



Vulnerability

non-communicable disease

remoteness

disaster risk management

climate change

RISING SEA LEVEL

diseconomies of scale

labor migration

volatile growth

natural disasters

EXECUTIVE SUMMARY

World Bank Group Engagement in Small States

The Cases of the OECS, Pacific Island Countries, Cabo Verde, Djibouti, Mauritius,
and the Seychelles — Clustered Country Program Evaluation



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WORKS**

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CONFERENCE EDITION

World Bank Group Engagement in Small States: The Cases of the OECS, PICs, Cabo Verde, Djibouti, Mauritius, and the Seychelles

Clustered Country Program Evaluation Executive Summary

AN INDEPENDENT EVALUATION

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All volumes of the Cluster Country Program Evaluation on Small States are found online at <http://ieg.worldbankgroup.org/evaluations/cpe-smallstates>.

Abbreviations and Acronyms

| | |
|----------|--|
| AAA | analytic and advisory activities |
| ADB | Asian Development Bank |
| ADDS | Agence Djiboutienne de Développement Social |
| CAT DDO | Catastrophe Deferred Drawdown Option |
| CCRIF | Caribbean Catastrophe Risk Insurance Facility |
| CDD | community-driven development |
| CPE | country program evaluation |
| DDO | Deferred Drawdown Option |
| DPF | Development Policy Financing |
| ECCB | Eastern Caribbean Central Bank |
| ELECTRA | Empresa Publica de Electricidade e Água (Cabo Verde utility company) |
| EU | European Union |
| FY | fiscal year |
| GDP | gross domestic product |
| GFDRR | Global Facility for Disaster Reduction and Recovery |
| HIV/AIDS | human immunodeficiency virus/acquired immune deficiency syndrome |
| IBRD | International Bank for Reconstruction and Development |
| ICT | information and communication technology |
| IDA | International Development Association |
| IEG | Independent Evaluation Group |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| OECS | Organisation of Eastern Caribbean States |
| PICs | Pacific Island countries |
| RAS | reimbursable advisory services |
| SDR | special drawing rights |

All dollar amounts are U.S. dollars unless otherwise indicated.

Acknowledgments

This Clustered Country Program Evaluation (Clustered CPE) represents a new product prepared by the Independent Evaluation Group (IEG). It includes this overview report as well as separate regional program evaluations of the World Bank Group programs in the Organisation of Eastern Caribbean States (OECS), the Pacific Island Countries (PICs), and more selective reviews of the World Bank Group programs in Cabo Verde, Djibouti, Mauritius, and the Seychelles.

Florence Charlier led this Clustered CPE, which was conducted under the guidance and supervision of Mark Sundberg (Manager) and Nick York (Director), and the overall direction of Caroline Heider (Director-General, Evaluation).

Ali Khadr and Swizen Rubbani (OECS) and Basil Kavalsky (PICs) led the regional program evaluations. Team members include Stephen Hutton (disaster risk, environment, and climate change for OECS, the PICs, and Djibouti), Pia Schneider (human development for OECS), Andrew Stone (business environment and access to finance for OECS), Xiaolun Sun (financial sector and infrastructure for OECS), and Anna Aghumian (partnership aspects for OECS).

Claude Leroy (Djibouti), Chandra Pant (Mauritius and the Seychelles), and Xiaolun Sun (Cabo Verde) led country case studies providing selected reviews of the country programs.

Core team members for this overview report were Stephen Hutton, Basil Kavalsky, Ali Khadr, and Swizen Rubbani. Yasmin Angeles and Aimée Niane provided administrative support. Alan Gelb (Center for Global Development), Ali Mansour (International Monetary Fund), and Jyoti Shukla (World Bank Group) were the peer reviewers for this clustered CPE.

IEG is enormously grateful to the numerous representatives of governments, private sector entities, and nongovernmental organizations in the OECS, the PICs, Cabo Verde, Djibouti, Mauritius, and the Seychelles, and to World Bank Group management and country team members (both present and former) who were willing to devote valuable time and effort to providing the evaluation team with information, views, and feedback.

Overview

This report selectively discusses the World Bank Group's strategic and operational approaches and development issues addressed in its engagement with small states over 2006–14. The report's goal is to facilitate cross learning, and it focuses on the engagement aspects of particular interest for small states, which are countries with a population of less than 1.5 million. Small states differ widely, but share several challenges, including limited institutional capacity, acute vulnerability to economic and natural shocks, and an inability to exploit economies of scale. Consequently, many small states benefited from growing International Development Association (IDA) access, despite exceeding the cutoff.

The cluster evaluated the programs of two regional groups: the six Organisation of Eastern Caribbean States (OECS) countries and nine Pacific Island countries (PICs). It also assessed four African country programs more selectively: Cabo Verde, Djibouti, Mauritius, and the Seychelles. The Independent Evaluation Group (IEG) selected the programs to ensure a range of country income levels and geographical coverage, and significant World Bank Group financing and knowledge work. The cluster evaluations used a common framework based on two pillars: strengthening

resilience and enhancing competitiveness.

The World Bank Group programs used a variety of strategic and operational approaches to respond to the more constraining parameters that small state country teams confront, including small IDA allocations and administrative budgets (in absolute size) and thin client institutional capacity. These approaches included engaging on a regional or multicountry level, addressing country capacity limitations (including capacity for program implementation), and using partnerships to engage jointly or in a coordinated way with others.

From a thematic perspective, the programs deployed several approaches and addressed key development issues tailored to small states. The programs sought to strengthen macroeconomic, disaster and climate, and social resilience; and enhance competitiveness by facilitating trade, strengthening the financial sector, expanding infrastructure and improving its management, and supporting leading sectors (such as tourism, fisheries, and agriculture). In particular, the World Bank provided support to client countries for managing disaster risk by improving preparedness capacity, helping to make infrastructure disaster-resilient, and focusing government planning processes more on resilience.

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The World Bank was the central architect of the Caribbean Catastrophe Risk Insurance Facility, which provides governments with liquidity to fund emergency responses after major disasters to contain fiscal disruption.

The program evaluations raise several issues for World Bank Group consideration in its engagement with small states. Selected issues to consider relate to the thematic aspects of engagement – seeking to strengthen clients’ resilience and enhance their competitiveness – and to the cross-cutting aspects at both at the country team and institutional levels.

Under the resilience pillar, the evaluations suggest that support for strengthening macroeconomic resilience needs to pursue a multifaceted approach to be effective. Guided by analytical tools such as the World Bank’s Comprehensive Debt Framework for small states, the support needs to focus on the multiple drivers of fiscal and debt sustainability, which are a major challenge for many small states. The approach to disaster risk management of directly supporting resilience building (notably for infrastructure) was helpful but had limits. Making real improvements in vulnerability requires continuing efforts to foster wholesale changes in public and private incentives and behavior, and the long-term risks of climate change (including helping countries access climate financing) need to be addressed. Important focus areas for

social resilience include preventing and managing noncommunicable diseases, strengthening social protection, and enhancing mobility to larger countries’ labor markets (as the Bank helped to do for the PICs with Australia and New Zealand).

Under the competitiveness pillar, a sharper focus is needed on the most binding business constraints, using lenses specific to the leading sectors – typically fisheries, tourism, and agriculture. Several World Bank Group programs have started such an approach. In the financial sector, key issues for attention include system soundness and risks (particularly in the OECS), access to finance for small and medium enterprises, and remittance costs. Finally, it is important for infrastructure work to continue focusing on separating regulatory functions from service delivery functions. Despite the pitfalls, a strong case can be made for continuing to support public-private partnerships in infrastructure service delivery and regional service provision and regulatory initiatives.

To ensure impact and contain transactions costs of delivering support, small state programs need to consider the thin capacity in the field and be selective when choosing what to support to build resilience or foster competitiveness. World Bank Group comparative advantage can guide program selectivity. Beyond competitive and concessional financing, the World Bank Group is well-placed to undertake

higher-level policy dialogue, engage regionally to support public goods or shared and harmonized development solutions, and foster synergy in public and private efforts through concerted World Bank– International Finance Corporation (IFC) engagement.

Cross-cutting considerations at the country team level include seeking opportunities to engage regionally or with multiple clients at the overall partnership framework level and under individual operations while managing prospective risks. Keeping programs selective thematically and limiting the number of support delivery vehicles is also important. Contingency planning, including the use of contingent financing instruments, has a key role in enhancing responsiveness to shocks, though ex post instruments (such as IDA's Crisis Response Window) can also help.

Support for building institutional capacity seems most effective when it is sustained and focused on a concrete area of concern to policy makers. Regarding the fiduciary aspects of World Bank portfolio implementation, the requisite client capacity can be ensured in many ways, though none is clearly superior in every context. The simplified procedures for investment project financing in small states have not eliminated procurement challenges, but clients say they made a positive difference. Small state clients have particularly limited capacity for coordinating support from multiple

parties, and therefore small state programs need to pursue (and deepen to the extent possible) collaboration with other development partners at the overall program level and through joint support vehicles embodying harmonized procedures.

Small state country teams need to continue to find ways to navigate constraints related to the business model, including financing envelopes and administrative budgets that are small in absolute size. The programs provided notable examples of effective leveraging of World Bank Group technical and financial inputs through appropriate partnerships (significantly, in some cases). They also provided examples of ensuring in-country representation at moderate cost—for example, through sharing liaison officers with the Asian Development Bank in some of the PICs.

Finally, at the institutional level, World Bank Group small state programs were responsive to shocks, often facilitated by IDA mechanisms. The small island economies exception, which makes IDA resources available to small states above the normal per capita income cutoff, provides a wholesale response to vulnerability; however, the question arises whether the IDA allocation formula could encompass measures of vulnerability that are more specific, or alternatively enhance and extend access more uniformly in recognition of small states' vulnerabilities. Whether small state-specific World Bank and IFC

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financing instruments are worth developing also merits consideration. Furthermore, the World Bank Group might want to monitor how well its technical staff serves small states under

its new global practice structure. Small states could benefit from knowledge brokering that is more intensive and pursuing partnerships at the institutional level.

1. Introduction

Background and Context

The purpose of this report is to facilitate cross-learning among World Bank Group programs in small states. It selectively discusses the World Bank Group's strategic and operational approaches and the substantive development issues addressed in small state programs that the Independent Evaluation Group (IEG) assessed under the clustered Country Program Evaluation. Based on this discussion, the report highlights specific considerations for effective future World Bank Group engagement in small states. Along with this report, the clustered country program evaluation (CPE) includes two regional program evaluations covering the Organisation of Eastern Caribbean States (OECS) during fiscal year (FY) 06–14, and Pacific Island countries (PICs) during FY05–15. It also includes more selective reviews of World Bank Group programs in four African states: Cabo Verde (FY05–14), Djibouti (FY05–15), Mauritius (FY07–15), and the Seychelles (FY07–15). Since the findings and suggestions going forward are based on a small and non-representative sample of country programs, they are not necessarily applicable to other small states. Given its selective coverage, the report highlights specific aspects of World Bank Group engagement with small states. It does not fully summarize the underlying country reports or compare World Bank Group program and country performance. Reading this report together with the underlying reports will provide a more comprehensive treatment.

Small states are clearly a heterogeneous group and differ widely in their needs, but they share a number of intrinsic characteristics and development challenges. Fixed costs in the public or private sector can be high relative to the small scale at which the countries operate, which implies high unit costs. Small states also face fixed costs in commercial and financial sector transactions, which are similarly high relative to typical transaction volumes in their economies. The countries are often in areas that imply high trade costs and particular vulnerability to natural disasters, including susceptibility to the adverse effects of climate change. Furthermore, small states face challenges relating to:

- Higher public spending and public sector wage bills relative to gross domestic product
- Output and trade (production focused on a few goods and services that are not scale-intensive, and concentration of exports, leading to higher exposure to trade shocks and contagion from partner country downturns)
- Labor markets (limited opportunity for employment, particularly the use of specialized expertise, entailing higher outmigration rates)

- Monetary and financial sectors (lower financial depth and banking sectors that are more concentrated, with some exceptions).

Small states also tend to have limited institutional capacity because of the extremely small absolute (though not relative) size of their public sectors. Greater exposure to economic and physical shocks leads to greater growth volatility in small states compared with larger states, and repeated shocks coupled with the inherent stresses on public finances and limited borrowing opportunities led to a buildup of significant debt levels in several small states.

IDA made special accommodations for small states' needs because of their vulnerability to economic shocks and natural disasters. Under the small island economies exception (in place since 1985), IDA granted 13 states access to IDA funding despite exceeding IDA's gross national income per capita operational cutoff. Furthermore, the 16th Replenishment of IDA (IDA16) changed IDA funding terms under this provision from blend to regular IDA credit terms, resulting in longer maturities and grace periods and suppression of interest. Additionally, the minimum base allocation per country under IDA's Performance-Based Allocation system gradually increased from special drawing rights (SDR) 1.1 million per year during IDA14, to SDR3 million per year under IDA16, to SDR4 million per year under IDA17. This gave much larger allotments to many small states, which have allocations not far above the minimum because of their size.¹

Country Program Selection

The basis for the initial pool of countries considered for inclusion in the evaluation was population size, income category, and borrowing status. The definition of a small state can vary, but the most common definition is a population of less than 1.5 million. IEG chose World Bank Group country programs for inclusion in the clustered CPE from a pool further restricted to the group of countries with a low- or middle-income classification,² and active IDA or IBRD borrower status. This resulted in a pool of 30 low- and middle-income small states that accounts for at least 20 percent of current IDA and IBRD client countries.

IEG then purposively selected countries from this pool based on several considerations. The pool was considerably diverse in location, geography, and income levels. Therefore, additional criteria for the final selection included the following:

- Global coverage—representing the three main regions where small states are clustered: Caribbean, Pacific, and Africa (including the Indian Ocean)
- Geographical diversity—inclusion of both island and non-island small states

- Income diversity – inclusion of a range of income levels within the middle-income classification, where small states are concentrated
- Exclusion of country programs covered by IEG evaluations in the past few years
- Significant World Bank lending (at least 15 operations during the evaluation period) and analytic work
- Regional approach – inclusion of at least one program in which the World Bank Group adopted a regional approach (which also helps increase the evaluation’s country coverage).

The final selection covered two regional groups and four African countries.³ Based on these criteria, IEG selected World Bank Group programs serving the six OECS countries and nine PICs (with a specific focus on Samoa and Tonga where the World Bank had the most substantial programs) for full program evaluations. IEG also evaluated World Bank Group programs in several African countries – Cabo Verde, Djibouti, Mauritius, and the Seychelles. However, because of budget limitations, IEG decided to limit the evaluations for these countries (mostly to competitiveness issues) instead of conducting full CPEs.⁴

Analytical Framework

A common framework underpinned the approach and evaluation questions across the regional program evaluations and country program reviews in the cluster.⁵ The framework distinguishes the following two broad, strategic objectives (or pillars) underlying World Bank Group engagement:

- *Strengthening resilience* to economic and natural hazard-related shocks and enhancing sustainability through macroeconomic policies providing greater resilience to macroeconomic shocks and ensuring fiscal and debt sustainability; improved natural disaster risk management, climate change adaptation, and sustainable use of resources; and human capital development through better education quality, enhanced labor force employability, improved health policies, and more effective social protection systems to improve social resilience
- *Enhancing competitiveness* through improved trade policies, a strengthened business environment, financial intermediation that is more effective, improved infrastructure services, and better-performing leading productive sectors.

