank can provide financial transfers only with the approval of government; hence, it would fund any data collection, training, or support for think tanks only with government approval. Third, donors need to build a strong developmental basis for their involvement in change. The other component of the donor strategy that the Task Force proposes for LICUS—the provision of health care and education to poor people—would help to strengthen this foundation.

#### **D. Donor Catalytic Role for Particular Objectives**

The donor catalytic role is evaluated with respect to three particular objectives: making the public sector more responsive, improving the private sector, and restoring post-conflict environments.

##### **1. Fostering a Responsive Public Sector**

Design of a donor strategy to increase government attentiveness to citizen concerns begins with three questions. Is there interest on the part of government officials in having donor assistance—particularly technical assistance—in establishing or strengthening political institutions? Does the government control the country? Do citizens have direct influence on the leadership of the LICUS, and, if not, is there potential for such influence? Although the answer to the first question is generally no, some post-conflict or new governments in LICUS might desire assistance in shaping or reshaping their countries' institutions. Control of the country is generally low in conflict countries. Citizen empowerment or influence over government is likely to vary most widely across LICUS according to whether there is a government in control of the country, whether there are elections, and whether the regimes in power are somewhat consolidated or highly insecure.<sup>15</sup> A combination of elections and consolidated authority is likely to be more conducive to reform than the lack of elections

and regime insecurity. That is, donors should be prepared to see many more “nos” in countries where elections are nonexistent and governments have not consolidated their authority.

**Structure of Donor Interventions.** The answers to these three questions would likely determine the basic structure of donor interventions, with a key determinant being the degree of influence exercised by the citizenry.

- **Some Citizen Influence.** One significant set of countries is characterized by a government in control of the country but hostile to reform, and citizens with some influence on the leadership of the country. Change is difficult in such countries but not impossible. Some donors are able to directly support activist groups and the press, for example with outside training, funding, study tours, and links with groups in other countries that confront similar challenges. Many other donors, though, are limited by mandates that restrict them to work on economic and poverty issues, where prospects for change are limited. (Even donors limited by their mandate, including the Bank, must still be conscious of the effects of their activities in these areas on the potential for change. Donors using local NGOs for social service delivery, for example, can exploit opportunities for later institutional reform by working with NGOs that show promise as reform activists or that are able to mobilize communities.)
- **Severely Limited Citizen Influence.** If the government controls the country, is resistant to reform and is also impervious to citizen influence, the strategy is different. In such tightly controlled autocracies, it is difficult to imagine significant efforts at civil society mobilization, no matter how thoroughly nested in social service delivery. Indeed, the earlier discussion indicates that such governments discourage nongovernmental service provision in part to prevent exactly such activity. The Bank is likely to concentrate its efforts on analysis so as to be prepared when circumstances change, and,

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<sup>15</sup> This conclusion is based on data collected by the Polity III project at the University of Maryland and the University of Colorado.

where possible, on dialogue with potential agents of change.

**Donor External Actions.** Externally, donors can undertake efforts that make it difficult for government officials to translate regulatory and financial malfeasance into a higher standard of living. This might involve providing support for groups that track and publicize the extent of leaders' assets in foreign countries—which in the past has had significant local political impact in LICUS—or publicizing business relationships between government officials and reputation-conscious firms in industrialized countries.

## **2. Improving the Private Sector Environment**

Improving the private sector environment in LICUS would stimulate investment, employment, and economic growth. It would require confidence-building measures based on expectations of enhanced political stability; restoration of law and order and improved governance; reduced risk of social instability, as a consequence of better delivery of social services to the poorest people; and changes, including deregulation, in the policy environment. The goal should be private sector-led growth, which in turn, could involve the small- and larger-scale indigenous sector and foreign investors.

**Bank Group and Private Sector Growth.** Given the poor governance and unstable environments of LICUS, the number and types of effective interventions that the Bank Group, and IFC in particular, can make to stimulate private sector growth are limited. Many of these interventions focus on SMEs and involve noninvestment activities. To discuss these it is useful to distinguish two broadly different groups of countries, according to the nature of the private sector.

### **a. Extensive Private Sector**

Some LICUS have substantial depth in the private sector: that is, there is a foreign investor presence; established, locally owned corpora-

tions; a dynamic SME sector; and some semblance of a sound banking system. However, poor governance limits the role of the private sector and, in many cases, aggregate private investment levels. The support IFC can provide in such countries is limited by several factors: in the poor policy and governance environments, much domestic industry relies on protection or other means of support and cannot pass IFC's economic and development impact appraisals; and many potential sponsors have been part of a corrupt system or even criminal operations and cannot pass IFC's screening test and credit requirements. These factors also affect the Bank's ability to deal effectively with the domestic private sector. Despite these obstacles, there are likely to be pockets of opportunity where poor governance has not completely eroded the ability of firms to expand and create new jobs and rising incomes. For example, support to the financial sector has been a key element of IFC's activity in these countries, given relatively strong institutions in which it can invest. Other sectors where IFC has been active include certain areas of agribusiness, natural resources, and—where the licensing regime has been acceptable—telecommunications.

**Privatization.** Privatization is another productive area for IFC and Bank support. In poor governance environments, privatization can remove parastatals from political control as vehicles for patronage or rent distribution. However, the process of privatization itself presents many opportunities for corruption, and, in the case of network industries, the post-privatization environment requires a degree of regulation that again provides opportunities for misgovernment. In this area, IFC has provided advisory assistance and direct investment support; the Bank has provided financial support through privatization technical assistance operations and adjustment operations that incorporate privatization.

### **b. Small, Weak Private Sector**

In countries with small domestic private sectors, little or no foreign firm presence, and instability or conflict-affected environments as well as



poor governance, there is less potential for involvement with the private sector. To the degree that realistic privatization is pursued credibly, the Bank Group can play a key role, as in the larger, more stable countries. Where there is a high degree of private sector activity, even if it is largely informal and small in scale, the Bank Group can be effective in working directly with SMEs to provide technical assistance, financing, and capacity building. In particular, microfinance institutions can operate in virtually any regulatory or governance environment, as they do not rely on formal means of enforcing repayments. The other types of interventions that have been developed to support micro-enterprise—chiefly basic capacity building and training—can also be effective in expanding informal sector activity. The Bank Group has considerable experience in these areas. Implementing these types of programs requires either local networks or partnerships with local institutions. IFC has been effective in establishing these partnerships, both by bringing in experienced NGOs or other service providers, and by building up locally-based organizations.

**SME Benefits.** Bank Group support of SME activity can bring strong benefits. In the more difficult investment environments, support may be limited to the informal sector and primarily involve assistance through specialized intermediaries. Programs that provide rudimentary training and basic technical assistance can dramatically increase the scale of microentrepreneurs' operations. When combined with funding through a microfinance institution, these interventions can directly and significantly increase incomes of poor people. (To have a broad impact, such interventions will need to be provided on an ongoing basis by local institutions, beyond the scale of what individual Bank Group-supported efforts can yield.) Over the long term, expansion of microenterprises and SMEs can also reinforce other agents of change, as a larger part of the population experiences financial stability and independence, and therefore can more effectively channel demands on government through local institutions.

