AFRICAN DEVELOPMENT
BANK GROUP

FOR DISCUSSION IN THE BOARD OF EXECUTIVE DIRECTORS

STRATEGIC AND OPERATIONAL FRAMEWORK FOR REGIONAL OPERATIONS

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Acknowledgements	This document is the product of a Bank-wide drafting team composed of A. Abou-Zeid, G. Grosso, A. Kamara, G. Manley and S. Pitamber. It was revised with guidance from the Operations Committee (J. Eichenberger, Z. El Bakri, M. Gantsho and L. Kasekende). The drafting team received valuable inputs from staff from across the Bank, including P. Afrika, J. Kanyarubona, G. Mbesherubusa, R. Thomas, I. Van Grunderbeeck, and V. Zongo.

Executive Summary

This paper presents the African Development Bank Group's strategic and operational framework for regional operations (ROs). It focuses primarily on ROs involving African Development Fund (ADF) resources in light of the need to come to closure on appropriate funding and other mechanisms in the ongoing consultations on the eleventh ADF replenishment (ADF-11). The framework is intended to provide a rigorous but flexible framework to mobilize resources for regional integration in Africa. It is an important building block of the Bank Group's broader strategy to promote regional integration, which includes advisory and analytical services, capacity building for countries and continental and regional organizations and the use of ADB resources where appropriate.

The framework is anchored in the strong consensus that greater regional integration is a key means for Africa to enhance growth and development and address common development challenges such as small, fragmented markets that limit economies of scale, geographic handicaps (landlocked and island states) and high production costs due in part to poor infrastructure. The framework draws on lessons learned from the Bank Group's experience and those of sister institutions. These lessons underline the strong development impact that ROs can have but also point to the need for stronger quality at entry, greater country ownership and reinforced project analysis and implementation frameworks to effectively address the technical and institutional complexities inherent in ROs.

The Bank Group sees the financing of ROs as core element of its development mandate. In response to stakeholder requests, the Bank Group will play a leadership role and support key continental initiatives, particularly the New Partnership for Africa's Development (NEPAD) initiative. This will fill a key void in the international aid architecture; the Bank Group is one of the few institutions focused on financing ROs. Operations will be selective and focus primarily on two areas: (i) infrastructure, particularly transportation but also energy, water and telecommunications; and (ii) promotion of regional public goods (RPGs) where the Bank Group can galvanize regional cooperation to address challenges that cannot be effectively addressed by either private finance or countries acting alone. The Bank Group will also place greater emphasis on partnership, with regional organizations that have the institutional capacity to develop and implement ROs, with bilateral and multilateral donors and with private sector operators. Increased partnership, which can include but must also go beyond co-financing, will allow the Bank Group to better leverage its human and financial resources to develop and implement stronger regional operations.

To deliver on this strategy, Management proposes a revised operational framework based on three pillars:

- Clear *basic eligibility criteria* to ensure that operations are sponsored by an appropriate entity, regional in character and backed by committed sponsors;
- *Prioritization criteria* to channel resources to the highest-quality operations as measured by development impact and alignment with Bank and client strategic objectives;
- A *financing formula* that provides a meaningful link to performance through the use of ADF country allocations to cover part of the cost of each operation and incentives for participation in ROs by leveraging country funds with the ADF regional envelope and ensuring flexibility to accommodate certain special cases.

The Bank Group's support for ROs will be implemented and closely monitored by both sector departments and the Operations Committee. It will include more rigorous management of the existing portfolio and the pipeline of future operations. Management will update the Boards of Directors annually and will prepare an assessment of the framework for the ADF-11 mid-term review, proposing changes as needed. The application of the proposed operational framework to the current pipeline of ROs for the ADF-11 period (2008-2010) yields encouraging results and effectively translates the Bank's strategic objectives.

The Boards of Directors are invited to discuss this proposed strategic and operational framework for regional operations.

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Acronyms and Abbreviations

ADB	African Development Bank
ADF	African Development Fund
AFFM	African Fertilizer Financing Mechanism
AICD	African Infrastructure Country Diagnosis
APRM	African Peer Review Mechanism
AU	African Union
AWF	African Water Facility
CAADP	NEPAD Comprehensive African Agriculture Development Plan
CSP	Country Strategy Paper
DAC	Development Assistance Committee (OECD)
ECOWAS	Economic Community of West African States
ENPV	Economic net present value
ESW	Economic and sector work
HIV/AIDS	Human immunodeficiency virus/Acquired immunodeficiency syndrome
ICA	Infrastructure Consortium for Africa
IPPF	Infrastructure Project Preparation Facility
MDGs	Millennium Development Goals
MICs	Middle-income countries
MLTSF	NEPAD Medium- to Long-Term Strategic Framework
MTR	Mid-term review
NEPAD	New Partnership for Africa's Development
NGOs	Non-governmental organizations
OECD	Organization for Economic Co-operation and Development
OPEV	Operations Evaluation Department
PBA	Performance-based allocation
PPPs	Public-private partnerships
RECs	Regional economic communities
RISP	Regional Integration Strategy Paper
RMCs	Regional member countries
ROs	Regional operations
RPG	Regional public goods
STAP	NEPAD Short-term action plan
T & T	Tsetse and trypanosomiasis
UA	Unit of account
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations Children's Fund
US$	United States dollar
WAPP	West African Power Pool

1. Introduction

1.1 This paper presents the African Development Bank Group's strategic and operational framework for regional operations (ROs). This framework addresses concerns raised by Bank Group shareholders and clients about the current framework and is intended to better position the Bank Group as a major contributor to regional integration in Africa. It is important to note that ROs are an important tool to promote regional integration more broadly, but not the only one at the Bank Group's disposal. A broader regional integration strategy paper and action plan is being prepared and will be presented to the Boards of Directors in the future.

1.2 The Bank Group's broader role in promoting regional integration includes support to the African Union (AU), New Partnership for Africa's Development (NEPAD) and regional economic communities (RECs) in their efforts to achieve deeper integration, particularly through dialogue to promote harmonized regional strategies and policies. The Bank Group provides support and financing for the development of viable regional operations. It acts as an advisor and strategic partner providing vision, leadership, analysis and capacity building on regional issues for regional member countries (RMCs) and continental and regional institutions.

1.3 This paper therefore focuses on the Bank Group's role as a catalytic financier of ROs as one element of the Bank Group's broader strategy to promote regional integration. It is primarily focused on ROs involving ADF-eligible countries, including those that involve ADB-only countries. The Bank Group's forthcoming strategy on support to middle-income countries (MICs) will address more specifically the Bank Group's role in promoting regional integration and ROs in MICs.

2. Rational and Context

The case for regional integration in Africa

2.1 Africa has the largest number of countries per square area of any developing region. On average, each country shares a border with four neighbors. With an average GDP of just US$ 4 billion, African economies are small in absolute terms. Africa's largest economy, South Africa, is only the world's 27th largest. African countries are also heterogeneous in terms of natural resource endowments and levels of development, and many face physical barriers[1] to greater participation in the regional and global economy. About 40 percent of Africa's population is in landlocked countries. The continent is characterized by small national markets, limited opportunities to create economies of scale, and high production costs (exacerbated by under-developed infrastructure) that combine to hinder the development of viable African firms and the expansion of trade, both intra-African and between Africa and the rest of the world. These handicaps make Africa a less attractive destination for foreign and domestic investment.

2.2 There is a strong consensus that one of the best ways to address these constraints is through greater regional and continental economic integration. This vision of an integrated Africa is reflected in the NEPAD initiative, a broadly accepted continental framework for cooperation. Creating physical links, coordinating the use of shared natural resources and harmonizing policies must be a key strategy for making Africa more competitive and increasing opportunities for growth, trade, private sector development and job creation. However,