Report Structure

The report has five chapters, including this introductory chapter. Chapter 2 discusses how the World Bank Group’s strategic and operational approaches sought to respond to a set of inherent challenges of working in small states in the programs assessed under

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the clustered CPE. Chapters 3 and 4 selectively identify and discuss instances of World Bank Group work in the programs that sought to help the countries strengthen their resilience (chapter 3) and enhance their competitiveness (chapter 4), focusing on aspects particularly relevant to their small size. Chapter 5 then identifies key issues for the World Bank Group to consider as it seeks to provide effective support to small state clients, based on the discussion in chapters 2–4.

¹ Small states had additional advantages in accessing IDA funding. For example, although the lending terms were adjusted for IDA-only countries under IDA17, those for small island states remained unchanged. There are also substantial financing incentives for small states to participate in regional IDA projects.

² The excluded countries are Bahrain, Barbados, Brunei Darussalam, Cyprus, Equatorial Guinea, Estonia, Iceland, Malta, Qatar, San Marino, The Bahamas, and Trinidad and Tobago. The evaluation retained Antigua and Barbuda and St. Kitts and Nevis because they are members of the Organisation of Eastern Caribbean States.

³ Country visits included Cabo Verde, Djibouti, Fiji, Mauritius, Samoa, the Seychelles, Tonga, and the six OECS countries. The team also visited Canberra and Wellington for discussions with the Australian and New Zealand governments.

⁴ Coverage of environmental resilience and social protection in Djibouti was the one exception.

⁵ Details on the choice of countries and the methodology used are provided in the approach paper for the cluster, notably the section on the evaluation framework and the results chain as well as appendix 6 (evaluation design matrix).

2. Strategic and Operational Approaches in the Small State World Bank Group Programs

This chapter discusses how the World Bank Group programs sought to mold their strategic and operational approaches to the client countries' small size. The chapter emphasizes the challenges in designing and executing a partnership framework, which are greater in small states, and illustrates the various ways that programs responded to these challenges, such as regional or grouped engagement, thematic and operational selectivity, flexibility to respond to shocks, and efforts to enhance client capacity and work jointly with other development partners. Note that these responses do not generally apply to all small state programs. The chapter does not seek to justify any judgments, the basis for which is in the underlying evaluation reports. The discussion in this chapter is cross-cutting, unlike the discussion in chapters 3 and 4, which is structured along thematic lines.

Challenges facing World Bank Group country teams in small states are particularly acute and tend to favor specific approaches. Many parameters that constrain choices are more tightly binding than in larger states. Financing envelopes (notably IDA allocations) and administrative budgets, though often large relative to client country population, are small in absolute terms, client institutional capacity is thin,¹ and data availability is a severe constraint. Furthermore, client countries' small size imposes additional constraints, including limited possibilities for exploiting economies of scale in government and infrastructure, and high vulnerability to both economic and natural shocks. These constraining parameters rarely point to a one-size-fits-all solution, but they typically favor certain ways of working when engaging with small states. Such approaches include:

- Working with client countries in a grouped or easily replicable way, which can facilitate World Bank Group support for joint or harmonized development solutions among the countries (with associated benefits to them) and help keep the unit transactions costs of delivering World Bank Group support in check
- Keeping a selective thematic focus of World Bank Group support and limiting the proliferation of financing and knowledge delivery vehicles. This increases the chances of making transformational contributions in specific areas while limiting unit transactions costs, given the small absolute size of financing and administrative budget envelopes
- Maintaining the World Bank Group program's flexibility to respond to shocks. Such responsiveness can be vital to avoiding major development setbacks, given the magnitude of the impact that shocks can have on small state clients

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- Helping address the limitations on institutional capacity that are inherent to small size to alleviate bottlenecks to development initiatives
- Finding ways to deal with the World Bank's portfolio implementation requirements, given the backdrop of limited client institutional capacity
- Working with other stakeholders in the most coordinated way possible (particularly aligning and harmonizing with other development partners) to contain transactions costs for the client countries and lessen the drain on their limited capacity
- Managing other aspects of World Bank Group engagement, including the constrained scope for in-country presence and the World Bank's systems, particularly in procurement.

Regional or Grouped Engagement and Support

At the strategic level, using a common World Bank Group partnership framework across countries can provide advantages in the right context. Engaging with several small state clients as a group can facilitate World Bank Group support for joint, harmonized, or replicated development solutions and can reduce administrative transactions costs. However, it can be perceived as constraining customization to country-specific needs, giving rise to a trade-off between engaging with small states as a group versus individually. This trade-off was apparent in the Pacific Island countries (PICs). In some of the small state programs reviewed (Cabo Verde, Djibouti, Mauritius, and the Seychelles), the World Bank Group had little basis for engaging with partnership frameworks serving more than one small country. Shared or closely harmonized approaches did not link the countries with one another or with third party countries except through broad cooperation platforms. World Bank Group financing and even nonfinancial services could be planned and delivered for regional initiatives and through multicountry platforms (alongside single-country operations) because the Organisation of Eastern Caribbean States (OECS) and the PICs, to a lesser extent, form part of recognized regional groups with formal institutional structures covering aspects of their cooperation.

The World Bank Group judiciously used a common partnership framework in the OECS to guide its engagement with all six countries during the FY06–14 evaluation period. Close political and economic ties among the countries – including a common currency and movement toward an arrangement similar to the European Union (EU) – anchored by regional organizations such as the OECS Commission and the Eastern Caribbean Central Bank (ECCB) facilitated the use of two successive regional partnership strategies. Largely because of this (and given the many similarities among the countries), priorities broadly aligned, and use of harmonized or shared

development approaches was widespread. However, some factors went against the grain of a common strategic framework. In practice, country needs and priorities could differ, and shared approaches frequently met with skepticism. Perhaps most important, eligibility for World Bank financing was not uniform—St. Kitts and Nevis and Antigua and Barbuda were eligible only for IBRD terms, and the remaining four were blend countries.² However, these factors did not eliminate the usefulness of a common framework. Among other things, they called for a selective and cautious approach to engagement at the regional level. They also meant that World Bank Group engagement drew on a blend of single-country, multicountry, and regional lending and nonlending instruments, and that World Bank financing operations in Antigua and Barbuda and St. Kitts and Nevis were rare compared with the blend countries, which accounted for virtually the entire World Bank Group program.

Circumstances in the PICs led to alternating between regional and single-country partnership frameworks. A regional partnership strategy also guided the World Bank Group program in the PICs during the first part of the review period, but the program moved to a country-based approach during the second half and is now reverting to a regional approach. Budget stringency mainly drove the preparation of a regional partnership strategy covering FY06–09. The countries, though numerous and more heterogeneous than the OECS, were linked through multiple regional organizations (notably the Pacific Islands Forum) and shared common challenges. However, the World Bank prepared individual strategies to respond to demand for more tailored engagement frameworks as the program expanded (fueled by increased country IDA allocations and the additional administrative resources available through the Pacific Facility, established by the governments of Australia and New Zealand). Country strategies were prepared for the Federated States of Micronesia, Kiribati, the Marshall Islands, Samoa, the Solomon Islands, Tonga, and Tuvalu, during 2011–15; however, a common regional framework (setting out the themes of promoting opportunities for regional and global integration and strengthening resilience to shocks) underlay and was attached to each of these. The World Bank is reverting to a regional approach and preparing a regional Country Partnership Framework covering the eight Pacific Island countries included in the Systematic Country Diagnostic.³ Overall, there was a tension between the obvious need for a regional framework and the desire for a deeper examination and presentation of some of the countries with relatively large support programs.

Beyond partnership frameworks, both the OECS and the PIC programs appropriately and abundantly used financing operations that involved multiple countries. Almost half of the financing delivered under the OECS program was structured in a way that benefited multiple countries, in some cases with a reach extending beyond the OECS to the broader Caribbean. These included operations working with and through operating

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regional institutions. They also included multicountry operations that use a similar template across countries. Regional operations supporting a shared or harmonized development solution can bring significant benefits, but they hinge on strong country commitment to the shared solution and to the regional institution implementing it.

Operations involving multiple countries were able to access IDA regional funds under certain conditions, but they were not always free of difficulty. Several projects involving multiple countries and satisfying certain criteria (including benefits that spill over country boundaries) were able to access IDA funds from regional IDA allocations.⁴ These IDA regional funds were strictly additional to the country IDA allocations and represented an important leveraging effect.^{5,6} Nevertheless, this pool of regional funds is limited and in high demand, and cannot be counted on.⁷ In many cases, the projects were blended with analytic and advisory activities (AAA) and/or trust fund grant financing. Examples include the World Bank's support for a pooled insurance mechanism against catastrophic weather-related events in the Caribbean, e-government services in the OECS, and support for fisheries in the Pacific, Western Africa, and the Indian Ocean. Regarding e-government services, the World Bank's Electronic Government for Regional Integration Project, implemented by the OECS Secretariat, mobilized regional IDA funds, and helped lay a foundation for harmonized e-government service development among the countries and pilot services such as electronic tax filing. The development of an e-platform (with associated transparency and accountability gains) for the successful OECS joint pharmaceuticals procurement program was among its contributions. Although the World Bank rightly promoted and sought to support shared or harmonized solutions implemented through regional organizations, political economy factors made progress difficult in some cases (for example, in the efforts to back a regional energy regulator model for the OECS).

Multicountry project platforms helped contain transactions costs and support harmonized action. The World Bank's use of multicountry project platforms in the OECS had the advantage of limiting transactions costs through replicable project design and more streamlined processing. The program used the horizontal adaptable program lending vehicle to deliver financing, notably to support human immunodeficiency virus/acquired immune deficiency syndrome (HIV/AIDS) prevention and control, and secondary education.⁸ In the PICs, the Pacific Facility (funded by the governments of Australia and New Zealand) provided a much larger operational budget. Nevertheless, the World Bank continued to look for ways to reduce transaction costs in defining its program modalities. The World Bank focused its multicountry financing operations on areas that needed to harmonize regional and country-level program approaches and management, such as aviation and disaster risk management.

The use of regional or multicountry knowledge vehicles featured heavily in the OECS and PICs programs and offered significant advantages. Most of the analytic and advisory tasks in the OECS and half in the PICs program consisted of regional or multicountry tasks. Coverage of regional issues, or similar issues across countries, was significantly more cost-effective for the World Bank. Regional AAA work was instrumental in bringing about transformational changes in some cases. A flagship study on temporary labor migration in the Pacific is the prime example.⁹ Another example is the Caribbean Growth Forum, a participatory, accountability-oriented regional initiative for identifying and acting on growth-enhancing measures at the individual country level. More examples include financial sector AAA in the OECS, upstream AAA on the financial structure of the Caribbean Catastrophic Risk Insurance Facility, the World Bank Treasury's management of the risk pooling mechanism under a similar facility in the Pacific, and analytic work on noncommunicable diseases in both the OECS and the PICs. Similar to financing operations, much of the AAA work that was not single-country covered a blend of regional and country-level issues.

Thematic and Operational Selectivity

Thematic and operational selectivity in small state programs can help manage small (in absolute size) IDA funding and administrative budget envelopes. Thematic selectivity allows financing envelopes that are limited in absolute size to be directed in a more concentrated way, with a greater chance of transformational impact in the face of fixed costs (in infrastructure, for example) where small state clients cannot take advantage of scale economies. Furthermore, engaging on a given theme involves a measure of fixed administrative transactions costs for World Bank Group support to have impact (for example, staff with the relevant expertise need to invest in country-specific knowledge and relationships). Similarly, each distinct World Bank Group operational support delivery vehicle – whether it delivers financing or knowledge – typically involves a fixed element of transactions costs for the World Bank Group and the client country, such as dealing with country missions. These costs can be controlled to some degree (by clustering tasks, for example). Compared with larger states, it is therefore particularly important to limit the World Bank Group program's thematic reach and avoid proliferation of distinct operational activities in small states. But given their capacity limitations, small states are also likely to turn to the World Bank Group for advice and support in a broad range of areas, making the selectivity challenge a recurring one.

Some of the programs achieved operational selectivity through the concentrated use of development policy financing (DPF), though the extent of their thematic selectivity varied. A context of macroeconomic unsustainability in the Seychelles at the start of the evaluation period gave the World Bank program a single-minded clarity of purpose.

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The World Bank focused its support on policy reforms to restore growth and financial stability while protecting the poor and vulnerable, to complement International Monetary Fund (IMF) support. Exclusive use of DPF, with largely just-in-time AAA supporting reform implementation, concentrated the delivery of World Bank financing, which contained unit transactions costs. Similarly, the World Bank program in Mauritius and Cabo Verde was organized closely around a government program. Although thematic selectivity was more difficult to discern in these countries, DPF also had a dominant role in delivering World Bank funding.

Thematic selectivity was a challenge for the OECS and to a minor extent the PICs programs, but efforts to limit the proliferation of financing instruments were visible in both regions. Thematic coverage in the OECS during the evaluation period was relatively broad. Selectivity tends to be a greater challenge in designing a regional strategy, given the natural tendency to combine individual country priorities that often are not precisely aligned. With respect to delivery vehicles, the OECS program saw limited use of DPF (although this has increased in Grenada in recent years), but it was notable for its use of regional and multicountry projects. Furthermore, the OECS portfolio's visible consolidation during the review period into fewer, larger operations concentrated in disaster risk management worked to reduce transaction costs, though it also made clear the binding nature of country absorption and execution capacity constraints. In the PICs, the decision to limit World Bank social sector involvement to areas in which governments requested it or where global trust funds were available as well as to leave support for the water and urban development sectors to other donors enabled increased depth of involvement in other key sectors. However, selectivity also faced difficulties: in many areas where the World Bank was less active, donors with programs in these areas complained about the World Bank's failure to engage. DPF support in Samoa and Tonga was an important part of the program, given the central role of the World Bank's macroeconomic and fiscal dialogue in the PICs and DPF's usefulness in promoting concerted donor action.

Maintaining Flexibility to Respond to Shocks

World Bank Group program flexibility to adjust in response to shocks is important considering small states' vulnerability to shocks and greater income variability. The small state programs reviewed under the cluster were implemented against a backdrop of numerous shocks to the countries – some generalized, such as the 2008–09 global financial crisis and the food and fuel price shocks immediately preceding it, and some idiosyncratic, such as hurricanes or storms. Although there was little detailed ex ante contingency planning in the partnership frameworks, the programs generally showed

significant flexibility in responding to such shocks – notably through changes in the timing or volume of financing (or both) and in the focus of AAA work.

The World Bank provided quick-disbursing funds after natural disasters in several countries. For example, the World Bank approved DPF operations in Samoa after the 2009 tsunami and Tropical Cyclone Evan in 2013, and in the OECS, it used emergency recovery loans to respond promptly to the damage from Hurricane Tomas in St. Lucia and St. Vincent and the Grenadines in 2010. The World Bank also used DPF (though less intensively than in other small state programs) to help meet exceptional financing needs in Grenada and St. Lucia in 2010 after the global economic crisis, and in Grenada beginning in 2014, after the country's fall into debt distress and selective default. However, the one-time (as opposed to programmatic) nature of the 2010 DPF operations limited their ability to provide ongoing momentum to support reforms, leading to delays in some reforms. The severe floods in the Seychelles in 2013 showed the need for prompt access to resources for emergency response. Although there was no explicit provision in the FY12–16 Country Partnership Strategy, the World Bank subsequently approved a DPF operation with a Catastrophe Deferred Drawdown Option (CAT DDO) to provide ready contingent funding if similar disasters occurred. In Mauritius, flexibility was evident, among other things, in an increase in the size of the planned DPF operations and a DDO introduced to cushion the impact of the unexpected financial crisis of 2008. However, in the IDA-eligible small states, the World Bank had limited scope for setting up contingent financing, as the CAT DDO is not currently offered to IDA-only countries.¹⁰ Institutional sources of crisis support that can be arranged ex post, notably IDA's Crisis Response Window, though helpful, allow only for limited responsiveness.

