Africa Group I Constituency
FY07 Interim Report
IBRD, IDA, IFC and MIGA

Mulu Ketsela
Executive Director

May 2007
# TABLE OF CONTENTS

**EXECUTIVE SUMMARY** ................................................................................................................... VII

**CHAPTER I .................................................................................................................................**

**ECONOMIC DEVELOPMENTS...............................................................................................**

1.1 Introduction ............................................................................................................................ 3

1.2 Global Developments ............................................................................................................. 3

1.3 Regional Developments ....................................................................................................... 4

1.4 Economic Outlook ................................................................................................................. 6

**CHAPTER II ............................................................................................................................**

**WORLD BANK GROUP OPERATIONS ...............................................................................**

2.1 IBRD/IDA Lending Operations during First Half of FY07............................................ 9

2.4 IFC Operations .................................................................................................................... 12

2.5 MIGA Operations ................................................................................................................. 15

**CHAPTER III ...........................................................................................................................**

**SELECTED BANK PROGRAMS AND POLICIES ..............................................................**

3.1 Towards a New Framework for Rapid Bank Response To Crises And Emergencies .................................................................................................................. 21

3.2 IFC Strategic Initiative for Sub-Sahara Africa ..................................................................... 29

3.3 Applying the Debt Sustainability Framework to Low-Income Countries Post Debt Relief .................................................................................................................. 33
3.4 Harmonization and Alignment for Greater Aid Effectiveness: Update .. 39

3.5. Global Environment Facility (GEF): Fourth Replenishment of the GEF Trust Fund.......................................................... 44

3.6 Good Practice Principles for the Application Of Conditionality: Progress Report............................................................................................................. 45

LIST OF TABLES ................................................................................................. 49

LIST OF BOXES ................................................................................................... 49

LIST OF FIGURES ............................................................................................... 49
ACRONYMS

AAA    Analytic and Advisory Activities
AAP    African Action Plan
AFDB   African Development Bank
AERC   African Economic Research Consortium
AML/CFT Anti-Money Laundering/Combating Financing of Terrorism
APDF   Africa Private Development Facility
APLs   Adjustment Program Loans
BWIs   Bretton Woods Institutions
CAS    Country Assistance Strategy
COMESA Common Market for Eastern and Southern Africa
CPIA   Country Policy and Institutional Assessment
DGF    Development Grant Facility
DPOS   Department of Policy Operations
EAP    East Asia and the Pacific
EFA    Education for All
EPAs   Economic Partnership Agreements
ESW    Economic Sector Work
EU     European Union
FATF   Financial Action Task Force
FIAS   Foreign Investment Advisory Service
FMTA   Financial Markets Technical Assistance
FSAP   Financial Sector Assessment Program
FSRB   Financial Style Regional Bodies
FDI    Foreign Direct Investment
FY03   Fiscal Year 2003 (July 2002-June 2003)
FY04   Fiscal Year 2004 (July 2003-June 2004)
GDP    Gross Domestic Product
HIPC   Highly Indebted Poor Countries
IAEs   Anti-Money Laundering Experts
IBRD   International Bank for Reconstruction and Development
IDA    International Development Association
IFF    International Finance Corporation
IFFI   International Financial Facility
IFI    International Financial Institutions
IMF    International Monetary Fund
IMFC   International Monetary and Finance Committee
LAC    Latin America and the Caribbean
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>LICUS</td>
<td>Low Income Countries Under Stress</td>
</tr>
<tr>
<td>LILs</td>
<td>Learning and Innovative Loans</td>
</tr>
<tr>
<td>MDB</td>
<td>Multilateral Development Banks</td>
</tr>
<tr>
<td>MDGs</td>
<td>Millennium Development Goals</td>
</tr>
<tr>
<td>MENA</td>
<td>Middle East and North Africa</td>
</tr>
<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
</tr>
<tr>
<td>MSME</td>
<td>Micro, Small and Medium Enterprises</td>
</tr>
<tr>
<td>NEPAD</td>
<td>New Partnership for Africa</td>
</tr>
<tr>
<td>OAD</td>
<td>Official Development Assistance</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>OP/BP</td>
<td>Operational Policy and Bank Procedure</td>
</tr>
<tr>
<td>PEP</td>
<td>Private Enterprise Project</td>
</tr>
<tr>
<td>PRGF</td>
<td>Poverty Reduction Growth Facility</td>
</tr>
<tr>
<td>PRSC</td>
<td>Poverty Reduction Support Credit</td>
</tr>
<tr>
<td>PRSP</td>
<td>Poverty Reduction Strategy Paper</td>
</tr>
<tr>
<td>ROSCs</td>
<td>Reports on the Observance of Standards and Codes</td>
</tr>
<tr>
<td>RTAs</td>
<td>Regional Trade Agreements</td>
</tr>
<tr>
<td>SIP</td>
<td>Small Investment Program</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>SMIs</td>
<td>Small and Medium Investors</td>
</tr>
<tr>
<td>SA</td>
<td>South Asia</td>
</tr>
<tr>
<td>SADC</td>
<td>Southern Africa Development Community</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>SWAPs</td>
<td>Sector Wide Approaches</td>
</tr>
<tr>
<td>UNECA</td>
<td>United Nations Economic Commission for Africa</td>
</tr>
<tr>
<td>UNFCC</td>
<td>UN Framework Convention on Climate Change</td>
</tr>
<tr>
<td>WBG</td>
<td>World Bank Group</td>
</tr>
<tr>
<td>WITS</td>
<td>World Integrated Trade Solution</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
EXECUTIVE SUMMARY
EXECUTIVE SUMMARY

Global Economic Developments

According to the IMF’s April 2007 *World Economic Outlook*, the global economy continued to grow at a robust 5.3 percent during 2006, supported by strong performance of emerging market and developing countries, and despite the high oil prices. In most OECD countries, recovery was driven by strong domestic demand which was bolstered by generally supportive financial conditions. The US economy continued to show signs of a slowdown largely due to a cooling in the housing market. The euro area posted its fastest growth in 6 years mostly due to strong domestic demand. The performance of developing countries continued to benefit from strong growth in China and India as well as the resilience in commodity prices. World trade continued to record strong growth with merchandise exports estimated to have grown by 15 percent in 2006.

Looking ahead, global economic performance seems set for a soft landing with global growth expected to moderate in 2007 and 2008 in spite of the lurking macroeconomic risks and challenges. Developing countries remain vulnerable to potential external shocks, particularly a disruptive correction of global imbalances and declines in non-oil commodity prices, or another hike in oil prices following a supply shock.

In light of these global economic developments and continuing risks, developing countries need to continue entrenching institutional frameworks for sound macroeconomic management to ensure adequate fiscal space for increased investment in infrastructure and for managing exogenous shocks. Strengthening resilience to shocks also calls for further deepening of structural reforms to diversify economic bases and foster private sector development. Without concerted efforts in these and other important areas, employment creation and achieving the millennium development goals (MDGs) will continue to be elusive.

Thus, the support of the WBG is critically important, together with engendering strong country ownership, for member countries to address critical needs and unlock the potential for sustained high rates of growth. Therefore, as discussed in Chapter II, it is a matter of concern that, at a time when the Bank and development partners are being urged to scale up aid, total commitments of the World Bank Group slowed down during the first half of FY07 when compared to the previous fiscal year.
World Bank Group Operations

IBRD and IDA Operations

IBRD new loan commitments during the first half of FY07 amounted to US$4.85 billion, some US$838 million lower than the comparable figure in FY06. Five middle income countries (Argentina, China, Colombia, India and Indonesia) accounted for 59.3 percent (US$2.83 billion) of IBRD commitments in FY07. Not a single SSA country benefited from IBRD’s lending during this period.

At US$2.89 billion, the level of IDA lending was 36 percent lower than that achieved in the first half of FY06. IDA committed US$1.19 billion to the Africa Region during the first half of FY07, which was nearly 40 percent lower than the figure for the comparable period in FY06. It is, therefore, important for the Bank to do everything possible during the second half to increase commitments, especially to Africa, in line with the 50 percent target for FY06-FY08 as agreed by IDA donors.

IFC Operations

IFC is the only WBG organization that experienced an increase in its commitments. During the first half of FY07, IFC’s total commitments amounted to US$2.70 billion, about 21 percent higher than in the first half of FY06. Disbursements were US$3.22 billion and approvals US$3.3 billion, or 51 percent and 48 percent higher, respectively, than for the first half of FY06.

For Sub-Saharan Africa, total commitments for this period were US$369 million, US$244 million higher than for the corresponding period in FY06. By the end of FY07, the IFC plans to have commitments of about US$770 million for SSA, which will be US$70 million higher than the commitments for fiscal year FY06. IFC disbursements to and approvals for SSA showed a remarkable performance during the period under review. Nonetheless, the share of commitments for SSA continues to fall short of expectations.

MIGA Operations

During the first half of FY07, MIGA issued 16 new contracts worth US$264.8 million in support of projects, representing about 30 percent of the guarantees issued (US$898.9 million) for new projects during the comparable period in FY06. MIGA’s dismal performance should in part be seen in the light of contracts amounting to US$300 million which were postponed to a later date.
Selected World Bank Group Policies and Programs

Notwithstanding the decrease in commitments to client countries, the WBG has continued to evaluate its operational policies and procedures in the light of emerging needs at country level. Chapter III discusses recent efforts in this regard.

Towards a New Framework for Rapid Response to Crises and Emergencies

Up until now, the Bank’s responses to emergency situations have been guided by its emergency policy that dates back to 1988. While its policies, processes, and organizational structure have evolved since then in response to changing circumstances, the existing framework has proven to be inadequate to support the Bank’s evolving role and the increasing emergency needs of its clients. The Bank has therefore come up with a new strategy, namely the New Framework for Rapid Bank Response to Crises and Emergencies.

The new policy sets out a framework for a more rapid and effective response to crises and emergencies that is better aligned with borrower needs and the Bank’s experience and current engagement. It supports the Bank’s complementary role to other partners, including the United Nations agencies and regional organizations, and includes provisions to facilitate the Bank’s participation in and/or support to integrated international response to crises and emergencies. It also emphasizes a strategic approach to disaster risk reduction and crisis prevention in countries prone to recurrent natural disasters or facing an elevated conflict risk.

Strengthening Response to Fragile States

The Executive Board of the World Bank in January 2006 adopted a new framework - Fragile States - Good Practice in Country Assistance Strategies –for addressing the special problems of fragile states or low income countries under stress (LICUS).

The new policy framework focuses on a) the need to provide more, and better-organized, staff support through increased field presence, callable capacity, effective institutional back-up and cross-country sharing of lessons; and, b) incentives to attract top-performing staff to work in difficult environments. It also stresses the importance of achieving results on the ground while at the same time strengthening donor coordination and harmonization.

IFC Strategic Initiative for Sub-Saharan Africa (SSA)

The IFC Strategic Initiative for Sub-Saharan Africa (SSA) for the FY04 to FY06 period was approved by the Board in August 2003. The main objective of the Initiative was to
scale-up IFC’s operations and development impact in the region by focusing on its three main pillars—improving investment climate, enhancing support to SMEs, and adoption of a proactive approach to project development to support the corporation’s investments. In December 2006 the Board reviewed progress in the implementation of the Initiative.

The overall assessment of the report is that steady progress was made in implementing the Initiative in all the three pillars and to achieve the main objectives. The IFC provided a US$30 million grant for establishing the Investment Climate Facility (ICF) initiative to support investment climate reforms in Africa. Largely funded by the IFC and UK Department of International Development (DFID), the ICF will initially commence operating with funding of US$120 million and PEP Africa will participate in implementing the Initiative’s programs.

The three main priorities of the Initiative will remain valid over the FY07-FY09 planning period. In this regard, the IFC plans to further enhance the three priorities by developing more external partnerships, improving organization effectiveness, and increasing cross-border activities.

