ADF-11 Strategic Directions and Indicative Lending Scenarios

Discussion paper

ADF-11 Replenishment: Second Consultation Meeting
June 2007
Tunis, Tunisia

AFRICAN DEVELOPMENT FUND

TABLE OF CONTENTS

STRATEGIC DIRECTIONS AND INDICATIVE LENDING SCENARIOS

PURPOSE & SUMMARY

This paper provides background on strategic directions and indicative lending scenarios for the 11th Replenishment of the ADF.

While Africa has recently shown positive achievements in terms of peace, stability and growth, many development challenges remain. Building on the stronger client focus brought about by the Bank Group reforms, the Fund's clients have started placing increasing demands on the ADF, which materialize into a strong prospective pipeline for 2008 - 2010.

In response to these growing expectations, as well as reflecting clear movement toward greater operational selectivity, ADF-11 will focus increasingly on activities where the institution has achieved demonstrably superior results – infrastructure and governance –, scale up its involvement with multinational operations and fragile states, and maintain its involvement in other key sectors.

Three possible scenarios are presented for the ADF-11 replenishment: a baseline scenario of UA 4.6 billion in total resources (a 15% increase over ADF-10 but zero growth in new donor commitments), a central scenario of UA 6 billion (50% increase), and a scenario of UA 8 billion (100% increase).

STRATEGIC DIRECTIONS AND INDICATIVE LENDING SCENARIOS

1. CONTEXT

1.1 The 11th Replenishment of the African Development Fund (ADF-11) comes at a critical moment for Africa. Continent-wide real economic growth has exceeded 5% for the third consecutive year – its best performance in 3 decades – and is forecast to accelerate further in 2007[1]. Over the same period, Africa has also generated a strong current account surplus driven largely by strong global demand for commodities, with demand expected to remain steady as robust global growth continues. Reinforcing an unusually favorable global economic climate as a key driver of improved economic performance is Africa's overall increased political stability, improved economic policies, and emerging structural reforms[2].

1.2 Yet despite this generally positive performance and outlook, Africa's fundamental development challenges remain huge – 23 African countries are expected not to meet any of the MDGs by 2015 – and the case for deeper international engagement has been both acknowledged and embraced. The ADF-11 replenishment provides an important opportunity for the international community to extend and deepen its partnership with Africa, helping it lay a stronger and more widely shared basis for growth and development, compete more effectively in regional and global markets[3], make urgently needed progress towards the Millennium Development Goals (MDGs), and reinforce positive developments toward greater stability. The ADF-11 replenishment represents one of the last opportunities to scale up support for programs that would deliver results before 2015.

1.3 In parallel, the global aid architecture has become increasingly complex - with more, and more diversified actors, more instruments, more scrutiny, and higher expectations. The average number of donors per country has nearly trebled since the 1960s, from about 12 to 33. New development partners, including emerging bilateral donors, vertical funds, foundations and the private sector, are playing an increasingly important role in delivering development assistance to Africa, and are in many cases seeking deeper partnership with the ADB to help them. While providing important new opportunities, these developments are also increasing the complexity of coordination, putting pressure on transactions costs, and making the challenges of focus, selectivity, and results more urgent.

1.4 Despite its unique pan-African character and focus, its long-term presence and engagement, and its successes in institutional renewal, the African Development Fund is still today not among the largest sources of development assistance to the continent, providing less than 3% of total ODA flows[4]. However, far-reaching institutional reforms, new talent and perspectives at every level, a sharper operational focus, more rigorous attention to demonstrating results, and a renewed presence in and partnership with regional member countries all provide a stronger delivery platform than at any time in the Bank's history.

1.5 The Bank Group is committed to seizing the new opportunities and meeting the challenges during the ADF-11 period. The primary tasks ahead are two: full

[1] Africa's average annual real GDP growth rate increased from 3.55% over the 1997-2002 period to 5.24% over the 2003-07 period. Today more than a third of Africans live in 17 countries that have grown at a rate of more than 4% per year for ten years. Africa is expected to grow at a rate of 5.8% in 2007, slightly higher than the rate recorded in 2006.

[2] The OECD Political Instability Indicator decreased from 11.5 in 2000 to 5.8 in 2005. According to the World Bank Doing Business Assessment, Africa has moved from last to 3rd place in terms of the pace of reforms.