Several cases of World Bank responsiveness to shocks through nonlending work were also laudable. In the wake of the global financial crisis, the World Bank Group provided support for immediate crisis resolution and strengthening regulation and supervision. In Cabo Verde, the World Bank delivered a macrofinancial vulnerability study to flag banking sector risks to policy makers and identify remedial policy actions. A 2013 Country Economic Memorandum concentrated on fiscal issues to design a reform agenda (focused on measures to augment domestic revenue and improve state-owned enterprise management) that would help the country rebuild macroeconomic buffers to absorb external shocks. Similarly, World Bank analytic work and technical assistance sought to help several PICs build economic resilience after conditions of duress. In Samoa, as the country was moving from moderate to high risk of debt distress, the World Bank and the IMF provided two technical assistance follow-up missions to help the country prepare a debt management reform plan focused on institutional arrangements, debt policy, and risk management. In Tonga, the World Bank combined agreement on a DPF operation with just-in-time support to the ministry of finance to

guide government decision making as the fiscal situation worsened after natural disasters and the global financial crisis. Furthermore, the World Bank supported post-disaster needs assessments after natural disasters in several of the PICs and the OECS, though in a few cases clients argued that they provided little added value to the initial rough estimates and the later, detailed analysis.

World Bank support for the OECS financial sector (mainly AAA) also exemplified responsiveness to crisis conditions. The global financial crisis precipitated the collapse of two regional insurance companies with heavy exposure in the OECS countries and more generally exposed weaknesses in the financial sector. Working in close cooperation with other partners, including the United Kingdom (which funded much of the work) and the IMF, the World Bank responded promptly to the ECCB and country calls for assistance, helping to resolve the insurance company failures and strengthen the legal and regulatory framework for both banks and non-bank financial institutions. A new insurance act that filled several gaps in the existing insurance legislation became effective in Grenada in 2010, though similar legislation in St. Lucia is pending. The World Bank also helped build the foundation for additional, more comprehensive improvements in bank and non-bank financial sector regulation and supervision, though this work is still in progress.

Addressing Institutional Capacity Limitations

The limited skills pool in many small states makes it infeasible to build and sustain the range and depth of policy making and service delivery capacity that larger states seek. As Brown (2010) and several others emphasize, small states' limited pool of skilled human resources (with a lack of depth in specialization to perform vital public service roles) makes the institutional capacity constraint uniquely binding and challenging to relieve, despite their extremely high per capita cost of public administration. The World Bank Group programs reviewed addressed a range of capacity constraint contexts (from Kiribati at the most binding end to Mauritius at the least binding end). However, the programs showed unanimous sensitivity to the constraint and responded with a variety of initiatives (including training, equipment, and resident and ad hoc expertise) aimed at enhancing client government and regional organization policy making and service delivery capacity, and private sector capacity in some cases. These initiatives (which varied in their effectiveness) were supported by World Bank financing operations, packaged as World Bank AAA or IFC advisory services, or provided with trust fund/third-party support. Project financial management arrangements that used existing country systems also helped reduce the burden on capacity in some contexts. Importantly, intensive e-mail and audio contact between World Bank staff and country officials allowed for informal capacity support in many of the programs.

Sustained technical assistance involving hands-on support for the nuts-and-bolts aspects of ongoing reform implementation was generally effective in building capacity. In the initial years of reform implementation in the Seychelles after the 2006–07 crisis, World Bank AAA and sustained hands-on support had a crucial role in helping the government rationalize public expenditures (particularly downsizing staff and removing subsidies) while establishing safety nets to protect the poor from cuts. The World Bank’s approach to building capacity for social protection reform was effective because it was sustained. The approach began with initial technical assistance to the ministry of finance to design a program for targeting subsidies in the 2008 budget, followed by customized assistance to the new social protection agency. By contrast, the World Bank did not sustain its capacity enhancement support into the second phase of public sector reform that followed off-loading inessential functions from the state. The World Bank could have been more proactive in continuing to help build capacity, notably by helping line ministries conduct strategic and functional reviews to identify their new roles and core functions.

Technical assistance also focused on helping countries strengthen data collection. In the OECS, World Bank technical assistance in coordination with other development partners helped improve education statistics and develop a strategy for education quality of education, collecting administrative data and publishing country and regional statistical digests on an annual basis. The technical assistance enabled the countries to move from a situation of complete absence of data to publishing annual statistics in a timely manner. The initiative involved working with the countries to benchmark statistical capacity using the Systems Assessment for Better Education Results, and was followed by training of staff responsible for statistics and education planning in the countries and the OECS commission and establishment of a community of practice for these officials.

Focused, just-in-time advisory input proved very useful in Mauritius’ higher-capacity environment. Feedback from stakeholders underscored the need to find better ways to build and sustain in-house capacity in line ministries (though it was unclear how much the government was willing to pay for these services). In interviews, several officials in line ministries noted that they welcomed discussion with the World Bank, but would like further exchanges to validate what they are doing. They see scope for more World Bank engagement in reviewing their work because this approach (pursued on an ad hoc basis) was very useful in several cases (urban transport and e-government strategy, for example). Yet, it was not clear how much the Government would be willing to pay for these services. Overall, though World Bank Group advice was often considered of better quality than alternatives, proposed instruments such as reimbursable advisory services (RAS) were found prohibitively expensive. Although in some middle-income countries RAS has become an instrument of choice and strongly shapes World Bank

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engagement, this is not the case in most of the small state programs. The exception was the Seychelles, where the Government requested RAS in a few areas (such as social protection).

A combination of technical assistance for reform implementation and DPF support proved effective in several programs. In Samoa and Tonga, the World Bank helped devolve responsibility for carrying out investment and routine maintenance to a new national highway authority. The Public Works Ministry then focused efforts on strategy, planning, and monitoring, and the World Bank provided substantial technical assistance to strengthen capacity in these areas. DPF supported the overarching policy changes, and investment project financing funded the investments needed to operationalize the new model. Programs in the health sector took a similar approach and were broadly successful in reaching their objectives. Hands-on technical assistance through investment project financing in Grenada helped implement DPF-supported reforms, notably to modernize and streamline customs administration.

Using limited public sector capacity more effectively often meant relying on private sector capacity, which fell short on occasion. In the Seychelles, nonessential functions were outsourced without first assessing the private sector's readiness to provide the services, and the potential capacity-building needs. For example, before the reform, the ministry of health provided laundry and catering services for hospitals. After outsourcing these activities, private operators proved unable to provide quality services at the required scale. In Kiribati, the World Bank realized that outsourcing maintenance of the main road (now under reconstruction) would need support to identify and train private contractors capable of performing the work. Another significant example of private sector capacity's pivotal role involved programs to provide financing to small and medium enterprises for business development services. The most successful programs rely on institutions that can provide hands-on assistance. In Cabo Verde, chambers of commerce were able to offer hands-on assistance to their members, and this was a key factor in the matching grant facility's success. The successful Mauritius Business Growth Scheme finances specialized expertise to small and medium enterprises in skills, technology upgrading, and marketing. The program relies on the effectiveness of the Mauritius Business Growth Scheme Unit (staffed by contracted professionals from the private sector) to respond to needs and help small and medium enterprises find local experts when necessary.

Several capacity-building initiatives appropriately focused on regional institutions. In the PICs, funding under the Pacific Facility (a trust fund established by the governments of Australia and New Zealand) enabled stronger policy dialogue and more intense AAA activity than was otherwise possible. The OECS has nothing comparable to the Pacific Facility, but the program's use of trust funds was particularly

intensive – more than five times the World Bank average. Several World Bank-supported capacity enhancement initiatives were organized regionally in both the OECS and the PICs, even when they benefited individual country institutions. For example, the ECCB benefited from capacity-building efforts and later took the lead in implementing debt management initiatives in the OECS based on the newly acquired capacity. This example also supports the notion that capacity building works best when focused on a concrete, practical set of issues of central concern to senior policy makers. By contrast, a trust-funded program to build capacity in a regional institution for generating and monitoring information on public programs was ineffective, partly because OECS country demand for such capacity was weak. World Bank support for building regional institutions' capacity in the PICs varied from good practice examples in aviation, fisheries, and the disaster insurance program, to limited involvement in other sectors.

Addressing Client Capacity for World Bank Portfolio Implementation

The programs used a variety of approaches to address the country capacity needs associated with World Bank portfolio implementation. World Bank in-country representation was not cost-effective in many cases because of the client country's small size. For example, the World Bank Group had no in-country presence in the OECS, but proximity to Washington allowed frequent country visits, and the World Bank provided fiduciary and procurement training in the Caribbean region every year, benefiting client country staff responsible for project implementation. There was also continuing informal support from World Bank staff in these areas in many of the programs. A small office in Mauritius ensured an in-country presence; the office housed the country economist, who was also the country liaison officer for Mauritius and the Seychelles. Frequent missions to the Seychelles helped sustain in-depth dialogue with the authorities. Travel in the PICs can be highly time-consuming. The World Bank deployed a field presence in Kiribati, Samoa, Tonga, and Vanuatu¹¹ by sharing locally recruited liaison officers with the Asian Development Bank (ADB). This seems effective in facilitating processing of World Bank operations and could be replicated elsewhere. However, interlocutors in the PICs were concerned about the need for increased World Bank technical staff presence in the field, and the World Bank is considering moving some positions from Sydney to Suva, Fiji as they come up for rotation. Promisingly, the PICs program also started appointing World Bank staff implementation support specialists, whose job description centers on helping country counterparts execute the World Bank portfolio. In Cabo Verde, counterparts considered the lack of in-country presence a serious handicap for better dialogue and smoother program implementation. Furthermore, the lack of daily flights to Cabo Verde prevents frequent missions, even though the country director is based in Dakar.

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Intensive use of DPF in some programs reduced the need to cope with World Bank procedures, but programs with more prevalent investment project financing found several ways to mobilize the needed capacity locally. In Mauritius, for example, the authorities chose to cancel an investment project financing operation because of burdensome procedures and expressed a strong preference for almost exclusive use of DPF. Various programs using investment project financing deployed a variety of approaches (often a blend) that were well suited to the small size of the client countries, such as institution building and supplementing capacity with outside expertise as needed. In some OECS countries (Grenada and St. Lucia), country project coordination units provided a capacity pool to implement portfolio-wide fiduciary functions and received ongoing support from the World Bank. This helped safeguard portfolio quality, though it also tended to raise issues of sustainability, and sector-agency coordination and ownership. Other pooling models included the use of regional project implementation units (OECS Electronic Government for Regional Integration Project), and shared project implementation units, such as the Tonga-based single technical fiduciary services unit that covers five countries under the PICs aviation project. In the latter case, the program, despite its success, shows the difficulty of adopting a multicountry approach because some countries express dissatisfaction and see the unit as an additional bureaucratic layer. Project execution functions on some projects in Samoa were outsourced to a private firm. In a few cases, line ministries or agencies (for example, in health or public works) were directly responsible for portfolio implementation, including fiduciary functions. However, in the small states programs reviewed, this tended to be the exception rather than the rule.

Fostering Partnerships

Effective ways for development partners to join forces are particularly important in small states, where financing from partners is often more of a lifeline to economic viability than in larger states. Given small states' limited capacity for coordinating donor support, coordinated action among development partners crucially lowers transactions costs for client countries. The World Bank needs to work particularly closely with regional development banks to be effective in these countries. The programs reviewed used a number of vehicles and modalities that facilitated unified or at least coordinated support (in addition to for forums for regular coordination among key donors, used notably in the Pacific and the OECS).¹² These vehicles varied significantly in permanence and formality, World Bank Group and other partner resource outlays involved, the breadth of issues addressed, and the precise instruments involved (financing, AAA, trust fund arrangements, and so on).

The Pacific Facility was a highly effective example of broad-based, strategic partnership with Australia and New Zealand, though its replicability elsewhere is uncertain. Under this trust fund arrangement, the donors provided the World Bank and IFC (separately under the Pacific Partnership) with fully fungible administrative budget resources that enabled the World Bank to increase its engagement with the PICs dramatically.¹³ The Pacific Facility arrangement (along with a similar facility benefiting ADB) was driven by a perception among the donor governments that both the PICs and the Pacific region (including the donors) would benefit if the World Bank and ADB were involved more intensively in policy dialogue. The circumstances that led to the arrangement are clearly unique, but it is possible that other small state programs could benefit from similar third party mechanisms.

The framework around the World Bank's use of DPF in some of the programs helped to align donor views in concerted support of the policy reform agenda. The use of DPF in the PICs contributed to donor coordination that was more effective. A striking example of clarifying and simplifying the donor interface with the government was in Tonga, where ADB, the World Bank, and the EU initially decided to provide budget support on an individual basis to offset the negative impact of the global crisis on remittances. Overall, these programs had several pages of separate policy conditions. At the government's request, the World Bank took the lead to propose a coordinated approach with a common framework with fewer conditions.

The World Bank and other development partners in many cases jointly delivered support for specific subsets of single-country or shared development issues. Several donors joined the World Bank in the Caribbean (and later in the Pacific) to support a pooled disaster risk insurance facility. The World Bank has administered a program since 2011 (the Supporting Economic Management in the Caribbean initiative funded by Canada) to strengthen revenue and expenditure management, with a particular focus on IT systems. The initiative mobilizes partners such as the Caribbean Regional Technical Assistance Centre, and has an underlying goal of fostering collaboration and shared support structures for harmonized systems across the beneficiary countries, which extend well beyond the OECS. The World Bank was one of multiple partners supporting the Caribbean Growth Forum, a process for identifying and acting on constraints to competitiveness in which a regional platform underpinned country-specific reform agendas. The World Bank's financial sector AAA in the OECS (which the United Kingdom supported) saw particularly close collaboration with the IMF and other partners, and its training and advisory work on debt management similarly involved other partners, including Canada and the IMF. A similar strategy to facilitate country implementation has been for the World Bank to combine multiple sources of financing, thus decreasing fragmentation and channeling funds to small states under a single set of procedures.¹⁴

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The donor community in the Pacific uses the Pacific Regional Infrastructure Facility to coordinate efforts supporting infrastructure financing. The facility, established in 2008 and funded mainly by Australia and New Zealand, conducts research and analysis on infrastructure needs and priorities and provides technical assistance to PIC governments. The facility proved to be a useful mechanism to identify infrastructure needs after natural disasters and plan how to meet those needs. The facility also helped shape a strategic approach among the donor community in some sectors, such as energy, but China's absence is viewed a weakness because the country is a major actor in infrastructure financing and construction.

The World Bank and ADB's special efforts to coordinate their infrastructure engagement in the PICs were particularly helpful. Along with alternating lead roles in specific sectors and countries, the two institutions cofinanced specific projects and worked to harmonize procedures. For a roads project in Fiji, the World Bank provided \$50 million in cofinancing to supplement ADB's \$100 million and decided to use ADB's procedures for both financing components—a major advantage for the implementing agency. Similarly, it was agreed that ADB financing will be subject to World Bank procurement procedures in a cable project in Samoa, building on an initial joint financing experience under a similar project in Tonga. Yet it remains challenging to put joint financing between the ADB and the World Bank into practice, especially applicable rules and procedures on procurement. In the Samoa example, eligibility of bidders is still an issue under the ADB procurement policy even though it was agreed to follow the World Bank's procurement procedures.

