Overview Paper
ADF-12 Strategic Directions and Indicative Lending Scenarios

Discussion Paper

ADF-12 Replenishment
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AFRICAN DEVELOPMENT FUND

Executive Summary

Consultations for the ADF-12 come at a critical time. With only five years remaining before the 2015 Millennium Development Goals (MDGs) deadline, Africa stands out as the continent with the biggest development financing gaps even as it has made significant progress in the last decade. The 2008-2009 global economic and financial crisis has further challenged ADF countries and donors alike, both of which are struggling to make the best use of limited resources in the face of exacerbated and competing demands. ADF countries' demand for medium and long-term financing is driven by their need to restore economic growth to pre-crisis levels and their determination to achieve the MDGs, bridge significant infrastructure deficits, achieve regional integration, and invest in climate change adaptation and mitigation.

In dealing with the challenges encountered over ADF-11, the Fund has responded flexibly, rapidly and effectively, highlighting its critical role as not only a financier for Africa's development but also the convener and the voice of Africa's low-income countries. ADF-11 has also shown the significant progress the Fund has made in improving its delivery capacity, its institutional effectiveness and its focus on quality and development results. And the results achieved under ADF-11, as noted at the ADF-11 MTR, highlight ADF countries' own accomplishments and commitment even in these challenging times.

As agreed with Deputies, and consistent with both the needs of the continent and the ADF's comparative advantage, under ADF-12 the Fund will deepen its strategic role and consolidate its operational engagement in the priority areas of infrastructure, governance, regional integration, and fragile states. In infrastructure, the Fund will scale up investments (especially in rural infrastructure and agricultural water management so as to enhance food security), increase project size, and prioritize projects that promote regional integration. A key innovation in ADF-12 will be to mainstream climate change into all new infrastructure operations and screen all projects for climate risks. In governance, the Fund will focus on improving core governance systems and institutions in the area of economic and financial management at the sector, country and regional levels with attention towards the private sector enabling environment. The Fund will build upon its regional integration accomplishments, scaling up its engagement in regional infrastructure, regional public goods, and capacity building. The Fund will mainstream crosscutting issues—particularly private sector development, climate change, food security, gender, and the social sectors—into all Fund operations in an innovative and more deliberate manner. Proposed, selective enhancements in a number of these areas are presented in the ADF-12 Discussion Papers.

Regional member countries' demand for ADF resources and the increased capacity of the Fund to deliver the required support is reflected in the ADF-12 prospective pipeline of 336 national and multinational projects valued at UA 12.35 billion. The ADF-12 prospective pipeline is concentrated in the Fund's core areas that reflect countries' priorities. The proposed projects complement other donors' activities, are focused on results, and emphasize the Bank Group's strategic focus, strengths and comparative advantage. Three replenishment scenarios are presented for Deputies consideration: A baseline scenario assuming the replenishment level for ADF-12 remains the same as that for ADF-11 in real terms; a second scenario assuming a 50 percent increase over the ADF-11 replenishment level, and; a third scenario assuming a 70 percent increase over the ADF-11 replenishment level.

Deputies are invited to share their views on this paper and provide guidance with respect to Management's proposals. In particular;

- Do Deputies agree with the broad strategic directions as presented, including the proposed policy adjustments as detailed in the ADF-12 discussion papers on regional operations, fragile states and PBOs?
- Do Deputies concur with the proposal to emphasize climate change initiatives within ADF-12 operations?
- What are Deputies' views on the lending scenarios in light of ADF countries' increased demand for Fund resources?

Management appreciates the extraordinary efforts required by all, including donors, partners and the Bank Group itself, for the Fund to continue providing meaningful support to its regional members and for Africa to achieve its full potential.

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Abbreviations

ADB	African Development Bank
ADF	African Development Fund
ADF-10	Tenth General Replenishment of the African Development Fund
ADF-11	Eleventh General Replenishment of the African Development Fund
ADF-12	Twelfth General Replenishment of the African Development Fund
GAP	Governance Action Plan
MDGs	Millennium Development Goals
NEPAD	New Partnership for Africa’s Development
NDS	National Development Strategy
OECD	Organisation for Economic Co-operation and Development
PBOs	Policy-Based Operations
PRSP	Poverty Reduction Strategy Paper
UA	Units of Account

OVERVIEW PAPER: ADF-12 STRATEGIC DIRECTIONS AND INDICATIVE LENDING SCENARIOS

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1. Introduction

1.1 Consultations for the Twelfth General Replenishment of the African Development Fund (ADF-12) come at a critical time. With only 5 years left before the 2015 Millennium Development Goals (MDGs) deadline, Africa still has the biggest financing gaps of any continent. These gaps—and the shrinking timeframe—are compromising Africa's chances of making significant progress in the near term and achieving its potential.

1.2 Exceptional circumstances have marked the Eleventh General Replenishment of the African Development Fund period (ADF-11). The 2008-2009 global economic and financial crisis has challenged donors and ADF countries alike, both of which are struggling to make the best use of limited resources in the face of exacerbated and competing demands. In ADF countries, the crisis slashed gross domestic product growth from 6.5 percent in 2008 to an estimated 3.2 percent in 2009.[1] Consequently, ADF countries are straining more than ever to balance their budgets and mobilize the enormous financing they need to reduce poverty and regain pre-crisis growth levels. At the same time, they will require additional resources to adapt to the effects of climate change, which are expected to hit low-income countries the hardest. Donors are also facing multiple domestic and external demands, with several replenishment and capital increases for international financial institutions looming on the horizon.

1.3 Against this backdrop, the African Development Fund (ADF or Fund) is entering the ADF-12 consultations better positioned than ever to deliver high-quality assistance to African low-income countries. ADF-11 implementation to date, which was documented and discussed at the ADF-11 Mid-Term Review, attests to the Fund's renewed focus and increased delivery capacity and its ability to respond flexibly and rapidly to new demands and circumstances. At end-December 2009, i.e., 2 years into the ADF-11 cycle, 86 percent of the resources available under ADF-11 had been committed. Annual disbursements reached UA 935 million in 2009, double the amount of the corresponding period during the Tenth General Replenishment of the African Development Fund (ADF-10). High demand and quickly growing commitments reflect both the continent's great financing needs in the ADF's areas of strategic focus and the Fund's improved performance. Decentralization to 25 countries has brought the ADF closer to its clients and allowed it to regain its leadership role, with the African Development Bank (ADB or Bank) Group playing a catalytic role as Africa's voice in the G-20 and other international fora. As a result of these accomplishments and the Fund's strategic selectivity, the quality at entry and results focus of ADF operations and the alignment of the Fund to recipient countries' priorities have improved significantly.[2]

1.4 These achievements and confidence in the ADF's increasing capacity to deliver results prompted Deputies at the ADF-11 Mid-Term Review to reiterate their strong support for the Fund's continued role as a strategic African institution. Deputies agreed to launch the ADF-12 consultations early and supported consolidating and deepening current strategic priorities in ADF-12 while urging the Fund to be innovative and continue to strengthen its institutional capacity. Management committed to an Action Plan to push forward a number of key issues by mid-2010 and is actively implementing the remaining steps of its institutional reform agenda.