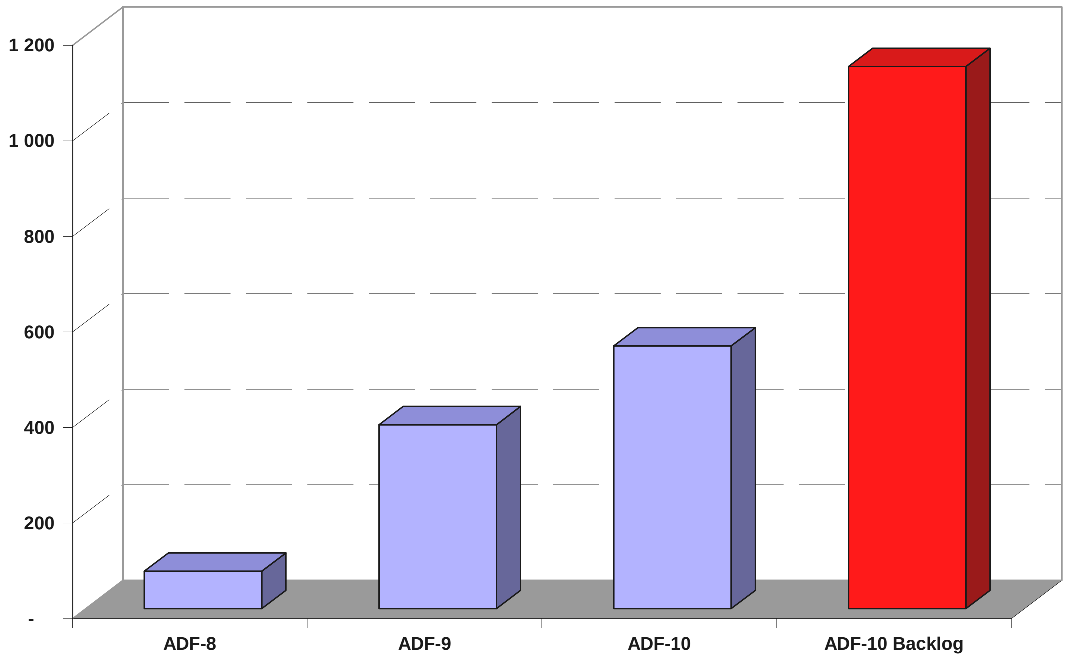
[1] Of Africa's 53 countries, 15 are landlocked (28%) and another three, including the Democratic Republic of Congo, are nearly landlocked, with extremely limited access to the sea. Africa also has 5 "water-locked" island nations who face economic challenges related to their geography.

economic growth is not the only thing at stake. Regional integration is also essential to deal effectively with disease, climate change, conflict and technological advancement, for example. These are challenges that don't confine themselves to national borders; they are regional, continental and even global in scope. Collective approaches are required to tackle these issues and ensure that Africa's development is sustainable.

The Bank Group's Work on Regional Operations

2.3 The Bank Group's RMCs increasingly recognize the value of regional solutions to their development challenges and of projects that promote regional integration. In response to strong client demand for regional operations, the Bank Group has responded by earmarking a growing proportion of ADF replenishment resources for ROs. Starting from 5% under ADF-8, the RO envelope rose to 10% during ADF-9 and now stands at 15% under ADF-10. Demand for ROs continues to grow, and has outstripped the resources for ADF-eligible countries. The backlog of unfinanced requests at the close of ADF-10 period is expected to be UA 1.1 billion. The current pipeline of regional projects, including the backlog and projects that could be developed over the next three years, amounts to UA 2.4 billion.

Figure I: ADF Support to Regional Operations
(UA millions)



Source: Bank Group

2.4 From 1996 to 2006, the Bank Group financed 134 ROs amounting to nearly UA 1.2 billion. The Bank Group's RO work has been strongly concentrated on the infrastructure sector, with roughly 50% of the Bank Group's financing going primarily towards regional transportation and energy projects. Bank Group regional operations have also supported objectives in other areas, including: private sector and trade development, increasing regional agricultural productivity and food security, efficient management of shared natural resources (i.e., forests and water), environmental conservation, prevention of communicable diseases, and greater policy harmonization to promote common development objectives. ROs have been concentrated primarily in West Africa (40%) but with sizeable portfolios also in East Africa (18%) and Southern Africa (12%) as well as pan-African and multiregional operations (26%).[2] Annex 1 provides further details on Bank Group lending for ROs over the last decade.

[2] Based on the 5 regions identified under the Lagos Plan of Action. The 8 AU-recognized RECs demonstrate significant overlaps that complicate regional analysis.

Lessons Learned

2.5 A number of key lessons emerge from both the Bank Group's own experience with ROs and those of other multilateral institutions.[3] Generally, regional operations have the potential for creating significant benefits and a number of regional operations have successfully achieved project objectives and results. One of the key findings of recent evaluations is that economic returns on ROs can be higher than national operations because ROs often create significant economies of scale and lead to the rationalization of production or open entirely new productive opportunities that cannot be achieved by a single country. In addition, ROs are proving to be successful in addressing inherently regional development challenges (i.e., communicable diseases, environmental preservation) where national programs have not fully achieved objectives.

2.6 However, developing and implementing regional operations involves significant additional challenges compared to standard country operations that are primarily related to the technical complexity of the operations themselves and the additional coordination and financing challenges inherent in multi-country operations. As a result, preparation and supervision of regional projects on average costs 1.5 times that of national projects. More specific lessons emphasize the need for:

- ***Collective ownership by participating countries.*** A strong country and regional political commitment is critical to the success of the RO. In many cases this will require significant policy dialogue with national and regional actors to ensure agreement upfront from all stakeholders.
- ***Policy harmonization.*** In addition to ownership, general or sector policy harmonization is often critical to achieving the benefits of ROs. Differences in legal, procurement and financial frameworks across countries can render project implementation more cumbersome. Certain ROs will require sector policy harmonization and reforms in order to achieve project outcomes. This is particularly critical in regional infrastructure investments where differences in agricultural, water, energy, telecommunications and customs policies can create delays or significantly reduce anticipated project benefits. Sector policy harmonization problems are in some cases compounded by the lack of sufficient upstream economic sector work (ESW) to draw on.
- ***Capable regional project management structures.*** The structures put in place to manage ROs have in some cases lacked the necessary capacity and/or mandate to be effective. It is imperative that implementation units, with responsibility for execution, monitoring and reporting, have appropriate human and financial resources as well as a clear mandate and operational scope, particularly relative to relevant national agencies where there may be overlap. RECs may act as appropriate regional project management structures provided they have the required institutional and technical capacity. The Bank Group must also be prepared to allocate more resources to supervising and facilitating implementation of ROs.
- ***Enhanced project analysis.*** Economic and risk analysis of complex regional projects has not always been sufficiently rigorous. Projected economic benefits may be overestimated.[4] Key technical, financial, environmental or coordination risks may be overlooked or insufficiently mitigated leading to considerable project delays or failure. Reinforced project analysis teams are needed to identify and plan for risks and ensure higher quality at entry.
- ***Co-financing arrangements.*** The financing needs for regional infrastructure alone are huge. Equally demanding are the analytical and implementation capacity requirements to effectively develop ROs. This underlines the need to build partnerships with bilateral and multilateral development agencies as well as the private sector to leverage the Bank's financial resources, expertise and institutional capacity. The evidence suggests that co-financed ROs are more likely to achieve their development objectives.

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[3] In addition to external documents, these lessons draw on a January 2007 preliminary analysis of regional project completion reports by the Operations Evaluation Department (OPEV).

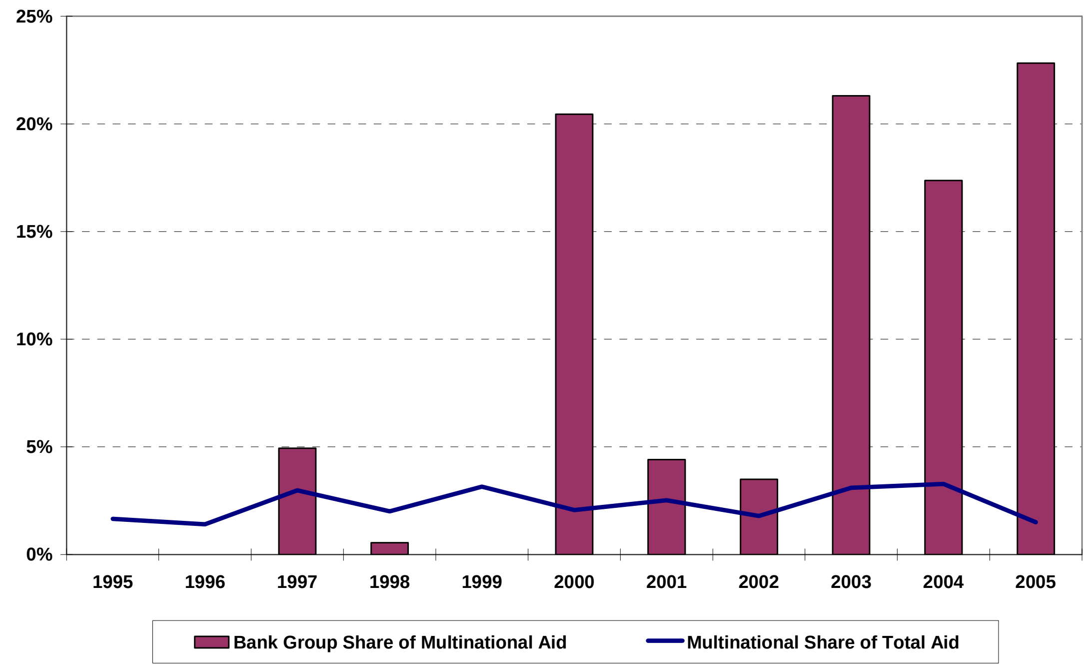
[4] Examples include unrealistic assumptions for increases in traffic flow from transportation infrastructure projects or in agricultural production from irrigation.