Other Aspects of World Bank Group Engagement

Many standard features of the World Bank's business model, though tailored to sound, accountable support delivery in larger states, are poorly adapted to small states. World Bank administrative budgets in particular cannot meet many of the fixed costs of field presence. Consequently, opportunities for policy dialogue and implementation support are more restricted. Fiduciary procedures associated with World Bank financing place demands on limited client institutional capacity. The programs reviewed had to find ways to deal with these multiple challenges, and they found multiple ways—including some mandated at the institutional level—of better adapting the World Bank's standard business model to small states.

Poor adaptation was visible in the extremely high preparation and implementation support unit costs associated with World Bank financing in some of the programs. In the OECS program, preparation and implementation support costs per dollar of financing were at least 10 times the World Bank average. And costs were similar in the

PICs. In both cases, the high unit costs reflect both the small amounts lent and the intensive hands-on engagement needed. By contrast, costs in Mauritius and the Seychelles were significantly lower (neither was significantly above the World Bank average in Mauritius), likely because financing was delivered almost exclusively through DPF.

Small state country teams devised numerous creative ways to manage budget constraints. Budget augmentation is a major tactic, and the PICs program is the most striking example of its use. The Pacific Facility and Pacific Partnership provide the World Bank Group with dramatically larger administrative resources and help overcome the constraints of engaging and delivering financing, investments, and AAA. The OECS program had no comparable wholesale administrative budget augmentation, but instead used a number of trust fund arrangements to broaden and deepen the reach of analytic and advisory work, such as backing from the United Kingdom in the financial sector and from Canada on debt management. In these and other programs, the Global Facility for Disaster Reduction and Recovery (GFDRR) funded much of the technical assistance that contributed to the growing World Bank disaster risk management engagement as well as to the Caribbean Catastrophe Risk Insurance Facility and its equivalent in the Pacific.¹⁵ Much of this funding was World Bank-executed, and helped complement constrained World Bank administrative budgets. Many small states also benefited from increased budget allocations to fragile and conflict-affected situations. Another major tactic for adapting to budget constraints in the OECS and PICs programs was frequent use of regional and pooled or replicated ways of cutting unit transactions costs. These included grouped partnership frameworks and regional and multicountry instruments, such as the horizontal adaptable program lending project arrangement. In some cases, these offered additional advantages beyond reducing transaction costs—for example, regional projects could mobilize regional IDA funds to supplement country IDA allocations. Without such instruments and approaches, the unit costs of delivering both financial and nonfinancial services would likely have been significantly higher. Another adaptation involved diverse arrangements to support clients' handling of procedures associated with World Bank project financing, including outsourcing arrangements, and countrywide, cross-country, and regional implementation units. Despite these various approaches (and because of them, in some cases), administrative transaction costs associated with preparation and implementation for the World Bank still tended to be high relative to total project costs.¹⁶

Procurement was an ongoing challenge in the small state programs reviewed. Interlocutors frequently cited procurement as the main problem they face in dealing with World Bank procedures. However, the World Bank's 2013 Operational Policy for Investment Project Financing, which allows for simplified procedures (including

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simplified procurement procedures) in fragile—including small—states seems to have significantly benefited the programs. The simplified procedures, which counterparts viewed favorably, allow greater flexibility in competitive bidding, prior review thresholds, and supplier and bidder numbers and qualifications. The streamlined procedures simplify formalities and are better suited to the substance of small state realities, including the frequent difficulty of generating bids at a reasonable cost. The World Bank and client countries occasionally found more ways to adapt procurement to small state realities. For example, a regional telecommunications project in the Caribbean used pooled procurement (managed by the St. Lucia Project Coordination Unit) for broadband assessment on behalf of several participating countries, with good results. The PICs aviation program is using a similar approach (World Bank 2016a, chapter 4; 2016b, appendix H).

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¹ This limited capacity does not stop at the government but extends to the private sector as well.

² Because of the OECS countries' high debt levels, they have had little appetite for IBRD financing. In some cases, they have been reluctant even to fully use their national IDA allocations (this is the case with Dominica and St. Vincent and the Grenadines, for instance).

³ The eight Pacific Islands included in the Systematic Country Diagnostic are the Federated States of Micronesia, Kiribati, the Marshall Islands, Palau, Samoa, Tonga, Tuvalu, and Vanuatu. The diagnostic excluded Fiji because a Country Engagement Note had been prepared just before the Systematic Country Diagnostic.

⁴ Subject to specific access criteria, regional IDA grants can also be provided to regional organizations that support small states implementing regional IDA projects.

⁵ For example, in the Organisation of Eastern Caribbean States (OECS) program, projects designated as regional included operations to support catastrophe insurance, e-government, communications infrastructure, a regional energy regulator, and disaster vulnerability reduction. (However, in practice, the regional content of the disaster vulnerability reduction operations was relatively minor.) All operations except the catastrophe insurance mobilized regional IDA funds (totaling \$42.6 million), along with the financing from country IDA allocations from which they drew (a total of \$53.6 million), with a leveraging effect of almost \$4

for every \$5. Similarly, in FY15 the small states in the PICs contributed about SDR30 million from their national IDA envelopes, which leveraged an additional SDR100 million from the regional IDA envelope.

⁶ One potential risk with IDA regional funds is that they may unwittingly bias World Bank operations towards activities that are eligible under these regional funds. This is particularly important for climate and disaster resilience operations, since only some components of disaster risk management – disaster risk financing, early warning systems – are eligible under regional IDA funds. The majority of disaster risk management needs (and financing gaps) for Small Island States are actually in risk reduction, which is national or sub-national in scope. That said, the evaluations under the cluster did not find evidence of such bias in Bank activities. Disaster risk management financing at the national level has been large and increasing fast. And regional IDA funds were not a huge portion of the financing envelope.

⁷ For example, under the FY15–19 OECS partnership framework, no regional IDA funding was available to any of the six regional projects under preparation (even though each met the relevant criteria) because of high demand for regional IDA 17 funds in the Latin America and the Caribbean region.

⁸ Other instances of using the horizontal adaptable program lending instrument, such as supporting e-government and communications infrastructure, are counted as regional projects.

⁹ Chapter 3 of this report discusses this work.

¹⁰ IDA's Immediate Response Mechanism does however provide a means of setting up contingent components in World Bank IPF such that undisbursed project funds can be drawn upon quickly in cases of emergency.

¹¹ The position in Kiribati has been vacant for some time and a new recruitment process is ongoing.

¹² A key forum in the OECS is the Eastern Caribbean Development Partners Group, which meets quarterly in Barbados to coordinate assistance to the OECS.

¹³ See World Bank (2016b), chapter 2 for a more complete discussion of the Pacific Facility and the factors leading to its establishment.

¹⁴ The Pacific Resilience Program, for example, combined IDA grants and credits (both national and regional allocations) as well as grants from the Global Environmental Facility, GFDRR, and the Pilot Program for Climate Resilience.

¹⁵ Over FY11–15, for example, GFDRR contributed about \$44 million in funding for technical assistance to small island developing states.

¹⁶ Administrative transactions costs also tended to be high relative to total project costs on the client side. For example, the project implementation cost in one project in the PICs was 30 percent of the total project cost.

3. Strengthening Resilience

The resilience pillar reflects core development constraints that small states need to address because of their vulnerability to shocks from the global economy and natural disasters. IEG assessed the World Bank Group's contributions to strengthening resilience in-depth only in the Organisation of Eastern Caribbean States (OECS) and the Pacific Island countries (PICs), and in the Djibouti program to a lesser extent (limited to environmental and social resilience). Based on these assessments, this chapter selectively reviews World Bank Group approaches and contributions to strengthening resilience that bore special links (thematically or operationally) to the small size of the client countries, but does not systematically provide evidence for evaluative judgments, which can be found in the underlying country program evaluations. The resilience pillar includes three dimensions of resilience: macroeconomic/fiscal resilience; environmental, climate change, and disaster resilience; and social resilience. The importance of these dimensions is not limited to dealing with shocks: a stable macroeconomic environment, long-term environmental sustainability, and sound human capital are all fundamental requisites of sustained economic growth with shared benefits. However, vulnerability is a source of special difficulties that small states face in addressing these issues, so this chapter emphasizes that aspect.

Strengthening Macroeconomic/Fiscal Resilience

Macroeconomic (particularly fiscal) resilience was a major issue driving World Bank Group support in the OECS and many of the PICs. Budget deficits are a chronic phenomenon for small countries facing diseconomies of small scale in government, despite respectable revenue collection in most cases. This is especially true where services delivery is to a widely dispersed population, as in some of the PICs. Frequent natural disasters and economics shocks (including the 2008–09 global financial crisis and the food and fuel price crisis immediately before it) compounded these structural problems. The combination of these factors and occasional poor policy choices, such as investment in overscaled infrastructure, often led to a buildup of high debt levels. For example, debt levels in the OECS largely exceed the 60 percent debt-to-gross domestic product (GDP) convergence criterion for the currency union. However, the debt problem is also evident in some of the PICs, particularly Fiji and Samoa, and Tonga and Tuvalu to a lesser extent. Confronted with these issues, the World Bank programs sought to help strengthen sustainable fiscal and debt management through numerous activities aimed at improving public revenue and expenditure policies and management, fiscal and debt management, and broader public sector performance. This chapter discusses two aspects of the World Bank's work that particularly resonate with

small states: establishing pooled insurance mechanisms against catastrophic weather-related events, and debt management, including fiscal and debt sustainability.¹

The World Bank was the driving force in establishing pooled insurance programs that provide liquidity payments after natural disasters in the Caribbean, and later in the Pacific. The World Bank had an essential part in developing the Caribbean Catastrophe Risk Insurance Facility (CCRIF), a multicountry insurance pool that provides insurance coverage to governments against parametric risk (specified hurricane wind speed, earthquake magnitude, and excess rainfall) at significantly lower cost than previously available. This allows rapid payout after a disaster to provide the liquidity needed for urgent response. The facility is now independent and self-sustaining, operating on the premium payments of member governments, including the OECS. Among other key contributions, the World Bank worked on the development of in-depth country risk profiles and the CCRIF's financial structure, and helped convene donors who supported the facility. World Bank financing helped capitalize the CCRIF and cover initial premium payments for some member countries. The World Bank has since supported similar efforts in the PICs with the Pacific Catastrophe Risk Assessment and Financing Initiative (managed directly by the World Bank Treasury), a pilot program involving four countries (the Marshall Islands, Samoa, Tonga, and Vanuatu) that appears successful to date, though it is unclear if a standalone facility like the Caribbean model will be feasible. Both the CCRIF and the Pacific Catastrophe Risk Assessment and Financing Initiative involved Japan and numerous other development partners besides the World Bank in various capacities. Neither facility seeks to cover the value of assets; their function instead is to provide governments with liquidity to fund emergency responses after major natural disasters, thus avoiding disruption to normal spending programs.

World Bank support, mostly analytic and advisory activities (AAA), helped build debt management capacity in the OECS and the PICs. World Bank inputs to help build capacity for debt management in the OECS were relatively modest and focused, consisting of mostly AAA and training undertaken with funding from Canada. The initiative was part of a larger effort coordinated through the Eastern Caribbean Central Bank (ECCB) and involved the IMF and other partners. The initiative strengthened capacity at the ECCB and in the individual countries for debt management assessments, medium-term strategies, and sustainability analysis. In the PICs, the World Bank helped establish debt units and debt monitoring systems and provided associated training. Separately, the World Bank also introduced the Comprehensive Debt Framework, a general framework for approaching debt management in small states that articulates the multiple policy levers affecting public debt and their interconnectedness, including growth and the underlying business climate, the fiscal position, resilience to natural disasters, and active debt portfolio management. The framework underpinned

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subsequent World Bank work in the OECS – including the FY15–19 regional partnership strategy and the Grenada programmatic development policy financing (DPF) series that began in FY14 – and was later presented in the Pacific .

The World Bank also used DPF in the PICs (and to a lesser extent in the OECS) to address fiscal and debt sustainability issues, with mixed results. Donors in the PICs looked to the World Bank for leadership in this area, and the DPF instrument proved important for effective donor coordination supporting dialogue about a common reform agenda. The fiscal situation in Tonga worsened because of natural disasters and the global financial crisis, driving debt to above 50 percent of GDP by 2010. Four World Bank DPF operations between late 2011 and 2014 supported measures to strengthen public financial management. The World Bank’s program in Samoa also featured intensive use of DPF to support enhancing fiscal resilience, and three DPF operations were approved during FY10–15 in a context in which a combination of natural disasters and the global crisis had similarly worsened fiscal and debt indicators. In both countries, World Bank AAA and technical assistance were an essential part of the package to support improved revenue and expenditure efficiency, debt management, and public financial management. Some outcomes were favorable, and the operations helped frame close coordination among donors providing budget support. However, the Samoan government’s decision to borrow for the construction of a new Apia airport terminal (on harder-than-agreed terms) undercut progress on debt sustainability. The OECS program also used DPF, though less intensively. The World Bank delivered a one-time DPF operation to Grenada and St. Lucia to help cope with financing needs after the global crisis in 2010. Both operations supported measures to help strengthen fiscal resilience (for example, introducing a value added tax in St. Lucia, and upgrading the Automated Systems for Customs Data in both countries). In Grenada (in contrast to St. Lucia), parallel hands-on project support helped secure better outcomes associated with the operation. However, World Bank engagement in both countries through one-time DPF was less sustained than in Tonga or Samoa, where the serial nature of World Bank DPF ensured some continuity in dialogue and support for reforms. Approval in FY14 and FY16 of two DPFs (part of a planned three-part programmatic DPF series) accompanying IMF support changed this in Grenada. The series provided a useful mechanism for coordinating with other partners providing budget support, such as the Caribbean Development Bank.

Strengthening Environmental Resilience

Both the PICs and the OECS face severe risks from natural disasters because of their location, geography, and size. Cyclones in particular occur frequently and have potential for devastating impact. For example, Hurricane Ivan in 2004 caused damage

and loss to Grenada exceeding 200 percent of GDP, and Cyclone Pam in 2015 inflicted damage and loss to Vanuatu of about 64 percent of GDP. Natural disasters cause direct losses to property and people, but also affect development because reconstruction needs contribute to high debt burdens and the resulting limited fiscal space. Because of the amount of damage disaster events cause, disaster risk management is a central development challenge of higher priority than in most other country contexts, and the need for disaster preparedness and risk reduction is critical. Climate change will exacerbate disaster risks, with rising temperatures increasing the frequency of the most serious storm and drought events, and rising sea levels contributing to more serious disaster effects on coastal areas, where most of the population resides. Poorly planned development, such as construction in highly vulnerable coastal zones, has increased disaster exposure. Many of these issues also apply to Djibouti – though not exposed to tropical cyclones, other climate phenomena affect the country, such as flooding and drought.

Disaster risk management was a core part of World Bank engagement in both the OECS and PICs programs, covering three broad areas: reducing disaster risks by increasing infrastructure resilience, enhancing capacity and preparedness (including financial preparedness), and policy reform. The World Bank also supported some of these elements in Djibouti. Project experiences and results were context- and case-specific across the three country groups, but common themes emerged in each of these areas. Many of the activities supported in disaster risk management engagements are similar to those in larger countries, but they face particular challenges in the small states context, often driven by capacity limits, thin markets, and higher unit costs from an inability to exploit economies of scale. World Bank operations included emergency response and reconstruction efforts, building disaster resilience into infrastructure interventions; enhancing preparedness capacity for coping with disasters; developing pooled risk reduction facilities to cushion the fiscal impact of disasters; supporting land use and zoning policies that reduce disaster impacts; and helping countries cope with the consequences of climate change. Both programs also featured multicountry project platforms that offered reduced transactions costs and possible economies of scale in certain areas. Beginning in FY11 the OECS program provided financing for disaster risk management investments in the four IDA blend countries through the Disaster Vulnerability Reduction Project, established as horizontal adaptable program loan financing. The recently approved Pacific Resilience Program similarly established a regional platform for World Bank engagement with the PICs on disaster risk management.

