

**LOW-INCOME COUNTRIES UNDER STRESS:
UPDATE**

OPERATIONS POLICY AND COUNTRY SERVICES

December 19, 2005

ABBREVIATIONS AND ACRONYMS

AFD	Agence Française de Développement (French Development Agency)
CAR	Central African Republic
CDD	Community Driven Development
CG	Consultative Group
CPIA	Country Policy and Institutional Assessment
CPR	Conflict Prevention and Reconstruction Unit
DEC	Development Economics
EC	European Commission
EXT	External Affairs Department
FRM	Resource Mobilization Department
FY	Fiscal Year
HR	Human Resources
IBRD	International Bank of Reconstruction and Development
ICF	Interim Cooperation Framework
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IRS	Internationally Recruited Staff
LEG	Legal Department
LICUS	Low-Income Countries Under Stress
LICUS TF	Low-Income Countries Under Stress Trust Fund
MDG	Millennium Development Goals
NGO	Non-Governmental Organization
OECD- DAC	Development Assistance Committee of the Organization for Economic Co-operation and Development
OED	Operations Evaluation Department
OPCS	Operations Policy and Country Services
PKO	Peace-Keeping Operation
PREM	Poverty Reduction and Economic Management
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
RFTF	Results-Focused Transitional Framework
SDV	Social Development Department
SFR	Strategy, Finance and Risk Management
SLF	Senior Level Forum on Aid Effectiveness in Fragile States
TFO	Trust Fund Operations
UN	United Nations
UNDP	United Nations Development Programme
WBI	World Bank Institute

LOW-INCOME COUNTRIES UNDER STRESS: UPDATE

CONTENTS

Executive Summary	v
I. Background and Purpose	1
II. Progress to Date	2
A. Country Strategies	2
B. Global Research and Policy Partnerships	3
C. Institutional Reform	5
D. Results and Impact	6
III. Priorities FY06 – FY07	9
A. Country Work	9
B. Research and Operational Support and Guidance	10
C. Partnerships	13
D. Institutional Reform	14
IV. Conclusion	16

Tables

Table 1. Differentiated Approaches and Tools	3
Table 2. CPIA ratings change from 2001 to 2004	7

LOW-INCOME COUNTRIES UNDER STRESS: UPDATE

EXECUTIVE SUMMARY

1. This report summarizes progress to date under the Low-Income Countries Under Stress (LICUS) initiative, and priorities going forward.

2. **Context and use of term “fragile states.”** LICUS are among the most difficult development challenges, with weak institutions and high risks of conflict constraining poverty reduction for their own populations and creating potential negative spillovers for neighboring countries. Strengthening assistance to these countries remains a central priority for the Bank. The last three years have seen increasing international interest in approaches to assist fragile states. The OECD-DAC has endorsed a set of draft Principles for Good International Engagement in Fragile States; several bilateral donors and regional organizations have developed or are developing policies to guide their assistance in fragile states; and there has been rising attention at the UN to the need for integrated approaches to support peace-building in the most fragile and conflict-affected countries. To facilitate a harmonized approach, and recognizing the increased international use of the term fragile states, the Bank now proposes adopting this term in its own work.

3. **Progress.** Country teams across the Bank have engaged strongly in efforts to improve the Bank’s response in fragile states, resulting in greater coverage of analytic work, more targeted assistance strategies, and the development of new tools and approaches. Where approaches show the potential to be useful across countries and regions, they are drawn into staff guidance or briefing notes to support their wider application—including the note on Good Practice in Country Assistance Strategies that accompanies this report. The Bank has supported collaborative research on aid allocations to fragile states; the political economy of reform; effective project approaches; and peace, security, and development linkages. Multidonor partnerships have been a consistent hallmark of the Bank’s work on fragile states, both at a policy and operational level, and the Bank’s operational and research work has been influential in informing international policy debates. Finally, Management has completed a number of institutional reforms designed to strengthen the Bank’s response in fragile states, including closer management review and support, changes to the performance measurement system, and new financing instruments, including the LICUS Trust Fund.

4. **Impact.** The first three years of the LICUS initiative have seen modest but significant improvement in the quality and impact of the Bank’s programs on the ground. Average overall and governance ratings within the CPIA have improved more strongly in LICUS than in non-LICUS countries, and the percentage of commitments at risk and projects at risk has declined from 36 to 26 and from 29 to 23 percent, respectively. There have been no miraculous turnarounds, however. Experience indicates that countries will require long-term investment – and there is still considerable work to be done in honing the Bank’s strategies and approaches and improving institutional responsiveness.

5. **Challenges.** There are three overall challenges for the Bank’s approach to fragile states:

- There is scope to increase the attention to peace-building and state-building¹ goals in fragile state assistance strategies, making these a central focus of development activities in all sectors as appropriate to the country context.
- Taking an integrated approach to peace-building and state-building in fragile states requires stronger partnerships with other organizations, working together to combine different areas of mandate and expertise in pursuit of common goals;
- Stronger engagement in peace-building and state-building will require a much stronger organizational response from the Bank. Over 70 percent of LICUS offices have zero or one internationally recruited staff in the field. There is a need to continue to strengthen the Bank's field presence, ability to provide surge capacity to country teams, and research and policy engagement with external partners.

6. **Work program.** This report lays out a comprehensive work program to meet these challenges. Work at the country level continues to be the first priority, with several countries facing fragile war-to-peace transitions, rising conflict, or the need for assistance to sustain difficult reform programs. This work will be backed up by strengthened country support, research, operational guidance from the central departments, and the replenishment and continued implementation of the LICUS Trust Fund, as described in an accompanying paper to this report.

7. **Peace-building.** To strengthen the Bank's contribution to peace-building endeavors, it will build on successful country experiences by ensuring more systematic consideration of peace and development linkages in country assistance strategies and in the cross-cutting processes it supports. Planned work will also focus on drawing good practice lessons from development programs in areas of active insecurity.

8. **State-building.** To support more effective approaches to state-building, the Bank will focus on developing good practice country examples and, where appropriate, operational guidance on leadership support; basic economic and administrative systems; prioritizing institution-building to core state functions; robust economic governance approaches; private sector development; and effective service delivery approaches.