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[1] The Bank estimates that the gross domestic product of Sub-Saharan Africa as a whole will decline from an estimated 5.3 percent in 2008 to a projected 1.1 percent in 2009. Thus, even though ADF countries have been adversely impacted by the crises, their maintenance of a gross domestic product of 3.2 percent demonstrates their relative resilience and their capacity to manage their economic affairs.

[2] See Managing for Development Results. 2008. *Multilateral Development Banks' Common Performance Assessment System (COMPAS) 2008 Report;* Multilateral Organisation Performance Assessment Network (MOPAN). 2009 and 2007. *MOPAN Common Approach: African Development Bank 2009* and *The Annual MOPAN Survey 2007: Donor Perceptions of Multilateral Partnership Behaviour at Country Level.*

1.5 In sum, African low-income countries' massive and immediate short-term financing needs, required to meet the MDGs, and the Fund's demonstrated capacity to deliver growing volumes of high-quality aid, are prompting the ADF to ask donors for their solidarity during the ADF-12 period. This solidarity is essential to enabling the ADF continue to play a transformative role in helping Africa achieve its potential.

1.6 The purpose of the ADF-12 Cape Town meeting is fourfold: (i) to discuss strategic priorities and a broad policy framework for ADF-12, including potential adjustments to the regional operations, fragile states and policy-based operation (PBO) frameworks; (ii) to discuss the foundations of the financial framework for ADF-12; (iii) to present the indicative demand for ADF resources for the 2011-2013 period; and (iv) to begin discussing alternative lending scenarios and the replenishment size for ADF-12. As agreed in Helsinki, issues of capacity, effectiveness and results, which are central to the replenishment discussions, will be discussed in the May meeting.

1.7 This paper presents a snapshot of the strategic direction and operational priorities that will guide the Fund's engagement with 40 African low-income countries during the ADF-12 period. Following this introduction, Section 2 of this paper briefly discusses ADF countries' financing needs and absorption capacity. Section 3 describes the role of the Fund and its strategic priorities for the ADF-12 period and briefly summarizes the principal policy framework adjustments proposed by Management for PBOs, regional operations and fragile states. The sectoral breakdown of the ADF-12 prospective pipeline is presented in Section 4, and Section 5 introduces alternative lending scenarios. Conclusions follow in Section 6.

2. ADF Countries' Financing Needs and Absorption Capacity

2.1 ADF countries' demand for medium and long-term financing is driven by their determination to reach the MDGs, bridge significant infrastructure deficits, achieve regional integration, and invest in climate change adaptation and mitigation.

2.2 The prospects of ADF countries **reaching the MDGs** are in doubt, and are worsening in the aftermath of the global financial and economic crisis.[3] Recent projections show that Sub-Saharan Africa lags behind the MDG target of halving the proportion of people living on less than US$ 1.25 per day by 2015, and the 2008 food crisis has reversed the limited progress made in reducing hunger in sub-Saharan Africa. It will also prove difficult for many African countries to reach MDGs related to health and education. Africa faces a large financing gap in attaining the MDGs. The Bank Group estimates that ADF countries would need an additional US$ 30 billion per year between 2011 and 2015 to raise investments to levels that would boost growth sufficiently to realize the MDGs.

2.3 Africa's **infrastructure gaps** are particularly glaring. African countries' infrastructure lags far behind that of other developing countries, and the gap is widening. Poor infrastructure in Sub-Saharan Africa cuts national economic growth by 2 percentage points each year and reduces business productivity by as much as 40 percent. Only one in four Africans has electricity within the home and less than 60 percent of Africa's population can access drinking water. Furthermore, only 40 percent of rural Africans—compared to 65 percent of the rural population in other developing regions—live within 2 kilometers of an all-season road, and red tape along international trade corridors keeps the movement of freight below 12 kilometers an hour.[4] Water storage in Africa is the lowest in the world and the largely underdeveloped condition of irrigation infrastructure exacerbates the continent's vulnerability to the adverse impacts of climate change and food insecurity. The negative effects of this severely limited infrastructure are compounded by high production costs and institutional inefficiencies in service delivery.

[3] United Nations. 2009. *The Millennium Development Goals Report.* United Nations Department of Economic and Social Affairs.
[4] All statistics from the World Bank Group. 2009. *Africa's Infrastructure: A Time for Transformation.*

2.4 The Bank Group estimates that annual financing requirements for infrastructure in ADF countries will range between US$ 36 and US$ 80 billion between 2010 and 2020, depending on growth and the efficiency of public investments.[5] Given that public investment in infrastructure in ADF countries ranges from 5 to 6 percent of gross domestic product, it follows that US$ 18 billion to US$ 53 billion (US$ 13 billion to US$ 35 billion excluding Nigeria) in funds are needed from the private sector or the donor community. Even if the Bank Group meets only a fraction of this demand, the implications for its resources are significant.

2.5 Under the leadership of the African Union and the New Partnership for Africa's Development (NEPAD), the Bank Group helped revise the Africa Action Plan on **regional and continental integration**. This action plan details the objectives, challenges and opportunities of implementing credible regional integration projects during 2010-2015. It covers nine sectors and proposes a rigorously prioritized pipeline of operations at different stages of implementation. This pipeline requires US$ 10.2 billion in resources, of which US$ 7.7 billion is for infrastructure and US$ 1.7 billion for agriculture and food security. The financing for most of the projects for consideration under ADF-12 would go to low-income countries.