Regarding infrastructure interventions, successive World Bank projects helped ensure more disaster-resistant standards and funded risk reduction infrastructure such as seawalls and dikes. World Bank reconstruction projects targeted high priority assets

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such as schools and medical clinics, which can function as emergency facilities after a disaster by supplying water, sanitation, shelter, and services. Improved facilities can be much more resilient. For example, infrastructure in Grenada financed under a 2001 emergency response project survived the devastating 2004 Hurricane Ivan, and two retrofitted schools were the only schools in the country left largely undamaged after the storm. However, some targeting had less leverage, such as housing reconstruction in Tonga. Protective works reduced the risks to assets and communities, though designs tended to focus on concrete measures (such as seawalls) instead of natural alternatives that may be less disruptive. The World Bank also contributed to greater resilience by ensuring that it financed infrastructure to higher design standards, as in the design of a crucial bridge in St Lucia. However, the cost of building more resilient infrastructure can be substantial, and available financing is sometimes sufficient to cover only a portion of what is needed, such as for the West Coast Road in Samoa. Furthermore, many works projects faced serious delays because of government capacity limits, complications with land issues, procurement challenges, and cost overruns.

The programs included a range of activities aimed at enhancing preparedness and risk management capacity, with mixed results. Early warning systems seem to be of high value, though some disasters are still hard to predict and thus provided little warning, such as a severe flood event in St. Vincent and the Grenadines and St. Lucia in 2013. After-action reviews developed, implemented, and improved disaster plans. However, planning processes rarely used the hazard maps and other analytic work produced, and they can be difficult for the public to use. Technical training led to some improvements in data management capacity, but high turnover limited the training program's impact because trained experts move to the private sector or emigrate – a challenge in all countries, but particularly acute in small states like the PICs and the OECS, where emigration rates are high and capacity is thin. Efforts to improve data collection struggled with maintenance problems, and many once-functional stations are no longer operational. Policy dialogue has the potential for shifting broader planning and investment behavior, and it made a difference in a few cases (for example, encouraging a state-owned water utility in St. Vincent and the Grenadines to invest in reducing its pipe network's vulnerability to storm damage). However, examples of a climate resilience focus in government planning are rare except in donor-financed projects.

World Bank programs also sought to bring a broader resilience focus to government planning processes. There was significant progress in increasing finance ministries' awareness of disaster risk and ability to manage its fiscal implications, but examples of other tangible policy changes are relatively few. World Bank efforts to shift land use policy had limited impact because the tourism industry and private landowners oppose zoning. The World Bank helped update building codes in some countries to provide stronger standards against cyclones, but the codes often met with weak compliance and

enforcement except in the public sector. Development in highly vulnerable areas is a major driver of increased disaster risk, and governments rarely supported preventive resettlement, so the potential burden of World Bank resettlement safeguards hindered engagement. The government of Samoa, with World Bank support, tried to encourage voluntary resettlement inland after a tsunami by building a high-quality road and relocating some services, but after some initial relocation in the years after the disaster, many people returned to the coastal strip, which is the focus of their livelihoods and community assets. After occupants of highly vulnerable flood zones in Djibouti were resettled for creation of flood protection works, informal settlements encroached on these zones soon after.

Strengthening Social Resilience

The PICs and the OECS shared certain challenges in education, employment and skills, health, and social protection. High and rising unemployment was an important shared challenge, particularly when growth slowed after the 2008–09 global crisis. Both country groups drew significant remittances from temporary labor migration, but it was much more important in the PICs. The rapid emergence of noncommunicable diseases as a major threat to human capital was a significant shared health challenge among these countries. In education and social protection, challenges tended to be more country- or group-specific. However, shared concerns included education quality and skills, and adequate protection of the poor and vulnerable, particularly after shocks. The OECS countries' education priorities included expanding access to secondary education and addressing systemic issues, such as curriculum reform and teacher skills.

Regarding social protection, few of the PICs had formal social protection mechanisms, except for Fiji. The OECS countries had systems that were more developed but poorly targeted (despite being costly) and excluding many of the needy. Finally, HIV/AIDS prevention and control was also a major concern for the OECS countries considering the high and rising prevalence rate in the Caribbean in the early 2000s, which was second only to Sub-Saharan Africa.

Three aspects of World Bank support for social resilience are of interest from a small state viewpoint. The OECS, PICs, and Djibouti programs provided support for strengthening social resilience in several ways during the evaluation period. The programs included significant support for strengthening social protection mechanisms, which itself is significant, but the support contained few elements particular to the small size of the client countries (World Bank 2016, chapter 3).² A key aspect of World Bank project support for HIV/AIDS prevention and control and for secondary education in the OECS that is interesting in a small state context was its structure as a regional platform (discussed in chapter 2). The discussion here is confined to labor

migration in the PICs, noncommunicable diseases in the OECS and the PICs, and the use of community-driven development initiatives in support of the social protection agenda in Djibouti. The temporary labor migration issue affected the long-term economic viability of several PICs in a way that would not affect larger states with greater diversification opportunities in domestic economic activity. However, the World Bank's work in this area exemplifies the potential for transformational impact in small states using primarily multicountry policy dialogue and AAA. Similar observations apply to the World Bank's work on noncommunicable diseases in the PICs and OECS, but the work's impact is still unclear because the involvement is relatively recent. The community-driven development initiatives are of interest inasmuch as the Djibouti program was unique among the programs reviewed in using them.

The World Bank's work on temporary PIC labor migration effectively used regional policy dialogue and AAA to address a key constraint to social resilience. *Pacific Islands at Home and Away: Expanding Job Opportunities for Pacific Islanders through Labor Mobility*, published in 2006, was the cornerstone of the economic and sector work. The report asserts that the PIC economies could not generate the employment needed to meet demographic trends and presents evidence that remittances have a vital role in social protection. The World Bank's *Pacific Futures* report in 2012 argued that it is difficult to see a path to economic viability without substantial reliance on remittances and sustained development partner assistance in the long term. This body of economic and sector work and, crucially, the policy dialogue with Australia and New Zealand during its preparation and dissemination was instrumental in influencing the two countries' decisions (especially New Zealand) to expand employment programs for temporary migrants from the PICs. The blend of analytical rigor and practical guidance was particularly valuable, including providing examples of similar programs elsewhere. The World Bank also worked hands-on with specific PICs to help them implement the programs on their end. A 2014 impact evaluation of New Zealand's Recognized Seasonal Employer program found large, positive effects on households in Tonga and Vanuatu that sent migrant workers abroad, including per capita income increases of more than 30 percent, greater ownership of durable assets and, in Tonga, a 20 percentage point increase in school attendance for 16- to 18-year-olds.

The World Bank helped client countries in the OECS and the PICs improve knowledge and raise awareness of the growing noncommunicable disease burden, and began institutionalizing prevention. Noncommunicable diseases have emerged as a new challenge that needs to be addressed together with a myriad of other health challenges, including the continuing threat of communicable diseases and the objective of ensuring universal health coverage. Widely disseminated FY11 analytic work covering the OECS highlighted noncommunicable diseases' high contribution to life years lost (70 percent, which is above the 60 percent average for middle-income countries in Latin America

and the Caribbean) and recommended health promotion and prevention programs, better surveillance, regional legislation and policies, and staff training. Major risk factors included childhood obesity, which is a specific target of subsequent Caribbean-wide World Bank nonlending technical assistance to support awareness-raising and prevention activities such as toolkit distribution to health ministries. The World Bank is working with several other development partners and governments in the PICs, where obesity rates are among the highest in the world, to support implementation of a roadmap that will improve understanding of noncommunicable diseases and help reduce their burden. The World Bank is advocating for policy changes in many sectors—including education, transport, and agriculture—to help educate the population and promote healthier behaviors. World Bank DPF already supports some key actions, such as increased taxation of tobacco, sugar drinks, and high-fat foods. Diabetes early detection and treatment was a particularly important part of the countries' approach.

A series of community-driven development (CDD) projects in the Djibouti program sought to target urban poverty, with modest results.³ The first project in the series, initiated in 1999 as part of the post-conflict reengagement program was mostly successful in developing basic urban infrastructure and generating temporary work in 20 of the poorest neighborhoods and in establishing a CDD implementation agency which later became the social development agency, the Agence Djiboutienne de Développement Social (ADDS). Subsequent World Bank operations in the series were accompanied by parallel projects funded by several development partners, all implemented by the ADDS and now part of the Djibouti Poverty Reduction Program.⁴ Nevertheless, the more recent World Bank operations (the 2008 Urban Poverty 1 and the 2014 Urban Poverty 2, which is still ongoing), which focus on one neighborhood in Djibouti Ville, have produced only modest results thus far despite the long-standing World Bank support to the urban sector.⁵ The main concerns include little use of some infrastructure, poor maintenance,⁶ and the absence of targeting measures to improve the living conditions of the poorest in this neighborhood.⁷

The Djibouti program's response to the 2008 food crisis paved the way for the institutionalization of broader social protection mechanisms. The sharp increases in international food prices in 2008 underscored the inability of existing social protection programs to mitigate the negative impact of food price increases on the poor in order to respond adequately to crises of this kind. The World Bank's 2008 Food Crisis Response Development Policy Grant, complemented by a medium-term technical assistance program, laid the groundwork for an unprecedented government commitment to a social protection program. A pilot social safety nets project that simultaneously addressed the two most serious human development challenges in Djibouti—malnutrition and unemployment—was launched in 2010. The pilot project was

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followed by a scaling-up project in 2012 in response to a severe drought in 2011, and two additional financing operations were approved in 2014 and 2016. The series of operations, which combines nutrition and workfare activities that target households with pregnant women and children 0-2 years of age (0-5 in certain areas), created the foundations of a social safety net system. It helped create a social registry to identify and target poor and vulnerable households, which is now being used to implement the first national cash transfer program (launched in January 2016). This first and very basic cash transfer program covers the entire country. Preliminary results from a rigorous impact evaluation confirm the benefits of providing participants with access to income through the workfare program compared to nutrition activities alone.

Reference

World Bank. 2016. *Regional Program Evaluation of the Organisation of Eastern Caribbean States: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines*. Washington, DC: World Bank.

¹ A more comprehensive discussion of macroeconomic issues is provided in the OECS and PICs RPEs.

² For example, the Organisation of Eastern Caribbean States (OECS) program consisted of comprehensive diagnostic work on existing social protection mechanisms in the countries, followed by financing to support reforms in some countries. For details, see World Bank (2016), chapter 3.

³ The series consisted of the 1999 Social Development and Public Works operation (P044584); the 2003 Supplemental (P082221); the 2008 Urban Poverty 1 operation (P088876); the 2010 Additional Financing (P120190); and the 2014 Urban Poverty 2 operation (P145848).

⁴ The African Development Bank, the Islamic Development Bank, the French Development Agency, and more recently the United Nations Children's Fund financed parallel projects to the World Bank's.

⁵ World Bank engagement in Djibouti's urban sector dates back to 1984 with the first government urban upgrading programs.

⁶ The 2015 Implementation Completion and Results Report points out that there is still no systematic policy for maintenance of existing infrastructure, and that facilities and roads built with World Bank support are not cleaned routinely and are likely to deteriorate rapidly.

⁷ The project focused on the better-off part of *Quartier 7* and did not include specific actions to improve the living conditions for the *Djaga Bouldouq* slum residents.

4. Improving Competitiveness

The enhancing competitiveness pillar was prominent in all the World Bank Group programs evaluated under the cluster. The pillar covers enhancing the policy and regulatory framework for market-led growth, strengthening the financial sector, expanding and better managing infrastructure, and promoting leading productive sectors. IEG assessed World Bank Group contributions to enhancing competitiveness in-depth in the programs in Cabo Verde, Mauritius, and the Seychelles, and in the Organisation of Eastern Caribbean States (OECS) and the Pacific Island countries (PICs). Based on these program assessments, this chapter selectively reviews World Bank Group approaches and contributions under the competitiveness pillar where the subject matter or the approach are of particular interest or importance in a small state context. Similar to other parts of this report, this chapter does not typically provide evidence to support judgments about effectiveness (which are found in the underlying evaluations).

Small economies generally need stronger competitiveness than larger states because of their limited scope for diversifying and producing at efficient scale. It became apparent during the evaluation period that traditional growth sources were not generating strong, sustainable growth rates, especially when considering periodic natural disasters. The World Bank Group programs reviewed (like programs in other small states) need to increase their competitiveness through enhanced policy and regulatory environments, better-functioning financial sectors, improved infrastructure, and better-performing leading productive sectors. Therefore, World Bank Group programs evolved to concentrate more on competitiveness than in the past, and this was particularly striking in the PICs, where the strategy is evolving toward “bending the growth curve upward” (in the words of the country director).

Enhancing the Policy and Regulatory Framework for Market-Led Growth

World Bank Group programs sought to address key areas such as liberalizing and facilitating trade and enhancing skilled labor availability. Many of the programs included wide-ranging efforts to improve the business environment, often based on the Doing Business framework and involving collaborative World Bank-IFC work. However, many features of its work in this area was not of specific interest to small states, except for the possibly greater intrinsic importance of a conducive business environment for small states. This section confines the discussion to two areas: trade policy and facilitation, and labor skills. Regarding foreign trade, openness is vital since small states cannot capture economies of scale through production for the domestic market, and facilitated trading arrangements are particularly important to lowering

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costs and fostering transparency and better governance. Regarding labor skills, investment climate assessments and similar work consistently highlighted the need for technical and commercial skills, given the limited supply in small states. For example, the World Bank's 2011 enterprise survey in the OECS identified "an inadequately trained workforce" as one of the top constraints to private business success (behind only access to finance and electricity).

The programs' coverage of trade policy and facilitation was selective. A focus on trade policy was evident in Mauritius and the Seychelles (where trade barriers were more significant at the start of the evaluation period), but was less evident in Cabo Verde, the OECS, and the PICs, where tariff and nontariff barriers were less significant. However, some OECS countries focused on trade facilitation. A 2010 World Bank report on trade and labor in Mauritius catalogued nontariff trade restrictions and implementation bottlenecks, and was instrumental in subsequently dismantling some of the nontariff barriers. However, support for continuing protection remains strong in some areas, and nontariff barriers such as administrative procedure and discriminatory regulations (between imported and locally produced products) remain important despite being eliminated *de jure*. World Bank support in the Seychelles helped produce substantial reductions in the cost of importing and exporting during the evaluation period, and it improved customs administration in some of the OECS countries. The support was particularly effective in Grenada, where coordinated World Bank-IFC activities helped the country transition to the Automated System for Customs Data World, introduce paperless customs processing, and streamline procedures, resulting in a significant decrease in the time needed to import and export.