3. Strategic Orientations

3.1 In light of the importance of regional integration for Africa and in response to strong RMC demand, the Bank Group is committed to playing a greater role in ROs as one of the pillars of its broader strategy to promote regional integration. The Bank Group sees promotion of deeper regional integration as a key area of its mandate, anchored in continental initiatives such as NEPAD, the Comprehensive African Agriculture Development Plan (CAADP/NEPAD), the African Peer Review Mechanism (APRM), the Infrastructure Consortium for Africa (ICA), the African Water Facility (AWF), and the African Fertilizer Financing Mechanism (AFFM). The Bank must scale up delivery, building on its accumulated experience to ensure greater selectivity and higher quality operations, stronger and deeper partnerships and greater financial leverage from private and public sources.

3.2 The case for deeper Bank engagement in regional operations is reinforced by the Bank Group's positioning within the current aid architecture. Most aid (71%) is channeled through bilateral sources that generally have not given a high priority to regional projects. Over the past 10 years, average annual aid for regional projects has accounted for less than 3% of total aid to Africa. The Bank Group has emerged as the one of the lead financiers of ROs in Africa, primarily through the ADF window, accounting for nearly a quarter of all regional investments in Africa in 2005.

Figure 2: Aid for Regional Operations in Africa
(Percent)



Source: OECD DAC database

3.3 The Bank Group is well positioned to fill the gap in donor support for ROs. In 2006, the Bank created a department dedicated to NEPAD, regional integration and trade whose strategy is to become both a center of excellence and reference on African regional integration for external partners and a focal point within the Bank for mainstreaming this issue in regional and country dialogue and strategy. With sovereign and non-sovereign operations under the same roof, and both concessional and non-concessional instruments at its disposal, the Bank is ideally positioned to support public-private partnerships and work across the full spectrum of African countries: from middle-income countries to more fragile states.

3.4 While regional integration is a multidisciplinary issue and covers a wide range of sectors, the Bank Group will be appropriately selective in its operations, focusing on areas where it can best deliver on its mandate and demonstrate superior results. The Bank Group's regional operational focus will primarily be on infrastructure and regional public goods (RPGs). The

Bank has a strong track record in regional infrastructure. Based on the 2007 OPEV review of regional project completion reports, the percentage of infrastructure projects with an overall satisfactory performance rating was 67% compared to 38% for other sectors.

Infrastructure

3.5 Inadequate infrastructure significantly increases the costs of doing business for firms in Africa and makes potential investments unattractive. It can constitute a major obstacle to effective provision of essential social services; and, it impedes the development of domestic competitiveness both at home and abroad. Recent studies suggest that indirect costs, including basic services such as power and water, are significantly higher in Africa than in other developing regions.[5] Internal transport costs are estimated at nearly twice the levels of other developing regions. Africa's needs in regional infrastructure are huge. It is estimated that US$ 24 billion is needed to fund projects already identified that would fill Africa's infrastructure gaps in transport, energy and telecommunications. Better infrastructure will improve the delivery of basic services, increase economic efficiency across all sectors creating better prospects for job creation and private sector development and investment in order to sustain the higher and more broad-based growth needed for greater impact on poverty. This strategic focus builds on the Bank's long experience in infrastructure and growing focus on infrastructure in its national operations. It will also back the Bank Group's efforts to deliver on a number of continental infrastructure initiatives where it has been asked to play a leading role. These initiatives include NEPAD, the Infrastructure Consortium for Africa (ICA), and the African Water Facility (AWF).

3.6 The Bank Group will play a proactive role in shaping Africa's regional infrastructure development plans. Two important studies are currently being carried out in parallel by the Bank Group and the World Bank. They are the Medium- to Long-Term Strategic Framework Study (MLTSF) and the African Infrastructure Country Diagnosis (AICD). The MLTSF will draw lessons from the Short term Action Plan and will propose an enhanced framework remedying the current deficiencies of the Short-Term Action Plan (STAP). In particular, it will set up mechanisms for efficient monitoring of the STAP that would keep it aligned with regional strategies of RECs. The aim of this exercise is to anchor Africa's infrastructure development agenda in a broadly supported action plan, developed in conformity with RECs, and based on country strategies and plans. The Bank Group has also put in place the NEPAD Infrastructure Project Preparation Facility (IPPF), which provides funds to develop bankable regional infrastructure projects that may then be financed by the Bank, other donors or private investors. It is leading a "tunnel of funds" approach in order to foster better cooperation between donors and investors and optimize the use of available resources.

3.7 The Bank Group will maximize synergies between its public sector activities and its private sector window for greater impact. Although private investment in infrastructure in Africa is on the rise, it has been relatively limited compared to other regions and overall needs. Private investment has been narrowly focused in terms of sector (i.e., primarily telecommunications, ports, power generation and rail) and project type (i.e., greenfield projects mostly, as well as concession/management contracts). In some sectors, such as power and water, private sector involvement has not met expectations and proven to be unsustainable for a variety of reasons including deficient regulatory and legal frameworks, poor financial performance leading to underinvestment and inappropriate risk-sharing arrangements.

3.8 The Bank Group strategy to support increased mobilization of private investments for RO in infrastructure will draw on these lessons. Specifically, the Bank will: (i) prepare a detailed strategy and action plan for public-private partnerships (PPPs); (ii) systematically review prospects, obstacles and prerequisites for private investment in ROs; (iii) explore and promote adequate mechanisms and frameworks for corporate governance of government-owned infrastructure utilities, often an important player in ROs; (iv) continue to support capacity building of government agencies, including those responsible for establishing and monitoring legal and regulatory frameworks; (v) strengthen coordination, consultation and knowledge exchange with other key donors; and (vi) mobilize donor funds and guarantees,

5 See for example: Center for Global Development, "Business Environment and Comparative Advantage in Africa: Evidence from the Investment Climate Data", 2005

including from emerging donors such as China, India, and Islamic banks, in support of PPPs.

3.9 ADF funding for regional projects may also include studies necessary to support regional infrastructure integration, and capacity building activities for the executing agencies in charge of implementing projects, including RECs and other regional institutions. It may also finance selected policy-related programs that promote regional integration, better governance and harmonization of regulatory frameworks that provide the "soft" infrastructure to accompany physical investments.

Box 1: The Bank and Regional Infrastructure - The West African Power Pool (WAPP)

WAPP Electricity Interconnection Project

Participating countries: Ghana, Togo and Benin

ADF Financing: UA 32.2 million loan

Status: Approved in 2007, expected completion in 2010

The West African Power Pool (WAPP) is an ambitious regional program to create an integrated electricity market in the ECOWAS sub-region through the interconnection of individual national electricity grids. The overall goals are to lower the price of electricity and improve system reliability through interconnection, economies of scale and leveraging the most efficient regional production sources (i.e., hydro and gas). The Bank has been involved in the development and financing of both studies and infrastructure for the WAPP since the 1990s. One of these projects was the Nigeria-Benin interconnection project that the Bank Group supported through a UA 12.5 million loan in 2002.

This year, the Bank Group provided UA 32.2 million to finance the next phase in WAPP interconnection, linking Benin with Togo and Ghana. In addition to lowering costs by nearly 30%, the project is expect to significantly increase electricity access rates, reduce the number of power failures and cut power rationing, particularly during drought years for countries dependent on hydropower. The project is aligned with regional and continental strategies: it was included in the ECOWAS energy master plan and was a NEPAD priority project with a grant from the NEPAD-IPPF used to finance the feasibility studies. The Bank Group was the lead financier, providing 45% of total project costs, with co-financing for the project provided by the World Bank, the Islamic Development Bank and the West African Development Bank.

The Bank Group will continue to support the WAPP during the ADF-11 period with several interconnection projects in the current pipeline.

Regional Public Goods

3.10 There is broad agreement that international financial institutions have a key role in the promotion of RPGs. Deeper engagement in this area must be one of the key objectives of the Bank Group's regional operations. The importance and special challenges of public goods have received increased attention recently, particularly with the acceleration of globalization and the recognition that many economic and social challenges can only be addressed through international cooperation.

3.11 Public goods are those whose benefits can be enjoyed by one party without (or hardly) reducing its availability to others. In addition, it is difficult or prohibitively expensive to exclude others from these benefits. They are therefore non-rival and non-excludable.[6] Regional public goods create positive spill-over effects (i.e., promotion of positive externalities or mitigation of negative ones) for countries belonging to a geographical region. RPGs may yield direct utility. In many cases, however, the RPG itself does not generate direct revenues and has an indirect positive influence on the revenue generation capacity of other social and economic activities in the region.

[6] Non-rivalry: Consumption of the good by one party does not reduce the amount available for others to consume. Non-excludability: Once provided to one party, public goods are available to all at no additional cost.