### 3. *Strategies for Change in Post-Conflict Countries*

The underlying problems of governance that affect non-conflict LICUS are also present in the post-conflict countries. While each conflict situation is different, there are a number of common features: dominance by elites; lack of confidence by economic actors, such as investors; weak state capacity, especially in judicial, financial, fiscal, administrative, and regulatory functions; large informal economy and parallel markets; poor economic policies; widespread unemployment; large displaced populations; lack of skilled labor; and damaged or obsolete physical capital.

**Substantial Donor Leverage.** The menu of possible donor interventions to enhance reform varies substantially across the post-conflict LICUS. In some post-conflict countries, unlike all other LICUS, donors have tremendous leverage over government decisions about reform because of huge financial flows and the presence of troops from donor countries. In such environments, donors should use that leverage to effect reform, particularly those reforms for which government cooperation is absolutely essential—for example, ensuring a stable legal and regulatory environment, and developing political rules and institutions that encourage governments to respond to citizen needs. These are the same reforms that are most likely to defuse renewed conflict. Such a model is being attempted in Kosovo and Bosnia.

**More Limited Donor Leverage.** In most post-conflict countries, however, donors cannot take advantage of the presence of either troops or financial flows, and their influence over institutional change is more limited. Moreover, because donors need to rely more on external NGOs to address massive and urgent human needs in these countries, opportunities to influence events through local NGOs are more limited. Still, institutional change is high on the agenda of leaders of post-conflict countries, almost by definition—since they must put in place institutions that were destroyed by conflict. To take advantage of this, donors should be ready with advice on the costs and

benefits of different institutional decisions for economic development.

***Severely Limited Donor Leverage/Direct Reform Support.*** In countries where governments discourage nongovernmental collective action, donor activities are more slanted toward international publicity; other

efforts, such as working with NGOs, are less likely to be possible or bear fruit. Finally, in countries where there is a more active give-and-take between government and opposition, and more institutional incentives for government officials to be responsive, donors can begin to directly support reforms and reform efforts.

## V. DELIVERING BASIC SOCIAL SERVICES IN LICUS

Given that donor projects in the public sector of LICUS have had a poor record, why should donors attempt to provide basic social services rather than focusing their efforts directly on fostering change? There are five reasons why support for basic social services is important. First, basic health and primary education outcomes are particularly poor in LICUS: the services that most influence these outcomes—primary schools, water, sanitation, and health clinics—depend to an extent on government provision, and LICUS governments typically are disinclined or unable to provide them. Second, change may take a long time and in the meantime neglect of the basic human services of health and education may do irretrievable damage. Third, primary education is likely to assist change, and health, water, and sanitation services help to curtail diseases that have international effects. Fourth, electorates in developed countries have come to regard primary education and basic health as particularly legitimate uses of aid. Finally, by visibly helping poor people improve their access to education and health, donors increase the perceived legitimacy of their efforts to promote change.

### A. How Might Donors Increase Service Provision?

Increasingly, to help governments enhance the provision of primary education, water, sanitation, and basic health care, donors are using a sectorwide budgetary approach. The delivery of these basic social services in LICUS may not be able to rely on the conventional channels of provision because the central government usually lacks either the capacity or the intent to use resources in a cost-effective manner. Donors in LICUS are currently innovating in various institutional directions: social funds, post-conflict funds, multidonor trust funds, UNDP area-based schemes, and independent revenue authorities. All of these approaches use channels other than central government ministries (though they can be

designed so that in the longer term they can contribute to government capacity). This report suggests a range of options to harness the potential of these channels. At one end of the range is making greater use of existing partial solutions for specific concerns, such as vaccination. At the other end of the range, with more potential for scaling up, are independent service authorities (ISAs), which are quasi-autonomous agencies with a temporary remit to deliver basic services. In between are options such as social funds. Even within the category of social funds there are a range of designs, and their features can be modified to make them more or less like ISAs. Neither social funds nor ISAs are intended completely to circumvent government. For example, both can include central government as part of the supervisory structure, and both can work with government at the local level.

***Piecemeal Provision.*** Some organizational structures are not viable as channels for substantial donor finance. For example, for the Bank to deal directly with actual providers (“retailers”) of services would entail extremely high administrative costs. Yet any indirect relationship must be consistent with verification of the cost-effectiveness of retail operations. One approach is to split up provision into a range of services, each delivered by a UN agency; for example, UNICEF might take responsibility for child immunization (as it already does in some countries). However, there are problems with extending such an approach to cover other social services that are currently supplied by the government, such as primary education.

***Integrated Provision.*** At the other end of the spectrum from piecemeal provision by different agencies is an integrated provision by a social fund or an independent service authority. A scaled-up system should have seven features to be effective in LICUS.

*Feature 1.  
Institutional autonomy with high standards  
of accountability directly to donors*

Donor finance should be handled by an organization that is directly accountable to donors as well as to the government. Standards of accountability need to be atypically stringent, reflecting the atypically high degree of opportunism in LICUS societies. Accountability should concern both integrity and performance. This is already a common design feature in social funds. A good example of this feature being followed in a LICUS is the Angolan Social Action Fund. The fund is an autonomous institution created by the Angolan government and is overseen by the Ministry of Planning. It has been granted a high degree of autonomy concerning administrative, financial, and management procedures. Experience has confirmed the value of such autonomy. For example, the social fund in Sierra Leone was designed so that technical management was outside the government, enabling the fund to keep functioning despite government instability. However, the preservation of autonomy is often a struggle, and the intensive scrutiny needed in some LICUS environments has an administrative cost.

*Feature 2.  
Appropriate and distinct incentive systems  
for staff*

High standards of accountability require a second feature: employees of the organization should be subject to an incentive environment different from that of the civil service. There should not only be accountability for expenditures, but also accountability for quantifiable aspects of service delivery. These aspects could be monitored by an evaluation unit reporting directly to the board of the organization. The provision of private sector salaries is already a standard feature of many social funds in LICUS, and has proved effective. For example, in Angola the social fund has been able to recruit high-quality staff and achieve strong commitment, ensuring against corruption. Incentive systems have proved useful even in noncorrupt environments:

for example, in Eritrea, the Community Development Fund found that a system of incentives based on merit motivated the staff of the social fund and helped to ensure strong performance.

*Feature 3.  
A wholesale-only operation contracting  
with multiple retail channels*

The third feature of an effective organization is that it would confine itself to wholesaling functions, leaving actual retail provision to other organizations. It would attempt to contract with multiple types of retail organizations so that the cost-effectiveness of different modes of delivery could be compared. The retail organizations might include local government, local communities, local NGOs, local faith-based organizations, and private firms. Most social funds follow these principles. Even in difficult environments it has usually proved possible to find private firms. For example, the Tajikistan Social Investment Fund found that small private contractors emerged in response to competitive bidding even in remote regions, and generally produced an acceptable quality of work. NGOs and faith-based organizations are commonly from cultures that are unfamiliar with, or even hostile to, scrutiny. However, a condition for funding should be proper audit and evaluation. When local community organizations and local NGOs are used, donor funding may have a strong and not always positive effect on indigenous service providers and their ability to resist powerful political and social forces within the country.<sup>16</sup> Research suggests that collective organizations that exhibit reasonable per-

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<sup>16</sup> As Kremer and Gugerty discovered, a program meant to increase social capital among women's groups in rural Kenya "...increased turnover among group members [and]...increased entry into group membership and leadership by younger, more educated women, by women employed in the formal sector, and by men." They conclude that the characteristics that changed were also those that made the organizations attractive to donors initially. See Mary Kay Gugerty and Michael Kremer, "Outside Funding of Community Organizations: Benefiting or Displacing the Poor?" NBER Working Paper 7896, National Bureau of Economic Research, Cambridge, Massachusetts, September 2000.