The programs typically did not address labor mobility, skills development, and training in a systematic way. Few programs focused on labor skills shortages (often because support was forthcoming from other partners) even though diagnostic work suggested that shortages are one of the most significant constraints to competitiveness. As discussed under the social resilience subpillar, the World Bank was instrumental in helping to enhance temporary labor migration opportunities in the PICs. Although the initiative was important, it did not intend to help build skills (and evaluative evidence suggests it has not done so). Recognizing this, Australia and New Zealand established add-on skills training that allows workers to receive formal qualifications. Although skills development issues are complex and fraught with difficulties, World Bank-supported initiatives in the OECS suggest some scope for effective support. A 2007 Caribbean-wide World Bank report found that despite up to 11 years of formal education, school leavers had no diploma and lacked the skills needed in the job market. The report recommended scaling up youth training programs and increasing workforce job training, relying (among other things) on regional training programs, transparent funding mechanisms, and increased labor union participation in training

programs. The World Bank supported projects in St. Lucia and Grenada afterward under a framework originally intended to accommodate more countries. The projects helped establish vocational training systems in the two countries and harmonize certification. Training agents help graduates with their job searches, mentor them, and monitor their performance, and social workers and psychologists help youth with social and life skills. Although the projects were not successful in every respect, they helped lay a foundation for the countries to continue building the training systems (World Bank 2016a, chapter 3).¹ More generally, depending on the country context, attention may be needed in the small states to the prevalence of and dependence on foreign workers at all professional levels, and the policies and laws behind this. For example, the Seychelles is heavily dependent on imported labor, which is a debated political topic in the context of promoting economic diversification and building a more resilient economy around local content development, and a subject of World Bank dialogue.²

Strengthening the Financial Sector

World Bank Group programs in the financial sector responded to context-specific circumstances, with some commonalities. For example, most countries in the cluster had high financial penetration, but access to financial services in many of the PICs was underdeveloped. Furthermore, the remittances associated with the region's large, temporary labor migration flows highlighted the significant transfer costs. As discussed in chapter 2, the failure of two multinational insurance companies with heavy exposure in the OECS countries after the 2008–09 global crisis created significant systemic risk, underscoring the urgency of strengthening the legal and regulatory environment. Increasing access to finance—particularly for small and medium enterprises, which have can constitute most of the means of production in small states—was an area of concern in nearly all of the programs (diagnostic work consistently identified access to finance as a top business constraint). Except in the OECS after the global crisis, World Bank Group support for the financial sector did not add up to a strategic approach to the sector and rarely formed part of results frameworks. However, all of the programs included periodic interventions that made useful—if mostly modest—contributions to financial resilience and deepening. This section confines the discussion to two small state-related financial sector elements in the programs aimed at expanding access to financial services and reducing remittance costs in the PICs program, and at improving access to finance for small and medium enterprises in several of the programs.

World Bank Group assistance in the PICs sought to improve access to financial services and reduce remittance costs. IFC was instrumental in supporting banking development and provided support to Bank South Pacific, the largest local bank in Papua New Guinea, with branches in Fiji, Samoa, the Solomon Islands, and Tonga. Partly because of

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this support, Bank South Pacific now reaches 200,000 formerly unbanked people. The World Bank Group also worked with governments and private financial institutions to help reduce remittance costs on Pacific routes. The World Bank-IFC-supported Pacific Payments Legislation Project contributed to lowering these costs—for example, the average cost of transferring \$200 decreased from 15 percent in 2010 to 11.5 percent by 2015.

World Bank Group programs pursued several avenues to help improve access to credit for small and medium enterprises. A World Bank-supported 50-50 matching grant facility in Cabo Verde helped enhance the capacity of private operators (especially small and medium enterprises) to acquire new technology and managerial expertise. Chambers of commerce had a key role in expanding services to their members under the project. In the OECS, IFC support to a large commercial bank in St. Lucia sought to catalyze financing for small and medium enterprises. The initiative helped offer a range of financial services and saw some uptake in lending, but the practice was largely confined to vehicle loans and lacked dynamism because critical constraints in the broader environment were only partially addressed. IFC and the Australian Agency for International Development developed the Pacific Microfinance Initiative in the PICs to promote innovative ventures and broaden access to basic financial services. The initiative provides entrepreneurs with performance-based grants through financial institutions on a matching basis. The initial experience had mixed results—the initiative had some success when it worked with a robust institution, but it had difficulty building a viable project pipeline. Aside from provision of financing, some of the programs also sought to address underlying constraints, including credit information. IFC provided advisory services toward establishing a credit bureau in Cabo Verde, and undertook a similar project in the Caribbean. World Bank support also helped extend coverage of the Mauritius credit bureau (established in 2005) to include nonfinancial institutions and utilities along with banks and insurance and leasing companies.

The Mauritius program supported a package of reforms to facilitate financing for small and medium enterprises. The World Bank's 2012 Private Sector Competitiveness Development Policy Loan operation supported efforts to facilitate the use of movable and intangible assets as collateral and establish a modern movable collateral registry. However, amendments to laws are necessary and were drafted, but they are not yet adopted. The World Bank also helped design an initial version of the successful Mauritius Business Growth Scheme (later modified). The revised program offered reimbursable government financing on a 90-10 cost-sharing basis to buy specialized expertise on skills and training, technology upgrading, standards, and marketing. Repayment is on a royalty-based system linked to the beneficiary enterprise's incremental growth. Similar programs are being replicated in other countries, based on the Mauritius Business Growth Scheme's sound performance. However, World Bank

efforts to help restructure the Development Bank of Mauritius through the private sector DPF operation failed, and the government is now considering creating a new bank to serve small and medium enterprises. Finally, IFC support to selected banks helped train loan officers for expanded small and medium enterprise lending.

Expanding and Better Managing Infrastructure

Infrastructure raises special issues in small states that the World Bank Group (among other donors) can help address and was typically a key part of the programs. Small states bear large infrastructure costs relative to gross domestic product (GDP). Infrastructure planning and investment require technical skills that are often not locally available, and low financial returns make it difficult to attract private investment. World Bank financing can help stretch costs during the time it takes to realize the benefits of infrastructure investments. When provided on grant or highly concessional terms, World Bank financing can subsidize investments that are not financially viable, but are indispensable for nation building and poverty reduction. Furthermore, small state capacity constraints make donors' technical expertise in project design, contracting, and implementation highly valued. Donors can help involve the private sector, resolve information asymmetries to enable negotiation of fairer contracts, and provide support for the legal and regulatory frameworks required for corporatizing public service providers and for private participation.

The World Bank Group programs used multiple approaches tailored to the small states' needs to help close remaining gaps in access and enhance quality, increase affordability, and ensure greater fiscal sustainability of investments. IEG reviewed program approaches to help improve management and regulation; involve private partners in investments and operations; foster telecommunications development through a holistic approach that includes legal and regulatory reform, private sector participation, and infrastructure investment; support investments in renewable energy; and (where appropriate) encourage regional initiatives to reduce costs and enhance infrastructure effectiveness and efficiency. Infrastructure in particular is often poorly maintained in small states because of the extraordinary complexity of developing policies, planning, and overseeing project design and preparation, and the thin, overstretched institutional capacity – a phenomenon characterized in the PICs as build-neglect-rebuild (PRIF 2013). In response, the World Bank Group sought to help develop and monitor sector programs and prepare projects, devolve program management to independent authorities (including responsibility for implementation and maintenance), outsource routine maintenance to the private sector, prepare sound legal and regulatory frameworks, and establish independent regulators (World Bank 2016b).³

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World Bank Group support made significant contributions to improved roads sector management, but was less successful in St. Lucia's water sector. The program in Cabo Verde contributed strongly to improving road network financing and management. For example, the Ministry of Infrastructure and Transport made steady progress in its capacity to plan and manage the sector, and the General Inspectorate of Public and Private Works progressed in regulating civil construction and the housing market. Similarly, the Road Agency improved in planning and implementing road network works; the Civil Engineering Laboratory made progress in testing and conducting road quality control; and the Road Maintenance Fund progressed in generating sustainable financing. The performance-based management contracts worked so well that they are now more widely applied and scaled up to include rehabilitation works and a longer duration (up to five years).⁴ World Bank project support in Samoa was instrumental in downsizing the Public Works Department and making outsourcing the default mechanism for road maintenance. World Bank support resulted in the complete separation of policy and regulation from service provision in all transport modes, with additional outsourcing of services (Tonga's roads sector is now taking a similar approach). However, World Bank Group support to improve water sector management in St. Lucia had little impact. A new Water and Sewerage Act in 2006 (amended in 2008) made creation of a regulatory commission possible in 2009, though it did not begin functioning until 2012. A tariff review in 2013 allowed the Water and Sewerage Company of St. Lucia to start recovering operating costs, but financial performance remained poor during much of the evaluation period, and St. Lucia's aging water and sewerage infrastructure periodically leads to severe water shortages.

Outside of telecommunications, World Bank Group efforts to foster private participation in infrastructure investments and operations encountered difficulties. The remoteness, small scale, and risks of political interference in places where "everyone knows everyone" often deter investors, despite the prospective advantages of public-private partnerships for addressing capacity and fiscal constraints in small states. The World Bank Group's support for public-private partnership approaches faltered in several cases, partly because it had insufficient in-depth understanding of political economy constraints.⁵ Examples include the efforts in St. Lucia to bring private management into the water and sewerage company to improve the utility's financial performance (with IFC acting as transaction adviser), and efforts in Mauritius to bring private participation into the Cargo Handling Corporation Ltd. to lead the company's turnaround and mobilize much-needed investment for port operations. In both cases, lack of government consensus and opposition from vested interests aborted the process. In Cabo Verde, against an initially failed privatization of the water and energy company Empresa Publica de Electricidade e Água (ELECTRA) and other constraints, continued support by the World Bank and other partners for energy and water sector reform is

slowly yielding results. ELECTRA recently reorganized under an improved legal and regulatory framework and began more sustainable cost recovery. World Bank Group efforts in the PICs to help attract private investment in infrastructure have not yet been effective, but its consideration of a partial risk guarantee generated some interest.

Holistic approaches to developing telecommunications (a lifeline for many small states) involving support for legal and regulatory reform, investments, and competition were among the World Bank Group's most effective areas of engagement. Information and communications technology (ICT) is a critical factor in many small states' long-term economic viability. ICT offers the potential for diversifying growth sources (particularly into services and small and medium enterprises, and creating opportunities for local income generation. It also has potential for achieving greater equity in economic opportunity by facilitating access to job information or price information to primary producers, and in social service delivery across diverse islands (such as diagnostic services in health care and learning networks in education. Furthermore, ICT can help build more capable and sustainable institutions. Telecommunications fits World Bank Group strengths, given the blend of policy changes and infrastructure investments that the World Bank can support, and IFC's ability to catalyze private sector participation. In the PICs program, World Bank-IFC synergies possibly had the largest impact in telecommunications. The World Bank supported legal and regulatory reform to foster market liberalization and competition and provided financing for cable infrastructure, and IFC investments had a major role in encouraging the entry of new private operators, resulting in dramatically lower telecommunications costs and wider coverage. The number of mobile cellular subscriptions nearly quadrupled between 2006 and 2014. However, access to broadband Internet has still not progressed significantly, and its pricing remains high in many islands.

World Bank Group support for second-generation telecommunications reforms encountered difficulties. World Bank support in the OECS during (and especially before) the evaluation period facilitated increased competition and lower cost of services. However, the later support was less effective in securing the legal and regulatory framework updates needed to keep pace with a rapidly evolving ICT industry. In addition, implementation of World Bank-supported universal service projects to broaden access to broadband Internet met with difficulties and were scaled back. World Bank support in Mauritius helped decrease telecommunications prices by enhancing Mauritius' capacity on the South Africa Far East fiber optic cable, strengthening the regulatory authority's role, and facilitating large private sector investment in broadband networks. However, Mauritius has yet to amend its Information and Communication Technologies Act regarding the major issue of spectrum management to align the regulatory framework with international best practice. Although reforms contributed to ICT's remarkable growth in Mauritius, the

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unfinished reform agenda is starting to weigh on performance. Mauritius began to lose ground recently compared with neighboring countries (such as Kenya), which have greater capacity to attract traffic with lower wholesale bandwidth prices.

The World Bank Group programs reviewed provided some support for renewable energy development. Along with offering many small states an economical, emission-free way to meet energy needs (particularly in providing access for outer islands or remote areas), renewables can reduce dependence on costly oil imports, and decrease vulnerability to oil price shocks. The World Bank Group developed several interesting approaches to this area, but World Bank-IFC collaboration that is more intensive may be desirable. In Tonga, a World Bank-supported energy road map was significant in establishing the cost advantages of solar and wind power, particularly for outer islands. The country has now set a target to generate 50 percent of its energy through renewables by 2020. In Dominica, a World Bank technical assistance credit supported drafting alternative energy legislation to define the legal and regulatory framework for developing alternative energy technologies (hydropower, wind, and geothermal). The World Bank also provided technical and policy advice on geothermal energy development in Dominica and St. Lucia, which can help in attracting potential investments. A World Bank project (with Global Environment Facility support) in Fiji to finance sustainable energy was highly successful, by all accounts. The program consists of a guarantee fund channeled to commercial banks through the Fiji Development Bank. The loans triggered numerous small, village-based projects that helped the government move closer to its objective of 100 percent electricity access by 2020. However, similar programs in other PICs and in the Seychelles were not as effective, and loan uptake was limited. In Mauritius, the World Bank supported the use of bagasse (a by-product of the sugar industry) for electricity generation, serving multiple objectives to promote clean energy by reducing fossil fuel dependency and reducing oil import costs.

World Bank Group support for joint infrastructure regulation, policies, and management through regional institutions and arrangements had a mixed record. Individual countries were ambivalent regarding the usefulness of such institutions, often viewed as competing with national agencies. World Bank support for regional institutions was effective in some cases, but encountered setbacks in others. The experience illustrates the political reality-laden pitfalls in a model that offers a sound small-state development solution (at least from a technical standpoint), and emphasizes the need to tread carefully. The World Bank supported a major aviation upgrade in the PICs. To receive support under the program, participating countries had to commit to implementing the regional safety program (starting with Tonga, where the World Bank had been engaged to help corporatize the airports since 2000). They were also required to separate operations from regulation, and implement a \$5 safety and security levy on all international departing passengers (to fund membership in the Pacific Aviation

Safety Office, the regional organization). When the program expanded to other countries, the World Bank decided to use the Tonga-based advisory implementation unit (which had proved its capacity) to reduce overall transaction costs. Although the unit is working effectively, some officials (in Samoa and Kiribati, for example) expressed dissatisfaction and saw it as another bureaucratic layer. In the OECS, the World Bank designed its project support to help establish the Eastern Caribbean Energy Regulatory Authority as a full-fledged regional regulatory body for energy that could eventually serve all the countries, but project implementation encountered difficulties. The OECS governments agreed in principle on the advantages of a regional approach, but practical doubts about costs, duplication of mandates with national authorities, and forfeiture of sovereign interests – even by the two countries participating in the project – caused the World Bank to scale back the prospective regional arrangement.

Promoting Leading Sectors

The fisheries, tourism, and agriculture sectors account for dominant shares of production in the countries. Mauritius attained greater diversification (with textiles and ICT, for example), but most of the smaller countries in the cluster highly depend on tourism, fisheries, and tropical agricultural products for income and export earnings. Tourism also offers potential for the domestic fisheries, horticulture, and livestock sectors. World Bank Group programs engaged on one or more of these areas, and IFC efforts to mobilize private investors through technical services and investment promotion complemented World Bank work – typically on sector policy frameworks. Fisheries, in particular, could be an area of World Bank Group comparative advantage (and of synergistic World Bank–IFC collaboration), given the need for adherence to global or regional agreements, good policy and implementation frameworks, infrastructure, and value chains to derive benefits from fish processing.

