ADB Engagement in Fragile and Conflict-Affected Situations
ABBREVIATIONS

ADB  – Asian Development Bank
ADF  – Asian Development Fund
AIB  – Afghanistan International Bank
CPS  – country partnership strategy
DCO  – development coordination office
DMC  – developing member country
FCASs – fragile and conflict-affected situations
IED  – Independent Evaluation Department
MDG  – Millennium Development Goal
MFF  – multitranche financing facility
PNG  – Papua New Guinea
PSD  – private sector development
PSDI – Private Sector Development Initiative
RMI  – Republic of the Marshall Islands
Roshan – Telecom Development Company of Afghanistan
SOE  – state-owned enterprise
TA   – technical assistance

NOTE

In this report, “$” refers to US dollars.

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.
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EXECUTIVE SUMMARY

During the annual consultation meeting of Asian Development Fund (ADF) donors held in Ha Noi, Viet Nam, in May 2011, ADF donors reaffirmed the importance of development effectiveness as the central, underlying theme of ADF XI and gave special consideration to fragile and conflict-affected situations (FCASs).

In 2010, 10 ADF countries were identified as FCASs. The broad picture for FCASs is bleak with regard to achieving the Millennium Development Goals by 2015. Climate change is likely to compound the burden placed on FCASs as they strive for speedy recovery and development. The institutional capacity of FCASs to address these and other development concerns is extremely limited. FCASs need to deepen state-building and peace-building and develop the capacity to perform core state functions, foster a modern and competitive private sector, and develop critically needed infrastructure.

The Asian Development Bank (ADB) has made significant progress in facilitating reconstruction and development in FCASs. Since 2007, when ADB adopted its approach to engage with weakly performing countries, ADB lending and grant assistance to FCASs has averaged $654 million per year, or 6% of combined ordinary capital resources and ADF loans and grants. The share of ADF funding to FCASs has been stable, averaging $435 million per year, or 16%. In Afghanistan, ADB is implementing $1.27 billion worth of infrastructure projects that use innovative approaches to suit the particular conditions in that country. ADB has extended discussion of fragility to the preparation of country partnership strategies in Papua New Guinea and Timor-Leste, and has started to use information from political economy studies to better design and implement projects. ADB’s Private Sector Development Initiative and state-owned enterprise reforms in the Pacific are improving the investment climate for the private sector. ADB has strengthened its relations with governments and development partners by opening development coordination offices in several fragile Pacific countries.

ADB recognizes that the path to development in FCASs is diverse and discontinuous because of their constraining and volatile political economies. Hence, ADB will continue to apply the approach adopted in 2007 with three main thrusts:

(i) **Sustain long-term commitments.** This is achieved by prioritizing fragile situations; enhancing the use of the multitranche financing facility and a sector-based approach among other project modalities; incorporating new approaches to peace-building and state-building in project design; strengthening ADB’s field presence; and conducting fragility assessments for country partnership strategies.

(ii) **Concentrate on capacity development.** National capacity development will continue to be incorporated into ADBs’ project interventions, and diagnostics based on the country performance assessment will be supplemented with sector and macro assessments.

(iii) **Intensify strategic partnerships.** Efforts will focus on (a) strengthening collaboration with development partners and cofinancing, (b) enhancing the participation of civil society and the private sector in development, and (c) strengthening ADB’s engagement in international dialogue on FCAS issues.

ADB seeks donors’ guidance on continuing to apply its three-thrust approach to FCASs and its efforts to further improve various elements of the approach.
I. INTRODUCTION

1. During the annual consultation meeting of Asian Development Fund (ADF) donors held in Ha Noi, Viet Nam, in May 2011, ADF donors reaffirmed the importance of development effectiveness as the central underlying theme of ADF XI. Donors endorsed the strategic priorities of Strategy 2020\(^1\) and gave special consideration to fragile and conflict-affected situations (FCASs).