2.6 **Climate change** is a daunting issue. Africa is the continent most affected by the adverse impacts of global climate change, which are undermining its efforts to meet the MDGs. Estimates like those of the Stern Review on the Economics of Climate Change[6] show that climate change could cost developing countries, particularly those in Africa, up to 19 percent of gross domestic product by 2030. For the poorest countries, adaptation is a clear and immediate priority, but charting a low-carbon growth pathway should also be pursued where practicable. Recent climate change adaptation costs and the cost of putting Africa on a low-carbon growth pathway have been estimated at US$ 22 billion to US$ 31 billion per year between 2010 and 2015, and between US$ 52 billion and US$ 68 billion per year by 2030. These costs are expected to increase significantly unless prompt action to curb global warming is taken.

2.7 Over and above Africa's pre-crisis development financing needs are the needs created by **the 2008 food and financial crises and the resulting global economic downturn.** African low-income countries are typically the least cushioned to withstand unforeseen and dramatic events such as those created by the financial crisis. To move beyond the global downturn, these countries will need additional support.

2.8 ADF countries' large development financing needs are matched by their growing **absorption capacity**, evidenced not only at the macro level by improved Country Policy and Institutional Assessment ratings, but also at the project level by improving disbursement rates and performance indicators. In this respect, Gleneagles Scenarios[7] conducted for eight ADF countries by the MDG Africa Working Group have shown that scaled-up aid for already-designed projects and programs awaiting financing could be absorbed without compromising macroeconomic stability and growth.

3. The Role of the ADF and Strategic Priorities for ADF-12

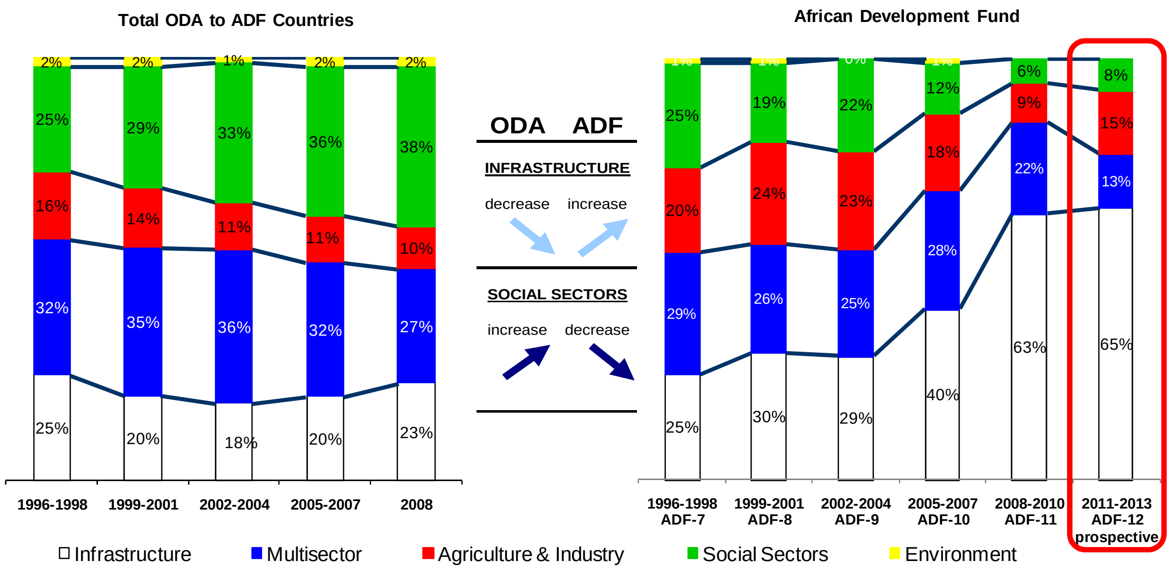
3.1 The ADF-11 Mid-Term Review left no doubt as to the ADF's transformative role as the financier, the convener and the voice of Africa's low-income countries. It also highlighted the Fund's significant progress in improving its delivery capacity, its institutional effectiveness and its focus on quality and development results. As agreed with Deputies, and consistent with both the needs of the continent and the ADF's comparative advantage, the ADF-12 period will deepen the Fund's strategic role and consolidate its operational engagement in the priority areas of infrastructure, governance, regional integration, and fragile states. These priorities are relatively underfunded by the wider donor community (Figure 1). The Fund will scale up

[5] According to estimates by the Africa Infrastructure Diagnostics Study, the cost of addressing Sub-Saharan Africa's infrastructure deficits is around US$ 93 billion a year, nearly half of which is needed for the power sector.
[6] Stern, N. 2006. *Stern Review on the Economics of Climate Change.*
[7] Gleneagles Scenarios comprise three components: (1) a sector-by-sector analysis of a country's existing medium-term expenditure framework; (2) the preparation of a hypothetical spending profile for the use of funds on MDG projects and programs identified in national development strategies or plans and prioritized by the authorities for the use of funds that could be made available consistent with delivery of the Gleneagles Commitments; and (3) a macroeconomic analysis of authorities' scaled-up expenditure path.

its operations significantly in these sectors, building on initial investments from ADF-11 and investing increasingly in selected sub-sectors, integrating climate change mitigation into its regional operations, and expanding its support for private sector development activities.

3.2 Also in ADF-12, the Fund will mainstream crosscutting issues—particularly private sector development, climate change, food security, gender, and the social sectors—into all Fund operations in an innovative and more deliberate manner. Insofar as knowledge is concerned, the Fund will pursue its ambition to become Africa's lead knowledge institution and the voice of the continent on development issues.

Figure 1: Total Official Development Assistance and African Development Fund - Funding by Sector



Note: *ADF= African Development Fund; ODA=official development assistance*

Source: *African Development Bank*

Consolidating Existing Priorities: Infrastructure, Governance, Regional Integration and Fragile States

Infrastructure

3.3 Infrastructure is a sine qua non for economic activities that drive growth and development. Well-developed and well-maintained infrastructure is critical for private sector development and agricultural production, increased competitiveness and productivity, deeper economic and social integration, better employment opportunities, and market development. In times of economic downturn, infrastructure investments stimulate recovery. Developing infrastructure also contributes directly and indirectly to the attainment of several MDGs.

3.4 Accordingly, the ADF's approach to infrastructure in ADF-12 will continue to reinforce the three pillars adopted for ADF-11: (i) scaling up investments, (ii) increasing project size, and (iii) emphasizing projects that promote regional integration. In addition, projects in the ADF-12 prospective pipeline will pursue more public-private partnerships and more cofinancing with partner development agencies.