[3] In 2005, Africa accounted for just 2% of international trade and world foreign direct investment flows.

[4] According to OECD DAC report. Total net ODA disbursed to sub-Saharan Africa between 2000 and 2004.

implementation of the many individual components of the ongoing institutional reforms; and, delivery of an appropriately focused, ambitious, and effective package of ADF-financed operations.

2. ADF-10

2.1 Total resources for ADF-10 amounted to UA 4.0 billion, including internally generated resources of UA 1.2 billion, and a carry-over from previous replenishments of UA 359 million. These resources were allocated for three broad purposes: (i) country-level projects with PBA (Performance-Based Allocation) derived resources (82% of total resources); (ii) multinational projects to promote regional integration (15% of total resources); and, (iii) a Post-Conflict Country Facility (PCCF)[5] to help select countries clear their arrears and re-engage with the international community (UA 250 million).

2.2 At year-end 2006, 62% of ADF resources had been committed through a total of 149 operations. The ADF expects to have committed available ADF-10 resources by year-end 2007. In general, demand from RMCs has surpassed the ADF's financial resources. In particular, the demand for multinational projects has far outstripped the resources identified for this purpose, and a large backlog of potential multinational projects will exist at the outset of the ADF-11 period.

2.3 The sector distribution of ADF-10 operations has been discussed previously and will not be re-covered in detail here. Infrastructure projects approved in 2005 and 2006 and planned for approval in 2007 amount to 52% of total ADF-10 resources, versus 23% under ADF-9. But despite a sharpening focus on infrastructure operations (itself largely reflecting country-level demand), ADF-10 continues to provide considerable support for agriculture (16%) and human development (14%).

3. ADF-11 STRATEGIC DIRECTIONS

3.1 The ADF-11 lending program will be more selective, with intensified focus on core areas that reflect country-driven development and financing priorities, greater complementarity and reduced overlap with other development partners, and a more rigorous results-based assessment of the Bank Group's established and potential strengths. Five main principles have informed the development of a prospective program for the next 3 years.

- ***Core development priorities.*** Stronger and more equitably shared economic growth is an essential precondition for sustained poverty reduction. Reducing major constraints to the emergence of new opportunities to raise incomes and the provision of essential services in support of human development is increasingly seen as a top priority; more supportive conditions for investment, especially by the private sector, and regional integration are especially critical.

- ***Country-level commitment.*** ADF financed operations must have the strong support of client countries, identified as part of a focused, selective and prioritized country strategy.

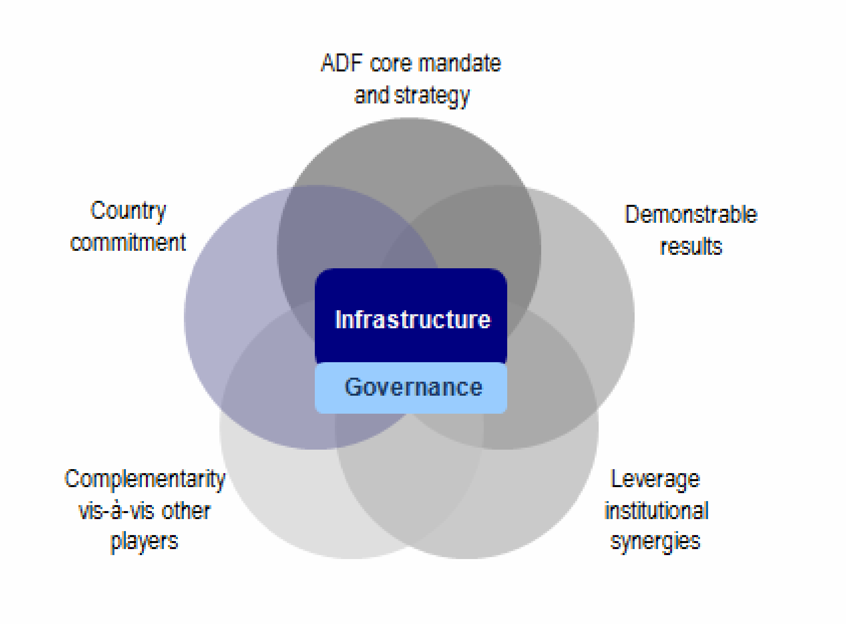
- ***Focus on results.*** ADF operations should focus most strongly on activities where it has produced or has the potential to achieve demonstrably superior results in terms of project delivery, and monitorable development impact (*see* Annex).