9. **Partnerships.** The Bank will continue to encourage multidonor approaches at the operational level. It also anticipates actively engaging in discussions on the UN Peace-building Commission and will provide continued support for other international partnerships, such as the OECD-DAC group, and collaborate with regional organizations, and efforts to better coordinate and enhance post-conflict recovery planning processes with the UN.

10. **Institutional reform.** A stronger strategic and partnership framework will only be effective if the Bank is able to improve its own organizational response. The Bank will review the measures necessary to increase field presence and incentives and central or regional organizational capacity,

¹ Bank support for the goals of peace-building and state-building focuses on use of the Bank's core economic and development competences to support these goals through activities within the Bank's existing mandate, as laid out in the framework paper "*Fragile States—Good Practice in Country Assistance Strategies.*" Assistance also needs to be adapted to the country context, as laid out in the differentiated approaches within this paper.

and will, where appropriate, include specific recommendations in the Spring 2006 Strategic Staffing paper and the Medium Term Strategy and Financing Paper.

LOW-INCOME COUNTRIES UNDER STRESS: UPDATE

I. BACKGROUND AND PURPOSE

1. This report summarizes progress made to date under the LICUS initiative and priorities going forward. It is accompanied by two other papers: “Fragile states: Good Practice in Country Assistance Strategies” and “Low Income Countries Under Stress Implementation Trust Fund: Request for Replenishment and Special Support for Sudan.”

2. The LICUS initiative supports countries at the bottom of the CPIA performance spectrum (35 countries in FY06).¹ They share a common fragility, in two particular respects:

- Weak state policies and institutions: undermining the countries’ capacity to deliver services to their citizens, control corruption, or provide for sufficient voice and accountability.
- Risk of conflict and political instability: between 1992 and 2002, 21 of 26 countries with intermediate or worse civil conflicts were also LICUS.

3. The 2002 LICUS Task Force (headed by Paul Collier and Ngozi Okonjo-Iweala) highlighted the development challenge posed by these states. LICUS have twice the income poverty and child mortality rates of other low-income countries; they also pose a risk of negative spillovers for their neighbors and the wider global community, through the spread of conflict and organized crime, refugee flows, epidemic diseases, and barriers to trade and investment. The Task Force built on the Bank’s strong experience in post-conflict reconstruction (spearheaded by the Conflict Prevention and Reconstruction Unit), but also underlined that fragility stems from interlinked risks of institutional failure and conflict, occurs across a wider range of countries and affects all development sectors. Its final report recommended the need for stronger political analysis, innovative operational approaches, closer donor partnerships, and a series of institutional reforms to improve the Bank’s responsiveness.

4. In 2002, the Bank established the LICUS initiative to follow-up on the Task Force work and thereby strengthen responsiveness and impact in these states. The initiative has three main activities: country strategy work, external policy partnerships, and internal institutional reforms. The initiative is coordinated through a small unit located in OPCS, but actual implementation of the initiative is a Bank-wide effort, involving close collaboration with Regions and country teams, as well as central units such as DEC, PREM, SDV, EXT, LEG, SFR, FRM, WBI and HR. Because state effectiveness and accountability and vulnerability to conflict are closely interlinked, the LICUS initiative has worked particularly closely with the SDV Conflict Prevention and Reconstruction and PREM governance units to build on the substantial track record of research and operational engagement in these areas.

¹ Twenty-eight countries falling at or below 3.0 in FY06 and 7 “marginal” LICUS rating 3.1 or 3.2.

II. PROGRESS TO DATE

A. Country Strategies

5. The 2002 Task Force report noted that LICUS principles would be introduced within Bank activities at a country level progressively over time, as new country assistance strategies are developed and brought forward to Board. Over the past three years, the initiative has engaged closely with strategy development processes in a number of LICUS country situations, including: Afghanistan, Cambodia, Central African Republic, Comoros, Guinea Bissau, Haiti, Liberia, Nigeria, Papua New Guinea, Somalia, Sudan, Timor-Leste, Togo, Tajikistan, and Zimbabwe.

6. Country level engagement had resulted in the development of a range of promising new approaches. Where these show the potential to be useful across different countries and regions, OPCS has supported training seminars and developed staff guidance or briefing notes to support their wider application. Operational guidance notes developed in this way have included the joint World Bank/UN framework on transitional results planning (a simplified application of PRS principles to fragile states); operational guidance on development policy operations in fragile states, and a discussion note on leadership training. Over 20 staff seminars² have been held on a range of emerging issues for fragile states, including political economy of reform, transitional results frameworks, security and development linkages, service delivery and community driven development, policy and governance reform and aid allocations.

7. As country work has progressed, it has become clear that there are both common themes and differences across the LICUS spectrum. Common themes include:

- the centrality of efforts to build state capacity and accountability, including strong attention to the most basic state administrative and delivery systems, complementing capacity investments with robust efforts to improve accountability, and balancing state capacity-building efforts with support for civil society and the private sector;
- the importance of peace, security and development linkages, including the need to design interventions which are sensitive to political and conflict dynamics, and the importance of efforts to reduce crime, instability or conflict as development goals in their own right in fragile situations;
- donor harmonization, including aspects of ownership, alignment and harmonization particular to fragile states such as the need to aim at simplified overarching planning and monitoring tools, focus on different priority results, address non-aid resources and align with a broad group of stakeholders;
- the need for a strong and flexible institutional response, including the critical importance of field presence, specialized staff skills and knowledge, speed, adaptability, and long-term partnerships.

² For additional information see LICUS website: *Knowledge and Learning: Seminar Series* <http://intranet.worldbank.org/WBSITE/INTRANET/UNITS/INTOPCS/INTLICUS/0,,contentMDK:20182934~hlPK:527819~menuPK:531906~pagePK:64137152~piPK:64136883~theSitePK:388759,00.html>

8. Work at the country level has shown that while these themes remain applicable across the fragile state spectrum, differentiated approaches are needed to respond to different country contexts. The four principal country contexts which have emerged across the regions include countries in prolonged political crisis; those in post-conflict or political transition; countries going through a gradual reform process; and those facing deteriorating governance or rising conflict risk (see Table 1). A framework to guide strategy development in these different contexts is summarized below and laid out in more detail in the accompanying paper to this report, entitled “Fragile States: Good Practice in Country Assistance Strategies.” These approaches are not intended to be prescriptive (each country strategy needs to be firmly rooted in country-specific analysis), but rather to provide a basic framework and menu of tools to facilitate the sharing of lessons between countries and regions.