### **Box 3. Wholesale-Retail System of Basic Service Delivery: Burkina Faso**

Burkina Faso has recently established a decentralized, performance-based management system in health that provides several lessons for delivering social services when the central government is failing.

**Features.** In early 1999, Burkina Faso introduced a new system for delivering health services in all of its 52 health districts. Districts were required to prepare health plans, in consultation with community and civil society groups; these were then translated into performance-based contracts with the central Ministry of Health. Districts set targets based on performance indicators (drawn from the Bank's initiative on Heavily Indebted Poor Countries and other international health indicators). Each district had a bank account that would be replenished quarterly upon satisfactory review of performance, as well as of future plans. The reviews covered both technical and financial management and accounting criteria. IDA resources were used to "top off" the contributions of other donors and the government.

**Evaluation.** An internal and external evaluation of the program was conducted in late 2000. It found that the new system resulted in increased autonomy, responsibility, and flexibility of the health districts in planning, execution, monitoring, and evaluating district plans. Further, there was greater flexibility in the use of resources (since the resources were given as budget support) and in the development of management tools to ensure greater accountability in the use of financial resources. Although the program was only a little over a year old, the evaluation concluded that there were significant improvements in health indicators, as well as in the collection and use of data on performance of the health system.

**Lessons Learned.** Several lessons can be drawn from the experience with the Burkina health program. The first is that it is possible to introduce a decentralized, performance-based system in an otherwise poorly-performing, centralized health system. Second, the quarterly reviews of the district's contractual performance created a culture of monitoring and evaluation by the districts themselves, while providing donors and the central government with some assurance about whether the scheme was working. Third, the performance-based system was accompanied with untied funds, which was the only way the districts could fulfill their contractual obligations. Finally, the combination of district-led contracts, quarterly reviews, and untied funds led to a clear improvement in health indicators and a better system for monitoring and evaluating progress in Burkina Faso's health system in the future.

formance and independence from political and social influences may not be able to sustain such performance and independence when the resources flowing through them increase and make them more attractive targets. In the event that indigenous organizations are overwhelmed by outside pressures as resource flows increase, donors need to be prepared to heighten supervision and to change retail channels. However, with this caveat, using multiple channels can raise cost-effectiveness.

#### *Feature 4.*

*Finance both capital and recurrent costs as appropriate*

The fourth desirable feature of an effective organization is that it would fund both the capital and the recurrent costs of retail provision as judged necessary. That is, the organization

would not specifically aim to create retail organizations that became viable without continued funding. The organization would be providing a flow of services through its contracts with retail providers, rather than initiating a succession of projects. Burkina Faso (not itself a LICUS) provides an example of such a wholesale-retail system of basic service delivery (see Box 3).

**Application in LICUS.** The Burkina Faso model outlined in Box 3 does not aim for sustainability at the retail level, and so donors finance recurrent expenditures. Potentially, such funding could be on a large scale, could be directed to private companies, and could continue over an extended period. This contrasts with social funds, which (with exceptions) have tended to focus on small-scale, pump-priming activities, demand-driven by local community

organizations. Such a focus is far too limiting as a means of delivering basic social services in environments where government provision is seriously deficient. In many LICUS, sustainability of basic service provision is dependent on major changes in governance and performance at the systemic level. Sustainability of basic service provision at a level appropriate for the attainment of the Millennium Development Goals cannot normally be secured in LICUS environments through cost recovery.

*Feature 5.*

*Donor coordination*

The fifth feature is that the organization would gradually become the channel for all donor funds for the purposes of primary education and basic health care. This would enable the organization to coordinate public provision. This feature of pooled funding is already accepted in multidonor trust funds (MDTFs). Several countries, particularly those emerging from conflict, have benefited from Bank-supervised MDTFs, which have (in most cases) encouraged greater harmonization among donors and resulted in the more efficient and effective delivery of services to war-torn communities. An example of a highly focused MDTF is the Africa Program for Onchocerciasis Control. Financed entirely through grants, this program has reached out to even the most difficult countries—including many that do not have active programs with the Bank—to combat river blindness. There is considerable potential to broaden the Onchocerciasis Control program to tackle other rural health problems.

*Feature 6.*

*Matching funding*

For an organization to be effective in financing incremental provision of services it is desirable that it channel *both* donor and government resources for the provision of basic services. In the context of the overall strategy for LICUS, this matched funding would have advantages to both parties. From the perspective of the LICUS government, it would induce donors to provide aid when they otherwise would not do so. From the perspective of the donor, matched funding

provides a defense against fungibility that is not possible at the project level. LICUS governments obviously already spend part of their revenue on primary education and basic health care. It is critically important that donor funding does not simply substitute for these expenditures, and the only way of ensuring this is by committing the government to explicit expenditures. Since in most LICUS the budget cannot be adequately monitored, the only way to verify government expenditures on primary education and health care is to channel them through a distinct organization that is subject to proper scrutiny. Government would commit to providing that level of finance as a share of GDP equal to its current expenditures on the services to be taken over by the fund. Donor funding would be conditional on regular government payments, and an interruption of government payments would interrupt donor payments. Donor resolve would presumably be put to the test by some governments, so it would be important to clarify appropriate donor responses in advance and then to adhere to these agreements so that governments can rapidly see donor behavior as predictable.

***Independent Revenue Authorities.*** Matching funding is already a common feature of social funds, although it sometimes encounters difficulties. However, existing matching is only for incremental activities, not those already undertaken by government. (This is a major limitation because it fails to address the problem of fungibility in provision, which becomes progressively more serious as the fund increases the scale of its activities.) No social funds currently take over responsibility for existing government provision. The closest analogy is with independent revenue authorities, which have been established in a number of LICUS to overcome problems of poor performance by the civil service in revenue collection. Independent revenue authorities have adopted a number of the features desirable for a well-functioning organization. They are autonomous agencies, with their own staff incentive systems and with intensive scrutiny of performance. However, the feature of particular pertinence here is that independent revenue authorities are not just responsible for the collection of new taxes;

rather, they take over the entire system. The main reason this approach has been adopted in LICUS on the revenue side but not on the expenditure side appears to be that both the international financial institutions and LICUS governments have regarded effectiveness in revenue collection as being more important than effectiveness in expenditure. For most LICUS this is likely to be the wrong prioritization. Revenue efficiency is less important in LICUS precisely because LICUS governments are not effective in spending revenues to deliver services.