[5] Deputies agreed to allocate UA 100 million from ADF-10 to the PCCF to support arrears clearance for post-conflict countries. An additional UA 150 million from ADF-10 was made available on an as-needed basis.

- *__Complementarity.__* While focusing on these areas, and activities for which it has a clear mandate from the international community, the ADF must work more closely and effectively with development partners to ensure that priority country needs are properly addressed.

- *__Institutional Synergies.__* The Fund will work actively to create and build on activities where there are potential synergies with the ADB, such as leveraging the resources of the Private Sector window.

Figure 1 – Strategic Principles



3.2 Based on these principles, infrastructure (broadly defined) and governance will have particular weight as core areas for intervention during ADF-11. Both are critical to achieving demonstrable and enduring progress in a wide range of areas that are themselves also essential for sustained and sustainable development: greater market integration facilitated by better infrastructure and policies; improved access to public services, employment opportunities, and markets for goods; economic diversification and improved competitiveness. Strong linkages with agriculture and human development offer important avenues through which to widen and leverage the human and development impact of strategic capacity building investments in such sectors as water, sanitation, power and transport.

3.3 The Bank Group is committed to invest more actively in regional integration and to support the NEPAD initiative. Coupled with the emerging recognition that more regional integration is an essential engine of development in Africa, and growing country demand for the necessary investment, support for multinational operations will be a critical component of ADF-11 (*see* separate paper on a Proposed Framework for Multinational Operations).

3.4 Fragile states present enormous challenges as well as a compelling case for the ADF to be more effectively engaged. Under ADF-11 the Bank Group seeks to increase significantly, but selectively, its engagement in fragile circumstances and has proposed a strategy through which to do so (*see* separate paper on a Revised Framework for Enhanced Engagement in Fragile States).

3.5 The Bank Group will also work with RMCs and development partners on a country-by-country basis to ensure that no priority development needs are left totally unfunded. High-priority cross-cutting issues such as gender, clean energy and climate change adaptation - whose development implications are wide, complex and urgent - will be integrated systematically into all appropriate areas of Bank Group operations.

3.6 A brief summary of the Fund's prospective strategic priorities and thematic areas is provided in Figure 2 below.

Figure 2: Areas of Operational Focus

Financing Instruments	Areas of Focus	More specifically…
Fragile States	Infrastructure and capacity building	Focus mainly on post-crisis countries Strong cooperation with other organisations
Multi-national	Regional infrastructure and public goods	Projects to promote regional integration and public goods Increase PPPs and to leverage additional resources
	Capacity building operations and regional integration policy studies	These activities will be financed by trust funds specifically designed to address them
Country Allocations	Economic and social infrastructure	initiatives like NEPAD, ICA, RWSSI and AWF Continued support for human development and agriculture Increase PPPs and linkages with private sector operations Enhanced selectivity, including through stronger partnerships, ICT projects linked with tertiary education and science & technology programs.
	Governance and macroeconomic reform programs	Within donor harmonized frameworks. Enhanced country-level selectivity

Note: For further information on strategic focus please refer to the Deputies Report, Enhanced Engagement in Fragile States Paper and Multinational Operations Strategy Paper

3.7 In short ADF-11's prospective strategic directions incorporate an intended sharpening of the Bank Group's operational and strategic focus. Infrastructure and governance will account for approximately 76% of resources compared to 69% under ADF-10. Focusing on the best performing sectors within the Bank is expected to favor better results[6].

3.8 While substantially scaling up its operations in these areas, the Fund will maintain its involvement in other key sectors for Africa's development, albeit with enhanced selectivity. In particular, the ADF will support work to increase agricultural productivity, crucial for pulling millions out of rural poverty. This will involve financing rural infrastructure, especially irrigation and enhanced marketing, as well as agro-industry investments to foster agricultural transformation. The Fund will also selectively support higher education, science and technology with the aim of developing middle- and higher-level skills required to improve delivery of key public services, attract foreign direct investment, and build the skills foundation for greater private sector development.

4. ADF-11 PROSPECTIVE LENDING PROGRAM

4.1 The projected operational pipeline for the ADF-11 operational period (2008-2010) is built upon: (i) strong RMC demand; (ii) the broad ADF strategic priorities identified above; (iii) a significantly more rigorous internal process flowing from the Bank's reorganization; (iv) careful assessment of the Bank's capacity to deliver, and material improvements in that capacity; and, (v) integration of important elements of the Harmonization agenda.