2. At the ADF X Midterm Review Meeting in November 2010, Asian Development Bank (ADB) provided a comprehensive assessment of its engagement with FCASs based on its Approach to Engaging with Weakly Performing Countries adopted in 2007.\(^2\) Donors welcomed the approach and expressed support for ADB’s efforts in FCASs. This paper presents the ongoing issues confronting FCASs and the results of ADB’s engagement to address them. It discusses the lessons learned and seeks donors’ guidance toward further enhancing the ADF’s effectiveness in assisting FCASs.

II. FRAGILITY AND CONFLICT

3. In 2010, 10 ADB developing member countries (DMCs) were identified as FCASs. These may be grouped as (i) fragile DMCs with small, isolated, and underdeveloped markets and limited resources and infrastructure and (ii) conflict-affected DMCs with significant violence occurring nationally or subnationally that disrupts society and the economy. Eight of the 10 FCASs are fragile and are in the Pacific: Kiribati, the Republic of the Marshall Islands (RMI), the Federated States of Micronesia, Nauru, Palau, Papua New Guinea (PNG), Solomon Islands, and Tuvalu. The remaining two FCASs are conflict-affected: Afghanistan in the Central and West Asia region and Timor-Leste in the Pacific. In total, FCASs comprise 34% of DMCs with access to the ADF and 30% of those eligible only for ADF funding.

4. Some DMCs were once but no longer identified as FCASs (e.g., Nepal since 2008 and Vanuatu since 2010) and may be classified as in a transitional situation. They have left fragility or conflict behind, and their economies are exhibiting some capacity for self-sustained growth, at least partly because of improved governance and structural reforms. However, because they continue to display broad weakness in the institutional and human capacity needed to deliver essential public goods and services, the risk of relapsing into fragility remains. (The list of countries identified as FCASs since 2007 is in Appendix 1.)

A. Key Issues in Fragile and Conflict-Affected Situations

1. The Broad Picture

5. Millennium Development Goals and fragile and conflict-affected situations. Representatives of g7+ countries, bilateral and multilateral partners, and civil society participated in the International Dialogue on Peacebuilding and Statebuilding in Dili in April 2010, where they endorsed the Dili Declaration, which states: “We recognize that it will be extremely difficult to achieve the Millennium Development Goals (MDGs) in most fragile and


conflict-affected states by 2015. We urgently need to address conflict and fragility by supporting
country-led peacebuilding and statebuilding processes. The latest progress report on the
MDGs found none of the FCASs, except Palau, on track to achieve many of the MDGs. The
RMI, the Federated States of Micronesia, Solomon Islands, and Tuvalu exhibit mixed progress
in the assessment; Kiribati, Nauru, PNG, Timor-Leste, and Afghanistan are off track. The trend
is the same for DMCs in transition such as Nepal, which registered as being off track for almost
half of the assessed MDG indicators, including those on reducing extreme poverty and hunger.
FCASs are unlikely to meet the target of halving the proportion of people living in income
poverty by 2015. Afghanistan is off track for more than 70% of its reported indicators and is not
expected to fare well in indicators for poverty and education. Timor-Leste is off track for most of
its reported indicators.

6. Several constraints on achieving the MDGs in most FCASs have been identified: slow
economic growth, a lack of coherent policies and strategies, and insufficient human and
financial resources. Good governance, gender equality, and human rights need to be
developed. Sound policies and management of public expenditures must be put in place to
ensure more equitable wealth distribution through better and more effective service delivery.
This is especially relevant for some FCASs that have posted strong growth in recent years (e.g.,
PNG, averaging 5.7% from 2006 to 2010 and attaining 7% in 2010; Solomon Islands, averaging
5.7% and attaining 10% in 2007; and Timor-Leste, averaging 7.5% and attaining 13% in 2009).
As these FCASs have relied heavily on extractive industries, they exhibit unsustainable growth
patterns due mainly to the so-called Dutch disease and the mismanagement of revenues from
natural resources. As the latter may be a major problem in FCASs, the initiative for transparency
in extractive industries is important.