**Scope for Reform.** Establishing an organization with responsibility for basic service provision permits a range of actions, from leaving existing functions unaltered to radically reforming them. The scope for reform of existing provision can be judged only on a case-by-case basis. In the most likely case, in which the government agrees to the arrangement only if no reform of its existing services is attempted, the arrangement remains important since it ensures that government does not use increased donor funding of social services to reduce its own provision. Given the lack of transparency of budgets in LICUS, no other approach can prevent such substitution. As in other aspects of LICUS, waiting for budgets to become transparent makes the best the enemy of the good.

#### *Feature 7. Built-in transition*

How might such an arrangement for service delivery evolve into a system without any element of donor control? Clearly, once the country has improved its policies and governance, the delivery mechanisms that have been established during the LICUS phase may be taken over by the government. Recent example of such transfers are Zambia (not a LICUS) and Cambodia.

- The social fund for Zambia was started in 1991 with a high degree of autonomy. However, it worked with local governments

and built capacity there. In 2000, the government and the Bank introduced a 10-year program by which the fund will gradually be phased out as its functions are taken over by local governments. By working with local government, the fund was building capacity in the state even while it was bypassing the central government, and it is managing an exit strategy through which service provision will be sustained.

- UNDP's CAREERE Program in Cambodia began in 1991 as a joint UNDP/UNHCR response to repatriation and reintegration, and developed into a UNDP area-based program of social and economic recovery, reconciliation, and local empowerment. Initial work in relief and humanitarian assistance was immediately followed by transitional development activities. Village-level participatory structures were initiated in 1994, the first step toward a multitiered rural development planning and financing system. Subsequent follow-on UNDP projects concentrated on expanding the local development fund (for socioeconomic investments), building capacity, and strengthening local government structures. This approach has now been adopted by the government as policy. By 2000, the Cambodian Government assumed leadership and ownership of the decentralization process initiated through this program.

**Serving as a Model/Skills Pool.** Sometimes a much shorter transition strategy may be feasible. By demonstrating how basic service provision can be organized in an efficient manner, an ISA or other similar organization may rapidly become the model for normal government provision. After all, the rationale for the new system is not that government provision is intrinsically ineffective, but simply that the current central government systems make it ineffective. Even in the worst case, in which the government eventually establishes its own organization to provide services, rather than taking over the new organization, it will employ people from the skill base created through nongovernmental provision, while in the meantime education and health outcomes will

have been improved. Hence, concern about long-term compatibility with hypothetical government provision should not normally be a reason not to adopt a delivery structure that is viable in the current environment.

### **B. How Might New Service Delivery Systems Be Established?**

Independent service authorities are desirable only in LICUS environments, and even there primarily as complementary, transitional measures, bearing in mind that the ultimate goal is strengthened and sustainable government capacity to provide services and reduce poverty. In more normal low-income environments, the donor intervention should work directly to strengthen existing structures. In LICUS, the functioning of central government is strengthened indirectly. In the first instance this is by relieving it of the burden of performing some tasks, enabling it to focus on fewer activities. In the longer term it is by providing government with model systems that are already running effectively. This is, indeed, a defining difference between LICUS and other countries: primary education and basic health care are too deficient to be allowed to await more generalized reform that might not occur for many years.

**Government Role.** Clearly, donors cannot determine whether ISAs with these seven features are to be established in a LICUS. Such organizations can only be established by

governments. However, in LICUS environments donors could agree to make a common offer of grant support for such an organization should a government be agreeable to establishing it, and donors could use their technical and administrative expertise to assist with its establishment, as they have done with social funds and independent revenue authorities.

**Donor Coordination.** The prospects of acceptance are enhanced if donors coordinate their offers of assistance, if they harmonize on ISA features, and if they make essentially common offers in LICUS countries. In practice, some LICUS governments would accept these offers and others would not, but quite possibly acceptance would spread over time.

**Alternatives.** Each of the basic features has already been accepted by some LICUS governments, so there appear to be no insurmountable issues of principle. ISAs would provide an accountable means by which donors could spend resources so as to provide basic service provision in countries that are otherwise highly unlikely to meet the Millennium Development Goals. Where ISAs are not feasible, donors can still improve social service provision through nongovernmental channels using UN agencies, NGOs, or social funds. Perhaps the most important conclusion is not to be locked into the single mode of conventional government provision, and thereby to abandon a large group of poor people to unacceptable social conditions.



## VI. IMPLICATIONS FOR THE WORLD BANK GROUP

This chapter sets out the Task Force's recommendations for the strategy by which the World Bank Group can work more effectively to improve the lives of poor people and contribute to the attainment of the Millennium Development Goals in LICUS, acknowledging that there will be many unanswered questions to be worked on by various World Bank Group units to facilitate implementation.

### A. Approach

The World Bank Group and the donor community have developed a sensible approach to assisting poor countries. Embedded in the Comprehensive Development Framework and underpinned by the PRSP, this approach entails a comprehensive diagnosis of country problems; a lead role for the government, and participation by civil society, in the design and implementation of country programs; and partnership among government, donors, and civil society—with each partner working to its comparative advantage. This model provides a useful entry point in some LICUS, but it may need to be adapted in others in the absence of preconditions for its successful implementation. In such countries, government efforts will need to be supplemented by more direct work with nongovernmental channels—community groups, NGOs, and the private sector—and with decentralized levels of government.

***Rationale for Supplementing Government Channels.*** For the World Bank and other donors, working outside of government channels is not an entirely new way of trying to help the poor. The difference with LICUS is the need to systematize the use of nongovernmental channels as a supplement to government channels. Significant time will be required to strengthen public institutions and build capacity to the point where, for example, LICUS governments can take the lead in effectively and efficiently delivering services to poor people. In the meantime, to ensure that poor people are not penalized, there is a need to use alternative

means, with the government's consent, while building government capacity for the medium to long term. For the Bank, however, in all cases, comparative advantage and support to partners would be guiding elements of its work.

***Development Priorities.*** The development objectives pursued through this alternative approach would not necessarily be different from those pursued in low-income good performers; rather, for LICUS the differences would be in the starting point, the emphasis of priorities, the sequencing of reforms, and the approach to implementation. Among development priorities the emphasis may be first on contributing to security, stability, and the rule of law; and then on delivering basic social services to poor people. Other important priorities would be fostering a conducive environment for the private sector, especially SMEs; helping to build a civil society that can contribute to determining a direction of development and a public sector responsive to citizens; and helping to restore macroeconomic balance.

### B. Operationalizing the Approach: Instruments and Policies

How will a country-focused approach be operationalized in LICUS given the absence of the full array of enabling conditions? First, relative to better-performing low-income countries, much more emphasis would be placed on acquiring a deeper understanding of the social and political economy factors that underpin poor performance (hence, the Bank will give much more attention to analytic work) and transferring knowledge, and much less emphasis on transferring financial resources—particularly loans. This added attention to analytics should underpin the identification of the two or three priority, or zero generation, reforms on which change efforts should focus. Second, assistance strategies will emphasize strategic capacity building linked to the key reforms using a mix of innovative approaches to

strengthen institutions and train people inside and outside of the public sector. Third, delivery of basic social services to poor people (principally education and health, but also related infrastructural matters such as access to clean water and roads) will be a key emphasis. To supplement government efforts, service delivery will entail a vastly increased use of wholesalers and retailers that operate outside the public sector, either as private entrepreneurs, civil society providers, or autonomous agencies. Partnerships will be critical in the assistance strategies for LICUS, as will an accountability framework (harmonized with partners and underpinned by transparency of procedures and processes) and a focus on measurable outcomes. To avoid dislocation, the new approach would be phased in as country teams see opportunity to do so. However, the presumption would be that as the ongoing CAS period ends for a LICUS, the new CAS would reflect the proposed approach.