3.5 At the sub-sector level, the Fund will focus on the following areas:

- Transport: Expand development of regional transport corridors, trunk and rural roads, and urban programs that support or open up major centers of economic activity. For example, the Mombasa-Nairobi-Addis Ababa road project will help fill more than 700 km of missing transport links on the North-South corridor, boosting trade between Ethiopia and Kenya from US$ 48 million in 2007 to US$ 200 million by 2017, a 500 percent increase.

Transport accounts for about 63 percent of the ADF-12 prospective pipeline of infrastructure projects.

- Energy: Increase investments in power generation, especially for clean energy (hydropower stations, wind farms and solar energy) and regional power pools. Inter alia, ADF-12 has received requests to finance power interconnection projects in Central, East and West Africa that build on several ADF-11 initiatives. The Fund has also been asked to support hydropower and solar energy plants in several countries. In West Africa, the Fund plans to finance the regional power interconnection between Sierra Leone, Liberia, Guinea and Côte d'Ivoire (the final links in the West African Power Pool) during ADF-12. Energy projects account for 31 percent of the ADF-12 prospective pipeline of infrastructure projects.

- Water and sanitation: Boost access to water and sanitation in both urban and rural areas, especially focusing on peri-urban centers and the poorest 65 percent of rural populations. The ADF-12 prospective pipeline of projects for water and sanitation reflects a threefold increase over ADF-11.

- Information and communication technologies: Invest in broadband infrastructure networks supported by international submarine systems, national backbones, and rural networks, and build capacity for policy and regulatory frameworks at the country and regional levels. Consistent with the Fund's plan to better balance sub-sector investments, information and communication technologies will be a priority in ADF-12.

3.6 Given the importance of infrastructure to the Fund's portfolio, a key innovation in ADF-12 will be to mainstream climate change into all new infrastructure operations and screen all projects for climate risks. Climate change considerations will be taken into account at a very early stage of planning. Wherever practicable, low carbon options such as clean energy, rail or public transport will be promoted. Furthermore, food security will be mainstreamed by developing rural infrastructure and scaling up support for water storage and water management, including irrigation systems. Already, most of the roads proposed for financing have a rural component, as do at least 50 percent of projects in the infrastructure portfolio.

3.7 To complement its lending activities, the Fund will continue to leverage the Bank's thematic trust funds to provide technical assistance and economic and sector work which will focus mainly on road safety and climate change.

Governance

3.8 The Governance Action Plan (GAP), adopted in 2008, will serve as the ADF's main guidance for governance-sector interventions at the country, sector and regional level during ADF-12 and will structure the expansion of the Fund's support for economic and financial governance. The GAP's agenda and vision concentrate initially on public financial management and increase support for business-enabling environments starting in 2010.

3.9 The Fund will pursue its governance-related interventions particularly at the country and sector level. At the country level, the Fund will focus on improving core governance systems and institutions. As such, the Fund will sharpen its engagement in and increase its support for public financial management systems, focusing on budget processes, public procurement, and government auditing. At the sector level, the focus will be on mainstreaming governance. The Fund will increase its efforts to mitigate corruption and improve the enabling environment, especially in the sectors of infrastructure (energy and transport) and natural resources. The Fund will build on its ADF-11 initiatives, continuing to support regional member countries' implementation of the Extractive Industries Transparency Initiative and expanding its support for governance and anticorruption initiatives in private sector operations. It will pay particular attention to enabling legal and regulatory frameworks for business development and promoting effective financial sectors in ADF countries.[8]

[8] One of the ways that the Fund plans to accomplish these goals is to build on ongoing activities such as the Making Finance Work for Africa Partnership and the Private Sector Development Strategy. The first is a G8 initiative that was launched by the Bank, Germany and the World Bank in October 2007. Its objective is to support African countries' efforts to strengthen their financial sectors as a means of accelerating growth and reducing poverty.

3.10 Policy-based operations (PBOs) are the Fund's primary instrument for supporting ADF countries' efforts to strengthen economic and financial governance. While any potential significant adjustments to the Fund's PBO approach will await the Operations Evaluation Department's independent assessment scheduled for release in December 2010, Management's proposed adjustments[9] include (i) measures to strengthen the fiduciary risk management framework for PBOs; (ii) measures to consolidate and update the Bank's PBO-related policies; and (iii) in light of experience under ADF-11, acknowledgement of the value of using PBOs on a case-by-case basis to respond to exceptional circumstances such as crises and emergencies, post-conflict and peace-consolidation situations, and arrears clearance exercises in ADF countries.

3.11 The Fund will also exploit synergies between its lending and non-lending activities in order to maximize development results and improve economic and financial governance. Technical assistance provided through Pillar III of the Fragile States Facility and other vehicles will also strengthen capacity in public financial management. Building on the 2009 water sector governance guidance note, the Bank plans economic and sector work in 2010 targeted on the energy, transport, and extractive industries sectors. For example, the Bank Group will launch a flagship publication, *African Governance Outlook*, to assess performance and monitor trends in financial governance. It will also update the Fund's financial sector strategy to respond more effectively to current circumstances and needs.

3.12 In the context of the Fund's support for public financial management and debt relief initiatives, the Fund will scale up its support to ADF countries for debt management capacity building. In the absence of sufficient concessional resources and given the increasing number of ADF countries that risk falling into debt distress, building a strong and well-coordinated debt management capacity has become an important area of engagement for the Fund and its regional and international partners, especially the World Bank and the International Monetary Fund. In particular, the Fund will help ADF countries adopt and/or implement debt management strategies founded on the sound management of public resources and on revenue policies (for both domestic revenues and aid flows) that aim to alleviate fiscal pressures and reduce countries' need to accumulate unsustainable debt.

Regional Integration[10]

3.13 The Fund will retain regional integration as a distinctive priority area in ADF-12, scaling up its engagement with an enhanced approach. The basis for ADF-12 regional operations will be the current policy framework[11] and the strategic priorities of regional infrastructure, regional public goods, and capacity building. Climate change adaptation will become a vital element of regional operations under ADF-12, and will be dealt with both as new initiatives and as a complement to ADF-11 activities such as the Lake Chad Basin Sustainable Development Program, the Congo Basin Ecosystems Conservation Program, and the Institutional Support to African Climate Institutions Project. Management proposes to refine the regional operations framework in ADF-12, in part by (i) strengthening the selection and prioritization process for regional operations; (ii) further enhancing quality and results measurement; (iii) systematically monitoring, reviewing and reporting on regional operations; and (iii) strengthening financing modalities, in part by introducing a cap for regional public goods.