**Review of Debt Sustainability Framework for Low-Income Countries: Additional Issues**

Following the implementation of the Highly-Indebted Poor Countries (HIPC) Initiative, and the Multilateral Debt Relief Initiative (MDRI), the debt ratios of many low income countries (LICs) have become potentially sustainable. Global concern has now turned to the question of how to ensure that these countries do not slide back into unsustainable debt situations. It is against this background that in November 2006 the Boards of the IMF and the World Bank considered a joint paper - *Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief* – which recommended general guidelines on how staff could improve the application of the Debt Sustainability Framework (DSF).

The Board of Directors endorsed most of the recommendations, placing emphasis on a case-by-case approach to assessing the pace of debt accumulation for countries with debt below the DSF thresholds.

**Harmonization and Alignment for Greater Aid Effectiveness: Update**

As a follow-up to the International Conference on Financing for Development that was held in Monterrey in 2002, the World Bank has been working with other development partners to align support with partner countries’ own priorities and strategies; harmonize donor policies and procedures to reduce transactions costs; and to manage aid resources to achieve greater development results. As part of this process, the Rome High-Level Forum of 2003 identified the general framework for harmonization and the Paris High–Level Forum on aid effectiveness outlined a detailed framework of commitments and
operational targets to be met in 2010. In November 2006, the Bank presented to the Board an update on progress in these issues at an informal meeting.

The World Bank is playing an important role in key areas of harmonization, alignment and managing for development results while at the same time joining and supporting efforts of multilateral and bilateral donors. The Bank, in collaboration with other institutions, is also supporting implementation of the Paris Declaration at the country level through regional workshops aimed at helping countries to develop and strengthen their implementation plans and monitoring systems.

While the Bank has put a great deal of efforts in the harmonization and alignment agenda, progress has been uneven and there is need to broaden and deepen the process. One area where progress has been limited is in the preparation of Memoranda of Understanding in which donors and partners governments define the framework for their cooperation in financing operations.

**The Global Environment Facility (GEF): Fourth Replenishment of the Trust Fund**

Since its inception in 1992, GEF has achieved a strong track record of support to developing countries and countries in transition, providing US$6.2 billion in grants and leveraging US$20 billion in co-financing for over 1,800 projects in 140 countries. Through its Small Grants Program (SGP), GEF has also made more than 7,000 small grants, up to US$50,000 each, directly to nongovernmental organizations and community organizations.

The third GEF Assembly met in Cape Town, South Africa, in August, 2006 where the world’s largest environmental funding body – Global Environment Facility – received its biggest ever financial boost with governments agreeing to contribute US$3.13 billion to finance environmental projects over the next four years.

**Good Practice Principles for the Application of Conditionality: A Progress Report**

Following a request by the Development Committee (DC) in October 2004, the Bank undertook an extensive review of conditionality focusing on the rationale for and modalities of conditionality in policy-based lending (now known as Development Policy Lending) as well as trends and key challenges in the application of conditionality. The key findings of the review were endorsed by the DC in September 2005. One of the key recommendations of the review called on the Bank to implement five key principles to strengthen the quality of the Bank’s application of operational policy for development policy lending. A progress report was presented to the Board in November 2006.
The overall conclusion of the review was that the Bank’s recent practice in the use of conditionality was broadly consistent with the best practice. Most Bank programs supported country ownership by ensuring alignment with government priorities and customizing them to country circumstances. Moreover, they made frequent use of opportunities for harmonization, and in most cases only highlighted critical actions as conditions. They also responded to government needs for predictability of financing decisions. However, while satisfactory progress was made, many challenges remain and the review identified the important areas where further improvement will be required.
CHAPTER I
CHAPTER I

ECONOMIC DEVELOPMENTS

1.1 Introduction

Chapter 1 reviews the major economic developments in 2005/2006 and prospects for 2007/2008 in the global economy and other regions of the world, with particular emphasis on Sub-Saharan Africa. This section also assesses future economic prospects.

1.2 Global Developments

According to the IMF’s April 2007 World Economic Outlook, the global economy continued to grow at a robust pace during 2006 recording an estimated impressive 5.3 percent supported by strong performance of emerging market and developing countries. Domestic demand drove the recovery in most OECD countries bolstered by high commodity prices and generally supportive financial conditions. This performance was achieved in spite of the relatively high international prices of oil that prevailed for a greater part of 2006. During the review period, the euro area also bounced-back, posting its fastest growth in 6 years. There was pick-up in economic activity in other regions and countries as well, including China and India, which continued to post remarkable growth rates. World trade continued to record strong growth with merchandise exports estimated to have grown by 15 percent during 2006 compared to the year before.

The world economy is expected to continue on its rapid expansion pace in 2007 albeit at lower pace to around 4.9 percent as a result of an expected slowdown in economic activity in the US and Europe. The US economy, accounting for about 20 percent of global GDP, continued to show signs of slowing down as a result of the prospects of a cooling in its housing market, although private consumption remained robust.

Emerging markets are expected to post strong growth rates, supported by the relatively buoyant commodity prices. The high international price of oil – with prices expected to remain around the US$60 level through 2008 – has significantly contributed to the performance of most oil exporting countries.
Developing countries remain vulnerable to potential external shocks, particularly a disruptive resolution of global imbalances and declines in non-oil commodity prices, or a hike in oil prices following a supply shock. Global imbalances, therefore, continue to pose the biggest threat to the global economy. The specter of inflation was subdued in most developing countries in spite of the relatively high international prices of oil with most major central banks adopting, albeit cautiously, tight monetary policy stances to deal with inflationary pressures. The inflationary push resulted in some countries tightening their monetary policies during the year, although the pressures subsided towards the end of the year due to the easing in international commodity prices.

![Figure 1.1](image)


### 1.3 Regional Developments

#### Industrial Countries

Economic performance in the euro area rose by 2.8 percent in 2006, twice the pace of the previous year. Economic developments in most European countries have been supported by strong fundamentals underpinned by buoyant domestic demand and employment growth. Unemployment in the euro area was at its lowest in 15 years, with unemployment falling to 7.6 percent at the end of 2006. The accommodative macroeconomic policy in Europe boosted consumer confidence and saw the region posting the fastest growth rate in 6 years. The European performance was buoyed by special circumstances. In particular, Germany’s hosting of the world cup and anticipation of the introduction of the Value Added Tax (VAT) in 2007, boosted consumption expenditure in that country. The European Central Bank and other regional central banks remained vigilant in containing the inflationary pressures emanating from continuing high oil prices.
The US economy rallied towards the end of 2006 supported by a strong fourth quarter performance which was spurred by strong holiday consumer expenditure, improved employment performance and real incomes. Performance of the housing sector remained lackluster, putting a damper on growth prospects, and this was exacerbated by the poor performance of the manufacturing sector. Growth was estimated at 3.4 percent in 2006, and is expected to be slightly lower at 2.6 percent in 2007.

Japan’s growth rose by 2.2 percent in 2006 after going through a soft patch in the middle of the year as a result of unexpected decline in consumption expenditure. Monetary policy remained in a cautious mode to support the implementation of productivity enhancing reforms needed to sustain the growth.

**Emerging Markets and Developing Countries**

Developments in most emerging markets remain strong, punctuated by the risks associated with large current account deficits and rapid credit expansion particularly in emerging Europe. However, having accelerated to 6.0 percent in 2006, emerging Europe is also expected to slowdown to 5.25 percent in 2007. This sub-region is expected to benefit from increased FDI inflows coming with increased integration with the European Union. The accession to the EU by a number of these countries brought economies of scale, opening new trade and investment opportunities and also engendered macroeconomic and institutional reforms. The better performance of Western Europe, particularly German, the regions’ dominant trading partner, also played a significant part in this performance.

Latin America is projected to slowdown to 4.5 percent in 2006 compared to 5 percent the year before, driven by the expected benign global economic prospects and moderation of commodity prices from their high levels of 2006.

**Sub-Saharan Africa**

The performance of Sub Saharan Africa (SSA) remained strong as it benefited from the progress made in the introduction and implementation of macroeconomic reforms, marking a clear and sustained departure from lackluster performance in the last two decades. Real GDP growth is estimated to have risen to 6.2 percent in 2006 from 5.4 percent in 2005. The economies benefited from the strong international prices of commodities and a surge in capital inflows. Inflation remained in single digit levels in most countries, in spite of the surge in the international price of oil during the year.

The sub-continent has continued to register positive growth rates and sustained growth momentum with a number of countries recording double-digit growth rates for the past few years. This exceptional performance reflected improved and stable
macroeconomic conditions, continued implementation of strong structural and institutional reforms, including strengthening governance in public finance management.

1.4 Economic Outlook

Future global economic performance is expected to moderate in 2007 and 2008 in spite of the lurking macroeconomic risks and challenges. In the US, growth is expected to be slightly lower at 2.6 percent in 2007. Growth in the euro area is expected to stabilize around 2.3 percent in 2007 and to remain largely unchanged in 2008. In Japan, growth in 2007 is expected to be slightly above the 2 percent level with prospects hinging on the performance of the global economy.

Despite the positive growth prospects for SSA, challenges still remain if higher and sustained levels of growth are to be achieved. The region badly needs increased investments in infrastructure, particularly in transport and energy sectors. There is also urgent need to improve public expenditure management systems to ensure effective expenditure and financial controls that are essential for the delivery of quality services. Unless significant progress in infrastructure investment is made, the region will remain highly susceptible to adverse climatic outcomes, abrupt unwinding of global imbalances, and the cyclical nature and volatility of international prices of commodities. These factors place a considerable premium on the need for further reforms and diversification of economies in the sub-continent.
CHAPTER II
CHAPTER II

WORLD BANK GROUP OPERATIONS

2.1 IBRD/IDA Lending Operations during First Half of FY07

The World Bank provides financial support to its middle income member countries through IBRD loans and to the low income member countries through IDA credits and grants. The following section provides an overview of Bank operations during the first half of the fiscal year ending June 30, 2007.

The total IBRD/IDA lending commitments dropped by about 24 percent from US$10.21 billion in the first half of FY06 to US$7.74 billion in the corresponding period of FY07. Commitments by IBRD and IDA decreased by about 14 percent and 36 percent, respectively. In contrast, gross disbursements by IBRD went up by US$424 million whereas IDA’s dropped by as much as US$870 million. Thus, IBRD/IDA gross disbursements in the first half of FY07 were US$455 million less than in FY06. Combined IBRD/IDA net disbursements were negative US$2.31 billion in the first half of FY07 compared to positive US$2.85 billion in the same period in FY06. The major factor behind this development is the large debt prepayments of some middle income countries including Mexico.

Table 2.1: Summary of IDA and IBRD Lending Operations (US$ million)

<table>
<thead>
<tr>
<th></th>
<th>IBRD Actual</th>
<th>IDA Actual</th>
<th>Total IBRD/IDA</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY06 (1st Half)</td>
<td>FY07 1st Half</td>
<td>FY06 1st Half</td>
</tr>
<tr>
<td>Commitments</td>
<td>5,686</td>
<td>4,848</td>
<td>4,528</td>
</tr>
<tr>
<td>Gross Disbursements</td>
<td>5,838</td>
<td>6,252</td>
<td>4,670</td>
</tr>
<tr>
<td>Net Disbursements</td>
<td>(767)</td>
<td>(5,124)</td>
<td>3,620</td>
</tr>
</tbody>
</table>

Source: World Bank Database
Underlying this downward trend is the fact that the number of projects fell from 128 in the first half of FY06 to 106 in the current fiscal year. These are worrisome developments when viewed against the urgent need to ensure increased resource flows towards the Millennium Development Goals (MDGs) and the substantial increase in IDA 14 resources.

2.1.1 IBRD Lending Operations

IBRD new loan commitments during the first half of FY07 amounted to US$4.85 billion, some US$838 million lower than the comparable figure in FY06. The commitments in FY07 represented between 35 percent and 40 percent of projected commitments during the year. Five middle income countries, namely, Argentina, China, Colombia, India and Indonesia, accounted for 59.3 percent (US$2.83 billion) of IBRD commitments in FY07 (Table 2.2). Not a single Sub-Sahara Africa country benefited from IBRD’s lending during this period.

