

Chapter 3: Evaluation Highlights

- The Bank continues to rely almost exclusively on the CPIA to identify LICUS, although the CPIA does not sufficiently capture some key aspects of state fragility and conflict.
- The recently introduced LICUS business models are likely to permit a more tailored response to different groups of LICUS.
- But the operational guidance contained in the business models needs to be sharpened and the extent of operational usefulness of the business models tested through implementation.
- The Bank needs to review its aid-allocation criteria in light of its objectives for LICUS and ensure that LICUS are not under- or over-aided.



Operational Utility of the LICUS Identification, Classification, and Aid-Allocation System

This chapter assesses the operational utility of three aspects of the LICUS approach: identification of LICUS, classification of LICUS into business models, and the aid-allocation system for LICUS. Operational utility is assessed against the objectives of the LICUS Initiative.

LICUS Identification

Distinguishing LICUS from other low-income countries

The Bank's 2002 LICUS Initiative was motivated by general aid effectiveness concerns within the Bank. The 2005 Fragile States Report focused the initiative on state-building and peace-building objectives.

Despite this focus, the criteria used to identify LICUS were not refined to capture these aspects sufficiently. The CPIA, on which the Bank relies almost exclusively to identify LICUS, has its advantages. Most important, because it is based on policy performance (not outcomes), the CPIA has the conceptual advantage of reflecting more recent policy situations, whereas outcomes may be the result of and capture past policy situations. However, there are also several shortcomings:

- First, the CPIA fails to capture sufficiently some key aspects of state fragility, such as accom-

modation of political dissent and of conflict, such as political instability and security or susceptibility to conflict.¹ The Bank has recognized that security-

related variables are missing from the CPIA: "The CPIA . . . does not measure the reach of service provision and administrative control across geographical territory and it devotes greater weight to the economic, administrative, and service delivery functions of the state than to institutions dealing with security and rule of law" (World Bank 2005h, p. 7).

- Second, the CPIA gives equal weight to all its constituent elements, although some of them may have much more bearing on state building and peace building than others. It could be argued, for example, that improvements in the efficiency of resource mobilization or in the equity of public resource use should take precedence over some macroeconomic indi-

Despite the increased focus on state building and peace building, the criteria to identify LICUS have not been refined.

cators in the CPIA if state building is a key objective.

- Third, there is up to a 24-month lag between the period being measured by the CPIA rating and the time when the rating actually informs policy decisions. This makes it more difficult to identify—in a timely and effective way—policy improvements or deteriorations in LICUS that can guide resource allocation.
- Fourth, the confidentiality surrounding the CPIA (removed in June 2006), and consequent perceptions of the lack of transparency and objectivity, have not helped the dialogue among donors (who have had to devise proxies such as the CPIA-quintile-based definition of fragile states, since quintiles are publicly available, but not individual scores²) or among country clients (many of whom question their CPIA status relative to that of others).

A stronger approach to the identification of LICUS will require an analytical framework that more explicitly focuses on the objectives of the LICUS Initiative. Given the Bank's state-building and peace-building objectives and the shortcomings of the CPIA, the Bank will need to reexamine the appropriateness of the CPIA criterion to identify LICUS, and supplement it as needed.³

Donors and researchers have come up with different lists of difficult countries, using different definitions (Foreign Policy 2005; Van de Walle 2005). To the extent that the Bank's current list

LICUS misses some relevant countries, the effectiveness of the Bank's assistance is reduced. At the same time, to the extent that the Bank's current list

includes some countries not fully relevant to its objectives, Bank resources that could be used to address those objectives are not.

The criteria used to identify LICUS need to derive from the objectives of the LICUS Initiative.

LICUS Classification

Differentiating within the LICUS group of countries

LICUS are a highly diverse group (see chapter 1), and it is useful for policy purposes to catego-

rize them into smaller groupings, as the Bank has recently done using business models. The heterogeneity of LICUS was recognized by the 2002 LICUS Task Force, which identified six categories of LICUS: policy-poor but resource-rich; exceptionally weak government capacity; government/donor lack of consensus; limitations on engagement; countries emerging from conflict; and countries in early stages of a domestically generated reform process. The 2003 *Implementation Overview Report* (World Bank 2003a, pp. 3–4) also differentiated its guidance by type of LICUS—for example, countries in weak transition, countries with no progress or deterioration, post-conflict countries, and more stable and active countries.

This classification evolved into a more systematic, fourfold typology of business models in the 2005 *Fragile States Report*: deterioration, prolonged political crisis or impasse, post-conflict or political transition, and gradual improvement (appendix D). These business models are based on the extent of consensus between donors and government on development strategy and the pace and direction of change.

The first two types of LICUS (those experiencing deterioration and those facing prolonged political crisis or impasse) represent countries where there is little consensus between donors and government on development strategy. The other two (those that are post-conflict or in political transition and those experiencing gradual improvement) represent countries with such consensus. The pace and direction of change are then used to classify LICUS within each of these two groups for a total of four business models. These business models are likely to permit a more tailored response to different groups of LICUS but have yet to be fully developed.