Support for fisheries in Cabo Verde and the PICs typically blended analytic work, World Bank and IFC investment financing, and support for regional approaches. The World Bank’s fisheries sector strategy assessment in Cabo Verde in FY08 provided suggestions on how to create a viable fishing industry. In FY10 the first phase of the West Africa Regional Fisheries Program Adaptable Program Loan (cofunded by a Global Environment Facility grant and implemented in nine West African countries) financed technical assistance to design and implement a registration system and a national plan to combat illicit fishing activities, review the national fisheries development plan, and revise the legal framework. The program also financed construction of facilities to increase value added. In the PICs, the World Bank analyzed fisheries in the economies of Pacific Island countries and territories in 2009, and prepared a fisheries engagement strategy for the Pacific Islands in 2012. Funding of

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nearly \$40 million was approved in late 2014 for the Federated States of Micronesia, the Marshall Islands, the Solomon Islands, Tuvalu, and the Pacific Islands Forum Fisheries Agency to support both marine and coastal fisheries. The project (the Pacific Islands Regional Oceanscape Program) supports enhanced fisheries management in the region to ensure sustainability and protect coastal habitats. A key feature of the project – which built on regional IDA and Global Environment Facility funding – is to draw on regional agencies, notably the Forum Fisheries Agency (FFA) and the Oceanscape Unit within the Pacific Island Forum Secretariat, to support an implementation unit and to explore options for sustainable financing for conservation of critical fishery habitats. At the same time, IFC is supporting fish processing development to enhance the value added locally to tuna caught in the countries' waters and provide a significant increase in local employment.

World Bank Group support for fisheries in the Seychelles followed a similar approach. The Indian Ocean Tuna Ltd. cannery, in which the government owns a minority stake, is the largest single employer in the country. The World Bank undertook an analysis of the local tuna cannery, helping the government renegotiate its agreement with its private partner on fair terms, and developed a model to evaluate tuna's contribution to the national economy. DPF-supported measures, such as publication of fishing agreements and license information in 2013, helped enhance discussions on fisheries' contributions. The Seychelles also took part in the 2007 regional South West Indian Ocean Fisheries Project, a Global Environment Facility-financed project with the participation of coastal countries that sought to improve scientific knowledge, build capacity, and move toward a regional management framework while mainstreaming biodiversity. The Seychelles (along with Mauritius and the Comoros, among others) also takes part in the regional South West Indian Ocean Fisheries Governance and Shared Growth, a regional component of a follow-on project series designed to strengthen regional cooperation and aimed at developing sustainable fisheries management. Another World Bank and Global Environment Facility fisheries development and shared growth investment project financing operation is under preparation.

World Bank Group work on tourism was selective and had limited but growing focus on the overarching policy and regulatory framework. The weight and circumstances of the industry and the extent of World Bank Group engagement varied significantly among the countries in the cluster. For example, stayover and cruise tourism were a key engine of growth for several decades in the OECS, accounting for about 30 percent of GDP, but the countries face issues of declining market share. Competition among islands to attract operators was tight, often leading governments to grant large fiscal incentives. However, the picture was markedly different in the Seychelles, which had positive growth in its share of world tourism arrivals. Tourism in the PICs is somewhat

less developed (except in Fiji), but the countries are significantly focused on growth prospects. Highly selective World Bank Group interventions characterized much of the evaluation period, but assistance with strategy development (which the World Bank Group can provide) is becoming visible in some places. For example, the World Bank helped develop a new tourism strategy in Cabo Verde through analytic and advisory activities, including advising on international best practices and facilitating exchange of experiences on the institutional framework needed for coordinated sector management.⁶ The World Bank also provided analytic work in the OECS on backward links for the tourism sector (notably to agriculture) as well as on connectivity, particularly air transport and ferry. Concrete initiatives aimed at strengthening local and regional tourism links with the rest of the economy (especially agriculture) are being developed under the latest partnership framework. IFC provided well-regarded advisory work on tourism development in St. Lucia, and the World Bank provided institutional support in Grenada. IFC undertook a diagnostic of impediments to tourism development in five Pacific Island countries, and several activities were undertaken in Samoa (with the New Zealand Agency for International Development's support) based on the findings. IFC launched the Pacific Regional Tourism Initiative in 2012 (with a focus on Samoa, Tonga, and Vanuatu) aimed at mobilizing new investments to support up to 4,000 new tourist arrivals across the three pilot countries. IFC also has an advisory project aimed at creating new markets by promoting Pacific tourism in China and airline and cruise vacations originating in Fiji instead of in Australia, New Zealand, or other countries.

The World Bank Group programs had limited engagement in agriculture. Many countries in the cluster traditionally produced sugar, but with the dismantling of EU preferential trading arrangements for the crop, interest is growing in orienting agriculture toward commercial ventures through value chains in horticulture, and livestock production that can supply both domestic needs and the substantial demand from the tourism sector. However, World Bank Group engagement in agriculture was limited,⁷ and World Bank-IFC synergies do not seem to be as significant as in fisheries or tourism. A substantial World Bank intervention was in Samoa, where a project supports greater production of livestock and fruits and vegetables by subsistence and semicommercial farmers. The key will be to develop viable models of commercial farming linked to value chains that could be replicated. The project's success will depend on establishing links with the companies that currently import raw and processed foods, and contracting with reliable suppliers to Samoa's domestic and tourism markets. The World Bank provided analytic work on logistics in Grenada's cocoa and nutmeg sectors, and prepared an agriculture risk management strategy followed by a grant-funded initiative that enabled small nutmeg, cocoa, and livestock farmers to adopt improved technologies and improve resilience, productivity, and

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incomes. The reasons for the limited World Bank Group engagement in agriculture during the evaluation period are unclear, but they might reflect the need for substantial upfront investment in analytic work to better understand key factors such as land tenure systems and customary farming arrangements,⁸ and the need for substantial capacity building. This implies a long-term, staff-intensive engagement, which could be beyond the budget of country units.

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¹ Both projects received moderately satisfactory outcome ratings. See World Bank (2016a), chapter 3 for a discussion.

² In Mauritius, with growing unemployment, especially among the youth, the prevalence of low-cost foreign labor in construction, textiles, and services is a similarly a growing political issue.

³ World Bank Group support embodying these elements was particularly significant in the roads sector in Samoa and Tonga. For a discussion, see World Bank (2016b), chapter 4.

⁴ The introduction of performance-based contracts in Cape Verde also helped shift incentives towards better maintenance, as payments are based on operations and maintenance standards.

⁵ For more details, see, for example, chapter 4 of the Mauritius Country Case Study.

⁶ This further led to the approval in 2016 of an IDA credit to support Competitiveness for Tourism Development.

⁷ According to World Bank Management, part of the reason why the World Bank Group has had limited engagement in agriculture is historical: among the PICs, the early World Bank operations were implemented through the International Fund for Agricultural Development, and their multi-sectoral approach was not particularly successful.

⁸ In the PICs, for example, traditional land tenure arrangements is not the only constraint to agriculture. Other challenges include the lack of a well-developed value chain linking domestic farm production to local or export markets and the lack of financing. Beyond these difficulties, the problem of agriculture is structural in nature, linked mainly to high concentration of the population in rural areas, the lack of appropriate technologies and extension support, low literacy rates, cultural norms, and the perception of agriculture more as a default livelihood rather than a farm enterprise with growth and profitability objectives.

5. Considerations for World Bank Group Engagement

This chapter identifies key issues for the World Bank Group to consider in its continuing efforts to strengthen engagement in small states, but restricts discussion to issues arising from the program evaluations in the cluster. Therefore, they are not necessarily relevant to World Bank Group small state programs in general, and they do not capture all issues that can arise in small state programs. The issues discussed relate to the substantive, or thematic, aspects of World Bank Group engagement in seeking to help reduce poverty and foster greater shared prosperity: its support to the small state clients in the various areas under strengthening resilience (chapter 3) and enhancing competitiveness (chapter 4). They also relate to cross-cutting aspects of engagement – the operational framework or business model for World Bank Group engagement in small states (chapter 2).

Areas of apparent World Bank Group comparative advantage can guide selectivity in engaging with small states. Although the issues discussed in this section relate to wide range of thematic aspects, a World Bank Group country program cannot accommodate all of them. As discussed in chapter 2, thematic selectivity is particularly important in small state programs. Beyond providing investment financing and budget support on competitive and often concessional terms, the World Bank Group appears well-placed in certain respects, which can also help determine where to focus its engagement.¹ One area is undertaking higher-level policy dialogue (both on overall macroeconomic management and on a wide range of sectors and cross-cutting themes), backed by a strong capability for analytic work (including cross-country knowledge and analysis), where its effectiveness can often be enhanced by providing supporting investment or development policy financing. Another area is regional engagement (with client countries as a group and regional institutions) to support regional public goods or shared development solutions, though regional development banks may be equally well-placed in this respect.² A third area is aligning public and private sector efforts and action through concerted World Bank–IFC engagement, and a fourth area is acting as convener among development partners, helping to align and harmonize their support. The right areas for World Bank Group engagement will clearly vary across country contexts.

Continued World Bank Group engagement on regional development solutions and cooperation will be particularly important, despite the pitfalls. Strengthening resilience and enhancing competitiveness calls for World Bank Group support for individual countries' domestic reforms and investments in a range of areas. However, actual and

prospective regional agreements and arrangements in areas as diverse as fisheries, tourism, labor migration, disaster risk management, health, education, and infrastructure regulation can help significantly broaden development opportunities and increase their sustainability, at least for the Organisation of Eastern Caribbean States (OECS) and the Pacific Island countries (PICs). The World Bank Group is well placed among development partners to take an advocacy role with respect to regional initiatives and provide the technical and financial resources to support their implementation.

Key Issues in Strengthening Resilience

A multifaceted approach focused on the multiple drivers of fiscal and debt sustainability will be crucial to strengthening macroeconomic resilience. The World Bank deployed numerous efforts to help address the deterioration in fiscal and debt indicators in many of the countries during the evaluation period. Although progress in several areas (such as government employment and wage bill management) was difficult and will probably continue to see periodic setbacks, the World Bank has a continuing role in helping client countries determine appropriate fiscal policy stances, including the underlying revenue and expenditure policies. Public expenditure in particular poses unique, challenging problems in small states because of the fixed cost element in many government functions. The World Bank may also want to assume a more hands-on role in supporting countries with debt (stock) management, including advocacy with the donor community about the need for debt restructuring in some contexts. Furthermore, the World Bank can help country policy makers understand and address the role of other drivers of fiscal and debt unsustainability that are uniquely acute in the small state context: weak growth because of competitiveness deficiencies, and reconstruction spending resulting from vulnerability to natural disasters.

Fostering a wholesale shift in public and private incentives and behavior toward reducing vulnerability is a continuing challenge in disaster risk management. The World Bank did many things right in its disaster risk management engagements in the reviewed programs. It used relationships built from emergency response operations to its advantage to develop stand-alone lending platforms on vulnerability reduction under nonemergency circumstances, and it contributed to increased awareness of disaster and climate change issues in governments, especially in finance ministries. It used disaster risk management's heightened priority after severe events to deploy emergency interventions and then established nonemergency operations. The World Bank established and sustained continuous engagements and built a critical mass of experts with local knowledge and relationships, and it increased project size over time to reduce the burden of transaction costs. It deployed resources from the Global Facility

for Disaster Reduction and Recovery for high-priority activities, and drew on the IDA Crisis Response Window and climate funds to enable interventions that IDA resources alone could not manage. It used investment operations to support policy dialogue, and improved recognition of implicit liabilities. It also contributed to improved data and knowledge, including quantitative information of disaster risk. The World Bank provided good service to client governments through finance and technical expertise, yet its efforts only modestly reduced the overall level of disaster vulnerability. The strategy of direct financing for infrastructure has limits. IDA envelopes and current levels of climate finance compared with the high cost of making infrastructure climate resistant mean that only a small portion of assets can be covered by upgrades and retrofits. Without additional funding sources, it could take decades to make a major impact on vulnerability through direct financing, emphasizing the importance of finding ways to shift the behavior of public and private sector investors.

Disaster risk management activities have potential for expanded scope. Although its own financing volumes cannot match the scale needed, the World Bank can continue to fund resilience-building investments, capacity building for preparedness and disaster response, and (where appropriate) coordinate and assist with financial risk management. Furthermore, it could build on existing platforms and seek to involve other small states with high disaster vulnerability, but with which the World Bank has had little engagement to date. It could also work to ensure that other threats, such as earthquakes, are more widely addressed. Strengthening monitoring and evaluation, particularly by seeking to quantify reductions in vulnerability, is another important area of work.

Addressing the long-term risks of climate change needs additional efforts. Many World Bank experts see little difference between improved management of current disaster risks and climate change adaptation. However, although the overlap is substantial, the World Bank's approach sometimes neglected anticipatory adaptation to long-term climate change issues, and the activities it supported were too modest considering the threat level, especially in countries facing existential threats from sea level rise. Some of the World Bank's first explicit climate change adaptation projects were in the Caribbean (outside of the OECS) and Kiribati, but these operations struggled, trying to cover many sectors or countries and spreading themselves too thin, and sometimes struggling to achieve policy reform in the absence of concrete investments to harness public support.

The World Bank also has a role to play in helping countries access climate finance resources. The large number of funds (each with its own requirements) imposes high costs on small states with limited capacity. Similarly, the proliferation of donors interested in climate change adaptation in the countries led to a complex array of agencies, which imposes high coordination costs on governments. Although it helped

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some clients access climate funds, the World Bank could also encourage more coordination among donors, such as cofinancing larger programs or merging climate funds.

Engagement that is more intensive on environmental management will also be important, though not necessarily by the World Bank. The World Bank programs reviewed offered only limited engagement on environmental issues beyond natural disasters and climate change adaptation. Natural resources and the beauty of the natural environment are the basis for many small states' heavy dependence on tourism. Unchecked development, pollution, and degradation are a threat to terrestrial and marine environments. However, environmental protection was rarely a high priority for governments, which were often unwilling to use IDA or IBRD resources for these purposes. Therefore, environmental projects were limited to what was feasible with Global Environment Facility resources. The World Bank could do more through analytic work to convince countries of the economic rationale for environmental protection. A notable exception is the World Bank's recent engagement on fisheries in the Pacific, a sector that is a crucial part of the development strategy for several countries. The World Bank is also engaging in dialogue with Mauritius and the Seychelles on developing the "blue economy" (the Seychelles' term) or "ocean economy" (Mauritius' term), to orient future development around exploiting undersea resources³ and developing maritime services as an environmentally and socially sustainable growth path.

Continued engagement on noncommunicable diseases, in particular, will be crucial to strengthen social resilience. The World Bank has played an important role in raising consciousness about the threat of noncommunicable diseases, including the cross-cutting nature of viable ways to address the growing burden (such as higher taxation of foods and beverages that contribute to obesity). Going forward, support will be important for the design and implementation of prevention and treatment programs — both the overall policy framework and specific programs. Effective prevention programs will require a multisector approach that includes fiscal measures, education, health, infrastructure, and agriculture to address key risk factors, such as poor nutrition, alcohol and tobacco use, and lack of physical activity. The World Bank can also help with sustainable health care financing (which received minimal attention so far) and feasible ways of organizing tertiary care delivery when the cost of replicating facilities in individual countries can be prohibitive. At the same time, IFC can help catalyze greater private investment in health care and related services.

Social protection and labor mobility are also important. Regarding social protection, support in designing and implementing safety nets is particularly important to protect vulnerable households from the frequent large shocks that affect the countries. The

World Bank can provide support for designing and implementing appropriate social protection mechanisms. However, effective engagement centers particularly on good data systems and implementation capacity, which take time to build, and the OECS experience shows that effective engagement needs to be a long-term effort. Together with a focus on education quality, dialogue about how to increase labor mobility and broaden employment opportunities in larger states (possibly an area of World Bank Group comparative advantage) and providing support for it could also be a promising avenue for future work, particularly if it results in building technical and commercial skills. Still, the scope for replicating the transformational experience with increased temporary labor migration in the Pacific is uncertain. Existing PIC labor mobility programs might have scope for broadening country participation and better targeting poor households.