3.12 Because of these features, RPGs are generally not produced spontaneously by market mechanisms nor, often, will individual states or countries finance RPGs on their own. In many cases if one regional partner does not participate, sufficient financing will not be forthcoming and the regional objective will not be achieved. There is therefore a need for collective action and coordination to promote RPGs. As a continental institution, the Bank Group should play a constructive role in forging a regional consensus for collective action to promote RPGs; and it should be positioned to bring appropriately catalytic financing to bear.

Box 2: The Bank and RPGs - The Case of Infectious Diseases

Creation of Sustainable Tsetse & Trypanosomiasis Free Areas in East & West Africa

Participating countries: Burkina Faso; Mali; Ghana; Ethiopia; Uganda; and Kenya

ADF Financing: UA 44.6 million loan and UA 2.9 million grant

Status: Approved in 2004, expected completion in 2011

Infectious diseases are an example of RPGs that the Bank will finance fully from the ADF regional envelope. The prevalence of Tsetse and Trypanosomiasis (T & T) in 37 African countries has dire social and economic consequences: 55,000 people die every year from sleeping sickness; livestock and agricultural productivity losses are estimated at US$ 1.3 billion per year; increased pressure on land resources and environmental degradation due to forced migration. The result is human suffering, lower food security and greater rural poverty.

After years of largely ineffective and uncoordinated national prevention and eradication plans, a continental initiative was launched in 2001 recognizing the need for a comprehensive regional approach. As part of this program, the ADF financed its implementation in six countries. The objective is to create sustainable T & T-free areas in these countries by integrating suppression, control and eradication technologies on a regional basis while ensuring that reclaimed areas are exploited in an equitable and economically sustainable manner. The project provides mitigation measures through training, medical outreach, and sensitization. Preliminary results of the project include the elimination of farmer movement due to T & T, which has reduced land pressure and environmental degradation.

In order to continue to support this continental T & T eradication initiative, the Bank Group plans to finance additional projects during the ADF-11 period for East, Southern Africa and Central Africa.

Partnership

3.13 The Bank Group will increasingly work in partnership with others, both clients and like-minded donors. This will include country and regional dialogue and cooperation on regional integration and the identification, development and implementation of ROs. In some cases this will involve ad hoc multinational partnerships to develop and execute specific operations. In other cases, it will involve existing continental and regional bodies, including NEPAD, RECs or other regional organizations. Partnerships will be privileged with regional organizations that have the demonstrated backing of their member countries and the required institutional capacity. The Bank Group's own capacity building efforts should contribute to stronger RECs and regional institutions over time.

3.14 The Bank Group will increasingly look to develop partnerships to finance ROs, including with bilateral and multilateral partners and private investors. This will be a key strategy for leveraging Bank Group resources. Since 2003, the World Bank has placed greater emphasis on regional operations and is now a key player. Collaboration with the World Bank on regional integration is already bearing fruit and will be reinforced in the future through joint sector and project work, policy harmonization, increased staff contact and joint retreats. Concrete examples of collaboration to date include the East Africa Transport and Trade Facilitation project, the West Africa Power Pool and the Eastern Africa Submarine Cable System. There is also a strong pipeline of co-financed projects, including the Inga I and II Rehabilitation project.

3.15 The Bank Group has demonstrated its ability to build productive partnerships in ROs with a wide variety of development actors, including sub-regional development banks, UN agencies and bilateral donors. One example is the Mano River Basin HIV/AIDS Mitigation Project, which has diminished the spread of HIV/ AIDS in Guinea, Sierra Leone, Liberia and Côte d'Ivoire by addressing the disease along cross-border corridors of refugee movement, enhancing the institutional capacity of participating countries and raising awareness at all levels.

3.16 The Mano River Basin HIV/AIDS Mitigation Project has developed an innovative partnership and cooperation mechanism. The Global Fund has been one of the major co-financiers and has supported the project from the design stage. Furthermore, UNFPA has been brought on board to coordinate the implementation of the activities in the four countries, through a decentralized mechanism. In each country a number of NGOs selected by the countries and other UN bodies (i.e., UNICEF and UNHCR) are in charge of implementing the activities on the ground. The arrangement has been very effective in delivery of resources to the beneficiaries as well as implementing the activities in a timely and efficient manner. As a result, the project has managed to accelerate progress to meet the MDG on HIV/AIDS at a regional level.

Box 3: The Bank and Regional Infrastructure - Linking Post-Conflict States

The Kicukiro-Kirundo Road Project

Participating countries: Rwanda and Burundi

ADF Financing: UA 30.2 million grant

Status: Approved in 2006, expected completion in 2008

Rwanda and Burundi are landlocked countries gradually emerging from a decade of political instability that led to the deterioration of transport infrastructure. Reconstruction efforts to improve economic prospects depend to a large extent on establishing trade with regional partners and the outside world. Roads are the principal mode of transport covering about 90% of distribution needs: foodstuffs and agricultural products, industrial and capital goods, etc.

The Kicukiru-Kirundo Road project will facilitate and enhance trade between the two countries and with the outside world and reduce transport time and costs by building an all-weather permanent 97 km road link that will also open up regions with a high agro-pastoral potential via 149 km of feeder roads. The project will also build technical and operational capacities of national authorities and border services.

The Bank Group has partnered with the Arab Bank for Economic Development in Africa, the OPEC Fund and the Saudi Fund for Development to leverage its own funds and co-finance the project, which amount to UA 53 million. It draws on lessons learned from Bank interventions in both countries as well as from those of other donors in the road sub-sector, particularly the involvement of beneficiaries and civil society in project design and project sustainability.

4. Operational Framework

4.1 In order to deliver on this strategy, the Bank Group's proposed operational framework is designed to provide a rigorous but flexible tool to support regional integration through regional investments. It has been conceived in light of the lessons learned and the strategic orientations going forward. It is based on the following core elements:

- Basic eligibility requirements that ensure operations are driven by regional development needs and demonstrate strong commitment.
- Prioritization criteria that direct resources to projects that will have the greatest impact on development in Africa and that are closely aligned with the continental and regional development agenda as well as the Bank Group's own strategy.

- Financing modalities that reinforce the link with country performance and commitment, while providing sufficient flexibility and incentives.

Basic Eligibility Criteria

4.2 Regional projects must satisfy the basic requirements for all Bank Group operations (i.e., technical and economic viability, environmental standards, implementation capacity, etc.). In addition, to be considered for financing under this framework, regional projects must satisfy the following basic eligibility criteria:

- ***Project sponsors.*** Eligible entities will include: (i) governments and government entities of eligible RMCs; (ii) regional or sub-regional intergovernmental bodies and other intergovernmental vehicles; (iii) special purpose vehicles created to facilitate public investment in non-sovereign entities or PPPs; and (iv) operations sponsored by other multilateral or bilateral agencies on a case-by-case basis.

- ***Regional character.*** The operation must involve costs and/or benefits in at least two participating countries and require the involvement of all participating countries to achieve its objectives. The operation should clearly contribute to regional economic integration and/or the provision of regional public goods.

- ***Commitment.*** The project must have strong ownership by project sponsors at the country and regional level. Evidence of such commitment could include an intergovernmental or REC agreement or memorandum of understanding (already existing or under preparation).

Project Selection and Prioritization

4.3 In light of the strong demand for ROs and the limited pool of resources available, ROs will be selected and prioritized based on objective, measurable criteria. Eligible ROs will be assessed against two dimensions: (i) development impact; and (ii) strategic alignment.

- ***Development impact.*** Projects that demonstrate the greatest development impact will be given priority. Development impact will be measured by the project's contribution to: economic growth; regional integration and the provision of RPGs. Contribution to regional economic growth will be measured by a relevant indicator of economic value added.[7] The project's impact on regional integration will be measured by its contribution to regional infrastructure, common natural resource management and regional policy harmonization (i.e., movement of goods, services and factors of production, fiscal and economic management, sector and social policies, etc.).

- ***Strategic alignment.*** Preference will be given to regional projects that are strongly aligned with continental and regional objectives (i.e., ROs identified as priority operations under NEPAD[8] or REC regional integration plans) and the Bank Group's strategic orientations with respect to: (i) sector focus and selectivity; and (ii) harmonization and partnership. Priority sectors will include infrastructure continent-wide as well as other sectors identified in country or regional strategy papers. Selectivity will be reinforced by favoring projects that have already been identified as continental priorities and larger projects that best leverage the Bank Group's staff capacity and reduce unit transaction costs. Harmonization and partnership will be encouraged by giving preference to co-financing arrangements that promote partnership, donor coordination and leverage that Bank's own resources by mobilizing additional funds, including from sister institutions or the private sector.

Financing Guidelines

4.4 For all selected regional projects, an appropriate cost-sharing agreement is a key indicator of commitment at the level of individual countries and is expected to be established by

[7] Whenever possible the economic net present value (ENPV) should be used as the proxy for contribution to economic growth. Another generally accepted indicator may be used for projects that do not lend themselves to ENPV analysis.