Table 1. Differentiated Approaches across the Fragile States Spectrum

<p>Deterioration</p> <ul style="list-style-type: none"> • Interim strategy note, focusing on stemming decline in governance and social services, and contributing in economic and development areas to multi-donor conflict-prevention efforts. Limited new financing; focus on portfolio restructuring. • Increased use of CDD, private sector, NGO and ring-fenced mechanisms (including service delivery and local economic development in areas of insecurity). • State capacity and accountability: focus on transparency, dialogue and maintaining institutional capital to facilitate eventual turnaround. • Contributing to community level conflict prevention, and to multi-donor efforts for peace-building or governance reform at a national level. 	<p>Prolonged crisis or impasse</p> <ul style="list-style-type: none"> • Interim strategy note, focusing on maintaining operational readiness for re-engagement and providing economic inputs to early peace or reconciliation dialogue. • Small grant-based finance, aiming at local economic development and protection of human capital, generally through non-government recipients (including service delivery and local economic development in areas of insecurity). • Capacity and accountability: focus on institutional analysis, dialogue and counterpart training. • Use of socio-economic issues for restoration of dialogue/identification of entry points for change.
<p>Post-conflict or political transition</p> <ul style="list-style-type: none"> • Interim strategy note, focusing on rebuilding state capacity and accountability, and delivering rapid visible development results in support of peace-building. • Exceptional IDA allocation. • Joint needs assessment/recovery planning, linking political, security, economic, and social recovery. • State capacity and accountability: support for a broad state-building agenda, through institution-building and, where appropriate, development policy operations with robust oversight mechanisms and sector programs (including transitional projects working through CDD or NGO mechanisms). Leadership and civil society support. • Public administration, service delivery and economic development to address areas with crime, insecurity or conflict. 	<p>Gradual improvement</p> <ul style="list-style-type: none"> • Country Assistance Strategy, focusing on building state capacity and accountability, achieving selective development results, and boosting support for reform currents, supported by moderate IDA allocation. • Activities to boost domestic reform currents, including leadership support, communications initiatives, training and capacity-building. • State capacity and accountability: development policy operations (where appropriate and restricted in volume), supported by sector and capacity-building projects and with strong oversight mechanisms. Asymmetric reforms. • Public administration, service delivery and economic development to address areas with crime, insecurity or conflict.

B. Global Research and Policy Partnerships

9. Since the LICUS task force reported in 2002, there has been considerable international attention to countries under stress, with different terms adopted to describe these situations:

difficult partnerships, countries at risk, difficult environments, failing states.³ Reflecting the increased use of the term “fragile states” (in the OECD-DAC and elsewhere), the Bank now proposes to adopt this term for its work in these situations.

10. The Bank co-chairs the OECD-DAC Fragile States Group, which has an intensive on-going work program to build policy consensus on the international response to fragile state situations. In January 2005, a Senior Level Forum (SLF) on Aid Effectiveness in Fragile States (co-sponsored by the Bank, OECD/DAC, the EC and UNDP) brought together senior officials, leading development practitioners, government reformers in fragile states, and academics, to examine aid allocation to fragile states, donor coordination, donor policy coherence, effective service delivery and improved aid instruments.

11. At the SLF, the participants agreed to develop a set of Principles for Good International Engagement in Fragile States⁴. The Principles reflect a broad consensus that state-building is the central objective in fragile states, and that effective donor programs require integrated approaches across the political-security-development nexus, fast and flexible responses and long-term engagement. At the subsequent High-Level Forum in Paris in March 2005, development ministers and agency heads agreed to pilot these principles in a number of countries. Pilots for the principles are currently underway in the Democratic Republic of Congo; Haiti; Guinea-Bissau; Nepal; Somalia (co-led by the Bank); Sudan; Yemen and Zimbabwe. The DAC Fragile States Group also has an on-going work program on service delivery and whole of government approaches which the Bank is supporting.

12. Research completed by the Bank has made a significant contribution to the global policy debate. To complement country work, the Bank has engaged in a number of research partnerships in the last two years relating to fragile states. These include:

- A study on aid allocations, in collaboration with the DAC Secretariat and the IMF, which indicates that aggregate aid to fragile states may be too variable to support sustained poverty reduction and reform, and too unequal within the fragile state group: in aggregate, these countries receive 40 percent less aid than their policy and institutional performance and poverty would predict. This study contributed to agreement at the DAC to consider the development of a process to monitor aid flows to fragile states.
- A study on the spillover costs of fragile states for their own populations and for their neighbors. Results showed that state fragility typically reduces the annual growth rate of peacetime economies by 2.3 percent per annum relative to other developing economies, and that of their neighbors by 1.6 percent per annum.
- A series of country and project case studies on the characteristics of reform turnarounds and successful aid-financed projects in fragile states. This study,

³ In a recent paper “*Beyond the fragile state: Taking action to assist fragile actors and societies*,” the French Development Agency (AFD) refers to “*fragile societies*,” highlighting the importance of social reconstruction in any approach to these states. The Bank will also take this aspect into account in its work.

⁴ See *Principles for Good International Engagement in Fragile States*, OECD-DAC Draft Paper, (DCD (2005)8/Rev2, April 7, 2005, <http://www.oecd.org/dataoecd/59/55/34700989.pdf>).

conducted with support from the Netherlands and the UK, is still being finalized. Initial results indicate that, at a country level, sequencing of early reforms to produce rapid results and the protection of key interest groups are significant in sustaining war to peace transitions and governance reform; donor behavior (for example, predictable financing flows and early engagement in state institution-building) also plays an important role. At a project level, community driven development programs and social fund operations show a surprisingly strong track record of satisfactory development impact and resilience, even in the context of low-level conflict and setbacks in the overall governance environment.