7. Climate change, food security, and fragile and conflict-affected situations. Climate
change is expected to inflict on FCASs sea-level rise, more frequent and intense tropical
storms, and/or prolonged drought. The implications for food security can be grave. Climate
change is likely to compound existing food insecurity in Afghanistan and Timor-Leste, heavily
affecting those dependent on agriculture. These effects are more likely to be distributed
disproportionately on women and children. Food systems of Afghanistan and Nepal are highly
vulnerable to climate change; Afghanistan is on the list of regional hotspots for drought risk and
is suffering this year from severe drought. PNG and Timor-Leste can experience significant
vulnerability to climate change (Table).
Table: Vulnerability to Climate Change

<table>
<thead>
<tr>
<th>High Exposure&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Low Adaptive Capacity&lt;sup&gt;b&lt;/sup&gt;</th>
<th>High Sensitivity&lt;sup&gt;c&lt;/sup&gt;</th>
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<tbody>
<tr>
<td>Afghanistan</td>
<td>Afghanistan</td>
<td>Afghanistan</td>
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<tr>
<td>Nepal</td>
<td>Nepal</td>
<td>Nepal</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>Timor-Leste</td>
<td>Papua New Guinea</td>
</tr>
<tr>
<td></td>
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<td>Timor-Leste</td>
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</table>

<sup>a</sup> Temperature increases by at least 2°C or annual precipitation increases or decreases by at least 20%.
<sup>b</sup> Poverty rate of more than 30%.
<sup>c</sup> Agricultural employment above 40%.


8. Rising ocean temperatures are predicted to alter the migratory routes of tuna and other fish species that are critical sources of food and livelihoods in fragile Pacific economies. During such natural disasters as typhoons, floods, and tsunamis, providing agricultural extension and other services to small farms scattered across small islands in many Pacific FCASs becomes extremely difficult. Food production, trade, and consequently national food security can be threatened.<sup>8</sup>

2. Characteristics of Fragile and Conflict-Affected Situations

9. **Fragile developing member countries.** A distinctive feature of the eight fragile Pacific DMCs is that they are small, geographically isolated, and often have dispersed populations and markets. These features limit economies of scale and human resource capacity, which limit in turn knowledge sharing and the means to reach consensus on difficult decisions including those on economic reforms.

10. Improving the environment for private sector development is critical for economic growth in fragile DMCs. The following factors constrain private sector development: (i) the pervasive role of the state in many aspects of the economy; (ii) inadequate access to finance; (iii) outdated and inadequate business laws and regulations; (iv) inefficient and often expensive infrastructure; and (v) lack of competition because of small market size, public or private sector monopolies, and ineffective regulation.<sup>9</sup> Private sector development is essential for creating jobs for the increasing numbers of unemployed youths in fragile DMCs experiencing rapid population growth.

11. Fragile DMCs continue to suffer weak public governance, which greatly undermines states' ability to address the issues noted above. Their capacity to perform such core state functions as policy formulation, economic management, public financial management and procurement, revenue generation, and civil service management is still very limited. The latest World Bank government effectiveness ranking placed all fragile DMCs at levels 4 and 5, except for Nauru, which is at level 6 (level 1 being the most effective and level 6 the least). Four of the eight fragile DMCs improved their government effectiveness over 1996–2007 but still rated poorly. The other four DMCs experienced a decline.<sup>10</sup>

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12. **Conflict-affected developing member countries.** Afghanistan is currently considered the world’s most dangerous country for women. Afghanistan tops the United Nations’ ranking of countries with the worst child mortality in the region and is the second worst in the world.\(^\text{11}\) This ranking reflects serious weaknesses in social, political, and security systems after 3 decades of civil unrest, political instability, and ineffective law and order. Although significant progress has been made in reconstruction and development, it has been compromised by ongoing conflict and weak state institutions.