[6] Please refer to Annex I for more detail.

Regional Member Country Demand

4.2 Regional member country demand has increased substantially over ADF-10, reflecting: (i) the ongoing development needs of African countries, against the background of the Bank's own renewal and deeper engagement; (ii) greater RMC financial and institutional capacity to manage development resources; and (iii) increased demand for multinational projects to address development challenges through greater regional integration.

- **Development needs.** Despite some genuine progress, Africa's development needs remain enormous. To accelerate growth and poverty reduction and make more rapid progress on MDGs, all of the Bank's stakeholders expect ADF to deliver prioritized support and increased development results, particularly in light of the international consensus to significantly increase assistance to the Continent. Promising recent developments in several post-crisis countries has also generated increased demand.

- **Enhanced RMC capacity to manage additional resources.** African countries have been the primary beneficiaries of debt relief under the HIPC and MDRI initiatives[7]. This has created significant fiscal space in many countries for productive development investments within well coordinated debt sustainability frameworks. In addition, the Bank's annual Country Policy and Institutional Assessment (CPIA) has shown a positive trend over the past five years[8]. The clusters most relevant to project implementation capacity, (Public Sector Management and Institutions, Procurement Assessment and Governance) have all increased slightly on average.

- **Focus on regional integration.** RMCs are increasingly recognizing the value of regional solutions to national development challenges, particularly cross-border infrastructure investments that have the potential to unify markets, overcome physical handicaps and lower production costs[9]. This is driving a significant increase in the demand for multinational projects.

Internal Process Improvements

4.3 The current ADF-11 pipeline was developed through a coordinated consultative process under the auspices of the newly created Regional Departments, and fully involving the Sector Departments and field offices. An intensive iterative internal process, informed by consultations at the country level, has produced a pipeline of prospective operations that is well aligned with the Bank's strategic orientations, Country Strategies and priorities emerging from the countries themselves, and around which there is internal consensus. Identified projects are being prepared by Sector Departments and will be processed through the Bank's new structure and business processes. Many are expected to be ready for Board presentation in 2008.

[7] Since December 2006, 17 countries have benefited from the MDRI. Another 16 will become eligible upon reaching the HIPC completion points.
[8] The average CPIA rating for ADF countries increased from 3.03 in 1999 to 3.17 in 2005.
[9] More than 20% of African countries are landlocked, the highest percentage of any continent. It is estimated that it will cost approximately USD 24 billion to fill Africa's major infrastructure gaps in transport, energy, ICT and water.

Delivery Capacity

4.4 The Bank Group has improved its capacity to deliver quality assistance during ADF-11 through institutional reforms and increased staff capacity including in the field. A significant increase in average project size will also contribute to improved staff-work ratios.

- **Institutional reforms.** Business process reforms will streamline considerably the internal processes around designing and delivering operations – fewer internal steps with each adding clear value and improving quality; greater accountability at every managerial level, and on the part of defined country teams. A significant downward delegation of authority will contribute substantially to timelier decision-making, creativity, and professional engagement.

- **Increased capacity.** Recruitment of approximately 100 new international professionals for the operations complexes will be completed in 2007, representing a 23% expansion over current capacity. In addition, 22 field offices are now open; Resident Representatives have been appointed; Country Program Officers will be in place before the end of the year; and, the number of local professional staff is expected to double.

- **Project size.** Increasing average project size will provide economies of scale for RMCs and the Bank Group. The current ADF-11 pipeline features an average project size of UA 32.3 million compared to UA 18.3 million for ADF-10; countries with small allocations of course will continue to require appropriately scaled operations. The ongoing increase in operations staff capacity will allow ADF to considerably scale up its support while improving operations staff-to-project ratios[10].

Harmonization and Project Design

4.5 The Bank is committed to the Paris Declaration commitments related to harmonization, country ownership, mutual accountability, alignment, and managing for development results. Accordingly, the ADF-11 lending program will: (i) identify possibilities to make further use of RMC procurement and public financial management systems; (ii) reduce the number of independent project implementation units; and (iii) further increase the number of co-financed projects. The ADF will increasingly channel its operations through harmonized frameworks and project designs that lower transaction costs for borrowers. Building deeper partnerships at the country level will be a priority for the Bank's new field offices.