- In collaboration with the UN, the Bank is supporting a study on the economic impact of peace-keeping operations (PKOs) and collaboration between PKOs and the IFIs. With support from Australia and Norway, the Bank also launched in September a joint UNDP-World Bank research and seminar program drawing together lessons on state-building from a group of senior national reformers. Finally, the Bank and the United Nations Office of Drugs and Crime have initiated a collaborative program of activities at both the country and sector level, and have undertaken to share research work, including work on drugs, crime and development.
- OPCS and the IFC have collaborated on a simple resource guide on natural resource management for fragile states, providing staff with a framework of approaches, country examples and external resources and guidance to draw on.
- The Conflict Prevention and Reconstruction Unit is leading three major studies with impact for operational work in fragile states: on PRSPs in conflict-affected countries; jointly with DEC, on “Political Institutions, Development and a Domestic Civil Peace,” and private sector development in fragile and conflict-affected countries.

C. Institutional Reform

13. The LICUS Task Force report noted that a stronger Bank response in fragile states would need to be underpinned by institutional reforms to ensure strong management and staff attention and to adapt policies, procedures and financing instruments to the particular needs of fragile states.

14. **Organizational systems and incentives.** The Bank has implemented a number of institutional reforms to strengthen its response during the first three years of the initiative. These include the conduct of quarterly meetings on LICUS country operations with the Managing Director, Operations; delinking budgets for analytical work from lending volumes to allow more consistent knowledge work in countries with low lending programs; changes to the CPIA to better reflect the most basic performance improvements in countries struggling to establish core governance systems; changes to the post-conflict performance indicators to provide more specific measurement of progress in post-conflict countries; and improvement of HR incentives for LICUS hardship postings.

15. **Financing instruments.** Two key changes were made in IDA 14 in response to new DEC research and operational experience in fragile states. First, the exceptional IDA post-conflict allocations, while remaining at the same aggregate volume, can now be stretched over a longer time period to reflect research on absorptive capacity in fragile states. Second, provision

was made to provide exceptional support to fragile states (such as Haiti) which are re-engaging with the Bank after a period in non-accrual status and require higher initial assistance to clear arrears and restart government services.

16. **LICUS Trust Fund.** In March 2003, the Board of Governors approved the establishment of the LICUS Trust Fund with a grant from surplus. The LICUS TF addresses one of the key gaps in financing instruments identified by the task force in 2002, for non-accrual countries where the Bank previously had no instrument available to support early initiatives for governance reform. The LICUS Trust Fund is administered in close coordination with the Post-Conflict Fund, which also provides critical assistance through smaller grants to conflict-affected countries. The LICUS Trust Fund has provided support to several critical transition processes in fragile states, playing an important role in catalyzing multi-donor approaches and performing well against the three year results framework set by Board. The fund is now fully committed and has disbursed 60 percent, with several pipeline proposals awaiting a new replenishment. A detailed report on progress made under the LICUS TF is provided in an accompanying report.

D. Results and Impact

17. The new emphasis on fragile states under the LICUS initiative has resulted in some gains. The Bank has improved its operational readiness in the majority of countries from which it had disengaged; this has resulted in a stronger ability to support the early stages of peace or political transitions (for example in Haiti, Liberia, Sudan, the Central African Republic, and, most recently Somalia). Analytical work in LICUS is now regularly updated, and coverage of core fiduciary products is at par in LICUS to non-LICUS. Assistance strategies are now in place and

Box 1. Selected Development Impact—Selected Fragile States

Assistance programs in fragile states are achieving tangible results in difficult environments. Among countries in the later stages of fragile transitions, progress is being made towards sustainable long-term recovery. **Sierra Leone** no longer ranks in the bottom half of sub-Saharan African countries in development terms and has achieved sustained GDP growth in the range of 7 percent per annum, with considerable progress in attracting private sector investment, improving governance in core state functions such as justice, the defense sector and public procurement and devolution and local capacity-building. The Bank has played an important role in Sierra Leone's transition as chair of the CG process, and by providing timely assistance to budget support, reintegration, decentralized service delivery, energy and water supply. In **Timor-Leste**, concerted support for institution building has supported: annual planning and budgets which are firmly anchored in a National Development Plan; the development of solid financial management systems with regular budget execution reports and audits; a transparent system for natural resource revenue management; and the adoption of a Civil Service Act with ethics and disciplinary codes. Access to education and health services has improved dramatically, a community grants program has reached every village in the country, and while considerable challenges remain, the police force has been strengthened to a level where it has been able to mount an effective response to social unrest. The Bank has played a central role in leveraging and administering funds for both reconstruction projects and recurrent expenditures, and through flexible advice and capacity building on a range of key governance issues.

In countries undergoing the early stages of post-conflict or political transition, the Bank is working to reinforce recovery on the ground. In **Haiti**, the Bank has supported the Interim Cooperation Framework (ICF) and has played a leading role in economic governance, facilitating inter alia: preparation of the FY04-05 budget, allowing the country for the first time in many years to start the fiscal year with an approved budget; audit of the 2001-02 government budget; an improved macroeconomic framework; a reduction in spending through discretionary accounts from 60 percent to less than 10 percent; the creation of a civil society oversight committee, National Procurement Commission and Anti-Corruption Unit; and expanded access to basic social services. In **Liberia**, the Bank is supporting the Results Focused Transitional Framework (RFTF), to integrate and sequence donor reconstruction efforts, with a focus on verifiable results. While significant issues in economic governance have been encountered, encouraging progress has also been made in establishing a more accountable economic governance framework, reinvigorating basic capacity to carry out core state functions, launching development programs at community level; and a more than five-fold increase in the number of operational health clinics since the end of the war. Access to all counties and districts is now possible with the disarmament and demobilization of ex-combatants; and the first round of the 2005 elections passing peacefully.

current for 33 out of 35 LICUS countries, including four joint strategies with other donors. Strategies that are strongly linked to peace-building and state-building goals have been adopted in countries such as Afghanistan and Timor Leste. At the other end of the fragile states spectrum, reform efforts in countries such as Nigeria are being closely supported by the Bank.