[8] For instance, the NEPAD Short Term Action Plan (STAP) or the Medium and Long-Term Strategic Framework (MLTSF), the CAADP or projects identified in the NEPAD Spatial Development Program.

participating countries in advance. This cost-sharing agreement should be based on the distribution of total project costs and benefits across participating countries. As a general rule, the participating country will be expected to finance its portion of the total project costs, and all participating countries are expected to share costs. Bank Group resources will be made available to the participating country according to the terms and conditions of the borrowing window to which it has access as set out in the relevant Bank Group policies and guidelines. In particular, the Financing Policy Guidelines of the prevailing ADF cycle will apply to all ADF-eligible participating countries.

4.5 ADF-eligible countries (categories A and B)[9] will generally be expected to utilize a portion of their PBA-derived country allocations to cover one third of the project costs attributed to them. The remaining two thirds will come from the ADF regional envelope. The proposed financing formula is designed to provide a meaningful link to performance through the use of ADF country allocations to cover part of the cost of each operation, while also increasing incentives for participation in ROs by augmenting available country funds with the ADF regional envelope. This arrangement promotes country ownership and commitment, while providing very substantial financial incentives to participate in regional operations.

4.6 It is important to consider the possible implications for countries with relatively small ADF allocations or those countries that may participate in multiple ROs. To address these special cases that will inevitably arise, the basic one-third cost sharing formula will be coupled with a simple system of cumulative ceilings on the amount of drawdown on individual ADF country allocations. In brief, regional operations would be expected to utilize partial (one-third) support from country allocations up to a maximum amount of the country's overall ADF allocation. The ceilings would be scaled depending on the size of the country's PBA allocation as follows:

- ***Small ADF allocations.*** A participating country with an ADF country allocation equal to or less than UA 20 million will be expected to utilize its ADF country allocation to cover one third of allocated project costs according to the cost-sharing formula up to a maximum of 10% of its total ADF allocation.[10] Allocated costs in excess of this ceiling will be covered by the ADF regional envelope. This is a cumulative ceiling for the entire ADF replenishment period.

- ***Medium-sized ADF allocations.*** A participating country with an ADF country allocation greater than UA 20 million but less than UA 100 million will be expected to utilize its ADF country allocation to cover one third of allocated project costs according to the cost-sharing formula up to a maximum of 15% of its total ADF allocation.[11] Allocated costs in excess of this ceiling will be covered by the ADF regional envelope. This is a cumulative ceiling for the entire ADF replenishment period.

- ***Large ADF allocations.*** A participating country with an ADF country allocation greater than or equal to UA 100 million will be expected to utilize its ADF country allocation to cover one third of allocated project costs according to the cost-sharing formula up to a maximum of up to a maximum of 20% of its total ADF allocation.[12] Allocated costs in excess of this ceiling will be covered by the ADF regional envelope. This is a cumulative ceiling for the entire ADF replenishment period.

4.7 In line with current Bank Group lending rules, ADB-only countries (category C) will finance 100% of project costs attributed to them through the ADB window or with resources from another source. Management recognizes the risk that ADB-only countries may not have the same incentives as ADF-only countries to participate in ROs. In the near term, to minimize this risk and encourage ADB-only countries to participate in ROs, the Bank Group will make

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9 Category A countries are only eligible for the ADF window. Category B countries have access to both the ADF and ADB window. Category C countries are only eligible for the ADB window.

10 We estimate that approximately 15 countries would fall under the small ADF allocation ceiling during the ADF-11 period. This estimation is based on ADF-10 country allocations and applying the baseline replenishment scenario (12% increase) while holding relative country allocations constant (i.e., no assumptions about changes in relative country performance).

11 We estimate that approximately 12 countries would fall under the medium ADF allocation ceiling during the ADF-11 period based on the same assumptions outlined above.

12 We estimate that approximately 13 countries would fall under the large ADF allocation ceiling during the ADF-11 period based on the same assumptions outlined above.

efforts to identify sources of concessional financing. In some cases, the MIC Trust Fund may provide grant resources to develop ROs. Management is exploring other options for promoting regional integration generally and providing incentives to participate in ROs specifically in MICs. The forthcoming MIC strategy will provide proposals.

4.8 As an illustration of this mechanism, consider the following example. Four countries, including one ADB-eligible country are undertaking a UA 100 million regional project.

- Country 1 is an ADF-only country with a small allocation of UA 15 million, and a cumulative ceiling of 10%, or UA 1.5 million. Its allocated project costs are UA 20 million. Under the cost-sharing formula it would utilize UA 1.5 million from its ADF country allocation.

- Country 2 is ADF-only country with a medium-sized allocation of UA 50 million, and a cumulative ceiling of 15%, or UA 7.5 million. Its allocated project costs are UA 40 million. Under the cost-sharing formula it would utilize UA 7.5 million from its ADF country allocation.

- Country 3 is ADF-only country with a large allocation of UA 100 million, and a cumulative ceiling of 20%, or UA 20.0 million. Its allocated project costs are UA 30 million. Under the cost-sharing formula it would utilize UA 10.0 million from its ADF country allocation.

- Country 4 is an ADB-only country. It is not eligible for funding from the ADF regional envelope and would be expected to cover 100% of allocated project costs (UA 20 million).

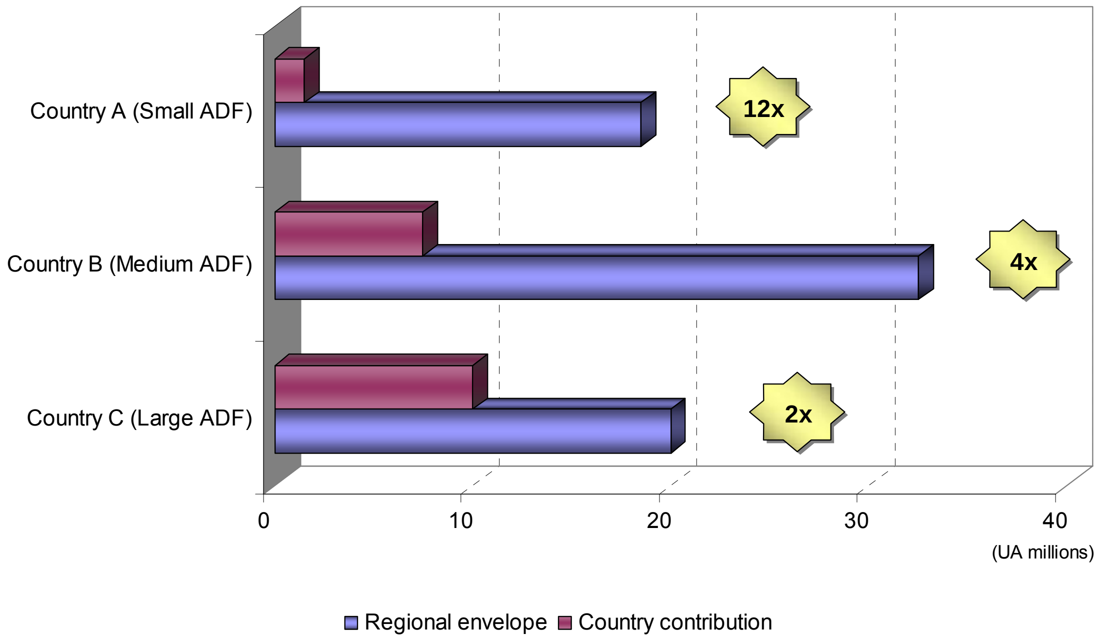
4.9 Table 1 below summarizes the financing mechanism for this project. Country 1's use of its ADF allocation is capped at UA 1.5 million with the remaining UA 18.5 million covered by the ADF regional envelope. Country 2's use of its ADF allocation is capped at UA 7.5 million with the remaining UA 32.5 million covered by the ADF regional envelope. Country 3's allocated costs are smaller than its cap. It therefore uses UA 10.0 million, or one third of allocated costs, from its ADF country allocation with the remaining UA 20.0 million covered by the ADF regional envelope. Country 4 must cover all allocated costs either with ADB funds or funds from another source.

Table 1: Example of RO Financing Mechanism
(UA millions)

			Project funds from:			
	Allocated Costs	**RO Cap**	**Country**	**Regional Envelope**	**Leverage**	**Remaining under cap**
Country 1 *(Small ADF)*	20.0	1.5	1.5	18.5	12x	0.0
Country 2 *(Medium ADF)*	40.0	7.5	7.5	32.5	4x	0.0
Country 3 *(Large ADF)*	30.0	20.0	10.0	20.0	2x	10.0
Country 4 *(ADB only)*	10.0	n.a.	10.0	0.0	1x	n.a.
Total	**100.0**		**29.0**	**71.0**		

4.10 As shown in Figure 3 below, this financing mechanism creates significant leverage for ADF countries as an incentive to participate in ROs. It is also important to note the amount remaining under the cumulative cap for future operations. If Country 1 or 2 participates in another RO during the same replenishment period, it will not be required to use its country allocation. This increases the opportunities for leveraging country allocations and creates an additional incentive for countries to participate in multiple regional integration operations.