Currently, for instance, the operational guidance on state capacity and accountability contained in each of the business models is broad and insufficiently customized to the institutional characteristics of countries that fall into various business models. For example, it states: “focus on transparency, dialogue and maintaining institutional capital to facilitate

eventual turnaround” (deterioration business model); “focus on institutional analysis, dialogue and counterpart training” (prolonged crisis or impasse business model); “support for a broad state-building agenda, through institution building and, where appropriate, development policy operations with robust oversight mechanisms and sector programs” (post-conflict or political transition business model); and “development policy operations, where appropriate and restricted in scope, supported by sector and capacity-building projects and with strong oversight mechanisms” (gradual improvement business model).

Further refinement of the business models by more explicitly factoring in differences in capacity to perform core state functions (such as resource generation, resource allocation, basic social service and infrastructure provision, and political accommodation of dissent and security) is needed to enable the Bank to better reflect the institutional situations of different groups of LICUS in its response, and thereby to meet its state-building objective better. For example, the Bank’s institutional response in political-transition LICUS, where state capacity to perform some or all core functions is lacking, will have to be different from that in political-transition LICUS with capable states.

The experience emerging from the implementation of the Bank’s differentiated business models needs to be systematically monitored and will comprise the ultimate test of the operational relevance of the business models. Implementation data should be used to ascertain how much value the business models add over the CAS-driven country-by-country approach.

Aid-Allocation System for LICUS

Twenty-three of the 25 LICUS are IDA-only countries for which IDA financing has historically been allocated based on the Performance-Based Allocation (PBA) system. Implicit in the PBA system is the assumption that aid is more effective in environments with good policies, institutions, and governance, with the CPIA rating used to determine institutional quality across developing countries.⁴ The policy

selectivity of the PBA system has increased over the years⁵ and fewer IDA funds have been available for countries with weaker policies, institutions, and governance. This has raised the question of whether LICUS are receiving appropriate amounts of IDA funding.

Adjustments to the PBA have resulted in increased IDA financing, including some post-conflict LICUS and LICUS experiencing political transitions (box 3.1). Indeed, during fiscal 2003–05, post-conflict LICUS received a large share of the IDA financing to LICUS, averaging \$8.1 per capita annually, compared with \$1.5 per capita in non-post-conflict LICUS.

All seven post-conflict LICUS received higher per capita IDA financing, even when compared with the average for non-LICUS LICs (figure 3.1). Yet it remains far from clear whether the current levels of IDA ensure that LICUS are not under- or over-aided.

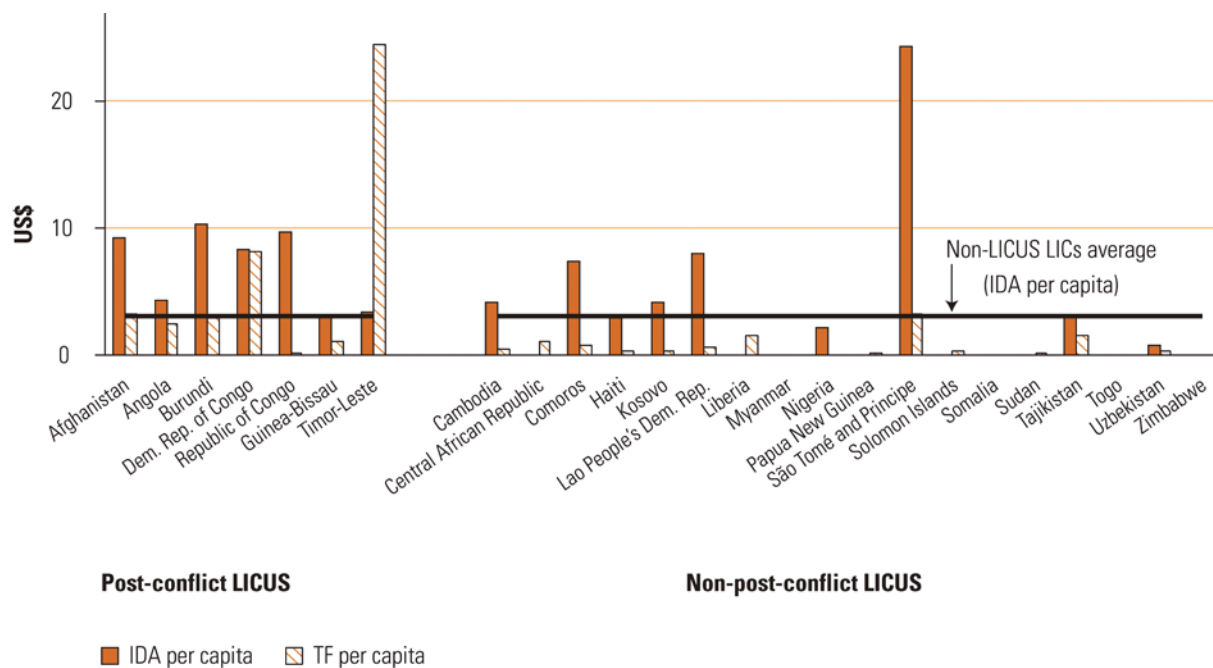
The aid-allocation issue has once again come to the fore with some research that questions the empirical evidence for the positive link between policies and aid effectiveness⁶ (which underlies the PBA), and other research that argues that aid can be effective in promoting sustainable policy turnarounds in failing states by building and strengthening the preconditions for reform or by enhancing the chances that the reform will be sustained once it is set in place (Chauvet and Collier 2004). The latter research finds that potential returns from aid to LICUS can be extraordinarily high, even though the risks of failure are substantial (Chauvet and Collier 2005). For its part, the Bank has yet to address the aid-allocation issue for LICUS in a way that reflects its objectives for these countries and ensures that LICUS are not under- or over-aided.