18. Development outcomes of the Bank's fragile states work are difficult to measure, in part because many of the country assistance strategies developed under the initiative are still relatively new, and in part because attribution of outcomes to the Bank's activities must remain cautious given the limited instruments the Bank can bring to bear in the most severe fragile states. The logical corollary of a central focus on peace-building and state-building in the Bank's assistance strategy for fragile states is that short-term results measurement should also emphasize these dimensions while continuing to focus on growth, poverty reduction and the Millennium Development Goals within the long-term vision for recovery.

19. With regard to peace-building, a number of LICUS countries have made progress in war to peace transitions over the last three years, including Sudan, Liberia and Burundi. Several others have negotiated complex political transitions with some success, conducting effective constitutional and electoral processes with widespread popular participation despite on-going insecurity (Afghanistan) or avoiding a reversion to conflict during sensitive electoral transitions (CAR). The Bank's contribution to these processes, given its mandate, has been modest: but activities have in general been increasingly well-coordinated with other international partners and adapted to the primacy of peace-building goals. All these transitions remain fragile, however, and conflict has also continued or increased in a number of fragile states.

20. The CPIA captures a number of components related to the capacity and accountability of state institutions, although it does not measure the reach of service provision and administrative control across geographical territory and it devotes greater weight to the economic, administrative and service delivery functions of the state than to institutions dealing with security and rule of law. Notwithstanding these limitations, the trend in the CPIA is moving in a positive direction in LICUS, with overall and governance ratings showing an improvement on average, and the number of countries in the very lowest range of the CPIA decreasing (see Table 2).

Table 2. CPIA ratings change from 2001 to 2004

	2001	2004
2001 LICUS group change in ave. CPIA over time—overall	2.5	2.8
2001 LICUS group change in ave. CPIA over time—governance	2.2	2.6
2001 non-LICUS change in ave. CPIA over time—overall	3.6	3.7
2001 non-LICUS change in ave. CPIA over time—governance	3.4	3.5
CPIA overall scores/b		
Total countries <= 2 or no data	10	8
Total countries <=2.5	15	11
Total countries <= 3	28	27
Total countries <= 3.2	41	36
CPIA governance scores/b		
Total countries <= 2 or no data	13	7
Total countries <=2.5	24	18
Total countries <= 3	49	37
Total countries <= 3.2	58	50

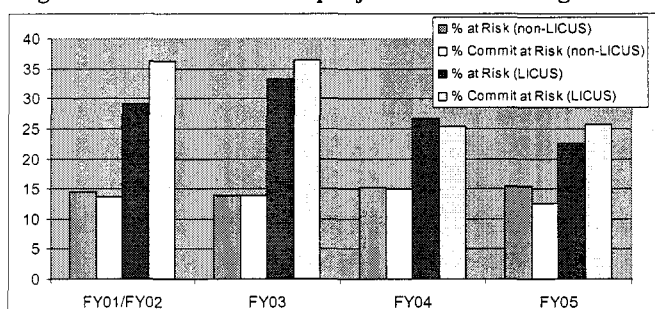
a/ IDA-eligible countries scoring less than or equal to 3.0 in 2001 are used as proxy for LICUS (21 countries with data); non-IDA eligible and > 3.0 IDA eligible in 2001 for non-LICUS

b/ IDA-eligible countries falling below specified CPIA scores in each year. Numbers do not equate to LICUS countries in a given year because Bank's LICUS monitoring process uses both the governance CPIA rating and the overall rating in monitoring the LICUS group: table 1 disaggregates the overall and the governance components of the CPIA to provide a more comprehensive picture. Improvements in the Post-Conflict Performance indicators for no data countries are not included.

21. Project portfolio performance is still weaker than in IDA as a whole, but with encouraging developments in the past three years. For completed projects, the percentage rated unsatisfactory in LICUS remains higher than the Bank average, at 36 per cent in FY04. In part this may be due to lags in reflecting stronger institutional attention to fragile states since FY03, since evaluations of completed projects do not include the current active portfolio. Discussions with country teams also suggest three additional factors related to past portfolio performance: the inherently high risk-low capacity environment present in fragile states; constraints in the availability of budget and experienced staff for preparation and supervision; and issues within the Bank's measurement system, which previously penalized projects which had made adjustments to development objectives in mid-course (a frequent issue in fragile states due to volatility in the external environment).⁵

22. Current portfolio performance does however show a significant improvement in LICUS, with commitment at risk declining from 36 percent to 26 percent of the total portfolio, and projects at risk from 29 to 23 percent, closing the gap with Bank-wide project performance (see Figure 1). Portfolio indicators also show signs of increased efforts by country teams in LICUS to identify problems early: the net disconnect (which measures the gap between task team leader identification of problem projects and eventual project ratings at closing) decreased significantly between FY01-02 and FY05.

Figure 1 . Performance of projects at risk in fragile states



23. In summary, the first three years of the LICUS initiative have seen a modest but significant improvement in the impact of the Bank's programs in fragile states. There have been no miraculous turnarounds, however. Experience clearly indicates that these countries will require long-term investment—and there is still considerable work to be done in honing the Bank's strategies and approaches and improving institutional responsiveness. Innovative planning tools and project instruments (e.g., linking political, security, economic and social priorities or supporting robust oversight of public finances) have been introduced in specific countries, but more work is needed to identify effective instruments and project design criteria, and to share effective approaches among countries and Regions. There are three overall challenges for the Bank's approach to fragile states:

- There is scope to increase the attention to peace-building and state-building⁶ goals in fragile state assistance strategies, making these a central focus on development

⁵ The last issue has been addressed through new OED procedures for the evaluation of projects which have amended development objectives during implementation, and improving HR and budget incentives will continue to be a focus of institutional reform work in the coming period.

⁶ Bank support for the goals of peace-building and state-building focuses on use of the Bank's core economic and development competences to support these goals through activities within the Bank's existing mandate, as laid out in the framework paper "*Fragile States: Good Practice in Country Assistance Strategies*." Assistance also needs to be adapted to the country context, as laid out in the differentiated approaches within this paper: in some contexts, for example, crime rather than armed conflict is a significant challenge; while in others efforts to build state transparency and accountability are pre-requisites to initiatives to strengthen state capacity.

activities in all sectors as appropriate to the country context. The good practice note on country assistance strategies in fragile states is intended to address this (while recognizing the imperative to base strategies in country specific analysis).