Table 2.2: Countries with Highest IBRD Lending Commitments (US millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>FY06</th>
<th>FY07</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>480</td>
<td>738</td>
</tr>
<tr>
<td>China</td>
<td>580</td>
<td>600</td>
</tr>
<tr>
<td>Argentina</td>
<td>215</td>
<td>595</td>
</tr>
<tr>
<td>Colombia</td>
<td>300</td>
<td>500</td>
</tr>
<tr>
<td>India</td>
<td>343</td>
<td>400</td>
</tr>
</tbody>
</table>

IBRD’s lending to middle income countries in Africa remains at its lowest level in several decades. Measures necessary to better respond to the diverse needs of these countries need to be further strengthened. Some of the measures under consideration include customization of innovative financing mechanisms, revising the cost structure of IBRD, reducing transaction costs partly through the use of country systems and expanding knowledge and advisory services tailored to individual country needs.

2.1.2 IDA Lending Operations

At US$2.89 billion, or between 26 percent and 32 percent of the projection range for FY07, the level of IDA lending was lower than that achieved in the first half of FY06 as well as in the previous 5 fiscal years. IDA committed US$1.21 billion (42 percent) to the South Asia Region and US$1.19 billion (41 percent) to the Africa Region during the first
half of FY07 (Table 2.3). However, expectations were that lending volumes to Africa would pick up considerably during the second half of FY07.

Table 2.3: IDA Commitments by Region (US$ millions)

<table>
<thead>
<tr>
<th>Region</th>
<th>FY06 1st Half</th>
<th>Share %</th>
<th>FY07 1st Half</th>
<th>Share %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>1,950</td>
<td>43.1</td>
<td>1,188</td>
<td>41.1</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>507</td>
<td>11.2</td>
<td>198</td>
<td>6.9</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>183</td>
<td>4.0</td>
<td>156</td>
<td>5.4</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>162</td>
<td>3.6</td>
<td>78</td>
<td>2.7</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>182</td>
<td>4.0</td>
<td>62</td>
<td>2.1</td>
</tr>
<tr>
<td>South Asia</td>
<td>1,544</td>
<td>34.1</td>
<td>1,206</td>
<td>41.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,528</strong></td>
<td><strong>100.0</strong></td>
<td><strong>2,888</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: World Bank Database

About 36 percent (37 percent in FY06) of IDA’s gross disbursements during the first half of FY07 went to 5 countries, including Tanzania and Nigeria from Africa Group I Constituency (Table 2.4).

Table 2.4: Countries with Highest IDA Disbursements (US millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>FY06</th>
<th>FY 07</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>663</td>
<td>528</td>
</tr>
<tr>
<td>Tanzania</td>
<td>207</td>
<td>297</td>
</tr>
<tr>
<td>Nigeria</td>
<td>156</td>
<td>198</td>
</tr>
<tr>
<td>Pakistan</td>
<td>394</td>
<td>187</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>327</td>
<td>170</td>
</tr>
<tr>
<td><strong>Share of Total IDA Commitments (Percent)</strong></td>
<td><strong>36.8</strong></td>
<td><strong>36.3</strong></td>
</tr>
</tbody>
</table>

Source: World Bank Database

2.1.3 IDA Grants

Total IDA grants during the first half of FY07 were US$473 million (Table 2.5) or about 59 percent of the amount in FY06. Africa received 58 percent of the grants in FY07 with
Burundi, Democratic Republic of Congo (DRC) and Rwanda accounting for the bulk (55 percent). Countries in Africa Group I Constituency received US$115.8 million (24.5 percent) which was close to the amount received in FY06.

Table 2.5: IDA Grants by Region in FY07 (H1)

<table>
<thead>
<tr>
<th>Region</th>
<th>US$ Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Africa:</strong></td>
<td></td>
</tr>
<tr>
<td>Burundi</td>
<td>273</td>
</tr>
<tr>
<td>Congo, D.R.</td>
<td>60</td>
</tr>
<tr>
<td>Comoros</td>
<td>82</td>
</tr>
<tr>
<td>Gambia, The</td>
<td>5</td>
</tr>
<tr>
<td>Lesotho</td>
<td>12</td>
</tr>
<tr>
<td>Liberia</td>
<td>12.3</td>
</tr>
<tr>
<td>Malawi</td>
<td>5</td>
</tr>
<tr>
<td>Niger</td>
<td>16.5</td>
</tr>
<tr>
<td>Rwanda</td>
<td>10</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>10</td>
</tr>
<tr>
<td><strong>East Asia</strong></td>
<td><strong>3.5</strong></td>
</tr>
<tr>
<td><strong>ECA</strong></td>
<td><strong>45</strong></td>
</tr>
<tr>
<td><strong>LAC</strong></td>
<td><strong>6</strong></td>
</tr>
<tr>
<td><strong>SAR</strong></td>
<td><strong>145</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>473</strong></td>
</tr>
</tbody>
</table>

Source: World Bank Database

2.4 IFC Operations

2.4.1 Commitments, Disbursements and Approvals

During the first half of FY07, IFC’s total commitments amounted to US$2.70 billion, about 21 percent higher than in the first half of FY06. Disbursements were US$3.22 billion and approvals were US$3.3 billion, both of which were 51 percent and 48 percent higher than for the first half of FY06, respectively.

2.4.2 Regional Breakdown

Table 2.6 below compares the regional breakdown of IFC’s committed portfolio for this reporting period to the same reporting period in the previous fiscal year.
Table 2.6: Commitments, Disbursements and Approvals

<table>
<thead>
<tr>
<th>Region</th>
<th>Commitments FY06 Q1-2</th>
<th>Disbursements FY06 Q1-2</th>
<th>Approvals FY06 Q1-2</th>
<th>Commitments FY07 Q1-2</th>
<th>Disbursements FY07 Q1-2</th>
<th>Approvals FY07 Q1-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSA</td>
<td>125</td>
<td>139</td>
<td>119</td>
<td>369</td>
<td>174</td>
<td>505</td>
</tr>
<tr>
<td>Asia</td>
<td>354</td>
<td>456</td>
<td>579</td>
<td>802</td>
<td>786</td>
<td>927</td>
</tr>
<tr>
<td>ECA</td>
<td>684</td>
<td>846</td>
<td>629</td>
<td>483</td>
<td>981</td>
<td>703</td>
</tr>
<tr>
<td>LAC</td>
<td>810</td>
<td>543</td>
<td>628</td>
<td>628</td>
<td>837</td>
<td>812</td>
</tr>
<tr>
<td>MENA</td>
<td>115</td>
<td>131</td>
<td>246</td>
<td>349</td>
<td>358</td>
<td>295</td>
</tr>
<tr>
<td>World</td>
<td>5</td>
<td>17</td>
<td>30</td>
<td>71</td>
<td>78</td>
<td>57</td>
</tr>
<tr>
<td>Total</td>
<td><strong>2,093</strong></td>
<td><strong>2,131</strong></td>
<td><strong>2,224</strong></td>
<td><strong>2,071</strong></td>
<td><strong>3,215</strong></td>
<td><strong>3,298</strong></td>
</tr>
</tbody>
</table>

Source: World Bank Database

For Sub-Saharan Africa, total commitments for this period totaled US$369 million, which is US$244 million higher than the comparable figure in the previous fiscal year. By the end of fiscal year FY07, the IFC plans to have committed US$770 million for SSA, which will be US$70 million higher than the commitments for fiscal year FY06. Nonetheless, the share of commitments for SSA continues to fall short of expectations.

However, IFC disbursements to and approvals for SSA showed a remarkable performance during the period under review. Disbursements and approvals increased to US$174 million and US$505 million from US$139 million and US$119 million, respectively, in the first half of FY06. Similar performance was achieved in other regions such as Asia, Europe and Central Asia (ECA) and Latin America (LAC).

With respect to committed portfolio by sector, the IFC continues to be heavily concentrated in the finance and insurance sector, followed by utilities. IFC’s investments in the Oil, Gas and Mining sector also continues to grow. Within SSA, IFC’s work continues to be heavily concentrated in Nigeria and South Africa.

### 2.4.3 Cancellations and Prepayments

During the first half of FY07, cancellations and prepayments (DCPs) totaled US$1.27 billion, compared to US$1.19 billion over the same reporting period in 2006. The main reasons for cancellations and prepayments in projects were the availability of alternative financing and other reasons such as expiration of the disbursement period. IFC will no longer present information on droppages following a decision to focus on commitments as the key measure of program performance.

---

1 Totals may not add due to rounding.
2.4.4 Financial Results and Portfolio Performance

During the first half of FY07, IFC generated income of US$2.07 billion before expenditures for its technical assistance programs (TAAS) and net gains (losses) on non-trading financial instruments. The comparable figure in FY06 was US$949 million. The Corporation recorded expenditures for TAAS of US$39 million during the review period compared with US$30 million in the first half of FY06. As a result, operating income totaled US$2.03 billion, representing 139 percent of the FY07 budget, and as compared with US$919 million in the first half of FY06.

During this period, realized capital gains from equity sales totaled US$1.61 billion, as compared to US$577 million during the corresponding period in FY06. In the first half of FY07, seven investments accounted for 81 percent of the realized gains.

In general, IFC’s FY07 operating performance continued its recent strong trend. This is in part due to the significant gains from its equity investments. Also, the overall quality of the loan book and equity investments has further improved, resulting in a small release of provision for losses on loans and guarantees. It is hoped that these high record profits will translate into increased portfolio commitments for frontier regions particularly SSA.

2.4.5 Private Enterprise Partnership for Africa (PEP Africa)

Technical Assistance is central to IFC’s strategy in SSA, and it underpins the development impact the Corporation needs to achieve in its investment program. The IFC Africa Department’s integrated investment, technical assistance and advisory services (TAAS) strategy has bolstered investment volumes, widened client access to non-financial services and increased donor support. Recent examples of this are:

- Access Bank Nigeria (value offering: entrepreneurship and banking for women);
- Lonmin, South Africa (value offering: increasing women’s participation in mining, community development and SME linkages);
- Kenya-Uganda Railway concession (value offering: SME linkages)

Table 2.7 illustrates PEP Africa’s performance to date.
Table 2.7: PEP Africa – Update as at December 31, 2006

<table>
<thead>
<tr>
<th>Indicators</th>
<th>FY07 Target</th>
<th>FY07 Q1-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of programs launched</td>
<td>24</td>
<td>22</td>
</tr>
<tr>
<td>Country coverage</td>
<td>20</td>
<td>14</td>
</tr>
<tr>
<td>Donor funds committed (US$)</td>
<td>US$42</td>
<td>US$46</td>
</tr>
<tr>
<td>Number of core staff</td>
<td>46</td>
<td>46</td>
</tr>
<tr>
<td>Number of program staff</td>
<td>60</td>
<td>28</td>
</tr>
</tbody>
</table>

Source: World Bank Database

Donors and private foundations have committed US$46 million toward PEP Africa programs that improve the investment climate, mobilize private investment and strengthen the SME sector. The IFC Africa region has shifted from program development to program implementation, with the number of TA programs remaining constant at 22. As of December 31, 2006, PEP Africa had secured program funding commitments from donors amounting to US$15.7 million. A further US$0.9 million in program funding has also been approved.

We continue to see a marked improvement since the IFC embarked on this strategy to integrate its investment, technical assistance and advisory services (TAAS) activities. IFC should also strengthen its assistance to countries in order to promote Public Private Partnerships and to leverage on its wide engagement with private sector players across the region. IFC also needs to strengthen the capacity of domestic technical assistance providers. This is going to be an important element as the corporation’s activities expand in SSA.

2.5 MIGA Operations

2.5.1 Guarantees

On gross basis, MIGA’s guarantees stood at US$4.75 billion, about 13 percent lower than the comparable figure in FY06. Net guarantees amounted to US$3.04 billion in the first half of FY07 against US$3.25 billion during the comparable period the previous year. At this pace, MIGA’s performance in FY07 is likely to be below that in FY06.