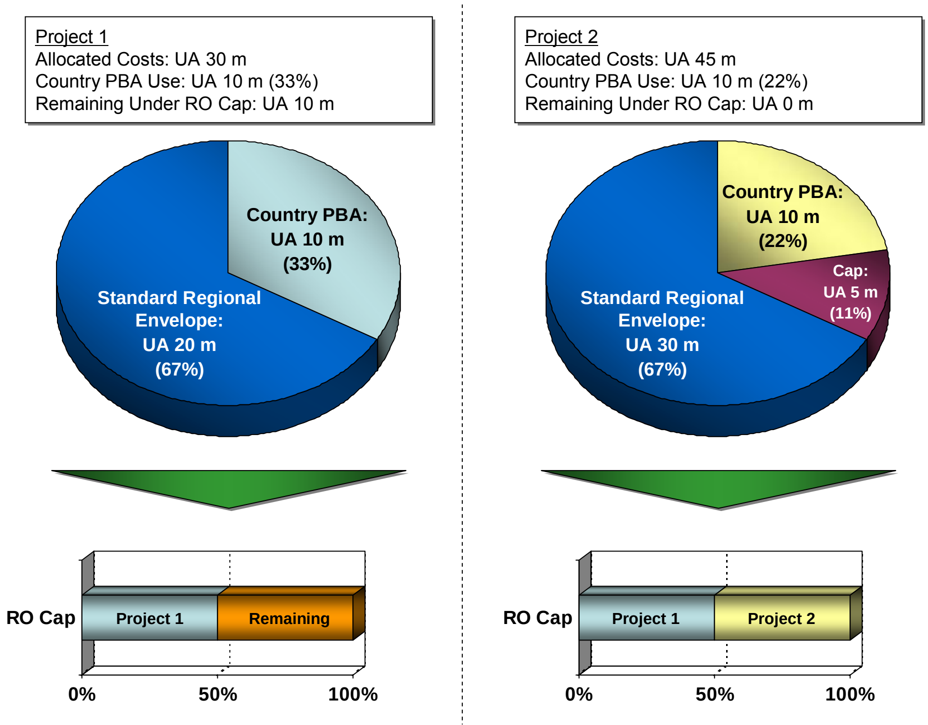
Figure 3: Leverage from RO Financing Mechanism
(UA millions)



Source: Bank Group

4.11 Figure 4 below illustrates the impact of the proposed ceilings on country cost-sharing for multiple ROs using the example of Country 3. With a "large" ADF allocation of UA 100 million, it participates in the regional operation described above with allocated costs to it of UA 30 million. It uses its country allocation to cover one-third of these costs, or UA 10 million, while the remainder is covered by the ADF regional envelope. Country 3 then participates in a second project during the same ADF replenishment period where its total allocated costs are UA 45 million. Generally, the Country would be expected to use its country allocation to cover one third of total allocated costs or UA 15 million. However, in view of its full cost-sharing for the first project this exceeds the remaining amount (UA 10 million) under its cumulative ceiling (UA 20 million). Therefore, Country 3 only uses its country allocation up to UA 10 million (22% of total allocated costs for this particular project), and the ADF regional envelope covers the remaining UA 35 million (78%). Of this, UA 30 million (67%) represents the standard contribution from the regional envelope and UA 5 million (11%) represents additional coverage provided out of the regional envelope due to the cumulative ceiling. If Country 3 were to participate in yet another RO during the same replenishment period, it would not be required to use any further portion of its country allocation.

Figure 4: Cumulative Ceiling of RO Financing Mechanism
(UA millions)



Source: Bank Group

4.12 To position the Bank to more effectively promote RPGs and to overcome the challenges inherent in developing them, operations whose primary objective is the financing of RPGs, appropriately defined, will be eligible for full financing from the ADF regional envelope without use of individual ADF country allocations. Given the nature of public goods there is an expectation that such financing would be fully on grant terms. To avoid diluting the desired link to performance and country ownership, no more than 20% of the total ADF regional envelope will be used to fully finance RPG projects. In all cases, the final financing arrangement will be subject to Board approval.

4.13 Loans for ROs drawn from the ADF window will be on terms and servicing obligations applicable to ADF loans. Loans provided as part of any RO will be signed with participating RMCs on the basis of an allocation of the project costs agreed upon during project preparation. Depending on the nature of the RO, the Fund may require a joint and several guarantee from participating RMCs.

4.14 While regional organizations are eligible to draw on ADF loan resources to finance multinational operations, all such loans will necessarily be guaranteed by their ADF-eligible member states.

4.15 The Bank Group's Policy on Loan Arrears Recovery will apply to all ROs. Some high priority ROs may require the participation of countries that are currently under Bank Group sanctions for loan arrears. In such cases, one of the other participating countries or a regional organization can take on the financial and implementation responsibilities of the country under sanctions.

5. Implementation and Monitoring

5.1 The Bank must increasingly work proactively with its RMCs to think regionally in developing poverty reduction strategies and identifying regional solutions to common challenges. Ensuring ownership among regional and national stakeholders is essential for successful implementation of ROs. Regional integration and regional operations will be emphasized in country dialogue. This will be reflected in Regional Integration Strategy Papers (RISPs) and individual Country Strategy Papers (CSPs). A RISP for Southern Africa was approved in 2004, and others will be developed in the future. CSPs will also specifically address regional integration and spell out the Bank's strategy for supporting the country's integration efforts in partnership with other donors. CSPs and/or RISPs backed by relevant analytical work will increasingly be a first step in the process of identifying suitable ROs and building the political support and engagement necessary for successful project implementation.

5.2 ROs will be prepared and submitted for Board approval according to the same procedures for national projects. ROs will therefore follow the normal internal review and quality assurance process. As with all projects, regional project proposals will include a results measurement framework, including progress indicators, expected results and a results measurement strategy. As previously noted, due to their technical and institutional complexity, ROs do require a reinforced preparation approach. They will generally demand more time and resources, including a larger project team, more and longer evaluation missions and/or greater use of consultants for technical expertise. This will be taken into account explicitly in annual business planning and budgeting. The NEPAD-IPPF will be an important tool for financing rigorous upstream project analysis.

5.3 The Bank Group will actively manage its pipeline of ROs to ensure that its financial resources, particularly the ADF regional envelope, are best used. It will also carefully monitor the results generated by ROs and draw on lessons learned to refine its regional approach. The Bank Group will therefore conduct annual and mid-year reviews.

- ***Sector regional portfolio review.*** Each sector department or sector vice presidency will review its pipeline of ROs under preparation and its portfolio of ROs being implemented. Based on the latest information, each sector department will produce a list of priority operations for preparation including the status of operations already in the pipeline as well as new operations proposed for preparation[13]. Sectors will also produce a summary portfolio review of ongoing operations focused primarily on problem projects and corrective measures to be taken. This work will be carried out in close consultation with Regional Departments as well as the Regional Integration Department to ensure strategic alignment and linkages with the broader regional integration agenda.
- ***Operations Committee regional portfolio review.*** Following the sector review, the Operations Committee will consolidate sector reports and prioritize ROs across the Bank based on the eligibility and prioritization criteria. This will be done at an early stage to facilitate the preparation of annual regional operations programs. The Operations Committee will be responsible for monitoring the use of the ADF regional envelope, including the availability of grant and loan resources to finance planned operations. This will include making recommendations about those operations that should be considered for full financing under the regional envelope as RPGs. The Operations Committee will also look at regional breakdown of the pipeline and seek to promote appropriate balance.[14] The overarching objective, however, will be to prepare the most effective projects with the highest anticipated impact, which will be achieved through broad consultation of internal and external stakeholders.
- ***Board reporting.*** Every year, Management will prepare a brief Board information note to provide an update on the use of Bank Group funds for RO and the status of the portfolio of regional operations.

5.4 As part of ongoing monitoring of the implementation of this strategic and operational framework, an analysis will be prepared for the ADF-11 Mid-Term Review (MTR). This will provide an opportunity to assess with ADF Deputies the effectiveness of the framework and discuss any proposals for modification (i.e., eligibility and prioritization criteria, financing framework, monitoring mechanism, etc.).

5.5 The Bank Group will also reinforce its results measurement and development impact

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[13] A concept note will prepared for all new ROs and will serve as the basis for judging the project.