3.14 Finally, the Fund will do more to improve regional and national capacities for driving and implementing the regional agenda. In this regard, the Fund's interventions will follow a two-phase approach. In Phase One, the Fund will assess countries that are lagging in their implementation of regional agreements. In Phase Two, it will assess the capacity constraints of regional economic communities. Based on these assessments, the Fund will develop a capacity-building program to help the institutions of both countries and regional economic communities implement regional agreements. This capacity building will pay special attention

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[9] See the ADF-12 Discussion Paper *Review of Policy-Based Operations Under ADF-11.* February 2010. Cape Town, South Africa.

[10] See the ADF-12 Discussion Paper *Proposed Adjustments to the Regional Operations Framework.* February 2010. Cape Town, South Africa.

[11] See African Development Bank. 2008. *Strategic and Operational Framework for Regional Operations (*ADB/BD/WP/2008/31, 19 February) and African Development Bank. 2009. *Bank Group Regional Integration Strategy 2009-2012 (*ADB/BD/WP/2009/24, 12 February).

to public-private partnerships, which mobilize private sector resources.

Fragile States

3.15 The Fund will continue to provide greater and better-tailored support to fragile states through its Strategy for Enhanced Engagement in Fragile States and Operational Guidelines for the Fragile States Facility, adopted in 2008. The Fund's strategic goal in fragile states will continue to focus on providing expeditious and meaningful support to countries emerging from crisis, and providing each country with differentiated assistance at critical junctures of its re-engagement and recovery process.

3.16 Building on early lessons from ADF-11, the Fund will fine-tune its operational framework in ADF-12. Management proposes[12] that in fragile states, the ADF continue to concentrate on rehabilitating infrastructure, supporting governance, building institutional and human capacity, and maintaining its selective use of PBOs (supported by adequate safeguards) so as to ensure predictable resource flows, reduce transaction costs, and increase ownership by recipient countries. Management also proposes to ensure sufficient Fragile States Facility resources for ADF-12 by (i) maintaining a times-two multiplier of the average of the highest two annual Performance-Based Allocations in ADF-11 for supplemental support, and (ii) taking Somalia, Sudan, and Zimbabwe's potential qualification for arrears clearances into account. Given the exceptional size of Zimbabwe's arrears, Management suggests ring-fencing the required resources. Finally, Management suggests a plan to refine countries' eligibility criteria for continued assistance and to introduce exit modalities to facilitate their smooth transition out of the Fragile States Facility during or at the end of ADF-12.

Crosscutting Themes

3.17 Building on its experience of integrating crosscutting issues during ADF-11, the Fund will mainstream private sector development, climate change, food security, and gender and social sector activities into all ADF-12 priority operations. As agreed during the ADF-11 Mid-Term Review, and in light of their critical impact on the African continent, the issues of climate change and food security will receive particular attention.

Supporting Private Sector Development

3.18 Because it works directly with both public and private sector actors, the Bank Group is uniquely positioned to help develop the private sector in ADF countries. Its strategic approach concentrates on creating a fertile environment for enhanced entrepreneurship; mobilizing private sector participation in the development of economic and social infrastructure; attracting domestic and foreign direct investment; and supporting the development of financial markets and services.

3.19 The Bank Group implements this strategy through a self-reinforcing approach combining (i) the development of diagnostics and strategy, such as the *Africa Competitiveness Report* (in collaboration with other partners) and *African Infrastructure Country Diagnostics*; (ii) enabling-environment programs in the areas of economic infrastructure, good governance, and regional integration; and (iii) catalytic transactions conducted through non-sovereign operations in areas where private financial institutions are reluctant to invest. Cofinancing operations are selected through an integrated framework that stresses commercial viability, alignment with national/regional and Bank priorities, additionality and complementarity, and expected development outcomes.

3.20 During ADF-12, the Bank will build upon its existing approach to promoting private sector activity in ADF countries. Based on ADF-11 trends, Management expects that about 60 percent (UA 3.7 billion) of the ADB's private sector operations in ADF-12 will reach ADF countries, mostly in the infrastructure sector (40 percent or UA 1.4 billion), for industries and services (30 percent or UA 1.1 billion), and for financial institutions (30 percent or UA 1.2 billion). With respect to cofinancing, every UA that the Bank invests in the private sector is matched by up to five UA from additional sources, including the private sector.

[12] See the ADF-12 Discussion Paper *Proposed Adjustments to the Enhanced Approach to Fragile States.* February 2010. Cape Town, South Africa.

In a bid to increase the multiplier effect of private-sector operations in regional member countries, the Bank has launched the African Financing Partnership, an initiative that brings together eight international financial institutions to coordinate financing for large projects such as the Main One fiber optic cable project in West Africa and the Lake Turkana Wind Farm in Kenya. The African Financing Partnership is the coordination platform for the Joint Action Plan to Respond to the Financial Crisis in Africa.[13] This Action Plan includes key strategic initiatives, such as the Global Trade Liquidity Program and Infrastructure Crisis Facility, which are now channeling the US$ 15 billion committed in the Action Plan to counter the effects of the financial crisis in Africa.

3.21 Because most ADF countries still lack adequate private sector-enabling environments, credit enhancements and/or other leveraging mechanisms are important to encouraging private sector activity. Management proposes to introduce new instruments or new uses of existing instruments during the ADF-12 period with a view to leveraging ADF resources for private sector operations in ADF countries, including fragile states, while managing risk prudently. These risk mitigation instruments, which include financing governments' equity participation in public-private partnerships with ADF resources, will be presented in the paper on new instruments at the May ADF-12 meeting.

Climate Change Adaptation and Food Security

3.22 *Climate Change*: ADF-12 will mainstream climate change initiatives by emphasizing collaboration, complementarity and coherence with the work of other actors. Building on its experience from the Copenhagen Summit, the Bank Group will continue to strengthen its convening role to generate a strong African voice for post-Copenhagen engagements in regional and global fora.

3.23 While adaptation is ADF countries' principal priority insofar as climate change is concerned, Africa also has the opportunity to avoid the lock-in of high carbon infrastructure and realize climate-compatible growth. Implementation of Bank Group adaptation policies that avoid deforestation and create clean energy projects will require significant additional financial resources.