During the first half of FY07, MIGA issued 16 new contracts worth of US$264.8 million in support of 11 projects, compared to US$898.8 million issued for 18 new projects during the same period in FY06. Of the projects supported, 5 were located in frontier countries, 3 were of South-South investments, 3 were infrastructure projects, and
3 were underwritten by the Small Investment Program (SIP) in support of small and medium enterprises (SMEs). The amount of new guarantees signed during the first half of FY07 represents approximately 30 percent of the comparable amount for the previous fiscal year. Much of this decline, however, is attributable to the US$300 million of contracts relating to the Bosnia S.A, the signing of which was postponed at the investor’s request.

With respect to Sub-Saharan Africa, MIGA continued to maintain a low profile as it guaranteed 3 projects only – Cameroon, Mozambique and Uganda - during the period under review. The agency had guaranteed 2 projects during the first half of FY06 and 3 projects in same period in FY05. The project in Cameroon was executed under the Small Investment Program (SIP) and, as such, was supported by US$1.8 million insurance. It involves the strengthening of a local bank’s balance sheet to help it transition from a savings and loan institution to a full-fledged commercial bank with an investment banking capability. In Mozambique, the agency provided a guarantee worth US$37.4 million for a project in the oil and gas sector. An infrastructure project in Uganda obtained a MIGA guarantee of US$39.6 million.

As it stands now, it appears that Africa is not benefiting from the services of the agency as might be expected, despite the region’s relatively huge demand for political-risk insurance. This undesirable situation should provide a strong case for the agency to reconsider its engagement approach in the region.

2.5.2 Cancellations

During the second quarter of the year, there was US$532.4 million in portfolio runoff, of which US$408.5 million was due to cancellations, and US$123.9 million due to replacements, reductions, expiries, and translation adjustments. Much of the second quarter cancellations are largely driven by the termination of contracts in respect of three large projects, two of which were in the infrastructure sector - one in Bulgaria (US$200 million) and the other in the Philippines (US$60 million).

As to the pattern of cancellations, 70 percent were due to repaid loans, followed by 13 percent each for changes in the client's corporate strategy and the sale of projects to new investors who opted not to keep MIGA's coverage. Cancellations attributed to the client's reassessment of the political risk environment and loan repayments are normal for the industry and reflect the nature of the business. These trends also underscore the role that political risk insurance plays in helping attract investments into countries where investors' risk perceptions were initially high, but changed after a few years. At the end of the second quarter, 56 percent of cancellations occurred after the fourth year of the contract, 22 percent occurred at the third anniversary, and the same amount of cancellations occurred prior to the third anniversary of the contract date.
2.5.3 Non-Guarantee Activities

During the first-half of FY07, MIGA received 2 new claims and continued to work on pending claims in Argentina and the Kyrgyz Republic and monitored several investment disputes which may give rise to claims. MIGA received a claim arising from a long standing dispute between its guarantee holder and the government of Egypt. The other claim was filed by a guarantee holder for a power project in Nicaragua, on the assertion that it has been expropriated. With regard to the pending claims, MIGA's guarantee holder and the government of the Kyrgyz Republic continued to work on meeting the conditions to the settlement reached following meetings with MIGA in August 2006. The second pending issue relates to a claim made to MIGA in 2005, involving a toll road investment in Argentina. A third project in Argentina is currently in arbitration and may give rise to a breach of contract claim.

During the period, MIGA was also engaged in negotiating and consulting with affected guarantee holders and relevant government officials in respect of several disputes in Guatemala, Nicaragua, Mauritania, Mozambique, Senegal, and Venezuela. One of these disputes involves issues related to expropriation, 4 involve breach of contract, and 2 involve transfer convertibility issues.

Technical Assistance (TA) constitutes the other major non-guarantee activity of the agency. Basically, MIGA’s TA program addresses the basic operational challenges faced by Investment Promotion Intermediaries (IPIs) in developing countries. At the end of the period, MIGA’s TA portfolio consisted of 41 projects, covering some 28 countries, i.e., 8 in Africa, 6 in Asia, 5 in Europe and Central Asia (ECA), 4 in Latin America and the Caribbean (LAC), and 4 in Middle East and North Africa (MENA).

The African countries that benefited from MIGA’s TA include: Ghana (needs assessment), Lesotho (capacity building), Liberia (needs assessment), Mali (capacity building), Namibia (investment legislation, institutions), Sierra Leone (restructuring and capacity building), and Uganda (investor outreach program).

Also, during the period, the agency released a new regional report, known as Snapshot Africa. The report displays the results of a study conducted by MIGA, comparing the operating costs and conditions for investors in 6 industries in 9 Sub-Saharan African countries: Ghana, Kenya, Lesotho, Madagascar, Mali, Mozambique, Senegal, Tanzania, and Uganda. The study examines the attractiveness of 6 sectors from the vantage point of investors -- textile, apparel, food and beverage processing, horticulture, tourism and call centers - which are sectors attracting the highest level of mobile FDI in sub-Saharan Africa. It examines also numerous thriving investments, underscoring the untapped potential of these sectors.
For prospective investors, *Snapshot Africa* provides information on investor costs and conditions in the above-mentioned sectors, and can assist them to develop their site selection options. The study can be found online at http://www.fdi.net/documents/WorldBank/databases/snapshot-africa/.
CHAPTER III

SELECTED BANK PROGRAMS AND POLICIES

3.1 Towards a New Framework for Rapid Bank Response To Crises And Emergencies

The World Bank Group has recently embarked on a new strategy, known as the *New Framework for Rapid Bank Response to Crises and Emergencies*, which is a comprehensive approach to dealing with crisis and emergency situations that are increasingly affecting client countries. Since its inception and especially in the past 20 years, the Bank has been responding to an increasing number of emergencies, including natural disasters (such as the Indian Ocean Tsunami), post-conflict reconstruction, pandemics (e.g., averting outbreaks of avian flu), and man-made disasters (such as oil spills). Bank assistance is usually channeled through multi-donor trust funds administered internally. The Bank’s responses to emergency situations have been guided by its emergency policy that dates back to 1988. However, its policies, processes, and organizational structure have evolved in response to changing circumstances. However, these have proven to be inadequate to support the Bank’s evolving role and the increasing emergency needs of its clients.

The main impetus for the change was the universal recognition that there has been an insufficient emphasis on approaching disasters strategically, taking into account the differing vulnerabilities of client countries, and focusing more on disaster prevention. Many of the problems identified could be linked to the following deficiencies in the current policy and procedural framework governing emergency operations: (a) absence of a truly rapid response to emergency situations; (b) insufficient financial and implementation assistance to countries in the critical early stages of recovery; (c) narrow definition of “emergency”; (d) lack of focus on social aspects of emergency assistance through its almost exclusive emphasis on physical reconstruction; (e) limited flexibility in dealing with other donors in supporting comprehensive recovery programs; and (f) inadequate attention to prevention and mitigation of future disasters as part of the borrower’s development strategy.

Thus, in the light of the Bank’s evolving role and the growing demands for it to respond rapidly and effectively to crises and emergencies, it was considered appropriate
and timely to make changes in the Bank’s emergency policy and procedures to improve the flexibility, speed, and effectiveness of the Bank’s rapid response and adopt a strategic approach to disaster risk reduction and crisis prevention in high risk.

The new policy sets out a framework for a more rapid and effective response to crises and emergencies that is better aligned with borrower needs and the Bank’s experience and current engagement. It supports the Bank’s complementary role to other partners, including the United Nations agencies and regional organizations, and includes provisions to facilitate the Bank’s participation in and/or support to integrated international response to crises and emergencies. It also emphasizes a strategic approach to disaster risk reduction and crisis prevention in countries prone to recurrent natural disasters or facing an elevated conflict risk.

To improve flexibility, speed, and effectiveness, the new policy introduces, among other things, the following key changes:

- a revised emergency definition which focuses on the impact rather than the cause and enables coverage of a wider range of actual or imminent crises and disasters;
- clarification of areas for Bank support to include preservation of human, social, and institutional capital and facilitating peace-building; the ability to finance up to 100 percent of the expenditures needed to meet the development objectives of emergency operations, including recurrent expenditures, local costs and taxes;
- the ability to include retroactive financing of up to 40 percent of the loan amount for payments made by the borrower not more than 12 months prior to the expected date of signing the legal documents;
- the availability of a Project Preparation Advance (PPF) of up to US$5 million (instead of US$2 million available previously) to cover start-up emergency response activities, and the provision of such PPF advances on grant terms to countries at high risk of debt distress which are eligible for IDA financing on grant terms only;
- the introduction of a fast-disbursing contingent loan to respond to future emergencies in countries at high risk for recurring disasters that are determined by the Bank to have appropriate institutional and implementation capacity for disaster response;
- where appropriate, and in response to the borrower’s request and in line with the Bank’s guiding principles, the ability to:
  a) extend such assistance to all borrower agencies and institutions involved in the emergency recovery effort; and/or
  b) support, in partnership with other donors, an integrated emergency recovery program that includes activities outside the Bank’s traditional areas, such as relief, security and specialized peace-building activities; and
when responding to crises and emergencies in countries that have insufficient capacity to implement start-up activities, the ability to accept, at the request of the borrower, alternative implementation arrangements for such activities, including grants to any public or private entity operating in the affected territory as well as grants to UN agencies or programs or other international or national agencies, including Non-Governmental Organizations (NGOs) active in the country.

- In exceptional circumstances, where no viable implementation alternatives exist, the Bank may also agree to implement, on behalf, and at the request of the recipient, all or part of start-up activities under a PPF extended on grant terms or under a trust fund grant for such activities.

The new policy applies to emergency operations submitted for the approval of the Executive Board on or after March 1, 2007. However, to permit an orderly transition, emergency operations under preparation in response to borrower requests for emergency assistance received by the Bank before March 1, 2007 may be processed under the old operational and budget policies.

3.1.1 Strengthening Response to Fragile States

Addressing special problems of Fragile States or Low Income Countries under Stress (LICUS) has become one of the most important priorities for the World Bank in recent years. Fragile States account for two-thirds of the world’s poor and constitute about half of the countries eligible for IDA assistance. This group of countries has twice the income poverty and child mortality rates of all low income countries. These countries are characterized not just by low-income, conflict and instability, but also by associated humanitarian crises such as the problem of refugees.

The World Bank identifies Fragile States by their weak performance as measured by the Country Policy and Institutional Assessment (CPIA). Generally, fragile states have a CPIA rating of up to 3.2 points. These countries:

(i) Have weak policy institutions and state capacities to deliver services to their citizens, to control corruption, or to provide for sufficient voice and accountability; and,

(ii) Face risks of conflict and political instability. Of the 26 countries with intermediate or worse civil conflicts between 1992 and 2002, 21 were classified as LICUS.

Fragile states pose risks of contagion to neighboring countries and the global community through the spread of conflict and organized crime, refugee flows, epidemic
diseases, and barriers to trade and investment. Therefore, improving the international response in these countries is a critical development challenge. Because of the intense and structural nature of problems facing them, the Bank’s engagement in these countries tends to be on a long-term basis in order to effectively respond to country needs.

3.1.2 Classification

Fragile States have also been classified according to levels of fragility:

(i) **Post-Conflict or Political Transition**: Characterized by high fluidity in the policy environment, availability of opportunities for rapid reform, and potential to scale up financial assistance. Bank interventions in such countries are often in cooperation with other international actors, especially in peace-keeping and humanitarian activities.

(ii) **Countries Undergoing Gradual Improvement**: Characterized by the presence in government of some pro-reform leaders, but facing entrenched systems which make change difficult, and general conditions are liable to periodic setbacks.

(iii) **Countries in Deterioration**: Characterized by sharp deterioration in governance or rising risk of conflict.

(iv) **Countries in Prolonged Crisis or Impasse**: Characterized by prolonged conflict or domestic political impasse, often with the presence of arrears of debt to the World Bank Group and other multilateral financial institutions. Generally, these countries have no access to new lending but may benefit from small grant-based programs.