Key Issues in Enhancing Competitiveness

The World Bank Group arguably needs a sharper focus on the most binding business constraints, using sector-specific lenses. Engagement based on the Doing Business framework and similar cross-cutting approaches led to useful reforms (such as those related to customs procedures), but engagement did not always focus on the most binding constraints. Many World Bank Group programs already take the approach of diagnosing and addressing constraints to competitiveness in the dominant sectors (fisheries, tourism, and agriculture), and this could prove to be a crucial complement in relieving bottlenecks to growth. A crucial role for IFC that can help catalyze private investment to encourage stronger growth in leading sectors is to actively search for investment opportunities in countries in which the World Bank is engaged on sector strategy and policy frameworks, and where it funds necessary public investments.

System soundness (including dealing with risks), access to finance (and financial services, where relevant), and remittance costs are important issues in the financial sector. The World Bank and other partners – notably the IMF – have a vital role in strengthening regulation and supervision and assuring system resilience to shocks in countries with an unfinished reform agenda, such as the OECS. Increased access to finance is a crucial ingredient in enhancing competitiveness (particularly for small and medium enterprises). A joint approach can yield important dividends, with systematic World Bank engagement on underlying policy constraints (such as collateral and credit information) in parallel with IFC efforts to catalyze the provision of financing and provide training to entrepreneurs through robust intermediaries (the choice of which matters). Learning through South-South exchange of experiences (for example, on the Mauritius Business Growth Scheme) can be of particular benefit in this context. Broadening access to financial services among the population in some countries, such as

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specific PICs, will also be important to ensure greater savings mobilization and channeling of resources toward productive investment. In countries where remittances from migrant labor are significant, continued engagement aimed at reducing remittance costs (which remain large despite the downward trend) can yield important benefits in additional savings mobilization.

The need to strengthen policy and regulatory frameworks while ensuring that the associated functions are separate from service delivery functions (and attracting private participation in the latter) is an important issue in infrastructure. Despite difficult recent experiences in some areas, encouraging incremental progress toward more harmonized and joint regulatory approaches across countries (where applicable) is an essential role for the World Bank Group. (Multisector regulatory bodies may offer advantages for small states in which opportunities for regional cooperation are more limited.) Facilitating greater private sector participation in infrastructure service delivery – an area of World Bank Group comparative advantage – similarly deserves continuing effort, though the recent experience in the World Bank Group programs reviewed was not smooth and alternative approaches may need to be considered in some cases. Helping countries adapt their legal and regulatory frameworks to technological advances in the industry (for example, the progressive blurring of the boundary between telecommunications and information and communication technology (ICT)) is an important issue in telecommunications. The World Bank can also contribute on the policy and regulatory framework needed to encourage renewable energy development while IFC actively helps attract the necessary private capital to underpin widespread production and use.

Issues in the Operational Framework for Engaging with Small States

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Regional approaches can offer significant benefits in some contexts, but they can face obstacles. Regional-level engagement is an area of World Bank Group comparative advantage in places where regionalism is relevant and tangible (as in the OECS and the PICs). Regional approaches are worth pursuing when prospective gains are large and regional institutions have member country support (fisheries in the Pacific, for example). However, significant upfront work is often needed to establish (and help build) commitment to shared development solutions. The countries' concerns include costs, encroachments on sovereignty, and uncertain benefits capture. In areas with few prospects for genuinely regional engagement (supporting shared development solutions, for example), multicountry vehicles for strategy, analytic and advisory activities, and financing can address shared agendas in a harmonized way while facilitating collaboration across countries on a scale that is more limited (such as

specialized laboratory facilities to serve a group of countries). Using such vehicles can also help reduce the World Bank Group's transactions costs. Trade-offs between regional and country-specific approaches at the overall partnership framework level could be resolved through a hybrid approach that combines a regional framework with short notes on selected countries. In particular, any regional-level results framework can at best be a partial reflection of World Bank Group support for country objectives, and results frameworks for the larger country programs can supplement it.

Thematic selectivity and moderating the number of delivery vehicles have important advantages. Thematic selectivity enables fewer projects of critical mass (reducing unit transactions costs) and more in-depth staff engagement, particularly where distance, lack of integration, or both precludes grouped engagement and multicountry knowledge or financing vehicles. Crucially, it can also help limit the number and size of visiting missions, reducing the strain on the client country's limited institutional capacity. Delivery of financing through programmatic development policy financing (DPF) operations can similarly help contain transactions costs in countries with a significant policy reform agenda that the World Bank can support.

Contingency planning, including the use of contingent financing instruments, has a key role in enhancing responsiveness to shocks. A shock is more than likely to require the World Bank to respond, given the impact of natural or economic shocks relative to the size of small states' economies. Contingent funding and insurance instruments (like those offered by the CCRIF, CAT DDOs, or emergency components in disaster risk management IPF operations), which disburse quickly and in a predictable manner, can help provide better responsiveness to disasters. The scope for using World Bank contingent financing instruments for disaster response is more restricted in countries that are IDA-only because CAT DDOs are currently not offered to them, although some instruments are available, such as IDA's Immediate Response Mechanism. The use of financing mechanisms that are arranged ex post, such as emergency recovery loans and DPF (more recently coupled with the ability to access IDA's Crisis Response Window) is also an essential part of responsiveness, but they take time to prepare and so have limited ability to support rapid emergency response.

Emphasis on data collection and knowledge work in small states is key. Data is a priority, because it is vital to monitor and measure progress. Moreover, the World Bank has generally not conducted sufficient research on small states, and, as an institution, still has many knowledge gaps in areas that are relevant for small states. The priority areas for additional work need to be guided by Systematic Country Diagnostic priorities. For example, in the PICs this evaluation points to a need for additional work on social resilience as well as on agriculture, including land tenure issues.

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It is also important for small state programs to pursue opportunities to improve governance. Wherever possible, it is important that the World Bank press for increased transparency and accountability in government and help promote reforms that break the “cycle of fraternity” which often plague institutions in small states. Countries with a very small population have weaker accountability mechanisms, as people know each other and are often part of the same communities or families. The adverse effects range from non-transparent procurement and discretionary granting of licenses to vindictive state action against businesses competing with those close to the ruling elite – and in extreme cases, elite capture of the state.⁴ Many developing countries face such challenges, but they tend to be more acute in small states. Promoting better governance, especially greater transparency and accountability, is critical to the effectiveness of World Bank efforts to help strengthen resilience. In macroeconomic management, transparent accounting of public funds and their use is crucial, especially in natural resource-rich small states. Effectively enhancing competitiveness often hinges on World Bank willingness to press for reforms that go beyond passage of suitable legislation to genuine implementation on the ground (which fell short in some areas in the programs reviewed). It is important for the World Bank to consider broadening its agenda to help foster greater accountability in such areas as the selection of CEOs of public bodies, where favors can often be dispensed to allies and opponents penalized. Independent watchdog bodies, such as the press and the judiciary, have a crucial role in holding the government to account, and World Bank support to strengthen the role of such institutions can help ensure the effectiveness of its support more broadly.

Capacity building seems most effective when it focuses on a concrete subject of immediate relevance and has client commitment and sustained World Bank Group support. Sustaining capacity for many highly specialized functions in small states will not be a viable proposition, and in such cases it is appropriate to supplement capacity instead of seeking to build it. When building capacity is the right solution, arranging to share capacity on a regional basis may be a viable option, and the World Bank Group can facilitate it. The cluster evaluation found little definitive guidance on the capacity building approaches that work best, and a variety of financing and delivery vehicles can be used. Crucial ingredients for an effective intervention seem to include concrete, practical subject matter (relating to ongoing reform implementation, for example) that holds sufficient interest and priority at the client country policy maker level, together with sustained attention and resources from the World Bank Group. Also, the World Bank Group could play a more active role in facilitating peer learning not only through the Small States Forum, but through practical, problem-focused knowledge exchanges between small states.

Client capacity for World Bank portfolio implementation can be ensured in different ways, and simplified procedures help, though they do not eliminate challenges.

Examples of approaches used include project implementation or coordination units in varying configurations – project-specific, national portfolio-wide, housed in a regional organization, and even shared across countries – to fulfill fiduciary functions. Other approaches include direct implementation by the line ministry concerned and outsourcing. World Bank field presence also varied. Although pooled arrangements (across projects, countries or both) seem more cost-effective for small states, evidence from the cluster evaluation does not conclusively show one model to be superior to others. The World Bank’s simplified procedures for investment project financing helped make the challenge more manageable, but appropriate arrangements to ensure the requisite implementation capacity on the client side remain crucial. Lessons from program evaluations in the cluster point to the importance of continuing dialogue with clients during project implementation via video or audio in order to improve results and lower costs.

Investing in multiple forms of partnership is clearly at a premium. It is especially desirable for development partners (and the World Bank in particular) to ensure coordinated support, given the importance of official development assistance flows, and small states’ lower capacity to coordinate development partner activities and handle multiple sets of interlocutors and procedures. Therefore, the extra effort and resources needed to pursue and sustain partnerships should factor into program planning. Better functioning partnerships can range from strengthened donor coordination mechanisms to increased use of joint support delivery vehicles, especially joint financing. The harmonization of procedures that joint financing embodies offers particularly significant benefits in small states, and it is important to extend their use as much as possible.

The World Bank Group needs to find ways to work around constraints related to the business model. The many constraints rooted in the small absolute size (not relative size) of financing envelopes and administrative budgets, though tightly binding, can be managed in various ways. As shown most dramatically by the Pacific Facility and the Pacific Partnership, World Bank Group technical and financial inputs can be significantly leveraged through appropriate partnerships, including using existing trust funds administered by the World Bank and IFC more intensively (though in many cases this does not come with additional administrative budget). Sharing staff and facilities with other development partners can manage the continuing challenge of World Bank and IFC representation in the field in small states, especially in countries that are far from World Bank Group hubs or with difficult access to them. National staff can help better understand and interpret the country governance environment, so using them seems particularly promising as a way forward.

CHAPTER 5

CONSIDERATIONS FOR WORLD BANK GROUP ENGAGEMENT

CONSIDERATIONS AT THE INSTITUTIONAL LEVEL

Funding allocations in IDA are not fine-tuned to vulnerability measures, though its mechanisms allow some responsiveness to shocks. IDA financing clearly provided major benefits to many IDA-only and blend small states under the small island economies exception, providing a wholesale response to their greater vulnerability. Furthermore, changes in the allocation formula (the increases in the base allocation and suppression of the per capita allocation ceiling) have significantly increased funding volumes in recent years. However, the allocation formula does not embody differentiation based on more specific measures of vulnerability (to natural disasters,⁵ for example), though IDA mechanisms such as the Crisis Response Window and the Immediate Response Mechanism can provide some measure of help to small states in coping with shocks. Whether such differentiation is worth pursuing could merit consideration. An alternative to differentiation could involve enhancing and broadening special treatment for small island states as a group in recognition of their inherent and unique forms of vulnerability. Empirically, many small island states struggled with high and unsustainable debt levels (some in spite of extraordinary access to concessional resources), though this was at least partly attributable to poor policy choices along with inherent vulnerability.

Are small state-specific financing instruments needed? Evidence from the cluster evaluation does not provide a conclusive answer (affirmative or negative), but the high unit transactions costs associated with World Bank financing in the OECS and PICs suggest the question is relevant. A simpler, more streamlined (perhaps modular) investment project financing vehicle could significantly facilitate World Bank business in small states. Similarly, the challenges that IFC has confronted in identifying investment opportunities of sufficient scale to be worth pursuing suggests it may be useful to examine the feasibility of more streamlined ways of delivering financing, perhaps through multipurpose country or regional venture funds that could help catalyze larger investment opportunities later.

Consideration could also be given to ways of surmounting the challenges that the institution faces in engaging with high-income small states. The World Bank's inability to provide financing in high income countries constrains its role as an active development partner in these countries. This concerns Nauru and Palau in the PICs⁶ and St. Kitts and Nevis and Antigua and Barbuda in the OECS.⁷ Most trust funds exclude them in view of their high income status. While RAS offers a potential means of World Bank engagement in the high income small states, their cost has mostly been seen as prohibitive, even by upper-middle- and high-income countries (with the exception of the Seychelles).

Does the World Bank's new global practices organization put small states at a disadvantage? This is ultimately an empirical question. The cluster evaluation can shed little light on the subject because the reorganization is too recent and not enough time has elapsed. However, a World Bank staff structure with greater thematic specialization globally (and inevitably less country specialization) risks short-changing small states in staff time and focus, and the World Bank might want to monitor the issue. To the extent that small state programs with limited budgets have difficulty attracting needed staff with the requisite experience, making the small states agenda a stronger corporate priority could help strengthen incentives to work on these countries.

Knowledge brokering that is more intensive and pursuing partnerships at the institutional level could serve small states well. The World Bank Group could examine the scope for additional activities to facilitate knowledge and experience exchange among small state policy makers and practitioners. The cluster evaluation found a number of approaches and experiences in the World Bank Group programs that could be of interest to other small states. For example, the well-regarded Small States Forum could be modified into a more continuous platform. At the same time, the World Bank could systematically publicize its small states website as the first stop in a brokering mechanism for virtual exchanges among countries. Regarding partnerships, pursuing closer working relationships with key donors engaged in small states at the institutional level could lead to more joint programming, greater use of joint delivery vehicles, and – crucially – harmonization of procedures. Efforts in specific areas, such pursuing greater global uniformity in sources and procedures for climate finance resources, would be of particular benefit to small states.

¹ Under the current World Bank Group's country engagement framework, in addition to World Bank Group comparative advantage, selectivity is guided by country development goals and priorities emerging from the Systematic Country Diagnostic for achieving the World Bank Group's twin goals of reducing extreme poverty and fostering shared prosperity.

² The World Bank Group is of course uniquely well-placed among development banks to support global public goods and development solutions.

³ Potential yields from marine biology, minerals, and other resources are in pharmaceuticals, food, cosmetics, manufacturing, and vitamins, for example.

⁴ Elite capture and patronage is an explicit risk mentioned in the Djibouti FY14-17 Country Partnership Strategy.

⁵ Existing vulnerability indices do not fully capture the specific challenges small states face. For example, those based on past vulnerability to shocks/disasters do not correctly reflect the existential threat suffered by atoll nations under climate change. Most atolls are located near the equator and thus were not historically exposed to cyclones; hence, they rate low in many of the indices based on historical exposure.

⁶ Palau cannot access IBRD without credit enhancements. Its GNI per capita of \$11,110 (2014) is far above the operational cut off for IDA, even to be considered for IDA's small island states exception. At the same time, Palau's insolvency and liquidity risks preclude it from accessing IBRD under normal borrowing terms. Nauru recently became a member of the World Bank Group and is classified in the same way as Palau.

⁷ Antigua and Barbuda and St. Kitts and Nevis are only eligible for IBRD. However, in light of their high public debt levels, these countries have not been able to borrow from IBRD for several years. St. Kitts and Nevis's last active IBRD project became effective in FY06 and with no new lending, its exposure to IBRD will fall to \$0.1 million by end-2018 (from \$2.1 million today). Antigua and Barbuda has only one active project with IBRD and its debt outstanding to IBRD was only \$2.5 million at end-March 2016.