3.24 A key priority in ADF-12 will be to generate policy options and projects to help countries adapt to climate change and support low carbon development. Adaptation measures will target key sectors such as agriculture, water and health, and mitigation initiatives will take place in the energy sector and in forestry and other land use sectors. Extending access to clean energy to the millions of Africans who suffer from "energy poverty" will be a priority. Measures have been put in place across the Bank Group to screen all projects for climate risks. New measures are also being adopted to ensure that (i) all operational and policy teams take climate change considerations into account at a very early stage in planning all investment, policy-based and knowledge products; and (ii) the Bank helps regional member countries take advantage of climate change-related opportunities by implementing the REDD+ mechanism and the Nationally Appropriate Mitigation Options.

3.25 *Food Security:* Guided by the Agricultural Sector Strategy for 2010–2014, all Country Strategy Papers and Regional Integration Strategy Papers will address food security as a crosscutting theme. The Agriculture Sector Strategy aims to help ADF countries increase their agricultural productivity, improve food security, and reduce the adverse impacts of climate change. Consistent with the findings of the joint ADB-International Fund for Agricultural Development evaluation[14], the Fund will continue to focus its efforts in this area on the infrastructure component of agriculture. Key interventions under ADF-12 include building and rehabilitating about 5,000 km of feeder and access rural and community roads, markets and storage facilities; supporting agro-processing and reducing post-harvest losses; and supporting regional trade and export infrastructure. ADF-12 will also significantly scale up operations for rural water management and irrigation systems. Fund-supported interventions are expected

[13] The Joint International Financial Institutions/Development Finance Institutions Action Plan to Respond to the Financial Crisis in Africa was launched in 2009 to support Africa's financial systems and lending to private sector.

[14] See African Development Bank, 2009. *Joint Evaluation of the Agriculture and Rural Development Policies and Operations in Africa of the African Development Bank and the International Fund for Agricultural Development.* ADB/BD/WP/2009/223. African Development Bank-Operations Evaluation Department.

to increase the agricultural land under improved water management by 300,000 hectares and increase water storage by 3 billion cubic meters by 2012.

Gender Mainstreaming and Social Sector Activities

3.26 *Gender*: On the basis of the Bank's Updated Gender Plan of Action (UGPA 2009-2011), the Fund will ramp up its activities in the following areas: (i) supporting investments that promote women's economic empowerment in infrastructure, agriculture and human development, and; (ii) building institutional capacity and knowledge-building by deepening analytical work in relevant areas and targeting support to generate and disseminate gender statistics. In addition, the Fund will scale up its work on gender-responsive budgets and gender auditing, particularly in the context of the Fund's policy dialogue around budget support. Country-level institutional capacity for formulating gender policies and implementing legal frameworks will be strengthened. Support under ADF-12 will address gender-based violence in fragile states, primarily in the form of technical assistance and the funding of studies that will feed into policy advocacy and improved service delivery.

3.27 *Social sectors*: In line with the priorities highlighted in the Bank Group's Medium-Term Strategy and with the Fund's greater selectivity and its division of labor with its partners, ADF-12 interventions in the social sectors will be limited to capacity-building operations in two niches: education and health. In education, Fund interventions will support higher education, science and technology, and technical and vocational training. In health the Fund will primarily focus on strengthening health systems through training and retention and through research support.

Knowledge Activities

3.28 The Bank Group's knowledge activities for the first two years of the ADF-12 period will be implemented under its Knowledge Management and Development Strategy 2008-2012. Activities will focus on developing regional member countries' capacity for enhanced policy-making, strengthening countries' statistical capacity, and conducting high-quality research on development challenges.

3.29 The Bank Group will continue to improve its flagship publications[15] and develop new knowledge products, such as flagship country and regional reports and Regional Integration Strategy Papers (RISPs). These knowledge products will provide in-depth analyses on topical issues and distill best practices and emerging evidence, especially in the area of monitoring, evaluation, and results measurements.

4. The ADF-12 Prospective Pipeline

4.1 As was the case for ADF-11, the prospective pipeline for ADF-12 is concentrated in core areas that reflect countries' priorities. The proposed projects complement other donors' activities, are focused on results, and emphasize the Bank Group's strengths and comparative advantage. The pipeline is developed using a rigorous bottom-up approach whose first concern is to respond to ADF countries' demand. The filtering process produces a pipeline that respects countries' development needs, exploits the areas of intervention where the Fund enjoys a comparative advantage, and meets the Fund's expectations of resource availability. Alignment to countries' poverty reduction strategies is ensured through a consultative process led by the regional departments and Field Office representatives. Anticipated operations are consolidated in the Bank's work program to give Senior Management a 3-year outlook and the opportunity to align the proposed list of projects to institutional objectives. Country Teams are the locus of intensive iterative internal consultation

[15] These publications include *African Economic Outlook*, *African Development Report*, *Africa Competitiveness Report*, *Selected Statistics on African Countries*, and *Compendium of Statistics on Bank Group Operations*. Since 2008, the Bank has taken the lead from the Organisation for Economic Co-operation and Development (OECD) in the publication of *African Economic Outlook*, which analyzes Africa's economic and social development every year and increased its coverage from 35 countries in 2007/2008 to 50 countries in 2009/2010. The report, which is now considered the world's most consistent and comprehensive analysis of Africa's economic performance, will continue to be a key knowledge piece both within the continent and abroad.

and coordination between regional and sector departments. Current Country Strategy Papers cover all or part of the ADF-12 period and preparation has started for many operations identified therein, with Board presentation planned for as early as the first quarter of 2011.