As at end-December 2006, there were 45 fragile states, out of which 25 were in Africa (Table 3.1).
Table 3.1: African and Non-African Fragile States

<table>
<thead>
<tr>
<th>African States</th>
<th>Non-African States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Angola</td>
<td>Afghanistan</td>
</tr>
<tr>
<td>Cameroon</td>
<td>Cambodia</td>
</tr>
<tr>
<td>Burundi</td>
<td>Georgia</td>
</tr>
<tr>
<td>Central Africa Republic</td>
<td>Haiti</td>
</tr>
<tr>
<td>Chad</td>
<td>Kyrgyz Republic</td>
</tr>
<tr>
<td>Comoros</td>
<td>Kosovo</td>
</tr>
<tr>
<td>Congo, Democratic Republic</td>
<td>Lao PDR</td>
</tr>
<tr>
<td>Congo, Republic</td>
<td>Lebanon</td>
</tr>
<tr>
<td>Cote d'Ivoire</td>
<td>Mongolia</td>
</tr>
<tr>
<td>Djibouti</td>
<td>Myanmar</td>
</tr>
<tr>
<td>Eritrea</td>
<td>Nepal</td>
</tr>
<tr>
<td>Gambia, The</td>
<td>Papua New Guinea</td>
</tr>
<tr>
<td>Guinea</td>
<td>Solomon Islands</td>
</tr>
<tr>
<td>Guinea-Bissau</td>
<td>Tajikistan</td>
</tr>
<tr>
<td>Liberia</td>
<td>Timor-Leste</td>
</tr>
<tr>
<td>Mauritania</td>
<td>Tonga</td>
</tr>
<tr>
<td>Niger</td>
<td>Uzbekistan</td>
</tr>
<tr>
<td>Rwanda</td>
<td>Vanuatu</td>
</tr>
<tr>
<td>Sao Tome and Principe</td>
<td>West Bank and Gaza</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>Yemen Republic</td>
</tr>
<tr>
<td>Somalia</td>
<td></td>
</tr>
<tr>
<td>Sudan</td>
<td></td>
</tr>
<tr>
<td>Togo</td>
<td></td>
</tr>
<tr>
<td>Zimbabwe</td>
<td></td>
</tr>
</tbody>
</table>

3.1.3 The New Initiative

The Executive Board of the World Bank in January 2006 considered a report on *Fragile States - Good Practice in Country Assistance Strategies (GPCAS)* and adopted its policy recommendations. The new policy framework focuses on a) the need to provide more, and better-organized, staff support through increased field presence, callable capacity, effective institutional back-up and cross-country sharing of lessons; and, b) incentives to attract top-performing staff to work in the difficult environments. It also stresses the importance of achieving results on the ground while at the same time strengthening donor coordination and harmonization.
3.1.4 Enhanced Staffing and Organizational Support

**Increased field presence:** The new scheme replaces the “mission model” with the “field presence model”. In recognition of the need for intensive supervision to ensure successful project implementation as well as the importance of timely interventions, a larger team of Bank staff will now be stationed in each fragile state as against the existing practice of periodic visits from Washington or the Regional Offices. It has also been recognized that field staff need to be multi-skilled to appropriately respond to evolving issues and needs. Moreover, it is now accepted that a minimum number of internationally recruited staff (IRS) needs to be mixed with locally recruited staff (LRS) for effectiveness. The new model will be flexible and will use annual reviews to identify needs for field presence in fragile states on a case-by-case basis.

**Callable Surge Capacity:** In addition to strengthened field presence, and having regard to the volatile nature of the situation in fragile states, the new model provides for a reserve of surge capacity from which additional skilled personnel could be deployed to fragile states on short notice, as the situation arises. While some of the callable staff may be based at the Head Office, others will be based in the regions. To add further flexibility to the system without overstretching the in-house skills, a roster of callable rapid response and emergency consultants will also be maintained.

**Institutional Backup:** At the corporate level, the plan is to have a central unit to carry out corporate strategy and policy functions and act as corporate entry point for external partnerships. This unit will ensure the entrenchment of strong but flexible processes needed to avoid delays, provide the framework for augmenting the low capacity in client countries and provide the framework for advice and clearance on policy, legal, fiduciary and financing issues. They will also pilot effective sharing of cross-country lessons that could help enhance effectiveness of processes and strategies over time.

Alongside the strengthening of the central unit, regions which have a large concentration of fragile states, like Africa, will establish dedicated regional units to deal with specific partnerships, strategy, and analysis.

**Appropriate Incentives for Staff:** Fragile States are challenging environments requiring top performers. To attract such workers to such environments calls for appropriate incentives, including attaching greater weight on serving in fragile states in promotion exercises.
3.1.5 Harmonization and Coordination with Other Donors/Role of Client Countries

Many other development partners including United Nations agencies are also active in fragile states. Therefore, effective delivery of the Bank’s interventions in fragile states calls for effective harmonization and coordination of activities. The new model places emphasis on close cooperation with other donors and on harmonizing procedures. The Bank explicitly recognizes that it will intervene only within its mandate and competences. In this regard, it will assist other agencies achieve their objectives by making inputs that relate to its comparative advantage and competence such as in financial management and project management.

While in the early-stages United Nations agencies take lead in matters of peace-making, peace-building and relief, the Bank recognizes that it still has some role to play in providing support in the areas of financial and accounting systems. The Bank assumes a more prominent role as a country enters the stage of economic and social reconstruction and recovery.

3.1.6 Role of Fragile States

Fragile states are at varying degrees of the “failed state” status but they are still expected to demonstrate leadership and to take on some responsibilities in order to maximize the benefits from Bank and donor interventions. Fragile states should therefore position themselves to maximize their capacity building efforts. Underscoring the importance of client participation, the GPCAS states that: “A strengthened consensus is useful, but it is also critical to recognize that fragile states cannot be assisted through a uniform approach - they face different challenges in the political environment, state capacity and accountability, and reform orientation” and that “Assistance strategy must remain firmly rooted in country-specific analysis and dialogue.”
Box 3.1: Paris Principles for International Engagement in Fragile States

- Take context as the starting point: sound political analysis is needed, above and beyond quantitative indicators of governance, institutional strength or conflict.
- Move from reaction to prevention sharing and responding to risk analysis, addressing the root causes of state fragility and strengthening capacity of regional organizations.
- Focus on state-building as the long-term vision, strengthening the capacity of state structures to perform core functions; their legitimacy and accountability; and ability to provide an enabling environment for strong economic performance.
- Align with local priorities where governments demonstrate political will to foster their countries’ development; where donor/government consensus is lacking, seek wider consultations and partial or shadow alignment.
- Recognize the political-security-development nexus, moving to support national reformers in developing unified planning frameworks for political, security, humanitarian, economic and development activities at the country level.
- Promote coherence between donor agencies, involving those responsible for security, political and economic affairs as well as those responsible for development aid and humanitarian assistance.
- Agree on practical coordination mechanisms between international actors, including upstream analysis; joint assessments; shared strategies; coordination of political engagement; joint offices, multi-donor trust funds and common reporting frameworks.
- Do no harm, avoiding activities which undermine national institution-building, such as by-passing budget processes or setting high salaries for local staff.
- Mix and sequence instruments, including use of both state recurrent financing and non-government delivery to fit different contexts.
- Act fast and with flexibility at short notice when opportunities occur.
- …but stay engaged long enough to give success a chance: capacity development in core institutions will take at least 10 years.
- Avoid pockets of exclusion, addressing "aid orphans" and coordinating to prevent excessive donor-driven aid volatility.

3.1.7 Africa, Fragile States and Neighborhood Spillovers

As the Bank strengthens its institutional capacity to assist fragile states more effectively, it is important to highlight a phenomenon that is important for Africa – “neighborhood spillovers”. As shown in Table 3.1, out of the 45 Fragile States in 2006, 25 were African countries. Many other African countries are adversely impacted upon by the problems of neighboring fragile states. Studies have shown that “neighborhood spillovers” are very costly in terms of economic and social impacts on other countries. According to World
Bank research, neighboring states lose on average 1.6 percent of GDP per year as a result of these spillovers. Out of the 28 non-LICUS in Africa, only 8 are free from the neighborhood spillovers contagion, while the remaining 20 are directly exposed to it. Therefore, one of the challenges under the new framework is to design and implement appropriate regional programs to mitigate the adverse impact of spillovers.

3.1.8 Conclusion: Looking Forward

The unique challenges facing fragile states provide an opportunity to the Bank to pursue its objective of poverty reduction. With barely 8 years left to the deadline for achieving the Millennium Development Goals, the Bank needed to review and reform the way it intervenes in those states. The institutional reforms aimed at improving and strengthening organizational capacity, for effective long-term engagement in fragile states is, therefore, very timely and appropriate. The fragile states, themselves, must be proactive and interested partners in the whole process. Looking forward, it is hoped that the changes will be implemented through a results-based action plan whose implementation will be monitored according to specific benchmarks and through an annual review.

3.2 IFC Strategic Initiative for Sub-Saharan Africa

3.2.1 Background

The IFC Strategic Initiative for Sub-Saharan Africa (SSA) for the FY04 to FY06 period was approved by the Board in August 2003 (see FY04 Annual Report). The main objective of the Initiative was to scale-up IFC’s operations and development impact in the region by focusing on its three main pillars—improving investment climate, enhancing support to SMEs, and adoption of a proactive approach to project development to support the corporation’s investments. The first implementation progress report was presented to the Board in December 2006.

3.2.2 Progress Made during FY04-FY06 Period

The overall assessment of the report is that steady progress was made in implementing the Strategic Initiative in all the three pillars and the main objectives were broadly achieved.

*Investment Climate Improvement*

Six investment climate programs were implemented by the IFC in the FY06, which included an assessment of Doing Business in Burkina Faso, establishment of a new public-private dialogue forum in Chad, and implementation of gender and growth assessments to identify constraints African business women face in Ghana, Kenya,
Tanzania and Uganda. The IFC Board also approved a US$30 million grant for establishing the Investment Climate Facility (ICF) initiative to support investment climate reforms in Africa. Largely funded by the IFC and DFID, the ICF will initially commence operating with funding of US$120 million and PEP Africa will participate in implementing the Initiative’s programs.

**Increasing Support to SMEs**

During the FY04-FY06 period, IFC developed various products and services to promote SMEs development in SSA. The products and services included the Mozambique SME, Kenya and Madagascar SSCs, Africa MSME, Microfinance, Local Currency Initiative, and trade finance initiatives. The Mozambique SME Initiative was launched in FY05 to improve SMEs direct access to finance. It was initially established as a pilot integrated risk capital and TA fund with a five-year term. The total budget amounted to US$12 million of which US$5 million was allocated for capital investment, US$4 million for technical assistance (TA) and the balance of US$3 million for operating expenses.

Setting up of the Mozambique project involved extensive consultations with local stakeholders and incorporated lessons learned from previous IFC SME sector interventions. The TA program included pre-investment and post-investment technical assistance aimed at preparing companies for investment and following up with mentoring and supervision to ensure sustainability of companies and investment returns. Sectors covered in the Mozambique SME program include agro-business, tourism and light manufacturing, the main growth industries of the country.

Progress made to date includes program start-up, staff recruitment, project identification and development, capacity development and investment processing. Further, twenty TA interventions involving 14 companies have been finalized. To-date, IFC has concluded two investments and four projects are under preparation.

**Proactive Project Development to Support IFC Investments**

The IFC has adopted a two-phased approach to proactively develop projects to support IFC investment activities. The first phase involves the creation of private sector investment opportunities, from the project concept stage by identifying investment needs in markets where private investors are inactive or unable to take part. The second phase focuses on identifying good projects developed by private sector sponsors, but which can be further enhanced by the corporation’s financial and non-financial products and services.

Effective collaboration among the Advisory Services, Infrastructure and Africa departments resulted in US$89 million investment commitments in AES Sonel, Cameroon in FY06. Acting as privatization advisor, the IFC Advisory Services managed to secure financing mandates for the Kenya-Uganda railways and port of Toamasina in
Madagascar. And through a combination of TA and investment, IFC promoted the Kolwezi project in the CDR in FY06.