The business models are likely to permit a more tailored response to different groups of LICUS.

Refining the business models by more explicitly factoring in differences in capacity would help the Bank to better address its state-building objective.

The extent of operational usefulness of the business models needs to be tested through implementation.

Figure 3.1: Highly Variable per Capita IDA and Trust Fund Financing across LICUS during Fiscal 2003–05



Source: Trust Funds and World Bank databases.

Box 3.1: Adjustments to IDA’s Performance-Based Allocation System That Affect LICUS

- Agreement under IDA 12 authorizing special pre-arrears clearance allocations to aid-eligible countries coming out of active conflict and in the process of normalizing IDA relations.
- Agreement under IDA 13 to provide exceptional allocations to countries emerging from severe conflict in support of their recovery and in recognition of exceptional need.
- Agreement by the IDA deputies during the IDA 13 Mid-Term Review to stretch out the phasing of the special post-conflict allocations to fit the cycle of absorptive capacity of receiving countries, while maintaining the same total allocation.
- Agreement (since 1985) to provide exceptional access to IDA resources to small island economies, which have per capita incomes above the IDA eligibility cut-off but have no or very limited creditworthiness, which limits or precludes access to IBRD borrowing.
- Agreement under IDA 13 to provide additional allocations to IDA countries in the aftermath of major natural disasters in cases where the existing allocation would not allow for a sufficient response.
- Agreement under IDA 13 (continued under IDA 14) to have a special provision for regional integration projects. Up to SDR 300 million of such projects yearly are envisioned under IDA 14.
- Agreement during IDA 14 that additional allocations may be provided on a one-time basis to countries in the process of reengaging with IDA after a prolonged period of inactivity on the basis of a strong transition plan with concerted donor support. The exception is to be used only after all other options have been exhausted and is not intended to last for more than two years, with a possible additional year, subject to strong performance.
- Agreement during IDA 14 also included exceptional IDA financing for natural disaster response and regional projects.

Sources: IDA 2002, 2004, 2005.

Early findings from the pilot implementation of the 12 Principles of International Engagement in Fragile States (OECD 2005d) show that there is a group of countries that receives low aid flows in relation to need and governance indicators, compared with other countries with similar governance indicators.⁷ Overall, eight countries—Burundi, the Central African Republic, Chad, Guinea-Bissau, Niger, Sierra Leone, Tajikistan, and Togo—show the greatest imbalances and appear to attract relatively little donor attention.

Although trust funds have been an important supplement to IDA financing, these funds, for the most part, were concentrated in a few LICUS that already benefit from post-conflict IDA financing (for example, Afghanistan, the Democratic Republic of Congo) (figure 3.1). During fiscal 2003–05, average annual trust fund financing per capita in post-conflict LICUS was \$5.6, compared with \$0.2 in non-post-conflict LICUS.

In addition to the introduction of exceptional post-conflict IDA financing, the Bank has made several other adjustments to the PBA system. Some key questions that need to be addressed include the appropriate number and size of adjustments to the PBA; the basis for specific adjustments, including the robustness of the high-risk/high-reward argument; and the countries that should or should not receive exceptional treatment.

Conclusion

The Bank needs to conduct a technical review of the cumulative effect of the various adjustments to the PBA system on financing to LICUS, as well

as develop criteria that enable it to determine assistance volumes that reflect its objectives for LICUS and ensure that these countries are not under- or over-aided.⁸

While it does not necessarily follow that more

should be provided to LICUS, the Bank needs to make a strategic assessment of the appropriate form and level of financial engagement in LICUS.

Earlier discussions have focused only on “more” or “less” aid but have not established “how much more” or “how much less.” Whether and to what extent the Bank’s aid-allocation criteria should be based on factors other than policy performance—such as levels of other donor assistance, assessment of potential risks and rewards, and regional and global spillovers—needs to be examined, keeping in mind that aid is limited and trade-offs will have to be made. While the aid allocation issue goes beyond the LICUS Initiative, it remains an issue of crucial importance for the achievement of the Bank’s objectives in LICUS.

Beyond its own financing, the Bank needs to help address the gap in the international aid architecture in relation to the aggregate allocation for fragile states. Elements of a strategy to address this would include strengthened efforts at coordinated donor planning in which the Bank would have a role (and for which the OECD Watch List on Fragile States may be a starting point) (OECD 2005e).

Trust funds have played an important role in supplementing IDA financing, but have been highly variable across LICUS.