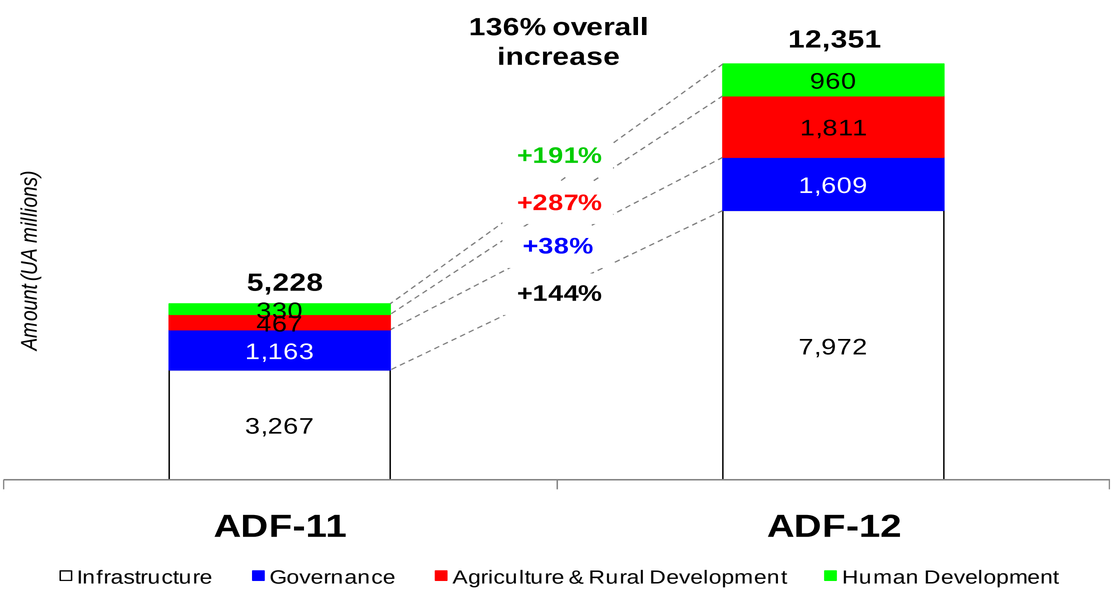
4.2 Building on the momentum and accomplishments of ADF-11, institutional reforms continue to improve internal business processes and shorten the time lapse from project concept to implementation. While progress has been made in delegating authority and responsibility to Field Offices, Management recognizes that more action is needed and has addressed the issue in the forthcoming Decentralization Roadmap. Inter alia, recruitment initiatives will continue under ADF-12—particularly in key technical areas—with a view to ensuring robustly staffed Field Offices. The Fund will also continue to increase the average size of projects and will prioritize efforts to build on the ADF-11 portfolio with follow-on projects that deepen the impact of existing initiatives.

4.3 Growing demand and increased delivery capacity is reflected in the pipeline of 336 national and multinational projects amounting to UA 12.35 billion (Figure 2). The number of projects under ADF-12 is expected to increase by about 50 percent over ADF-11. Similarly, at UA 37 million, average project size is anticipated to grow by 56 percent (from UA 24 million). Larger projects help to improve efficiency by cutting processing costs and reducing aid fragmentation at the country level. The ADF-12 prospective pipeline is comprised of:

- national projects valued at UA 6.85 billion, a 76 percent increase over ADF-11, and multinational projects valued at 5.49 billion (para. 4.5);
- UA 1.39 billion of prospective demand from fragile states for additional resources through the Performance Based Allocation, the Regional Operations envelope and the Fragile States Facility; and
- UA 1.15 billion of PBOs, a 5 percent increase over ADF-11 in nominal terms, but lower in relative terms.

Figure 2: Total Projects Pipeline for ADF-11* and ADF-12**

(UA millions)

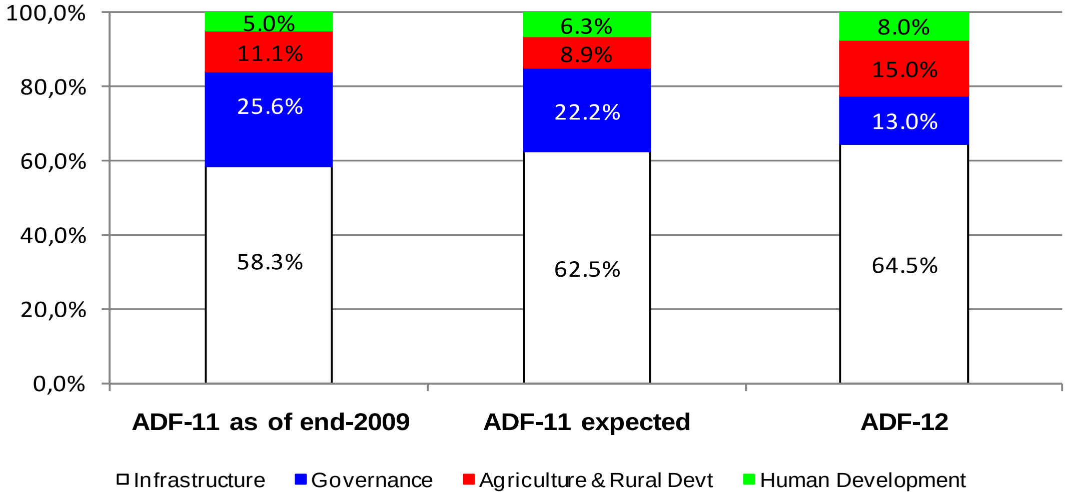


Notes: **ADF-11=actual resources + resources expected in 2010; **ADF-12= prospective pipeline; UA=Units of Account*

Source: *African Development Bank*

4.4 The distribution and allocation of projects in the prospective pipeline reflects the outcome of client country dialogues rather than target figures. The pipeline will evolve as new Country Strategy Papers are developed and country dialogues progress. At present, the sector distribution of the proposed projects (Figure 3) reflects the Fund's strategic orientation of continuity accompanied by increased activity in the agriculture and rural development sector to promote food security.[16]

Figure 3: The Distribution of the ADF-11 Pipeline and the ADF-12 Prospective Pipeline by Sector, Excluding Arrears Clearances