To assist the private sector overcome environmental and social challenges, particularly in post-conflict countries, the IFC has been collaborating with the World Bank on promoting good governance and regulatory capacity and engaging early on both advising on project design and resource mobilization. Towards this end, during the FY04-FY06 period, the Environmental and Social Unit strengthened its field presence in SSA as a result of which IFC has been able to engage more proactively with clients and to effectively partner with NGOs and donors.

3.2.3. Future Prospects

The three main priorities of the Strategic Initiative-improving the investment climate, enhancing support to SMEs and proactive project development to support IFC investment- will remain valid over the FY07-FY09 planning period. In this regard, the IFC plans to further enhance the three priorities by developing more external partnerships, improving organization effectiveness, and increasing cross-border activities.

**Improving the Investment Climate**

IFC’s investment climate work over the FY07-FY09 period will be conducted through joint WBG and other donor programs to maximize synergies, and will continue to focus on post conflict countries, and cover new TA product areas. The joint WBG program will aim to further consolidate gains made from the joint management of FIAS-PEP Africa programs on doing business indicators (starting a business, licensing, securing land and constructing facilities, and hiring workers) in Madagascar, Nigeria, Mozambique, Sudan, Liberia and the DCR. The FIAS-PEP Africa program intends to add similar joint work in 2 to 3 more countries during the same period. The program will also pilot new products, which will include secured lending (address legal and institutional constraints to secured lending in up to 4 countries), SME Taxation (develop transitional tax regimes for SMEs, making compliance easier to bring small companies into the tax net), and assessment of determinants of business informality beyond tax incidence.

**Enhanced Support to SMEs**

IFC’s top priority is to implement a coordinated approach to promoting the development of MSMEs by focusing on 2 areas. The first is expanding financing to MSMEs through Africa-based financial institutions. This program will allow IFC to deal with new institutions in new countries. Twenty five banks have already been approved under this program and the IFC intends to transact with 30 to 40 institutions by the end of FY09.
The Africa MSME program will be complemented by the microfinance program, which aims to support the creation of 14 to 17 new institutions over the next 3 to 4 years.

The second area is using business linkages programs to improve MSME’s access to markets. The 40 linkages programs (7 of which are in Africa) IFC has so far implemented have demonstrated that they can leverage many times the corporation’s contribution in TA for supplier development, certification and other programs in the value of new contracts for MSMEs. They can also offer opportunities for reducing risks in financing rural, hard-to-reach firms through the mitigation of local market opportunities created by large-scale firms. Most of the above SMEs programs are intended to be pilot projects aimed at testing various approaches to supporting small businesses. Performance results of the various pilots will be evaluated at the end of FY09 to identify effective ones to be scaled up.

**Proactive Project Development to Support IFC Investments**

The IFC will continue to proactively develop investment projects by focusing on TA-led business development, leveraging advisory mandates and improving market outreach. Through the PEP Africa initiative, the Corporation will scale-up value-adding TA services such as SME linkages, business risk mitigation of HIV/AIDS, gender equality, and the full range of environmental and social programs to create and support business opportunities. TA-led business development will target the extractive industries, financial markets, infrastructure and agribusiness sectors where opportunities abound. IFC will also make early stage equity investment in parallel with the TA-led interventions. To leverage its advisory mandate, the IFC will selectively engage at an earlier stage of the advisory process, placing emphasis on public-private partnerships (PPPs). Market outreach will be improved through the recently launched comprehensive mapping exercise, which will enable the Africa team to understand market gaps which IFC’s products and services can fill over the FY07-FY09 period.

**Partnerships**

IFC intends to strengthen and broaden its partnerships with IBRD and MIGA and also with the AfDB and South-South institutions. Partnership within the WBG will be strengthened by focusing on priorities of the AAP, and identifying client countries, sectors and projects for collaboration, and engaging governments and private-sector players. IFC and IDA will continue to work with African governments to promote favorable conditions for private investment and economic growth. IFC will also coordinate with the World Bank to ensure success of its advisory services in promoting PPPs.

IFC will continue to partner with AfDB in the PEP Africa TA programs and AMSCO operations. IFC will also seek new areas for collaboration with AfDB through the mobilization of joint financing for projects. South-South partnerships will be further
forged through IFC’s plans to explore joint investment opportunities with investors from Brazil, China, India and South Africa. Towards this end the East Asia and African Departments have already begun discussions with the China Development Bank and other Chinese institutions regarding joint investment opportunities in the energy, oil and gas, infrastructure, mining and telecommunications sectors.

Building a High Performance Organization

To meet its strategic and business goals in SSA, IFC needs to attract and retain talented and experienced staff in an increasingly competitive global labor market. In this regard, IFC is in the process of working with other units of the WBG on a comprehensive review of staff compensation system. The review is expected to come up with a more market-sensitive and performance-based compensation framework, which is needed to meet IFC’s business needs in its top-priority region.

3.2.4. Further Enhancement of the Initiative For Sub-Sahara Africa

The three main pillars of the Initiative remain relevant as the basis for scaling up IFC operations to promoting private sector development in the SSA. However, for the Initiative to succeed in realizing its objectives, it requires improvement in a number of areas. Firstly, IFC needs to scale-up its geographic coverage. Although the corporation plans to extend its investment and TA operations in more than 20 countries by the end of FY07, it can further expand its geographic coverage through the adoption of proactive outreach strategy. Secondly, while recognizing the importance of setting up initiatives such as the AMSME and MIFFA, which provide investment-linked TA services, it is vital that IFC strikes the right balance between this type of TA and stand-alone TA as is the case with PEP. This balance is warranted in countries where IFC does not have a presence and in post conflict countries in need of TA for improving the investment climate. The third area requiring improvement is IFC’s investment portfolio structure, which is biased in favor of the financial sector and loan financing. IFC must put in place strategies to scale up investment in special purpose funds and facilities to supply equity capital, trade financing, local currency financing etc. Lastly, IFC must take measures to strengthen its advisory services assistance to countries in promoting PPP in the infrastructure sector and also assist in building the capacity of local TA providers.

3.3 Applying the Debt Sustainability Framework to Low-Income Countries Post Debt Relief

3.3.1 Background

Following the implementation of the Highly-Indebted Poor Countries (HIPC) Initiative, and the Multilateral Debt Relief Initiative (MDRI), the debt ratios of many Low Income
Countries (LICs) have become potentially sustainable. Global concern has turned to the question of how to ensure that these countries do not slide back into unsustainable debt situations. It is against this background that in November 2006 the Boards of the IMF and the World Bank considered a joint paper - Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief – which recommended general guidelines on how to improve the application of the Debt Sustainability Framework (DSF). The paper examines (i) the scope for using the framework to assess the appropriate level of borrowing in LICs, especially, from non-concessional creditors; (ii) further integration of domestic debt in DSAs; and (iii) refinement of the existing scale of risk categories for debt distress ratings. The Board of Directors endorsed most of the recommendations, placing emphasis on a case-by-case approach to assessing the pace of debt accumulation for countries with debt below the DSF thresholds.

3.3.2 The DSF and the Post-MDRI Challenges

The report points out that with low debt ratios, many LICs could resort to new external borrowing to finance new investments, especially in infrastructure, to address constraints to sustained high rates of GDP growth. The likelihood of this borrowing behavior has been heightened by not just the recent expansion in the number of creditors, including official bilateral lenders, commercial banks and export credit agencies, but also by strengthened macroeconomic fundamentals, improved growth prospects and the still high prices of commodities. At the same time, emerging economies laden with liquidity and faced with shrinking spreads on investments in emerging markets, are stepping up their lending to LICs. The report argues that even though the share of these creditors in total official assistance to LICs is only about 10 percent, it is likely to be substantial in the next few years (See Box 3.2).
Box 3.2: The Growing Importance of Official Emerging Creditors in Financing to LICs

Over recent years, a number of emerging creditors have increased their official bilateral aid flows to LICs. According to debtor data, the share of these creditors in total official assistance to LICs is still small (around 10 percent) but is increasing steadily. In several cases, official loans from a single emerging creditor represent a large share of the recipient's GDP, but in most cases are still well below the share from traditional creditors. (The table below shows the countries with the highest debt outstanding and disbursed from emerging creditors in percent of GDP. The data is derived from IDA's Debtor Reporting System and may be incomplete or uneven. In some cases, large claims may correspond to the existence of protracted arrears and accrued late interest, and not necessarily recent disbursements.)

Emerging creditors are numerous. The six largest non-Paris Club bilateral creditors to LICs are Brazil, China, India, Korea, Kuwait, and Saudi Arabia. (Some of them have provided aid for many years, and therefore "emerging creditors" is used for them as shorthand.) Available data indicate that China has become, by a large margin, the largest creditor in this group, with claims of US$5 billion as of end-2004 (compared with US$2.5 billion in 1994). Kuwait, the second largest creditor in this group, had claims of US$2.5 billion. Although precise data are not yet available, (there is evidence that lending by emerging creditors, and particularly China, has increased very sharply in 2005 and 2006.

The terms of emerging creditors' credits to LICs are not well known. Many have non-traditional financial structures (including implicit or explicit collateralization, foreign exchange clauses, and variable fees) that hamper the assessment of their impact on debt sustainability. Given the size of these loans, more extensive information from creditors on their modalities and the terms of their lending to LICs would enhance the quality of DSAs.

The report notes that, to help detect current or emerging vulnerabilities, the existing DSF already embodies features that should help mitigate the risk of a new round of unsustainable debt situations. The report point to the fact that the DSF is:

- Proactive and forward-looking; rapid debt accumulation can quickly be detected through breaches of the indicative debt burden thresholds;
- Self-regulating and country specific: projections are scrutinized through stress tests that show vulnerability conditions at an early stage;
- Regularity of debt sustainability analyses (DSAs): country DSAs are updated annually to track emerging vulnerabilities so that they can be addressed timely; and,
- Transparent in its application: DSAs explain all the main assumptions underlying the projections and how these drive projected debt ratios and risk ratings, giving the opportunity to modulate these assumptions over time as circumstances dictate.
3.3.3 Further Improving the Quality and Rigor of DSAs

However, to further strengthen the use of the DSF in identifying risks raised by the new financing opportunities for LICs, the report provides for (a) strengthened guidance on the impact of debt-financed investment on growth; (b) a more rigorous application of the inbuilt precautionary features of the DSF; and (c) a detailed review of scenarios for rapid borrowing.

(a) Strengthened Guidance on the Impact of Debt–Financed Investment on Growth:
This focus on careful analysis of the growth impact of debt-financed investments. What has become clear from both empirical studies is that the relationship between public investment and growth is hard to generalize because of the multiplicity of factors that affect a country’s growth prospects, including the quality of policies, institutions, decision-making processes and the management of exogenous shocks.

(b) Precautionary Aspects: Because of the uncertainty associated with the public expenditure-growth relationship, the report calls for:

- Careful scrutiny of growth scenarios that incorporate sharp shifts in fiscal policy, the investment rate, the financing mix, productivity growth or other key policy variables.
- Paying due attention to historical scenarios as a basis for detecting undue growth optimism.
Box 3.3: Indicators for Analysis of the Link between Debt-Financed Investment and Growth

When available, the indicators listed below can help establish a link between public expenditure and growth, and ultimately define the scope for debt accumulation. Relevance and availability will vary by country. In general, a comparison with their evolution in the country's past and in relevant comparator groups would provide useful potential benchmarks.