13. The security situation in Afghanistan makes it difficult to keep project preparation and implementation on track. Security issues also raise the cost of doing business, partly by reducing consultants’ and contractors’ interest in projects, limiting competition, and raising quality concerns. Lack of capacity in government agencies compounds the problem. Some of these challenges are addressed by outsourcing project preparation and implementation to design engineers and supervision consultants engaged through the multitranche financing facility (MFF). Contract modalities are also modified to attract high-quality contractors. These approaches yield results without compromising principles of governance, transparency, competition, or efficiency. Security costs contribute to higher-than-average project costs.

14. Timor-Leste is on the way to recovery. The main issues remaining are shortfalls in the availability of experienced and qualified government staff and the evolving mandates of some key agencies, which continue to constrain the delivery of basic services. Security problems may now be absent, but state legitimacy and people’s engagement and trust are still being built. The creation of an enabling environment for private sector-led economic growth is hampered by broad weaknesses in public sector management.

15. Both conflict-affected DMCs need investment in critical infrastructure and in developing human and institutional capacity. The growth of a modern and competitive private sector must be supported. State-building and peace-building must be strengthened by developing rural livelihoods, empowering communities, improving community relations, and increasing public confidence in the system of government through mechanisms of accountability, transparency, and participation.

16. **Developing member countries in transition.** Ongoing concerns in these countries are exclusion and widening inequality. In Nepal, the government must act speedily to deliver unmet public service needs in rural and remote areas and preempt the deep frustration that can feed unrest and agitation by indigenous communities. Economic reform is needed even as the state struggles to effectively maintain peace and order in the midst of a protracted and disruptive peace-building process.

17. Close attention is required to the inclusiveness of growth. The same holds in Vanuatu, which has become one of the fastest-growing economies in the Pacific, driven primarily by tourism, construction, and aid inflows. However, growth has been confined largely to urban enclaves, generating few jobs in rural areas. Because of its location in the Pacific, Vanuatu remains highly vulnerable to natural disasters. Its remoteness, small market size, and limited absorptive capacity are key constraints on implementing external assistance.

B. Progress and Achievements

1. ADB Assistance to Fragile and Conflict-Affected Situations

18. Since the endorsement of its 2007 approach (footnote 2), ADB lending and grant assistance to FCASs has averaged $654 million per year, or 6% of combined ordinary capital resources and ADF loans and grants in those years (Appendix 2 Table). The share of ADF funding to FCASs has been stable at 16% of total ADF commitments, averaging $435 million per year (Figure A2.1). Afghanistan alone received 9% of this concessional funding, and significant proportions went to PNG (2.2%) and Nepal (0.9%). Total ADF grant financing to FCASs since the endorsement of the approach has been $1.4 billion, more than 80% of which went to Afghanistan.

19. During the same period, technical assistance (TA) grants to FCASs amounted to $70.2 million, or 8.13% of the value of all TA grants to DMCs (Figure A2.2). Two post-conflict countries received the largest proportion of TA grants to FCASs: Afghanistan with 16% and Timor-Leste with 27%. Also receiving significant proportions are Nepal (10%), PNG (14%), and Solomon Islands (9%). In 2010, capacity development, policy and advisory, and research and development TA assistance to FCASs amounted to $4.6 million.

20. By sector, TA to FCASs in 2007–2010 was primarily multisector (23%), public sector management (21%), and transport (19%). Multisector TA includes infrastructure development, capacity development, and the environment. These areas accounted for over 60% of all assistance. There was also a strong emphasis on energy (12%) and water (9%).