- Effective interventions in fragile states require stronger partnerships with other organizations, working together to combine different areas of mandate and expertise in pursuit of common goals.
- Progress in these countries will also require a much stronger organizational response from the Bank, in strengthening field presence, the ability to provide surge capacity to country teams, and research and policy engagement with external partners.

III. PRIORITIES FY06 – FY07

A. Country Work

24. The first priority will be to continue to offer close management and organizational support to country teams, providing advice on strategy and assistance in unblocking policy and procedural constraints to effective operations. The common principles and differentiated approaches laid out in the accompanying paper to this report represent best practice drawn from different country operations, which need to be more consistently applied across the Bank. Continued management attention and hands-on mission support is important to strengthen country level operations and facilitate the sharing of promising approaches between countries and regions.

25. There are a number of specific challenges ahead in the Bank's country operational work in fragile states. Country knowledge and operational readiness has improved but are not yet fully in place for all of the non-accrual countries. Countries such as Afghanistan, Burundi, Central African Republic, DRC, Guinea Bissau, Haiti, Liberia, and Sudan are undergoing post-conflict or political transitions which remain fragile: strong Bank support for these transitions, in close collaboration with other partners, is critical. At the more stable end of the spectrum, countries such as Timor Leste and Sierra Leone, who have made substantial achievements in peace-building and state-building, now face difficult periods of waning donor interest and support at a critical juncture in their transition to stronger performance and improved development and poverty reduction outcomes. A small number of countries face rising conflict risk or deteriorating governance and service delivery, requiring a careful adaptation from the Bank and other development partners. A number of the fragile states are HIPC-eligible: progress of governance and strengthening state institutions is also important to accelerate their access to debt relief. The Bank is also committed to continuing to support the implementation of the Principles for Good International Engagement in the nine pilot countries selected, and will ensure that this process receives close management support.

26. While the Bank's fragile states work focuses on a tightly defined group of countries at the bottom of the CPIA, operational experience has shown that fragility is less clear cut. First, fragility does not disappear when a country achieves a small increase in the CPIA: for this reason, the Bank has maintained close attention to 'marginal' LICUS who have made small performance improvements but remain fragile. Second, other countries outside the core fragile

states group have found elements of the donor debate on fragile states to be useful. This has included higher income countries facing the aftermath of conflict, genocide or social instability (e.g., Balkans); more strongly performing countries facing rising conflict risks (e.g., Nepal), and strongly-performing states facing fragility in particular sub-national regions (e.g., India, Philippines). The Bank proposes a pragmatic approach to this spectrum of fragility: maintain a focus on a core group of countries rating 3.0 or less on the CPIA where fragility is most pronounced, but encourage other clients or country teams to make use of tools and approaches developed for fragile states whenever this fits their needs and circumstances.

B. Research and Operational Support and Guidance

27. In support of work at the country level, this paper proposes a program that fully engages central and regional departments in research, operational guidance, staff training and institutional reforms organized around the four common themes identified across the fragile states spectrum: peace-building; state-building; international partnerships; and institutional flexibility and responsiveness. The focus will be on supporting country teams to elaborate and implement the approaches developed in the framework document on good practice in country assistance strategies. This will be supported where appropriate by the development of operational good practice notes and training to draw together experiences from different countries; and by further research and evaluation where the more general application of country-level approaches has not yet been assessed.

28. *Political economy and conflict analysis.* There has been a significant shift within the Bank's organizational culture over the last three years towards a consensus that development programs in fragile states need to be strongly rooted in an understanding of the political dynamics of reform. Specifically, the development of effective country assistance strategies for these countries involves greater discussion of political risk and the dynamics of political reform than was the case in the past. While some excellent examples of socio-political analysis have had important impacts on specific country programs, other teams have found it difficult to link more academic political analysis with concrete recommendations on the content of country assistance strategies or project design. To assist in strengthening the analysis available to country teams, OPCS, and PREM will collaborate in a program of joint country support—financed by the Government of Australia—to translate political analysis inputs into operational recommendations at the country level. The program will cover staff and regional seminars and specific, timely inputs to country assistance strategies and project design. Through joint efforts with SDV, OPCS and PREM, the program will also identify measures to harmonize and strengthen upstream political analysis.

29. *Peace-building and development linkages.* Vulnerability to conflict is one of the consistent characteristics of fragile states. Reflecting this, the links between development and peace-building form a common theme across the spectrum. There are also two emerging challenges in this area. First, there has been an increase in the number of countries where a lasting peace has not yet been achieved, and reconstruction is therefore taking place amidst on-going conflict, or in the context of continued high conflict risk. Second, there is a strong move within the international community to support increased harmonization and policy coherence between diplomatic, peace-keeping, state-building and economic reconstruction initiatives. Building on the work already completed by DEC, the Conflict Prevention and Reconstruction unit, and the LICUS initiative, the Bank will continue to strengthen its work on these issues.

30. Operational guidance, staff training and support to country programs is particularly needed in the following two areas:

- *Stronger integration of peace-building goals and activities in cross-cutting processes* which the Bank supports, such as recovery plans, PRSs, governance assessments, public expenditure work and public finance capacity-building. Experience shows that excluding peace-building issues and the state institutions dealing with peace and security from these processes risks making them ineffective in a fragile state context. Ensuring an integrated approach to peace-building, however, will require strengthened partnerships between the Bank (which can contribute economic, development and public finance expertise) and other donors or institutions who have expertise in specialized technical reform or capacity building in the political governance or security areas. A more detailed basis for the Bank's approach is laid out in the accompanying paper "Fragile States: Good Practice in Country Assistance Strategies."
- *Good practice guidance on the conduct of development programs in areas of on-going conflict.* The Bank now has significant experience (for example, in Afghanistan, Columbia, Sri Lanka, Nepal, and the Great Lakes) in supporting development projects which operate in areas of on-going conflict, but these experiences have not yet been drawn together and shared between regions. The Social Development Department has an on-going program to evaluate the use of community-driven development approaches in conflict-affected areas: this will be complemented by a collaboration between OPCS and PREM on initiatives to extend the reach of core state functions (such as customs and expenditure chain management) into conflict-affected areas.