Current Operational Pipeline

4.6 In summary, the tentative ADF-11 lending program reflects both strong client demand and ADF's enhanced capacity to meet this demand. Figure 3 below summarizes the current ADF-11 pipeline[11] and compares key elements to ADF-10 operational results.

[10] For 2006, the Bank Group's operations staff-to-project ratio was 6.6. Based on the current pipeline and planned recruitment for 2007, this ratio would be 7.4 in 2008.
[11] Please refer to Annex II for more detail.

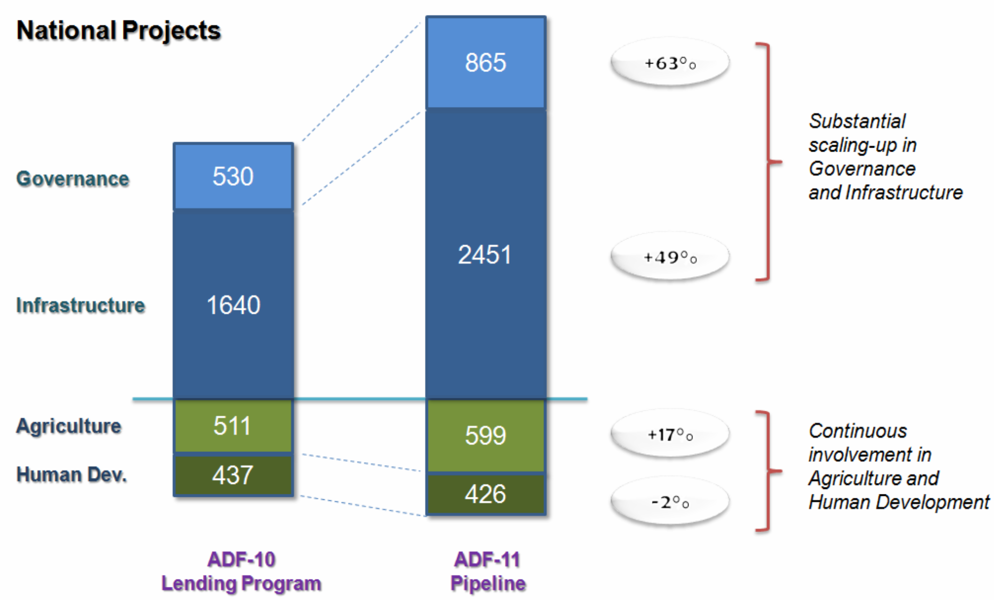
Figure 3: ADF-10 Lending Program[12] and ADF-11 Pipeline

Comparison per Sector	ADF-10		ADF-11 Pipeline	
	UA million	%	UA million	%
Agriculture	511	16%	599	14%
Infrastructure	1,640	53%	2,451	56%
Transport	*738*	*45%*	*942*	*38%*
Power	*344*	*21%*	*534*	*22%*
Water	*558*	*34%*	*975*	*40%*
Governance	530	17%	865	20%
Human Dev.	437	14%	426	10%
Total National	3,119	100%	4,341	100%
Multinational	551		2,829	
Total	**3,669**		**7,170**	
Number of Operations	201		222	

Comparison per Project	ADF-10	ADF-11 Pipeline
Harmonized Frameworks PBL/SWAP (%)	26%	38%
Co-financed Projects (%)	47%	76%
Average Project Size (UAm)	18.3	32.3