### *1. Partnerships*

Partnership with other agencies is central to Bank Group activities in LICUS, particularly because the environments are extremely difficult and other agencies may be more heavily engaged and may have a comparative advantage in terms of knowledge and working with civil society on the ground. The nature and form of partnerships will vary over time according to country needs, donor capacity, and interests; and some partnerships may be more formalized at the outset, while others proceed informally. Partnerships in LICUS could be forged on a country or broader multicountry basis as experience is gained working on these countries. They would include the following.

- The World Bank Group and the IMF should continue to coordinate closely in LICUS as they do in other low-income and middle-income countries.
- With their political, humanitarian, and developmental mandates, the United Nations agencies make powerful partners in LICUS. In particular, the World Bank Group and UNDP can build synergies that prove

advantageous to LICUS work. For example, it is clear that engaging LICUS in the manner outlined in the report would be most effective with a presence on the ground. However, the World Bank Group has no field presence in almost half the LICUS, for reasons ranging from security concerns to lack of cost-effectiveness given country volatility and the limited nature of programs in many of these countries. On the other hand, the UNDP has offices and representatives in all of these countries.

- There is similar scope for partnerships with the European Union, bilateral agencies, and other multilaterals. Cooperation is already ongoing with an OECD-DAC Task Force looking at the issues of LICUS (or, in their terminology, difficult partnerships). There have been preliminary discussions with some European bilateral agencies, the European Union, the African Development Bank, and other multilaterals on the issue of LICUS. It remains for the World Bank Group and the donor community to exploit emerging opportunities and explore various modalities for collaboration.

### *2. Economic and Sector Work*

The diagnostic gap for LICUS is substantial, particularly with respect to the political, social, and cultural issues that are determinant in LICUS; yet it is in these complex countries that the Bank Group most needs analytic work of good quality. The proposal is to close the diagnostic gap and build the analytic foundations that would enable more appropriate support to LICUS. A minimum set of good practice ESW would be useful and should be feasible even in countries where there is no government, or little commitment or interest on the part of the existing government. In these cases, the ESW would serve to build up the Bank Group's knowledge base on the country and help assure readiness to assist when a change strategy can be implemented. Such ESW should include (a) an Institutional and Governance Review (IGR); (b) a Development Policy Review (DPR); and (c) a Poverty Assessment. To the extent that the core

diagnostic or fiduciary assessments mandated by the institutions (such as the Country Procurement Assessment Report and Country Financial Accountability Assessment) are difficult to undertake as separate exercises in a given LICUS, fiduciary aspects can be integrated into one—principally the Institutional and Governance Review.<sup>17</sup>

- (a) *Institutional and Governance Review.* IGRs are relatively new and have only been conducted in a few countries. They focus on the functioning of key public institutions and have three distinctive features: (i) performance failures in policy management, service delivery, or accountability are taken as a starting point for analysis; (ii) standardized toolkits, surveys, and quantitative measures of performance are used wherever possible; and (iii) the feasibility of reform recommendations is analyzed with a rigorous assessment of a country's realities and constraints to reform.

For LICUS, the IGR approach would be expanded to include assessments of civil society and other nongovernmental institutions, which are important to independent policy analysis and to service delivery. With regard to public institutions, the IGR would review the government's budgeting entities and public expenditure management systems, along with the related financial management, accounting, and procurement processes. It would review the status of the rule of law and associated judicial institutions. The IGR toolkit would also include a new tool (societal mapping) to enhance sociopolitical and cultural analyses. This tool will help country teams obtain a deeper understanding of the political economy of a country and the cultural and societal ties or tensions at work in society. It can also help identify key issues and actors, including women's and

youth groups that may easily be overlooked as important influences for change. The mapping tool can also help identify groups or influences outside a country that can facilitate change. It can help assess local capacity for implementation, and thus enhance program design. In some of the non-core LICUS that are further along on the development continuum, societal mapping and the ensuing analyses could even be handled as a separate ESW product.

Societal mapping and related analyses are still new to the Bank Group, whose expertise in this area is slowly growing. The Development Communications Group in External Affairs has been doing some of this work, and expertise is also emerging in the Poverty Reduction and Economic Management Network and the Environmentally and Socially Sustainable Development Network. This would be pulled together and coordinated across the World Bank Group. In addition, think tanks, universities, and some NGOs have the capacity to do some or all of the analysis and can be contracted for this purpose. Partners, including some bilateral agencies and UNDP, also have this capability.

- (b) *Development Policy Review.* The DPR is designed to be the Bank's core integrative analytic instrument for a country, focusing on issues of country policy priorities, including consistency of policies and sequencing. For low-income (IDA) countries it underpins poverty reduction support credits, the CAS, and country dialogue. Recognizing that in some LICUS, it would be difficult to set out the government's policy priorities, the DPR would be adapted to reflect the World Bank Group team's assessment of these priorities based on secondary sources, consultations with civil society and others where possible, and primary sources where available. The DPR would consist of an analysis of the macroeconomic and structural policy issues confronting the country, including the environment for the private sector (focusing especially on SMEs and microenterprises).

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<sup>17</sup> The Poverty Reduction and Economic Management Network has developed guidelines for the recommended ESW. However, these guidelines will need to be adapted to LICUS circumstances.

It would integrate knowledge based on related ESW to review priorities, sequencing, and implementability of reforms. The depth and sophistication of the analysis would depend on data availability, so expectations are that it would not be as detailed or take as long to complete as DPRs for other countries. The DPR adapted for LICUS circumstances would be the core economic report for these countries, and would be updated every year to provide current information to the country team and to Senior Management.

- (c) *Poverty Assessment.* Like the present Poverty Assessment, this report would consist of a quantitative and qualitative assessment of the poverty situation in the country, focusing on access to social services by poor people to provide a basis for targeting and designing service delivery options. While preparation of the Poverty Assessment would not require a participatory process (as would preparation of the PRSP), a participatory approach should be pursued when feasible. Collaboration with NGOs and other civil society familiar with the poverty situation would be important.

*Analytic Periodicity.* The three analytic products would be produced on a schedule linked to development of the Country Assistance Strategy, but preceding it. As noted, the DPR would be updated annually. Country directors would have the flexibility to commission other ESW not listed here, if relevant and useful and as the opportunity arises.