[14] Regional balance is inherently difficult to define because operations may not fit neatly into existing regional groups. For operations involving the ADF regional envelope, the regional share of ADF allocations will be used as the performance-based benchmark.

assessment framework for ROs. In view of the complexity and importance of regional projects, solid baseline studies and data collection will be required and will be explicitly funded in new projects. Implementation of this strategic and operational framework will also necessitate enhanced monitoring and supervision for results. Furthermore, the Bank Group will reinforce its results measurement and development impact mechanism through an analysis of completed ROs that will be prepared for the ADF-11 MTR. This will mean going beyond portfolio monitoring to assessing outcomes on the ground. Concerned departments will conduct impact assessment studies for a sample of projects according to clear criteria. This will provide an opportunity to assess the effectiveness of the framework.

Current Pipeline of Regional Operations

5.6 The current pipeline of ROs includes roughly 60 operations amounting to UA 2.4 billion. (See also Annex 2.) It reflects the strategic priorities outlined in section 3:

- ***Focus on infrastructure and RPGs.*** Roughly two thirds (66%) of the RO pipeline consists of infrastructure operations, including transportation, energy, water and telecommunications. The remaining operations are primarily focused on promoting RPGs primarily environmental protection and natural resource management and communicable disease control and eradication.
- ***Larger average size of operations.*** The average size of operations in the pipeline is UA 41.5 million, compared to UA 8.6 million for the current portfolio. This represents a significant increase and should enable better use the Bank Group's human resources and limit transaction costs for clients.
- ***More partnership and co-financing.*** Roughly two thirds (66%) of the ROs in the current pipeline are planned as co-financing arrangements. This is also a significant increase compared to the current portfolio and provides opportunities for leveraging the Bank Group's funds with those of other donors and private sector operators, and reinforcing harmonization efforts. The majority of the operations, including roughly 80% of infrastructure operations, have been identified as priority ROs within the NEPAD framework, including the CAADP.
- ***Greater regional balance.*** The RO pipeline is broadly balanced across the West (21%), East (20%), Center (16%) and South (12%). There is larger proportion of continental and multiregional operations due to a number of significant operations that span several regional groups. The North region is the only region without a significant pipeline of operations, primarily because the region is composed on ADB-only countries.[15]

5.7 Even assuming a large ADF replenishment, it is unlikely that there will be sufficient resources to fully fund the RO pipeline. The eligibility and prioritization criteria, financing framework and implementation process described above have been used to run a preliminary simulation on the current RO pipeline.

5.8 Assuming the baseline ADF-11 replenishment scenario, the RO envelope would total UA 840 million.[16] Based on this total envelope, the Bank Group could develop approximately 17 very high priority ROs for a total amount of UA 1.2 billion. The sector focus on infrastructure would be sharper with roughly 71% of total resources used to finance infrastructure development, particularly regional transportation (51%), and the remaining 29% going to primarily to projects to promote sustainable management of shared water resources and infectious disease eradication. The regional distribution would also remain broadly balanced, although the percentage of East regional operations would rise to 26% of total operations. The desired strategic focus on larger, co-financed operations would be strengthened. The average size of operations would increase to nearly UA 70 million, with co-financed operations accounting for nearly 90% of all ROs.

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15 The Bank Group is working proactively to develop ROs in the North region, for example regarding climate change adaptation.

16 The ADF-11 baseline scenario assumes that donor ADF contributions remain constant in real terms, leading to a 12% overall increase in ADF resources. The RO envelope is assumed to be 20% of total resources, compared to 15% under ADF-10.

5.9 In terms of financing, the ADF regional envelope would be used to cover roughly 71% of total costs, followed by ADF PBA country allocations (22%) and ADB country contributions (8%). Looking at ADF only, the regional envelope would be used to cover 76% of all costs, with PBA country allocations used to cover 24%. This analysis assumes full grant financing from the ADF regional envelope for several RPG projects. This grant financing would amount to 13% of total ADF financing and 18% of the ADF regional envelope, in line with the proposed 20% maximum. The simulation also demonstrates the pertinence of the cumulative country ceilings. Most small ADF allocation countries as well as several medium-sized ADF allocation countries would reach their cap on the use of country allocations for ROs.

6. Conclusion and Recommendations

6.1 In response to increased RMC demand, the Bank Group has earmarked a growing pool of ADF resources to support regional operations. The Bank Group needs a rigorous and flexible framework to finance regional operations as a key element of its broader strategy to support regional integration. This paper presents Management's proposal to provide such a framework for operations that involve ADF-eligible countries. Forthcoming policy documents on regional integration and support to MICs will deal with the important questions of broader Bank Group support for regional integration and the Bank Group's catalytic role in ADB-only countries.

6.2 The proposed strategic and operational framework will enhance the focus of the Bank Group's operations by emphasizing regional infrastructure and RPGs. The quality of its ROs will be improved by explicit prioritization criteria that direct resources to the strongest projects, those with the greatest development impact and strongest strategic alignment. Country ownership, a critical success factor, will be enhanced by establishing a strong link to the existing PBA system through use of ADF country allocations from all participating ADF-eligible RMCs. In recognition of the technical and institutional complexities of ROs, the implementation and monitoring mechanism will be reinforced through stronger project preparation teams and a semi-annual monitoring framework.

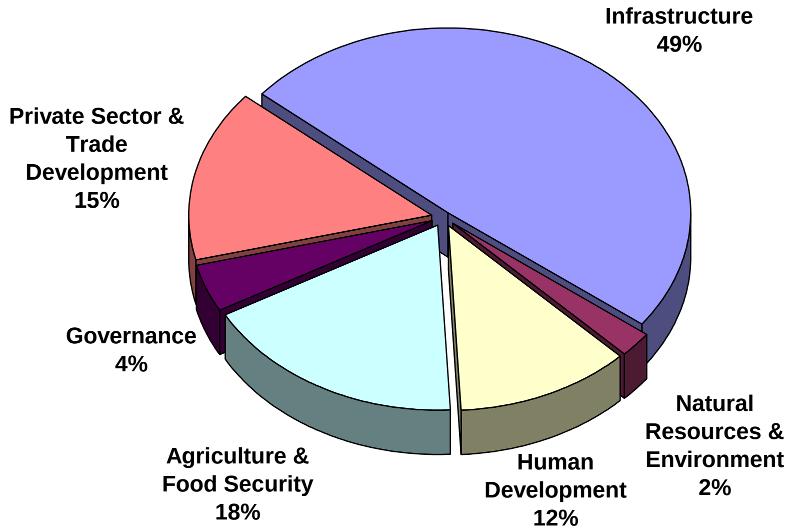
6.3 The Boards of Directors of the Bank Group are invited to discuss the proposed strategic and operational framework for financing regional operations.

Annex 1: Summary of Regional Operations (1996-2006)

Sector Distribution
(UA millions)

Category	Amount
Infrastructure[1]	567.5
Natural Resources & Environment	23.2
Human Development	134.6
Agriculture & Food Security	204.9
Governance	50.5
Private Sector & Trade Development	171.7
Total	**1,152.5**

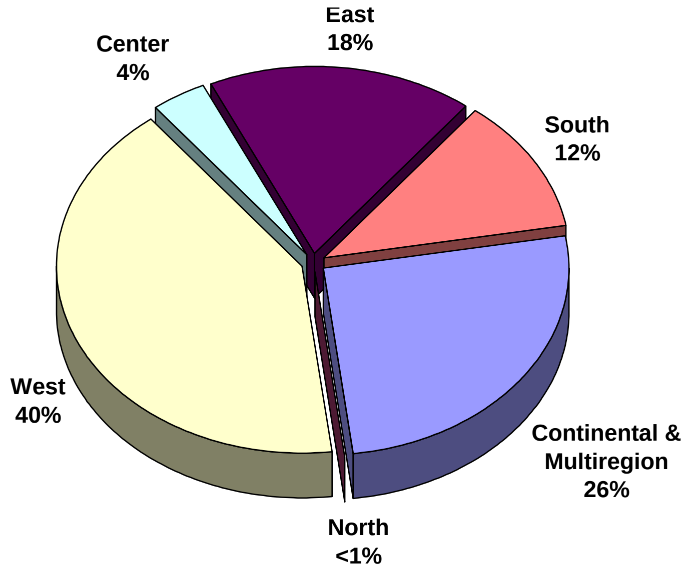
[1] Infrastructure includes transportation, energy, water and telecommunications.