This program of operational support will be backed up by continued longer-term research on peace and development linkages, including the on-going DEC research described above on political and post-conflict transitions. In addition, the program on state-building will include an evaluation of the economic and institutional provisions of peace-agreements, and lessons on the incorporation of a stronger state-building emphasis in post conflict recovery planning.

31. ***State-building.*** Fragile states, as the name implies, are fragile precisely because state institutions have limited capacity to deliver services to their citizens, to control corruption, or to provide for sufficient voice and accountability. In the long-term, therefore, a successful exit from fragility will only come about through stronger and more accountable state institutions which are resilient to political and economic shocks. An emphasis on state capacity and accountability needs to be anchored within an understanding of the political economy and peace-building issues described above—these two priority elements of the Bank's work-program are therefore closely linked. To strengthen the tools available to assist client governments to build capacity, and accountability within the state in the most fragile environments, OPCS, PREM, SDV, HD, and WBI will collaborate to develop five new programs of country support, evaluation and development of operational guidance and staff training during FY06 – FY08:

- ***Leadership support.*** Effective political leadership to mobilize positive change is critical in fragile state settings. Recognizing that reform programs will only succeed

with inclusive leadership support, the Bank has supported leadership seminars and retreats in Timor Leste, Burundi, the Central African Republic, Papua New Guinea, and Tajikistan. A continued OPCS/PREM/WBI collaboration will evaluate the lessons of these programs and provide further guidance and support to country teams in this area.

- ***Basic systems of public administration, public finance and macroeconomic management in fragile states.*** Feedback from country teams indicates that they lack sufficient tools to support clients in establishing the most basic economic management, public administration and public finance systems, in cases where these functions have collapsed or are not operating at a basic level of satisfactory delivery and accountability. An operational guidance note will identify tools and approaches for the development of core public administration and finance systems, emphasizing processes of agreement and implementation as well as technical design issues. DEC research will also focus on design and sequencing of macroeconomic programs in fragile situations.
- ***Robust economic governance measures for controlling corruption.*** Country experience in recent years has produced a number of innovative new approaches to introduce basic measures of accountability and control against corruption in the most fragile environments, from the use of oversight committees for public finance functions, to the outsourcing of procurement and financial management functions in post-conflict environments, to the use of social accountability mechanisms at national and local level. Country support from OPCS and PREM will focus on assisting clients and country teams to introduce credible transitional economic governance measures to support a strong emphasis on building capacity in country systems in fragile states.
- ***Private sector development.*** Building on work done by DEC and the CPR on private sector development in conflict-affected countries, the Bank will conduct further research on actions to strengthen the role and capacity of national private sector actors early in peace-building processes.
- ***Effective service delivery approaches in fragile states.*** Efforts to scale up development interventions to meet the MDGs in fragile states are often constrained by lack of consensus on effective models for service delivery in low-capacity, high risk environments. The Bank will contribute studies on health and the fast track education initiative in fragile states to the on-going OECD-DAC workstream on service delivery and will provide support to country teams in developing and implementing strengthened approaches for service delivery.

32. In addition to these specific operational initiatives, the Bank and UNDP are collaborating in a process to draw together senior national reformers from fragile states to identify lessons in the sequencing of key decisions and actions on building state institutions, in particular in the aftermath of conflict. Future work on this project, which is supported by the Governments of Norway and Australia, is likely to include an evaluation of the economic and institutional

provisions of peace agreements; and recommendations to strengthen the emphasis on core state functions in initial post-conflict recovery planning.

C. Partnerships

33. Close external partnerships have been a critical part of the LICUS initiative since its inception. Experience in the past three years has confirmed that any effective program to strengthen fragile states requires strong partnerships with other organizations and close collaboration in bringing different tools and expertise to work together: because support for diplomatic solutions, peace-keeping, state capacity building and social and economic reconstruction rests with different international actors, lack of coordination can utterly undermine sustainable recovery. The Bank will continue to focus on four particular areas of donor harmonization at the corporate and country level:

- ***Policy coordination.*** The Bank will continue to closely support the work of the OECD-DAC Fragile States Group in the coming period, contributing to policy work on aid allocations, coherence and service delivery as well as strongly supporting the pilot countries for application of the OECD-DAC Principles for Good International Engagement in Fragile States. The Bank will also seek to broaden the discussion on fragile states to include an exchange of views with non-OECD-DAC donors and stronger links with regional development banks and other regional organizations.
- ***Ownership and alignment.*** Two studies completed in the last 18 months on PRS processes⁷ have indicated that the applicability of the PRS in fragile states contexts would be improved by more focus on the process of policy formation, the encouragement of simple, results-focused formats for planning documents which would facilitate their use in domestic processes and government-donor dialogue, and (as noted above), efforts to facilitate the closer integration of issues related to peace-building into the selection of priorities. OPCS, the CPR and PREM will collaborate in the development of a program of support and operational guidance on PRSs in fragile states, based on the results of existing research and country experiences.
- ***Coordination of post-conflict planning processes and support to recovery.*** 2005 has seen high-level attention to the international aid architecture for fragile states, with progress toward creation of the new Peace-Building Commission at the UN World Summit. The OECD Fragile States Group includes work on diplomatic, peace-keeping and development policy coherence which the Bank is supporting. The Bank has agreed to actively participate when the Peace-Building Commission is established, and will continue the work initiated with the UN Department of Peace-Keeping Operations, UN Development Group and the Office for the Coordination of Humanitarian Affairs on mechanisms to better coordinate post-conflict recovery

⁷ See Cox and Thornton. "Developing Poverty Reduction Strategies in Low-Income Countries Under Stress: Final Report," Jan 5, 2005. <http://siteresources.worldbank.org/INTLICUS/64137330-1106774683908/20588679/PRSPsinLICUS.pdf> and "Towards a Conflict-Sensitive Poverty Reduction Strategy: Lessons from a Retrospective Analysis," The World Bank, June 30, 2005, [http://lnweb18.worldbank.org/ESSD/sdvext.nsf/67ByDocName/TowardConflictSensitivePovertyReductionStrategyLessonsfromaRetrospectiveAnalysis/\\$FILE/Toward+A+Conflict+Sensitive+PRSP+FINAL+2005.pdf](http://lnweb18.worldbank.org/ESSD/sdvext.nsf/67ByDocName/TowardConflictSensitivePovertyReductionStrategyLessonsfromaRetrospectiveAnalysis/$FILE/Toward+A+Conflict+Sensitive+PRSP+FINAL+2005.pdf)

processes. OPCS, the CPR, and TFO will also conduct a further evaluation and recommendations to enhance the use of multi-donor trust funds in post-conflict situations and other fragile transitions.