21. Fluctuations in ADF allocations to FCASs have been due mainly to the exit of the larger countries from FCASs status. Overall assistance to FCASs has increased, and more resources have been allocated to smaller countries. Fragile Pacific DMCs benefit from higher allocations, as 4.5% of the ADF has been earmarked for the Pacific. Afghanistan benefits from higher allocations because of its post-conflict status.\(^\text{12}\)

2. ADB’s Engagement with Fragile and Conflict-Affected Situations

a. Results in Fragile Pacific Developing Member Countries

22. Focusing country partnership strategies and business processes on fragility. ADB has brought discussion of fragility into the preparation of CPSs for PNG and Timor-Leste. It used information from the country performance assessments, new tools such as the fragility assessment adapted from the peace-building tool developed in Nepal, and political economy studies.\(^\text{13}\)

23. Focus on political economy. One key defining factor for FCAS engagement is consideration of the political economy. Political economy assessment provides a means to

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\(^{13}\) At the project level, the peace-building tool has been adapted for the ongoing preparation of the Kiribati South Tarawa Sanitation Improvement Sector Project.
understand features such as social, political, and cultural dynamics peculiar to a fragile DMC and significantly influencing its development efforts. In the area of state-owned enterprises (SOEs), the prioritization, sequencing, and nature of SOE reform are greatly influenced by the political economy (Box 1). Technical and managerial advice and assistance alone are often insufficient to support SOE reform in FCASs. Lack of understanding of the political economy may have contributed to earlier reform efforts’ failure to succeed. ADB’s Pacific approach includes a framework for addressing fragility by using political economy analysis across Pacific DMCs (footnote 9).

24. **Paying more attention to private sector development and reforms.** The implementation of the Private Sector Development Initiative (PSDI) and SOE reforms in the Pacific are good examples of ADB’s sustained efforts to improve the investment climate and to help boost private sector development (PSD) in fragile DMCs. Support in this area provided the cornerstone for ADB’s recent policy-based lending initiative in the RMI, which supported government reform of SOE operation and management.

<table>
<thead>
<tr>
<th>Box 1: Selected Dimensions of Political Economy in the Pacific</th>
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<tr>
<td><strong>Kiribati state-owned enterprise reform.</strong> The collective-action problem that appears to make Kiribati unwilling to privatize public enterprises and promote the private sector is the societal belief that benefits gained from dependence on the government outweigh their private costs. The most positive factor is the strong commitment of the current president.</td>
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<tr>
<td><strong>Telecommunications regulatory reforms in Papua New Guinea and Tonga.</strong> It was found that (i) the domestic policy constraints imposed by independent regulators were vulnerable to political interference and (ii) World Trade Organization telecommunication commitments provided greater policy certainty by constraining government policy reversals.</td>
</tr>
<tr>
<td><strong>Political economy and championing of reforms in Cook Islands and Samoa.</strong> The chances of success were improved by continuity in the political leadership and a stable political environment. Technically competent and supportive senior public servants also played important roles, as did the public support generated through nationwide summits or retreats and the sustained public dialogue that followed them.</td>
</tr>
<tr>
<td><strong>Presidential perspectives on political economy in the Republic of the Marshall Islands.</strong> “Reform proponents need to be cognizant of the pervasive and long-standing ‘welfare state’ attitudes developed over many years of the United States Compact and the way in which these attitudes shape perceptions about the role of government and the direction of national development. Consultative processes are also extremely important throughout all stages of reform....”</td>
</tr>
<tr>
<td><strong>Governance reform in the public sector in Pacific island countries.</strong> Three Pacific political values are identified: distribution, transparency, and competition. Working with these values, rather than against them, can improve the design of international aid efforts in the Pacific.</td>
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25. The PSDI has pursued SOE reform in a number of fragile DMCs. Solomon Islands has presented a good opportunity to pursue SOE reform with the support of the current government (Box 2). In the RMI weak public sector capacity has constrained progress, and in PNG the next phase of SOE reform requires a consensus within government on certain framing policy positions, which will ultimately affect the winding back of public monopolies and improve standards of public disclosure. In this environment, where fiscal necessities do not drive

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reforms, ADB continues its advocacy efforts and remains ready to reengage when a favorable political environment returns. These initiatives have demonstrated some gains, but results are mixed overall and require continued focused assistance in the medium term.