Regional Distribution
(UA millions)

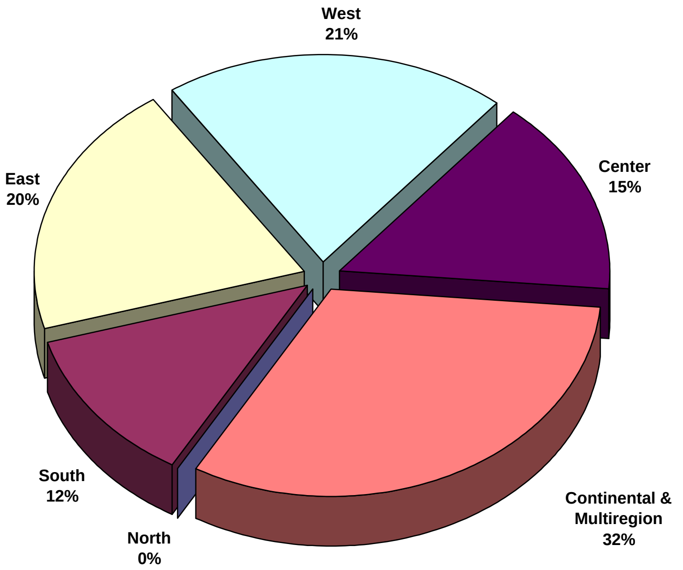
Category	Amount
Continental & Multiregion[2]	296.4
North	0.1
West	478.1
Center	41.9
East	203.0
South	133.0
Total	**1,152.5**

[2] Also includes investments in PPP initiatives.

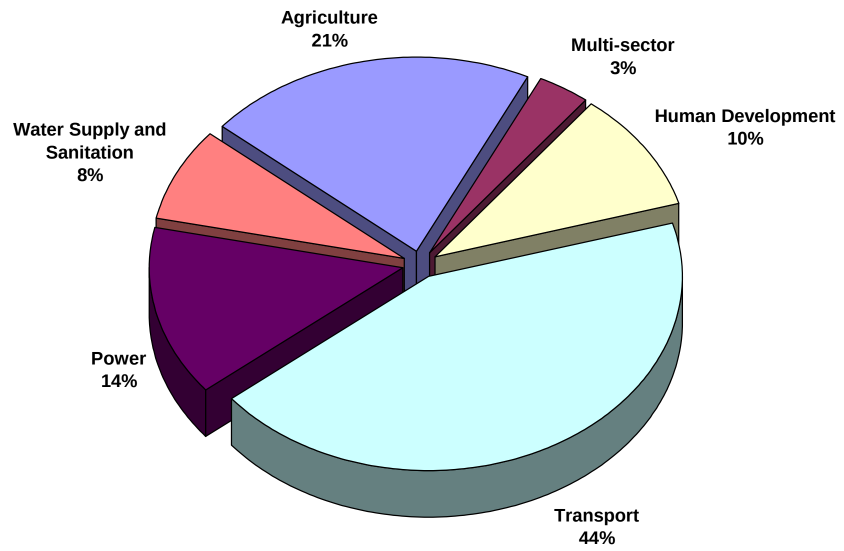


Annex 2: Pipeline of Regional Operations (2008-2010)

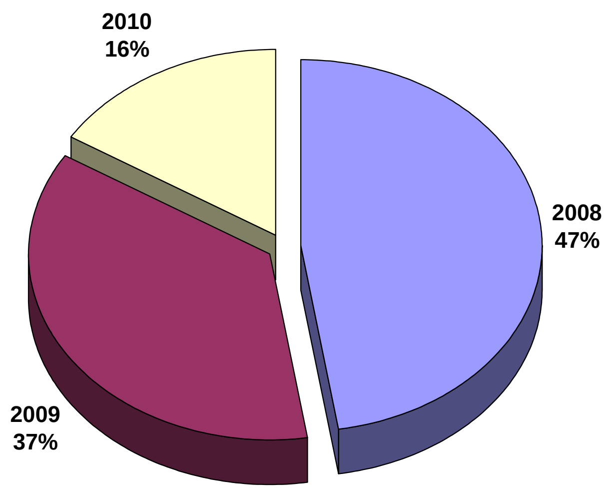
Regional Distribution



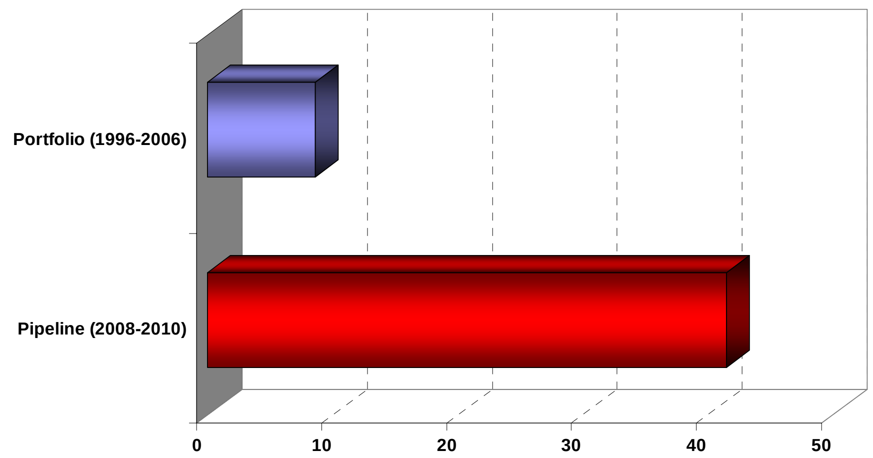
Sector Distribution



Distribution by Year

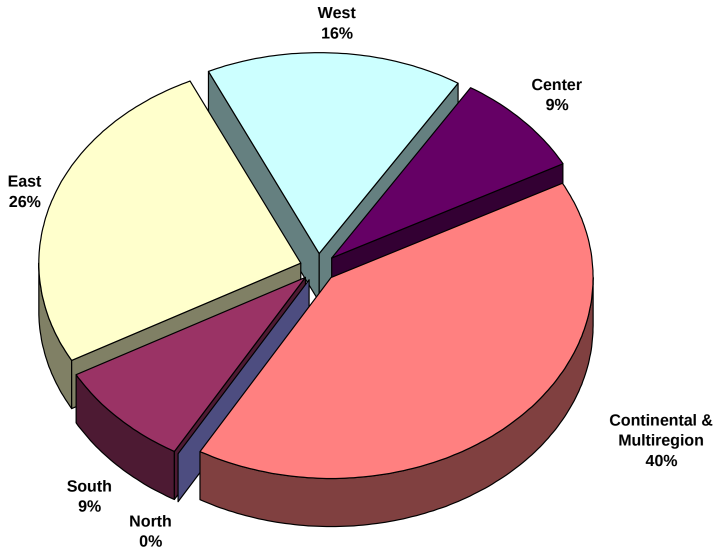


Average Project Size *(UA millions)*

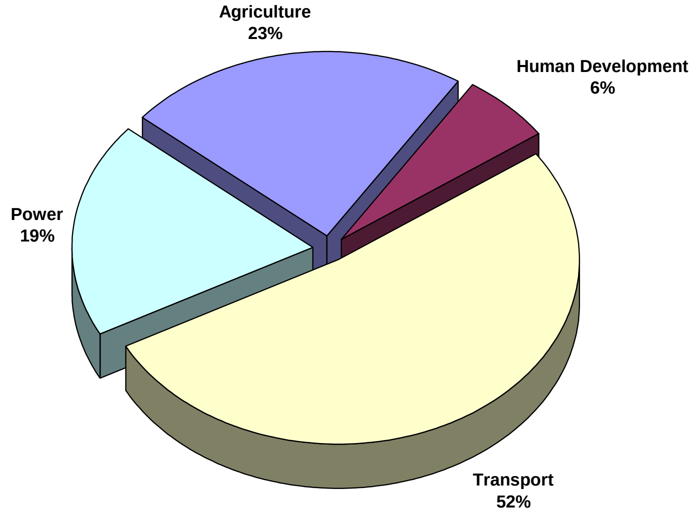


Annex 3: Pipeline of Regional Operations Under Baseline ADF-11 Replenishment (2008-2010)

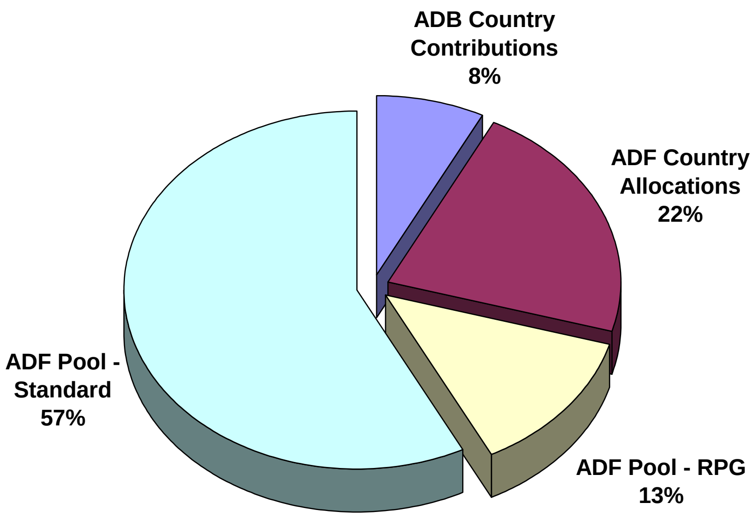
Regional Distribution



Sector Distribution



Financing by Instrument



Average Project Size *(UA millions)*