4.7 Several key points emerge:

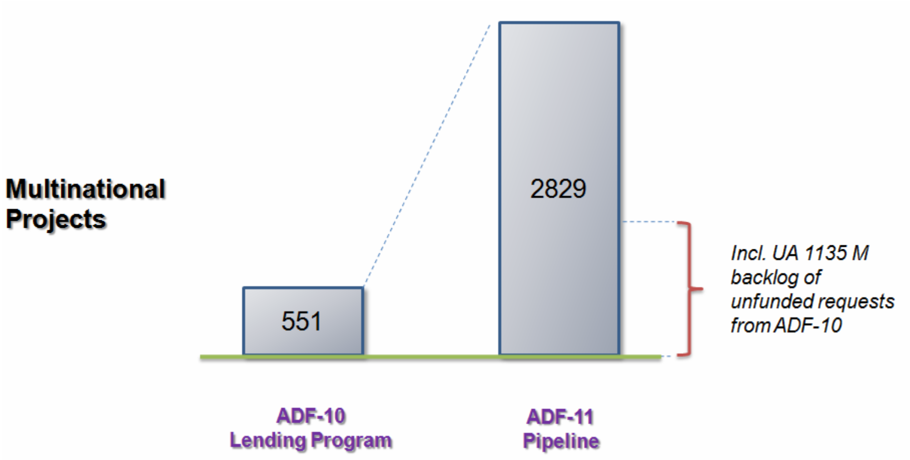
- Growing demand and delivery capacity is reflected in a pipeline of projects amounting to UA 7.2 billion. The number of projects would remain at broadly the ADF-10 level, but average project size is anticipated to nearly double.
- In terms of sector distribution, the ADF-11 pipeline reflects a growing focus on infrastructure, which accounts for 56% of total volume.
- In value terms, human development operations will continue at about their current level and agriculture projects would increase by 17%.



Note: amounts in UA millions

[12] With the lending program for 2007 not yet closed, ADF-10 numbers should be considered indicative.

- The pipeline comprises UA 2.8 billion in multinational projects[13], a fivefold increase over the ADF-10 levels.



Note: amounts in UA millions

- The current ADF-11 pipeline also shows other significant shifts in project design. The number of co-financed projects is expected to increase from 47% of total approvals to 76%; projects relying on RMC procurement and public finance management systems and program-based approaches are also expected to increase.

4.8 As summarized in Figure 4, the ADF-11 pipeline will reflect ADF's enhanced overall effectiveness.

5. INDICATIVE LENDING SCENARIOS

5.1 Three alternative financing scenarios have been developed. A **Baseline Scenario** assumes that donor subscriptions for ADF-11 remain at the same level as ADF-10 in real terms (i.e., adjusted for inflation). Under this scenario, and including internally generated resources of UA 1.7 billion and a carry-over of UA 0.3 billion[14], the total envelope would amount to UA 4.6 billion. At this level of replenishment, the Fund would be able to provide financing for:

(i) 78% of the current pipeline for national projects; and
(ii) 30% of the current multinational projects pipeline.

5.2 The **Central Scenario** assumes that total resources for ADF-11 increase by 50% compared to ADF-10 for a total envelope of UA 6.0 billion. At this level of replenishment, the Fund would be able to provide financing for:

(i) 104% of the current pipeline for national projects, providing limited room for pipeline growth during the ADF-11 period; and
(ii) 40% of the total multinational projects pipeline.

5.3 The **High Scenario** assumes that total resources for ADF-11 increase 100% compared to ADF-10 for a total envelope of UA 8.0 billion. At this level of replenishment, the Fund would be able to provide financing for:

[13] The excess of requests for multinational operations over available resources in the ADF-10 period stands at UA 1,135 million.
[14] This is the current estimate of maximum carry-over. See **ADF Financing Framework** document.

(i) 141% of the pipeline for national projects, providing room for pipeline growth during the ADF-11 period; and

(ii) 54% of the current multinational projects pipeline.

Figure 4: ADF-11 Financing Framework for Indicative Lending Scenarios[15]

	ADF-11 Financing Framework		ADF-10	ADF-11 Scenarios		
				Baseline Inflation	Central 50% Increase	Upper 100% Increase
	Unit: UA billion					
Sources	Donor Subscriptions		2,47	2,61	3,92	5,69
	Variation (%)			*6%*	*59%*	*130%*
	Advanced Commitment Capacity (ACC)*		1,20	1,73	1,83	2,07
	Carry-over		0,36	0,29	0,29	0,29
	Total Sources		4,03	4,63	6,04	8,05
	Variation (%)			*15%*	*50%*	*100%*
Uses	Country Allocations		3,23	3,38	4,52	6,12
	Multinational Projects		0,55	0,85	1,13	1,53
	PCCF/Fragile States		0,25	0,40	0,40	0,40
	Total Uses		4,03	4,63	6,04	8,05
	ADF 11 Pipeline Fulfillment	7,17		65%	84%	112%
	Pipeline National	4,34		78%	104%	141%
	Pipeline Multinational	2,83		30%	40%	54%