*Disseminating Analytic Findings.* Development communications can be a strong tool for facilitating change, and a communications program (such the one being developed by the Bank's External Affairs department) could be useful for country teams to develop and

integrate as part of the ESW program or CAS process.<sup>18</sup>

### 3. *Strategic Capacity Building*

Given that LICUS have a great need to improve institutions and skills, limited absorptive capacity, and limited resources for implementation, capacity building will have to be prioritized for each country as part of the assistance strategy formulation. (Although all LICUS have capacity problems, which are often among the root causes of their poor performance, they differ substantially with regard to their initial endowments of educated people.) Implicitly, one would expect the prioritization to follow that of the key areas identified for the zero generation reforms or for support in a given country.<sup>19</sup> Capacity building would then be strategic. Capacity building should also be part of a coordinated strategy that looks at the incentive structure facing institutions or individuals whose capacity is being built. Once priorities are identified, the World Bank Group would experiment with approaches it may not have tried before that have proved successful elsewhere.

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<sup>18</sup> Of the countries analyzed by the Task Force as illustrating LICUS issues, about two-thirds have I-PRSPs and PRSPs that have some underlying poverty analyses, which can provide useful entry points for dialogue and engagement. Countries that experience difficulties proceeding to PRSPs from I-PRSPs should not be pushed to do so in the near term, because of country conditions that preclude true ownership or leadership in the work or preclude the use of participatory processes. These countries could continue to update I-PRSPs using the Poverty Assessment until conditions are appropriate for a full PRSP. In essence, where an I-PRSP or PRSP is possible, the LICUS framework can be complementary; where it is difficult to work on these products, the LICUS framework provides a viable avenue for engagement.

<sup>19</sup> An important aspect of capacity building in LICUS will be the inclusion of women's groups. In fragile country situations, women's groups have shown a capacity to bring communities together around service delivery initiatives or directly productive activities that help bind people together and contribute to reducing poverty in the community.

**World Bank Institute.** The World Bank Institute (WBI) has a long experience with training and building capacity in client countries, and has also built up many partnerships with other organizations and with bilaterals in this area. WBI should thus play a much enhanced role in capacity building for LICUS. The World Bank Group should intensify its efforts to work with regional bodies, such as the African Capacity Building Foundation, which are implementing capacity-building programs, and with other partners that have experience in this area.

**Options.** Below are options (in which the WBI and partners would often play a prominent role) that could be tried in LICUS assistance strategies, depending on reform and service delivery priorities and country circumstances:

- (a) *Use of Twinning Arrangements.* These could be south-south, north-south, or within a region to build local civil society and government institutions. Such an approach could be used to develop independent economic and social policy think tanks, government civil service training institutes, central banks, and women's groups that would deliver social services to poor people. Like most of the capacity-building initiatives suggested, long-term arrangements will be needed in LICUS.
- (b) *Training of Trainers Program.* One area of constant capacity deficit is in economic management. A model for ensuring an adequate supply of well-trained people in countries with some capacity is to identify a local institute or university where faculty can be trained and a customized program developed for the country by IDA or other donor-financed trainers and advisers. This type of program is usually developed in the form of 4- to 6-week courses for people already on the job or about to begin.
- (c) *WBI and Other Donor-led Knowledge Transfer Efforts.* LICUS, especially the smaller countries that are more costly to service, may be prime candidates for WBI's distance learning and build-up of communities of practice initiatives. Partner agencies or countries that have similar programs could also be of benefit. With many countries now signing up for the Bank-supported Global Development Learning Network or for other connective technology infrastructure, some capacity building via these means can be undertaken in various sectors.
- (d) *Identification and Training of Diaspora Talent.* For many conflict-affected LICUS, significant concentrations of their citizens outside their borders are eager to contribute to development efforts when the chance is presented. The World Bank Group might, for example, consider expanding to other countries the diaspora initiative begun in the context of Afghanistan. This effort would have to be carefully designed, adequately financed, and monitored. This is an area of capacity building where partnership with other organizations that have a comparative advantage, such as UNDP, would be most useful.
- (e) *Identification and Training of Young Potentials.* One way to support and sustain a change program in LICUS is to identify young people with potential for managing the economy, and to provide sustained training and mentoring to prepare them to assume positions of responsibility. The World Bank Group could partner with foundations, universities, and bilateral agencies that have a comparative advantage in these areas to implement this program, with the Bank assisting with program design and monitoring. A key factor for success would be the receptivity of the home environment when people return, and adequate compensation—both difficult issues.
- (f) *Capacity Building by World Bank Group Staff.* Selectively and in partnership with the IMF and other donors, World Bank Group staff in LICUS could support capacity building and advisory efforts or fill identified gaps for a limited period. Staff participation must be based on a request

from the government or other local or international organization. The World Bank Group already supports such efforts on a case-by-case basis, including instances of staff who have provided advisory and capacity-building services in their own countries, at the request of the government or another international organization. The staff exchange program has also contributed in this area and could, with some modification, become a vehicle for advisory and capacity-building services in either the private or public sector.<sup>20</sup>

- (g) *IFC Capacity-Building Programs.* Through its project development and other facilities, IFC implements technical assistance and capacity-building activities (such as finance and SMEs) in some LICUS. In the few LICUS that have substantial and dynamic private sectors, IFC sees potential for further expansion of its activities (especially with SMEs), subject to due diligence to avoid tainted enterprises. In LICUS with less private sector breadth and depth, IFC (mainly the SME department), has been assisting micro, small, and medium enterprises with basic capacity building, technical assistance, and training, using partnerships with local institutions and twinning arrangements with NGOs and others to strengthen enterprises and support their expansion. In countries where IFC or the World Bank Group supports enclave natural resource extraction activities, IFC has been working to link these companies to the SME sector in a capacity-building and subcontracting role that enables the local

enterprises and the economy to benefit much more from the enclave activity.

#### **4. *Delivering Social Services***

One of the areas where the World Bank Group and other donors can have the greatest impact in LICUS is in supporting the delivery of basic social services to poor people. This is expected to be one of the top priorities in assistance programs for LICUS. The basic social services delivered would be primary health and nutrition, education, and the related infrastructural services (water supply, sanitation services, roads).

***Supplementing Weak Governments.*** The new approach makes clear that for service delivery to work effectively, channels to supplement weak government bureaucracy must be used. One option among many is to use a wholesale-retail approach to service delivery, in which the wholesaler is an ISA that contracts for services covering both capital and recurrent costs. The ISA is properly accountable, and able to contract with multiple modes of retail suppliers. This approach serves a dual purpose. It avoids channeling resources to government bureaucracies with little capacity and it helps poor people to improve the quality of their lives. It also allows time to build up government capacity to participate in service delivery more effectively. The challenge will be developing a transition plan that integrates ISAs into enhanced government capacity so as to forestall the perpetuation of the parallel structure. Using nongovernmental channels (including the private sector) would require a government's agreement, expressed through a memorandum of understanding or other means that could be part of the CAS process.