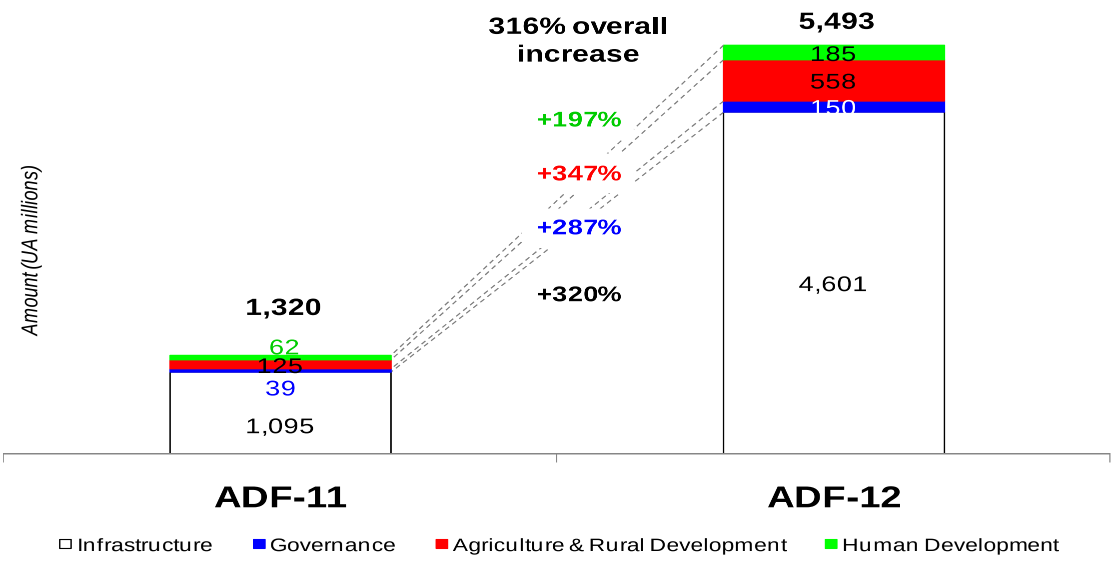
Source: *African Development Bank*

4.5 At UA 5.49 billion, the prospective pipeline of multinational projects has increased threefold over the ADF-11 level (Figure 4). As discussed in the ADF-12 paper, "Proposed Adjustments to the Regional Operations Framework," the regional operations filtering process in ADF-12 will be based on the 5-year indicative pipeline contained in the Regional Integration Strategy Paper (Step 1) and a rigorous ranking and prioritization process (Step 2). This process will rank projects on the basis of (i) their quality and readiness for implementation; (ii) collaboration and cofinancing with other development partners; (iii) projects' expected development outcomes and results; and (iv) projects' expected impact on climate change.

[16] As acknowledged at the ADF-11 Mid-Term Review in Helsinki, the Fund's support to the agriculture sector will focus on rural infrastructure activities. Thus, many projects classified as "infrastructure" in the Bank Group's database encompass an agriculture and rural development component.

Figure 4: Multinational Projects Pipeline for ADF-11* and ADF-12**

(UA millions)



Notes: **ADF-11=actual resources + resources expected in 2010; **ADF-12= prospective pipeline; UA=Units of Account*

Source: *African Development Bank*

5. Indicative Lending Scenarios

Table 1: The ADF-12 Financing Framework for Indicative Lending Scenarios[17]

(UA millions)

ADF Resources / Sources of Financing	ADF-11	ADF-12 Baseline Scenario 1	Change from ADF-11	ADF-12 Scenario 2 (50% increase over ADF-11)	Change from ADF-11	ADF-12 Scenario 3 (70% increase over ADF-11)	Change from ADF-11
Advance Commitment Capacity	2,063	1,763	-15%	1,959	-5%	2,044	-1%
Donor subscriptions	3,518	4,115	17%	6,479	84%	7,519	114%
Additional contributions	44	-	-	0	-	0	
Total Resources	**5,625**	**5,878**	4.5%	**8,438**	50%	**9,563**	70%
Carry-over amount	294	343		343		343	
Resources Including Carry-Over Amount	**5,919**	**6,221**		**8,781**		**9,906**	

Notes: *ADF=African Development Fund; UA=Units of Account*

Source: *African Development Bank*

[17] These scenarios assume that 17.5 percent of the pool of outstanding resources is allocated to the regional envelope and one-third cost sharing from the Performance-Based Allocations for 90 percent of regional operations. Internally generated resources are estimated to range between UA 1,763 million and UA 2,044 million, depending on the scenario.

5.1 Table 1 shows three financing scenarios for ADF-12. **Scenario 1** (the baseline scenario) assumes that the replenishment level for ADF-12 remains the same as that for ADF-11 in real terms (that is to say, the ADF-12 replenishment equals the ADF-11 replenishment adjusted for inflation). Under this scenario, and including internally generated resources of UA 1,763 million and a carry-over amount of UA 343 million[18], the total envelope amounts to UA 6,221 million. The Fund would be able to finance 63 percent of the current pipeline of national projects, and 28 percent of the current pipeline of multinational projects. At this level of replenishment, the Fund would thus not be able to scale up its activities and provide the critical mass of resources required by regional member countries to bridge their financing gaps, boost growth to pre-crisis levels and reach the MDG.

5.2 **Scenario 2** assumes that total resources for ADF-12 increase by 50 percent compared to ADF-11, producing an envelope of UA 8.8 billion. At this level of replenishment, the Fund would be able to finance 90 and 40 percent of the current pipeline of national and multinational projects, respectively. This would enable the Fund to finance most of its national program. However, the Fund would still fall short of realizing its ambitious agenda for regional integration, particularly in terms of accelerating investments in vital regional infrastructure links and meeting its ambitious climate change adaptation objectives.

5.3 **Scenario 3** assumes that total resources for ADF-12 increase by 70 percent compared to ADF-11, producing an envelope of UA 9.9 billion. At this level of replenishment, the Fund would be able to finance 102 percent of the current pipeline of national projects, leaving some room for growth in the pipeline during ADF-12. The 45 percent financing coverage of the current pipeline of multinational projects would enhance the Fund’s ability to leverage additional resources to bridge remaining financing gaps.

6. Conclusion

6.1 Entering ADF-12, Management is keenly aware of Deputies’ endorsement of the actions and results achieved under ADF-11. Building on the Fund’s and regional member countries’ accomplishments, Management proposes to consolidate these achievements and pursue innovations that will support Africa’s emergence from the global crisis and give African countries the tools and confidence they need to achieve the MDGs.

6.2 This paper has accomplished three goals. First, it proposed broad strategic directions for ADF-12, affirming the Fund’s continued focus on the core priority areas of infrastructure, governance, fragile states and regional operations, and proposing to mainstream support for climate change, food security and other crosscutting themes. Second, it presented the prospective pipeline for ADF-12, a pipeline that reflects a jump in the demand for ADF support and the Fund’s increased capacity to deliver. Finally, it discussed alternative lending scenarios based on different replenishment levels.

6.3 Deputies are invited to share their views on this paper and provide guidance with respect to Management’s proposals. In particular,

- Do Deputies agree with the broad strategic directions as presented, including the proposed policy adjustments as detailed in the ADF-12 discussion papers on regional operations, fragile states and PBOs?
- Do Deputies concur with the proposal to emphasize climate change initiatives within ADF-12 operations?
- What are Deputies’ views on the lending scenarios in light of ADF countries’ increased demand for Fund resources?

[18] This is the current estimate of the maximum carry-over. See the ADF-12 Discussion Paper *The ADF-12 Financing Framework*. February 2010. Cape Town, South Africa.