**Rates of Return**
- Microeconomic studies on rates of return of projects
- Implementation lags/gaps for investment and recurrent budgets
- Estimates of stocks and shortfalls in public capital
- Composition of public expenditures in terms of growth impact

**Structural Constraints**
- Policy and institutional constraints as indicated by the CPIA, public governance indicators, doing business surveys, PEFA, other public expenditure management
- Level and growth rates of public investment
- Completion or implementation rate of public investment projects
- Skill shortages that can only be alleviated in the long run

**Macroeconomic Constraints**
- The cost of capital, as indicated through firm-level surveys and real interest rates
- Rate (or rate of growth) of private investment
- Excess reserves/lending capacity in banking system
- Various real exchange rate measures (unit labor costs, export market share)

**Aggregate Trends**
- Growth rate of per capita GDP
- Growth rate of TFP
- Results of "binding constraints to growth" analyses

### 3.3.4 External Borrowing on Non-Concessional Terms

The document notes that the DSF, by focusing on debt in NPV terms, explicitly takes into account the degree of concessionality of different types of external loans. However, recognizing the uncertainty surrounding the growth impacts of public investment, the report advocates for a cautious approach when analyzing the impact of non-concessional borrowing on external debt sustainability. The report notes that concessional financing, defined as loans with a minimum grant element of 35 percent or more, is usually excluded from external debt limits but in practice, the measure of concessionality has been applied flexibly.
The case-by-case approach implies that some LICs could be granted waivers under the DSF with respect to the application of minimum concessionality that can be justified in specific country circumstances.

### 3.3.5 Private External Creditors

While they provide financing opportunities for LICs, the DSF recognizes that private sector capital flows into domestic public debt instruments could also contribute to debt unsustainability. Short-term capital flows could expose recipient countries to abrupt reversals in market sentiments as well as to exchange rate and monetary complications.

### 3.3.6 Better Integration of Domestic Debt

A major position of the new document is that the DSF’s capacity to detect early debt vulnerabilities would be strengthened if the discussion of domestic debt were better integrated in DSAs. It takes the position that domestic debt clearly matters for the risk of debt distress and this is corroborated by the results of a recent study conducted by Bank and Fund staff for 66 low-income countries. These empirical results call attention to the need to control domestic debt and to monitor it within the DSF.

#### Table 3.2: Domestic Debt in LICs

<table>
<thead>
<tr>
<th>Parameter</th>
<th>% of GDP</th>
<th>% of Total Debt</th>
<th>(Interest Bill % of Revenues)</th>
<th>Interest Bill (% of Total Interest Bill)</th>
<th>Short Term (% of Total Domestic Debt)</th>
<th>Ex-Post Real Annual Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>18.7</td>
<td>21.3</td>
<td>7.8</td>
<td>42.3</td>
<td>67.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Median</td>
<td>15.0</td>
<td>17.2</td>
<td>4.9</td>
<td>42.2</td>
<td>85.3</td>
<td>3.1</td>
</tr>
<tr>
<td>1/3 Percentile</td>
<td>9.8</td>
<td>13.2</td>
<td>2.9</td>
<td>35.8</td>
<td>47.2</td>
<td>1.9</td>
</tr>
<tr>
<td>2/3 Percentile</td>
<td>20.7</td>
<td>24.6</td>
<td>7.3</td>
<td>51.4</td>
<td>100.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Standard Dev. Max</td>
<td>16.5</td>
<td>16.4</td>
<td>8.4</td>
<td>23.2</td>
<td>37.2</td>
<td>5.9</td>
</tr>
<tr>
<td>Min</td>
<td>0.8</td>
<td>0.8</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
<td>19.8</td>
</tr>
</tbody>
</table>

| No. of Observ.       | 627      | 619             | 615                        | 609                                      | 384                                  | 579                              |
| No. of Countries     | 66       | 66              | 65                         | 65                                       | 44                                   | 64                               |

Source: Bank and Fund Staffs

But the paper also recognizes that the integration of domestic debt into the DSF poses many conceptual and technical problems, including the following: (i) the risks of default on external and domestic debts are different as governments could resort to
seignorage to avert default; (ii) domestic debt is used not only to fund fiscal deficits but also to prosecute monetary policy; (iii) the financial terms of domestic debts are usually different from those of external debt in terms of tenure and pricing; and, (iv) adding domestic debt to external debt raises data issues, because of the paucity of debt data in LICs. For these reasons, it is not possible to incorporate domestic debt into existing thresholds. But domestic debt can be taken into account when assessing the risk of debt distress and designing appropriate borrowing strategies. The report therefore posits that improved debt reporting is a key objective of ongoing efforts to build debt management capacity in LICs.

3.3.7 Fostering Creditor Coordination around DSAs

The DSF has no institutional or contractual basis and does not seek to bind creditors around a given course of action such as an overall lending envelope for a borrowing country, the appropriate degree of concessionality, or the relative priority of investments. Its main aim is to allow creditors and borrowers to make informed decisions about financing strategies. The ultimate responsibility for borrowing decisions rests with borrowing governments. Nonetheless, broadening awareness among creditors of the debt sustainability issues and the results of Bank-Fund assessments in specific countries can facilitate creditor coordination through a shared understanding of the impact of individual lending decisions on a debtor’s overall debt outlook.

3.3.8 Refining the Debt Distress Rating

Following the provision of MDRI to 20 countries, their risk ratings have improved dramatically. As a result, revising the risk category definition as required by the Boards of the two institutions in April 2006 now appears unnecessary. On the other hand, some initiative has been taken in the country policy and institutional assessment (CPIA) rating. The document makes a case for the use of a three-year moving CPIA average score in order to ensure that long-term, rather than short-term fluctuations, are used for determining the IDA grant share of countries. It has been agreed that the DSF should be allowed to build a longer track record before revisiting the question of the risk categories.

3.4 Harmonization and Alignment for Greater Aid Effectiveness: Update

3.4.1 Background

As a follow-up to the International Conference on Financing for Development that was held in Monterrey in 2002, the World Bank has been working with other development partners to align support with partners countries’ own priorities and strategies; harmonize donor policies and procedures to reduce transactions costs; and to manage aid resources
to achieve greater development results. As part of this process, the Rome High-Level Forum of 2003 identified the general framework for harmonization, and the Paris High-Level Forum on aid effectiveness outlined a detailed framework of commitments and operational targets to be met in 2010. In November 2006, the Bank presented to the Board an update on progress in these issues at an informal meeting. This section provides a summary of the progress made and the challenges, focusing on implementation by the donor community, including the World Bank, in light of commitments made in Rome and Paris to improve aid effectiveness.

3.4.2 International Efforts on Harmonization and Alignment

The report indicates that activities on harmonization and alignment have been taking place at the country level across the world but the breadth and depth of actions differ among countries and partner governments as they, together with donors, adapt the Paris Declaration commitments to the country context and circumstances. At least 60 countries around the world are collaborating with development partners including the World Bank to implement harmonization and alignment activities with broad and substantial implementation in 6 countries, and good but less extensive implementation in 10-15 others. It is noteworthy that five of the 6 countries making substantial progress, and 7 of those making significant, but not broad progress, are in Africa. In many countries, the key driver of progress is country ownership including in some cases the presence of a “champion” of harmonization and alignment in government.

The key activities being implemented include: joint analytic work; collaborative or joint programming and assistance strategies; multi-donor financing of program-based approaches; common financial management and procurement arrangements; harmonized project implementation procedures; use of country systems in some areas; joint or independent assessments of aid; “quiet” periods when field missions do not place; partnership arrangements such as delegated cooperation; and aid delivery through the use of harmonized budget support.

As reported by a number of partner country officials, these efforts are beginning to yield results as evidenced by some reduction in transaction costs and improving alignment of aid with country development strategies and priorities. However, these countries also report that more needs to be done to deepen and broaden these actions, particularly in aid predictability, donor selectivity, and assistance in strengthening and using country systems.

The international community has developed a framework for monitoring implementation of the Paris Declaration that involves reviewing progress in 2006, updating information on progress during 2008 in time for the Third High-Level Forum on Aid Effectiveness, and monitoring in 2010 to report on implementation against the 2010 targets. The Working Group on Aid Effectiveness (WG-EFF) has been charged with this responsibility and is undertaking both quantitative and qualitative assessments through
surveys and analytic work. The surveys cover indicators that can be measured quantitatively (Paris indicators 3 through 10) while the analytic work will assess those that can be measured qualitatively. The final report will be ready during the third quarter of FY07.

3.4.3 The World Banks’ Monitoring and Implementation Framework

The World Bank has taken a leadership role in key areas of harmonization, alignment and managing for development results while at the same time joining and supporting efforts among multilateral and bilateral donors and country partners in others areas. At the same time, the Bank, in collaboration with other institutions is supporting implementation at the country level through regional workshops aimed at helping countries to develop and strengthen their implementation plans and monitoring systems.

Four collaborative country assistance strategies have been completed with seven more planned, and discussions initiated in eleven other countries. During FY06, 43 percent of all Bank disbursements were in operations using program-based approaches while 20 percent of all analytic work in IDA countries was prepared jointly with other partners of which the highest was in Africa at 29 percent.

At the institutional level, the Bank is undertaking measures both internally and internationally to promote, support, and mainstream harmonization and alignment. In this regard, the Bank has made changes in its operational policies with respect to: aligning CASs to PRSPs; policy for DPOs; auditing requirements; modernization and simplification of procedures and processes; pooling of funds; procurement eligibility; and joint analytic work. Other areas where there is progress include financial management, procurement, legal aspects, and preparation of Memoranda of Understanding, environment, governance and anti corruption.

In line with the international processes, the Bank monitors implementation through quantitative and qualitative assessments. The quantitative assessments are harmonized with the international monitoring process using agreed definitions. Table 3.3 below represents the World Bank monitoring framework and the status of implementation against the Paris indicators for which donors are responsible. As the Table shows, there has been significant progress in implementation with disbursements of program-based approaches increasing from 37 of total disbursements in FY004 to 43 percent in FY06 while 9 percent of diagnostic and advisory services was jointly undertaken in FY05 compared to 12 percent in FY06. In Africa, the proportion of missions undertaken jointly increased from 31 percent in FY04 to 34 percent in FY05. The data for the use of country financial systems are distorted by the high volume of DPLs for IBRD countries using country systems for FY02. Considering investment
operations only, the proportion of operations using country systems increased from 31 percent in FY05 to 37 percent in FY05.

Table 3.3: Status of World Bank Actions on the Paris Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Comparative Data</th>
<th>Current Status</th>
<th>Paris 2010 Target (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unit</td>
<td>% Data Year</td>
<td>Unit</td>
</tr>
<tr>
<td>Disbursements using program-based</td>
<td>Bank</td>
<td>38 FY05</td>
<td>Bank</td>
</tr>
<tr>
<td>approaches</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Joint country analytic work</td>
<td>Bank IDA</td>
<td>9 14 FY05 FY05</td>
<td>Bank IDA</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parallel PIUs</td>
<td>ECA LCR</td>
<td>62 65 2001</td>
<td>Bank</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2001</td>
<td></td>
</tr>
<tr>
<td>Disbursements released on schedule</td>
<td></td>
<td></td>
<td>Bank</td>
</tr>
<tr>
<td>Aid using country procurement systems</td>
<td></td>
<td>The rating scale for using country systems for procurement remains under development by the Joint Venture on Procurement, a subgroup of the Working Party on Aid Effectiveness.</td>
<td></td>
</tr>
<tr>
<td>Aid using country financial management (FM) systems</td>
<td>Bank</td>
<td>64 FY02</td>
<td>Bank</td>
</tr>
<tr>
<td>Of which Investment lending using country FM systems</td>
<td>Bank</td>
<td>31 FY02</td>
<td>Bank</td>
</tr>
<tr>
<td>Joint Missions</td>
<td>AFR</td>
<td>31 FY04</td>
<td>Bank AFR</td>
</tr>
<tr>
<td>Technical cooperation coordinated with other donors</td>
<td></td>
<td></td>
<td>Bank</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: World Bank, OPCS.

With Bank leadership and support, the international community is also working to strengthen alignment between global and country-based programs, and to link global programs to country-owned operational development strategies, priorities and processes.

Some joint analytic work has been started on experiences of selected countries; and the aim is to establish a set of good practice principles for aligning global and country-based programs with country strategies, priorities and implementation processes.