***Nongovernmental Channels.*** Donors in many countries are increasingly using nongovernmental channels, but they find that some such channels have a weak accountability culture. Contracts for service delivery would need to have strong accountability frameworks and proper monitoring and evaluation procedures. There are several possible channels for service delivery—and some good practice

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<sup>20</sup> One of the issues with the present approach is that when a request comes and a staff member agrees to assist, staff and manager must spend considerable time looking for funding sources. This results in uncertainties for staff and delays for requesting organizations. The World Bank Group could eliminate these problems through a partnership arrangement with interested donors that sets up a trust fund to finance this activity. To avoid conflict of interest, World Bank Group staff take a leave of absence to carry out the capacity-building efforts.

examples with the World Bank Group and other donor projects.<sup>21</sup>

- (a) *Wholesaling Channels.* Delivering basic social services through nongovernmental channels will require both wholesale and retail channels. Where an ISA is created, it would decide which service delivery channels were likely to be most effective. The World Bank Group and its donor partners would need to design and ensure the implementation of a strong monitoring framework within an ISA to account for resource use and to ensure that the ISA does not undermine but supplements government capacity and that there is a clear exit strategy with monitorable milestones.
- (b) *Local and International NGOs.* In some LICUS there are well-established international and local NGOs that can serve as retail channels or can be trained to do so.
- (c) *Faith-based Organizations.* Faith-based organizations are common in many LICUS, particularly in Africa, where they play an important role in the provision of health and education services, and sometimes in conflict resolution. The World Bank Group has not traditionally had much contact with faith-based organizations, and most operational staff know little about them, but under the World Faiths Development Dialogue recently sponsored by the World Bank Group and the Archbishop of Canterbury, World Bank Group operational staff are getting to know more about these organizations and learning of the potential to partner with them in developing countries. Faith-based organizations represent a strong potential for collaboration in LICUS (see Box 4 for an example).

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<sup>21</sup> The examples are not exhaustive, but they give a good idea of the robust alternatives that are available for wholesale and retail service delivery. The choice of a particular vehicle depends on what is operational on the ground in each country or what can be created with the government's consent.

- (d) *Community Groups.* The World Bank Group already has a great deal of experience with community groups through community-driven development and related interventions.
- (e) *Social Funds as Autonomous or Semi-autonomous Agencies.* The World Bank Group has a great deal of experience with social funds, which have served as wholesalers and retailers of basic social services. Though not without their problems, social funds are popular: slightly less than one-half of LICUS have or have had social fund projects. The attraction is their community-based approach and relative autonomy from the government. A recent OED study yields lessons of experience that can be used to improve the design and functioning of social funds.<sup>22</sup>
- (f) *Private Sector Output-based Aid Approach.* The private sector can bid for service delivery contracts financed by World Bank Group or other donors; disbursements would be predicated on performance benchmarks based on agreed outputs. IFC and the SME department can work with private sector organizations in LICUS to develop their capacity in this area.
- (g) *UN Agencies and Other International Organizations.* The World Bank Group can work in partnership with other UN agencies such as UNICEF, UNDP, UNHCR, or other international organizations such as the Pan American Health Organization, to deliver immunizations, vaccinations, and other health services. A contractual relationship can be part of this partnership, with World Bank Group financing for immunization and vaccination campaigns. This can be done with the government's consent, or in cases where there is no government (as in Kosovo and East Timor), within a framework provided by an international organization, such as the UN.

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<sup>22</sup> *Social Funds: Assessing Effectiveness*, Sector Study, OED, World Bank, May 2002.

**Box 4. Delivering Basic Services:  
The Example of Sant'Egidio 33**

The Community of Sant'Egidio, a Christian lay association, with a volunteer membership of about 40,000, is committed to serving the poor, the homeless, and the sick, and to working for peace and interfaith dialogue. Its base is Roman Catholicism (it began when a group of Roman Catholic high school students launched reading and writing programs for children from immigrant families in 1968), but Sant'Egidio's beneficiaries represent a wide spectrum of religions, cultures, and countries. Sant'Egidio works in 60 countries, and its activities are financed through voluntary contributions, sometime supplemented by government funds.

Sant'Egidio often works in emergency situations: with Afghani and Kosovar refugees (with the World Bank), with victims of floods that ravaged Mozambique and Sudan in 2001, and with those in El Salvador who suffered through Hurricane Mitch in 2001. Other programs work directly toward development objectives, like a Guinea Bissau hospital rehabilitation program. Sant'Egidio's mode of operation highlights partnership and capacity building, always led by nationals of the country involved and with a highly participatory approach.

A major focus for Sant'Egidio now is an African HIV/AIDS initiative, started in Mozambique. Sant'Egidio views the threat of HIV/AIDS as a joint threat to both "northern" and "southern" countries, and it has a deep concern about the spread of HIV/AIDS and its devastating impact on children. Its multifaceted program seeks to arrest the spread of the disease through education and outreach to high-risk populations, increased testing, improved blood supply, reduction of mother-to-child transmission; and to improve care, with dignity and sensitivity for those already infected.

Since January 2000, in an effort to build on a successful but piecemeal partnership, Sant'Egidio and the World Bank have discussed a Memorandum of Agreement which would set out a broad framework for cooperation in poverty reduction and peace and reconciliation efforts in several countries in Sub-Saharan Africa, North Africa, the Middle East, Eastern Europe, and Latin America.

**5. Role of Financial Resources: Using  
Grants**

While LICUS have not been large recipients of IDA funding because of the performance-based allocation system, what they have received thus far in lending is not insignificant. Some countries use IDA funds less effectively than others, judging by their slower disbursements and poorer portfolio performance, and many LICUS are severely indebted, and should therefore limit borrowing even from IDA. Some have accumulated payment arrears to the Bank and other donors—a situation that will have to be resolved to pave the way for more effective assistance. However, rebalancing attention to knowledge does not imply extending no loans. A few countries are capable of absorbing carefully targeted and well prepared credits effectively. Such lending should be tightly justified by country teams, and the mix of instruments should reflect much more analytic, capacity-building, and knowledge sharing services. And in some cases, grants will be appropriate. It will thus be important that the operationalization of the IDA13 agreement take into account the needs of LICUS countries.

**6. Designing a Country Assistance  
Strategy for LICUS**

The design of an assistance strategy for a LICUS would flow from the analysis, propositions, and recommendations on sequencing and instruments outlined in earlier chapters. It would be a change strategy spelling out as much as possible the reforms and institution building needed to lay the foundations for a return to the growth path. It would be underpinned by the ESW listed above, particularly the political economy, social, and cultural analyses in the IGR. The proposed program of support should be fully costed, and expected outcomes and the indicators to measure success should be included, much as in a regular CAS. However, unlike for a regular CAS, there would be no requirement or expectation of participatory processes where it



is clear that country circumstances do not permit this.

**Range of Strategies.** Assistance strategies for LICUS could range from a Country Monitoring Brief focused on knowledge products and services, at one end of the spectrum, to a full-blown CAS at the other. In countries where government is not receptive or committed to reforms and does not allow access to information or data, or countries where there is no recognized government or the security situation inhibits access, the focus would be on pulling together information from all public and private sources to paint a picture of the economic and poverty situation. This could be done through support to partners and not necessarily or primarily by the World Bank Group. A social mapping exercise would still be feasible even for these difficult countries, and should be implemented.