- ***Partner coordination and harmonization in fragile states.*** As discussed in the note on good practice in country assistance strategies, donor coordination processes in fragile states can take a “results and resources” approach,⁸ but will often need to give strong recognition to results in the peace-building and institution-building areas; and take a broad view of resource availability and gaps, including non-aid resources such as diplomatic attention and, in some cases, peace-keeping missions. Efforts to achieve greater harmonization at the transaction level (reporting, procurement, financial management, etc.) are also particularly important in fragile states, where governments have less capacity to deal with multiple, time-consuming processes and may struggle to build core country systems in the face of the demands of fragmented donor procedures. OPCS will continue to provide support to country teams in developing approaches to partner coordination and will ensure that good practice is shared between countries and regions.

D. Institutional Reform

34. The Bank has completed a reasonably wide number of institutional reforms in the past three years to improve its response in fragile states. In particular, closer management attention to country strategy and implementation issues and the establishment of new financing instruments such as the LICUS Trust Fund have supported a strong response at the country level. However, there remain three critical gaps in the Bank’s organizational response, which will require attention over the coming period.

35. ***Human resource incentives.*** Staff in many fragile state situations have contributed intensive efforts to implement projects and support reform processes, and this has started to realize results in terms of improved project performance. However, feedback from staff continues to indicate that work in fragile states is insufficiently valued within the organization and that the level of staffing in the field is often insufficient to support the close engagement requested of the Bank by client governments and donor partners. The Bank is developing recommendations on the enhancement of human resource incentives tailored for staff posted in fragile states for Board consideration in connection with the spring 2006 Strategic Staffing Update Paper. These recommendations will cover two primary areas:

- ***Incentives for country managers.*** At quarterly reviews on the fragile states program, there is consistent agreement that decentralized country managers are critical to the success of Bank programs in fragile states: yet country manager postings in these countries are not perceived to generate strong subsequent career opportunities. The Bank will review and recommend on greater use of managed appointments and enhanced incentives for country managers in LICUS. It is expected that incentives will primarily be non-financial and related to re-entry and career development opportunities.

⁸ As laid out in the Africa Action Plan.

- ***Decentralization of staff to fragile state country offices.*** Fragile state country offices remain under-served by staff posted to the field. Over 70 percent of fragile states currently have either no internationally recruited staff (IRS) in the field or only one IRS (the Country Manager or a Liaison Officer). This is of particular concern, because hands-on support to client dialogue, policy formulation, donor coordination and implementation processes are needed to generate results in these environments, and can only be ensured by the presence of staff in the field. Recommendations will focus on the feasibility of increasing the number of decentralized internationally-recruited staff positions in fragile states.

36. ***Organizational support.*** Operational experience over recent years has indicated that fragile state programs require two types of specialized support. The first is greater staff access to the approaches and tools available to address the particular needs of fragile states. This process is already underway and needs to be further mainstreamed within regions, with support from central units through good practice and operational guidance notes, as well as staff training. In addition to the operational guidance described above, OPCS will continue to dedicate resources to staff seminars on emerging issues and will, in close coordination with SDV and PREM, develop a more comprehensive staff training program on emerging good practice in country assistance strategies, tools and approaches.

37. The second is the ability to tap specialized expertise for intensive periods when country teams are faced with new demands, such as new post-conflict settlements, the launch of major new programs in a fragile context, rising conflict risks which require rapid adjustment in the country program, or innovative programs which require assistance in design or in unblocking constraints in the Bank's policy and procedural framework. The Bank will evaluate the organizational capacity required to provide this support, and will take appropriate measures to strengthen central and regional capacity to mobilize a rapid, high quality response to country teams requiring supplementary specialized assistance and advice, in addition to carrying out external representation and institutional reform work on fragile states. The Bank will also identify any resourcing implications: if significant, these will be presented within the upcoming Medium Term Strategy and Financing Paper.

38. ***Policies, procedures and financing instruments.*** The Bank will continue to examine the performance measurement system to ensure that this adequately captures risks and improvements in the aid environment in fragile states. On-going efforts to simplify operational policies and procedures will also take into account the needs of fragile states. Many fragile states, for example, are faced with emergencies which require a rapid and flexible response from the Bank. The Bank is currently revising its emergency policies and procedures, which were developed to deal with natural disasters rather than fragile states, to improve the speed and consistency of emergency response.

IV. CONCLUSION

39. Renewed international attention to fragile states as well as increased institutional efforts within the Bank are starting to show signs of impact on the ground. Encouragement for innovation at the country level has paid off in the development of a strengthened strategic framework for assistance and new tools and approaches. However, the Bank still have much to learn about aid effectiveness in fragile states. The challenges going forward will be, first, to continue to strengthen country strategy and operational engagement, including continuing support for the most fragile LICUS, through replenishment of the LICUS Trust Fund as outlined in the accompanying paper. Second, to intensify efforts to share approaches between regions and country teams and develop new research to inform operations, with a particular focus on effectively linking Bank activities to peace-building and state-building goals. Third, to continue and strengthen international partnerships to assist fragile states, including opportunities arising from the new Peace-Building Commission, regional initiatives and work at the OECD-DAC. Last, to strengthen the Bank's organizational support and staffing systems and incentives to ensure that new approaches and partnerships can be carried through to implementation at a practical level.