* Assuming no MDRI shortfalls and excludes additional contributions to lower the structural gap. Refer to ADF-11 Financing Framework paper for detailed explanation of sources of funds

6 CONCLUSIONS

6.1 This paper has:

- Briefly summarized the Bank's broad strategic directions for operations in ADF countries during the ADF-11 period;

- Presented a significantly larger, but also more selective and focused, ADF-11 operational pipeline that broadly reflects these strategic priorities, as well as the priorities that have emerged from a more country-driven identification process and a restructured internal process;

- Outlined a number of key factors expected to improve the Bank's own delivery capacity;

- Presented for discussion three different indicative ADF-11 lending scenarios, ranging from zero real growth over ADF-10 new commitments to a doubling of operational volume.

[15] These scenarios assume that UA 400 million are allocated for fragile states, 80% of outstanding resources are allocated to the country-based PBA pool and 20% for multinational project, out of which about 1/3 would be PBA-based. Internally generated resources are estimated to range between UA 1.8 billion and UA 2.2 billion depending on the scenario. *See* **Multinational Operations Strategic Framework.** The Fragile States allocation formula relies on a multiplier over the average of the top two yearly PBA of a specific fragile country during ADF-10 period. Please refer to the **Enhanced Engagement in Fragile States** Paper. Hence, about 90% of total ADF-11 resource allocation would be directly based on the PBA framework and the remaining 10% would be indirectly linked to the PBA framework.

Annex I

Focus on Results

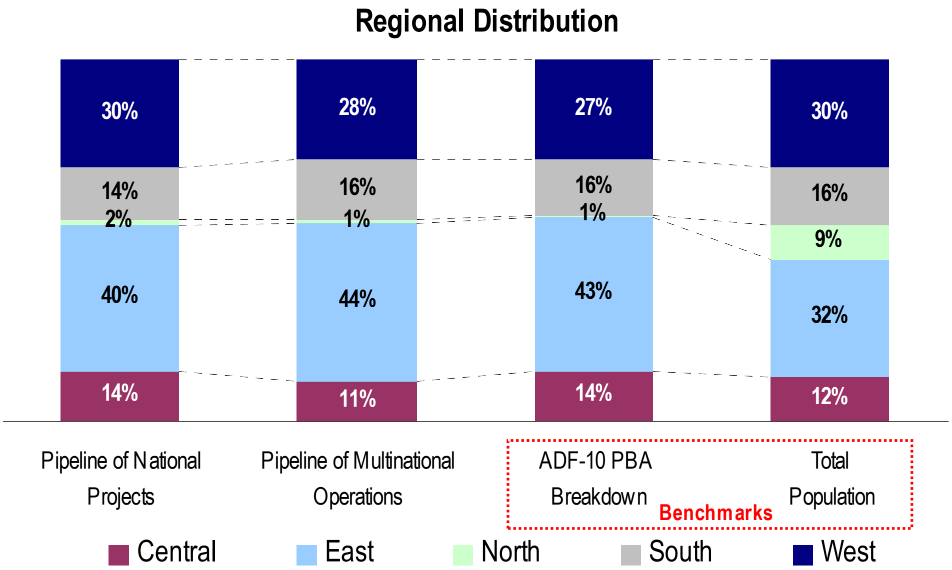
The Bank Group plans to focus more strongly on activities where it has achieved demonstrably superior results. As the figure below indicates, infrastructure and governance are the areas where the Bank has attained the strongest performance in terms of implementation, risk exposure and transaction costs.

Portfolio Performance			Core Sectors (Infrastructure & Governance)	ADF Total Projects
Transaction Costs	i	Project Cycle - from Identification to Effectiveness (days)	609	645
	ii	Average Project Size (UAm)	17	9
Implementation	iii	Age (years)	3.9	4.7
	iv	Disbursement Rate (%)	46%	30%
	v	Number of Co Financed Projects (%)	70%	47%
Risk	vi	Implementation Progress (Rating 0-3 Scale)	2.04	1.97
	vii	Development Objectives (Rating 0-3 Scale)	2.31	2.22

Annex II

Pipeline Analysis

The regional distribution of the national and multinational prospective pipeline is broadly aligned with two selected benchmarks: ADF-10 country allocations determined by the PBA system and population distribution.



In terms of sector distribution, both national and international pipelines reflect a growing focus on infrastructure, which accounts for 56% and 61% of total volume.