**Management Attention.** Most LICUS have a CAS or Transitional Support Strategy, although several LICUS are covered by neither (or the documents are dated). Many of these countries receive little Senior Management attention, because there is no mechanism to bring them forward for review. Under the new approach for LICUS, country teams would develop a strategy for change for these countries encapsulating, to the extent possible, the above guidance, including a “holding strategy” approach that builds on a watching brief, where this is appropriate. These strategies would be taken to the Operations Committee for Senior Management review and could be circulated to the Board for information. More detailed guidance for the proposed LICUS CAS approach would need to be developed.

### **C. Budget and Human Resource Implications**

The new strategy for LICUS has several consequences for the World Bank Group’s administrative budget and Human Resource Strategy.

**Budget.** The Bank’s Corporate Resource Management unit has developed an advisory tool that provides initial common baselines for Management decisions on country-level budgets. While for differing reasons, Regions may vary on the margin in the way they treat countries in the allocation process—large versus small, good versus poor performers—the regression model shows that the most important explanatory variables are lending and country performance. This is consistent with the variables that drive IDA lending allocations. Since the LICUS strategy favors analytic work, there is a need to look at the budget allocation process and practice to ensure that ESW is not penalized. In addition, work on LICUS is particularly difficult and sometimes slower than the average for the Bank because operations embody considerable capacity building. Corporate Resource Management and the Regions need to take this into account when looking at costing LICUS CASs. It is not clear from present data whether a higher overall budget for the Bank would be necessary to fund the new strategy for LICUS or whether a reallocation within the existing budget envelope would suffice. It is critical, however, that implementing the strategy not be left as an unfunded mandate.

**IFC.** For IFC, it is clear that resources constrain involvement in the difficult LICUS environments. With the exception of the large countries, there are unlikely to be substantial investment projects in LICUS, and therefore IFC cannot expect to make returns on commercial activity that cover its costs as it can in most of its core business. For example, financing a small microfinance institution is unlikely to yield positive financial returns to IFC given the costs of making and supervising the investment. It will, however, generate significant development impact. Therefore, IFC will need to think and budget creatively for the incremental budget it will need to build local knowledge and develop programs to provide technical assistance, capacity building, financing, and other support to SMEs.

**Human Resources.** Two emerging issues may require further analysis. First, the need for greater understanding of the special issues in LICUS and the use of certain tools to underpin the analyses in the various areas indicate a need for staff with skills in political economy, social, and cultural aspects of development, and related social science disciplines. These skills are in short supply at the World Bank Group. Recruitment of a small number of specialist staff to supplement the few on board and training of existing staff—country directors, country team members—in these areas will therefore be necessary. The Bank’s personnel department will need to follow up with the Regional Vice Presidential Units and the Networks to estimate the numbers needed. A second, critically important, issue that has emerged in discussions with focus groups of country and sector directors, task managers, and other operational staff is the inadequate incentives for staff to work on LICUS. Despite recent positive changes in the incentives to recognize teamwork on varying types of assignments, many staff still regard lending work as their most important output.

**Staff Incentives.** Because most LICUS have limited lending and analytic programs compared to typical low-income countries, they provide little challenge for country team members. Indeed, it is sometimes difficult for country directors to compose a country team for a LICUS. The bulk of country interaction may be very difficult process tasks, dialogue, hand-holding, informal capacity building, and maintaining good Bank-country relations—all of which are crucial in LICUS but difficult to capture and thus to reward. The poor incentive structure may lead staff to rotate rapidly from

LICUS assignments, with a consequent loss of institutional memory. To successfully implement the LICUS approach, it is clear that greater attention will be required to incentives, which need not be monetary. A few options are listed here, but there are probably many other positive incentives to make work on LICUS attractive—this is one of the areas for further work by the Bank’s personnel department, the Regional Vice Presidential Units, and the Networks.

- Developing CASs—with Operations Committee or Board review—is one incentive for staff to stay engaged on LICUS country teams.
- Other ideas are the development of a learning group for staff working on LICUS, with seminars led by well-known development economists with experience on LICUS from outside and inside the Bank Group; brown bag lunches; and special training sessions for country and sector economists at which senior managers from the Poverty Reduction and Economic Management Network, Development Economics Group, Human Development Network, and others participate.
- As part of a staff rotation program, the Bank’s personnel department could pay special attention to rotating experienced and high potential staff to LICUS.
- There could also be a “National Service Scheme” for Bank staff, with a special focus on LICUS work, which would allow a “natural” rotation of staff into these countries over time.

## KEY LICUS PROPOSITIONS

- Proposition 1. Priorities for reform should be based on the identification of likely large and quick pay-offs and should respect logical sequencing.*
- Proposition 2. Prioritize reform in whichever broad component of the CPIA—macro, structural, or social—is worst.*
- Proposition 3. Prioritize improvements in governance, reduce dependence on natural resource extraction, and intensify scrutiny of the uses—including the distribution and management—of natural resource rents.*
- Proposition 4. Prioritize policies that matter for private economic activity—for instance, macro and deregulation.*
- Proposition 5. Increasing tax revenue is normally not a priority.*
- Proposition 6. Governments should be encouraged to use nongovernmental channels for a range of services that would normally be more appropriately provided by government.*
- Proposition 7. Strengthen the agencies that can potentially contain opportunism, such as the police and the courts.*
- Proposition 8. Strengthen the professions to improve conduct; for example, get teachers to turn up for school.*
- Proposition 9. To reduce the risk of conflict, it is important to improve the national and international governance of revenue from primary commodities, and to diversify the economy away from primary commodities.*
- Proposition 10. In post-conflict societies the pace of economic policy reform can be significantly faster than elsewhere, and social policies may be relatively more important than macroeconomic policies.*
- Proposition 11. Choose reforms that meet the least resistance and that offer quick pay-offs to groups that are potential constituencies for further reforms. Avoid reforms that divide, or are opposed by, such constituencies.*
- Proposition 12. Donor agencies need to make special procedural efforts to be more selective in their knowledge transfer to LICUS. Programs should focus on two or three things that best meet the preceding criteria.*
- Proposition 13. Ensure that total net financial transfers to LICUS are appropriate relative to governance capacity, post-conflict status, and the levels of transfers to other low-income countries.*

- Proposition 14. There are advantages to providing financial transfers to LICUS through grants rather than loans, but transfers should be consistent with the overall framework for the provision of grants, and with equity of support to other clients.*
- Proposition 15. Channel finance to the private sector (but finance resource extraction only where the probability of resources being used well is reasonable).*
- Proposition 16. Refocus aid programs toward health and education, using as appropriate local government and nongovernmental channels of delivery.*
- Proposition 17. Place greater stress on accountability and scrutiny in all donor activities.*
- Proposition 18. While donor commitments to aid in post-conflict situations are helpful if made at an early stage, it should be accepted that actual disbursements may need to be atypically slow.*
- Proposition 19. The restoration of order through reform of the services entities that provide domestic order and security for citizens is a good early use for donor finance in post-conflict societies.*
- Proposition 20. Unless aid is effective in development it is unlikely to be effective in reducing conflict. Conversely, if it is effective in development, it is unlikely to have adverse effects on conflict.*
- Proposition 21. Use grants to build capacity for change in both government and society.*
- Proposition 22. More donor resources should be devoted to knowledge transfer activities—capacity building and advice—relative to financial transfers.*