With respect to the use of Project Implementation Units (PIUs), the report indicated that while there has been some attempt to integrate project management in a country’s existing institutions, the Bank’s practice of relying on parallel PIUs has not changed sufficiently to demonstrate that reliance on them is being phased out.
3.4.4 Challenges

As indicated earlier, while the Bank has put a great deal of effort in the harmonization and alignment agenda, progress has been uneven and there is need to broaden and deepen the process. One area where progress has been limited is in the preparation of Memoranda of Understanding in which donors and partners governments define the framework for their cooperation in financing operations. A key issue that often arises is in the articulation of the various responsibilities which do not always adequately take into account the different mandates, or the processes each donor uses to mobilize its own funds. Moreover, lack of timely consultation and incomplete knowledge by staff of good practices and options can create tensions and delays.

Within the Bank, there are pressures to deliver new lending operations within tight administrative budgets in which allocations are made for discrete products, such as the number of projects and products to be prepared and delivered and not on the degree of harmonization. Yet, as experience shows, working on harmonization requires significantly more staff time and financing. Moreover, multi-donor projects or single-donor sector-wide approach that rely on country systems take longer to prepare and they are more costly than stand alone project by as much as 15-20 percent.

As a result of these inbuilt incentives, staff are encouraged to focus more on stand alone deliverables such as lending operations and analytical products and not to engage in partnership and capacity building activities that are important for harmonization. Other key factors that have affected progress in harmonization include the degree of skill mix, the level of decentralization and budgets in staffing strategy.

To address these challenges, there will be a need for the Bank to make critical changes in the way it does business. At the country level, it will be important to address the staff skill mix, orient incentives with harmonization activities, and ensure that staff at all levels are knowledgeable and well positioned to take advantage of the harmonization and alignment agenda.

Going forward, the Bank has undertaken to address these obstacles in order to make further progress in harmonization and alignment. In this respect, the Bank and other donors must clarify their operational policies to minimize conflicting expectations and reduce areas where back and forth consultations with headquarters become factors in the ensuing coordination delays. Internally, the Bank will need to continue to reform the operational policies and procedures and ensure that they are widely disseminated to all staff, improve on the skills mix and training, refine the incentive systems and make further progress in decentralization.
3.5. Global Environment Facility (GEF): Fourth Replenishment of the GEF Trust Fund

Established 15 years ago, the Global Environment Facility (GEF) is an international financial mechanism with 176 member countries that addresses global environmental issues while supporting national sustainable development initiatives. GEF grants support projects in developing countries related to biodiversity, climate change, international waters, land degradation, the ozone layer and persistent organic pollutants. The World Bank and other international partners share credit for GEF’s achievements on the ground.

Since its inception in 1992, GEF has achieved a strong track record of support to developing countries and countries in transition, providing US$6.2 billion in grants and leveraging US$20 billion in co-financing for over 1,800 projects in 140 countries. Through its Small Grants Program (SGP), GEF has also made more than 7,000 small grants, up to US$50,000 each, directly to nongovernmental organizations and community organizations.

The World Bank Group has actively supported client countries in meeting their international obligations within its overall mandate of promoting sustainable development, and has helped them mobilize resources to cover the additional costs of initiatives aimed at meeting UNFCC objectives.

The third GEF Assembly met in Cape Town, South Africa, in August, 2006 where the world’s largest environmental funding body – Global Environment Facility – received its biggest ever financial boost with 32 governments* agreeing to contribute US$3.13 billion to finance environmental projects over the next 4 years. The funding comes at a crucial time when many fear that environmental and ecological red flags – loss of species and habitats, threats from changing climate, land degradation and desertification, pollution of shared waters, and health hazards posed by persistent organic pollutants – are increasing, and showing worrying signs of stress and severity.

The GEF Trust Fund is replenished once every 4 years, and in February of 2007, the Bank, acting in its capacity as trustee for the GEF Trust Fund, indicated that it had received Instruments of Commitments from twenty two contributing participants whose contributions amount to SDR960 million, thus exceeding the SDR929 million required under the effectiveness rule. The Fourth Replenishment of Resources of the GEF Trust Fund was therefore, declared effective.

* The countries that agreed to provide voluntary supplemental contributions are: Australia, Austria, Belgium, Canada, China, Denmark, Finland, France, Germany, Greece, India, Ireland, Japan, Korea, The Netherlands, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.
The replenishment will be used to fund critical environmental programs in developing countries, including small projects by NGOs and community-based organizations.

3.6 Good Practice Principles for the Application Of Conditionality: Progress Report

3.6.1 Background

Following a request by the Development Committee (DC) in October 2004, the Bank undertook an extensive review of conditionality focusing on the rationale for and modalities of conditionality in policy-based lending (now known as Development Policy Lending) as well as trends and key challenges in the application of conditionality. The key findings of the review were endorsed by the DC in September 2005. One of the key recommendations of the review called on the Bank to implement five key principles to strengthen the quality of the Bank’s application of operational policy for development policy lending. A progress report was presented to the Board in November 2006. This section provides a summary of the progress made since the adoption of these key principles and discusses their main implications for African countries.

3.6.2 Progress in Implementation

The review examined the application of good practice principles in Development Policy Operations (DPOs) that have been initiated after the endorsement of the findings and recommendations by the DC in September 2005. A total of 19 DPOs were evaluated comprising 12 from IDA only countries and 7 from IBRD or blend countries. For the purposes of the review, conditionality was defined as the set of conditions that must be fulfilled for the Bank to make disbursements in a DPO and they include maintenance of a stable macroeconomic environment, satisfactory implementation of the program including policy and institutional actions deemed critical for the program’s success. A typology of the different terminologies used in the context of loan design is presented in Box 3.4 below.
### Box 3.4: Good Practice Principles

<table>
<thead>
<tr>
<th>Principle</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>Reinforce country ownership by supporting only policies and programs for which there is clear evidence of ownership as indicated for example by the PRSP. Allow sufficient time for country processes such as parliamentary debate before determining details of Bank support and support the government in filling in any analytic gaps.</td>
</tr>
<tr>
<td>Harmonization</td>
<td>Agree up front with the government and other development partners on a coordinated accountability framework comprising actions, outputs, and outcome indicanment's own medium-term program.s own medium-term program.</td>
</tr>
<tr>
<td>Customization</td>
<td>Customize the accountability framework and modalities for Bank support to country circumstances such as capacity and readiness for reform; and the modalities and timing of support should respond to country and program-specific needs. Bank support for sensitive policy areas should be based on an understanding of the country specific political economy of reform.</td>
</tr>
<tr>
<td>Criticality</td>
<td>Choose only those actions critical for achieving results as conditions for disbursement.</td>
</tr>
<tr>
<td>Transparency and Predictability</td>
<td>Conduct transparent progress reviews conducive to predictable and performance-based financial support. Financial support decisions should be announced sufficiently early to be taken into account in the country’s own decision making and budget allocation processes and performance reviews should actively promote a culture of results management and measurement.</td>
</tr>
</tbody>
</table>

In general, the review shows that the average number of conditions per operation has been declining historically from about 30 per operation, to about 12-13 in FY06. The same trend was evident for the 19 DPOs reviewed. At the same time, the number of benchmarks declined to about 26 from an average of about 30 before the adoption of the best practice principles. However, the decline was more pronounced in IBRD and blend countries where they declined to an average of 7 per operation. In terms of content, the conditionalities remained concentrated in financial and private sector development, and in the social sector.
Box 3.4 Typology of Conditionality

Prior actions are those conditions that must be met before Board approval of the operation and in this regard, all conditions in a single-tranche operation, are prior actions. In a multiple tranche operation, conditions to be met before moving to the next tranche are tranche-release conditions. In addition, the Bank uses triggers and benchmarks to review and describe progress in a series of DPO loans. Triggers are critical actions for achieving and sustaining the results of the medium-term program and their achievement normally indicates sufficient progress to move to the next. They usually constitute prior actions of a follow-up operation and can be adapted and modified to reflect changing program environment. On the other hand, benchmarks describe the contents and results of the governments program in areas supported by the Bank. They are usually reported in matrices and are used to describe small steps in a reform process that represent significant though not necessarily critical progress markers for the implementation of the program.

The overall conclusion of the review was that the Bank’s recent practice in the use of conditionality was broadly consistent with the best practice. Most Bank programs supported country ownership by ensuring alignment with government priorities and customizing them to country circumstances. Moreover, they made frequent use of opportunities for harmonization, and in most cases only highlighted critical actions as conditions. They also responded to government needs for predictability of financing decisions. However, while satisfactory progress was made, many challenges remain and the review identified the following important areas where further improvement will be required:

- Upstream disclosure of analytic work that underpins program design, to incorporate recommendations into the government’s development strategy (PRSP) and policymaking cycle as well as to give space for political debate.
- Avoiding the use of policy conditionality in sensitive areas where ownership is uncertain or the political environment is fragile, and avoiding overlap of conditionality with the IMF unless it is clearly critical for the success of the Bank-supported program.
- Greater adherence to the criticality principle by avoiding certain process-conditions such as those related to adoption of action plans.
- Continuous monitoring of the use of benchmarks, with a particular emphasis on reducing their use in new operations and mature programmatic series.
3.6.3 Conclusions and Implications for Africa

Overall, there is no doubt that implementation of conditionality in a manner that is consistent with good practice principles is very critical in ensuring aid and development effectiveness in Africa and other developing countries. Moreover, it is evident that the Bank is making every effort to ensure that the application of conditionality is consistent with good practice principles. However, progress is slow and the challenges are many and complex.

Regarding ownership, it is clear that the Bank fully recognizes its importance for development effectiveness and that it should support policies and programs where there is clear evidence of ownership as indicated in the country’s development program such as the PRSP. At the same time, the Bank has acknowledged the challenges of assessing ownership and has noted that one realistic way of addressing this to analyze the governments expressed policy intentions or strategies and examine its track record in implementation. However, most government strategies and policy intentions are general and not written in a way that can be explicitly translated into conditionalities that are consistent with good practice principles.

Moreover, even when the conditionalties drawn from the government's own program are in line with good practice principles, it is possible that they can be “externally imposed”. This can occur for example if they are required within a time frame or sequence that is not appropriate for the government or if they are done differently from what the government thinks. For example, there may be broad agreement on privatization but there may be differences on the extent to which foreign participation should be involved.

With respect to criticality, there are cases when the conditions being suggested, although important, have no direct bearing on the successful implementation of the program.

In the case of harmonization, while the Bank is keen to make further progress, the donor community has not been able to synchronize and coordinate their procedures, systems and processes, even in countries where country-owned development programs are in place. Moreover, some borrower governments are reluctant to agree on a harmonized framework without a guarantee on predictability because this can disrupt the governments program over the medium term.

In conclusion, we note that the Bank acknowledges the remaining challenges in making further progress in the application of good practice principles for application of conditionality. The Bank has also identified areas for further work which we think is appropriate. However, we believe that these challenges cannot be addressed by the Bank alone and should be addressed in consultation with other stakeholders particularly, the borrower governments, civil society, and the donor community.
LIST OF TABLES
Table 2.1 Summary of IDA and IBRD Lending Operations
Table 2.2 Countries with the Highest IBRD Lending Commitments
Table 2.3 IDA Commitments by Region
Table 2.4 Countries with Highest IDA Disbursements
Table 2.5 IDA Grants by Region in FY07
Table 2.6 Commitments and Disbursements Approvals
Table 2.7 PEP Africa – Update as at December 31, 2006
Table 2.8 African and Non-African Fragile States
Table 2.9 Domestic Debt in LICs
Table 2.10 Status of World Bank Actions on the Paris Indicators
Table 2.11 Good Practice Principles

LIST OF BOXES
Box 3.1 Paris Principles for International Engagements in Fragile States
Box 3.2 The Growing Importance of Official Emerging Creditors in Financing to LICs
Box 3.3 Indicators for Analysis of the Link between Debt-Financed Investment and Growth
Box 3.4 Typology of Conditionality

LIST OF FIGURES
Figure 1.1 Real GDP Growth for Region/Country/Area