**Box 2: State-Owned Enterprise Reform Is an Example of Successful Privatization in Solomon Islands**

In early 2007, the Solomon Islands government decided to privatize Sasape Marina Ltd. Lack of investment and mismanagement had steadily undermined the company’s financial and operating position over the years, leaving both of the company’s slipways inoperable by the end of 2007. The minister of finance championed the company’s privatization as the best way to secure needed investment and ensure its long-term survival. The Private Sector Development Initiative (PSDI) was enlisted to help prepare the transaction, but a change of government in late 2007 sidelined the privatization process.

Following indications from the new government that the transaction should proceed, in 2009 the PSDI quickly reengaged by reconfirming the government’s endorsement of the sales plan and preparing bid documents. The transaction was successfully completed in 2010 and now serves as an important precedent for the ongoing privatization program. The current finance minister, who also championed the privatization of Sasape Marina Ltd. in early 2007, demonstrated that loss-incurring state-owned enterprises can be successfully privatized and attract significant private sector investment. A key lesson to be drawn from this transaction is the importance of flexibility in technical assistance supporting politically sensitive reforms such as privatization. Traditional standalone technical assistance would not have been able to see this transaction through, but the PSDI was able to do so cost effectively.

Source: ADB staff.

26. The success of the PSDI in promoting PSD in fragile DMCs arises largely from three factors: (i) All interventions are demand driven and based on joint, sound analytical work to diagnose the issues and prioritize reform actions with the governments; (ii) The PSDI is a multiyear initiative, allowing the full implementation of policy reforms; and (iii) The PSDI has a core team of consultants who can mobilize and demobilize as political support for reform evolves.

27. **Strengthening ADB’s field presence.** The opening of development coordination offices (DCOs) in Samoa in 2009, Solomon Islands in 2008, Tonga in 2009, and Vanuatu in 2010 has strengthened relations with national governments and other development partners. The DCO in Vanuatu, established jointly with the World Bank, has heightened the presence of both partners and created efficiencies and opportunities for better coordination. ADB is currently resuming lending in Vanuatu after a gap of several years. The improved relationship between the government and ADB has fostered stronger government engagement in project preparation. The DCO in Vanuatu has significantly improved the quality of cooperation with Vanuatu civil society.

28. ADB’s strengthened partnership and field presence respond to local political economies. A strong field presence is needed to update information and inform staffers who prepare projects of political economy issues affecting the sector they aim to assist. On-the-ground information provided by DCO staff has provided valuable inputs to project processing and implementation.

29. ADB’s joint DCO with the World Bank in Solomon Islands has enhanced the work of the country’s core economic working group, a forum for development partners and the government
to discuss reform programs. It also provided a platform for dialogue to coordinate agencies’ budget support during the global economic crisis. With a better practical understanding of the development context of the island nation, and with improved aid coordination, ADB is able to target and deliver its assistance more effectively.

30. **Promoting regional cooperation.** The lack of economies of scale is a major challenge for fragile DMCs. Pacific Island Forum leaders have long recognized that this challenge could be addressed by sharing scarce resources and aligning policies to strengthen national capacities. ADB has responded to this need by promoting regional cooperation in the areas of governance, education, and information and communication technology. ADB’s Pacific Regional Audit Initiative encouraged cooperation, peer-learning, shared networks and resources, and an effective means to teach and reinforce on-the-job audit skills.15 ADB’s program to create the Pacific Information Superhighway has promoted stronger south–south cooperation in education.16 The participation of the Government of India in this program as the provider of technology highlights opportunities for linking Pacific economies with Asia. Regional responses to Pacific DMCs’ fragility include the Pacific Aviation Safety Office, Pacific Region Infrastructure Facility and Pacific Infrastructure Advisory Center, and Pacific Economic Management Technical Assistance.17

31. **Long-term approach using flexible financing.** The MFF, sector-based approaches, and cluster TA provide modalities for more flexible project financing and long-term support to fragile DMCs. In PNG, MFFs have been used for road construction, civil aviation, and energy.18 They support the government’s long-term plan for infrastructure development and enable ADB to sustain the partnership needed for institutionalizing infrastructure maintenance. A sector-based approach used in transport in the Solomon Islands offered a comprehensive mechanism to improve the country’s ownership and efficient implementation of all external assistance.19 Cluster TA for Pacific Economic Management and the Economic Recovery Support Program, and the Pacific Climate Change Trust Fund are examples of flexible financing that supports long-term needs.20

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16 ADB. 2009. *Technical Assistance for the Creation of the Pacific Information Superhighway with the University of the South Pacific Network.* Manila.
32. **Responding to climate change.** ADB is facilitating climate change adaptation and mitigation and responding to related environment and food security issues in Pacific DMCs through its Pacific Climate Change Program and other joint global and regional initiatives such as the Coral Triangle Initiative, Pilot Program on Climate Resilience of the Climate Investment Fund, Asian Clean Energy Fund under the Clean Energy Financing and Partnership Facility, and Australian International Climate Change Adaptation Initiative.\(^2\)

The programs focus on four priority sectors:

(i) natural resource management, including agriculture and rural development, emphasizing the protection and management of coastal and marine resources, integrated watershed management, and building synergy between adaptation and mitigation;

(ii) water and urban development, focusing on flood control, drainage and sanitation, rural and urban water supply, and integrated water resource management;

(iii) energy, investing in emission-reduction solutions including energy conservation, efficiency, renewable energy, and reducing greenhouse gas emissions; and

(iv) transport, consisting mainly of climate-proofing roads, ports, and airports, as well as reducing greenhouse gas emissions from transportation.

33. The specific programs and activities on infrastructure adaptation, climate change mitigation, coastal and marine resource management, and disaster risk management have direct and indirect impacts on food and livelihood security in FCASs. They are intended to provide access to markets, lower transport costs and thus prices, and improve terms of trade.

34. ADB’s response to climate change in the fragile Pacific DMCs aims to reduce the vulnerability of the countries to risks and impacts of climate change and support countries’ efforts to sustain economic growth. Sector outputs lost to climate change have the potential to lower gross domestic product by 5%–13% per annum in Pacific DMCs, compounded by expected increases in the costs of public health care and of operating and maintaining physical assets. Project benefits can be at stake, depending on their location and the intensity and severity of flooding caused by heavy rainfall, sea surges, and abnormally high tides, as well as of wind damage caused by cyclones. Investment in climate-proofing project assets will prevent potential losses but requires incremental investments of 5%–20% for many development projects. Assured financing of the costs of climate-proofing and resilience-building through projects is crucial for most Pacific DMCs. This requires strategically engaging governments and development partners to mainstream climate change considerations into development plans, access financial resources from multilateral and bilateral sources, and facilitate public–private partnership.

35. ADB and its development partners have begun climate-proofing ongoing and planned Pacific infrastructure projects in the Cook Islands, PNG, Solomon Islands, Timor-Leste, Tonga, and Vanuatu that develop road systems (Box 3), ports and harbors, water supply, urban roads, and drainage and sanitation systems.

b. Results in Post-Conflict Situations

36. **Multitranche financing facility use in Afghanistan.** ADB’s MFF offers a flexible financing modality that supports the country’s medium- to long-term investment programs in an efficient and cost-effective manner. As a longstanding partner of Afghanistan, ADB will continue to implement its assistance through the MFF modality. ADB will remain in Afghanistan after the departure of the North Atlantic Treaty Organization-led International Security Assistance Force, which is scheduled to complete its mandate by the end of 2014. ADB will remain involved in transport, energy, and water management and irrigation. Urban services may be considered at some point in the future, though that decision will be made only at the time of the new CPS in 2013.

37. ADB is currently implementing three MFFs in Afghanistan worth $1.27 billion: the Road Network Development Investment Program, the Energy Sector Development Investment Program, and the Water Resources Development Investment Program. The implementation of these programs draws on lessons learned from implementing the Afghanistan Railway Project (Box 4), where ADB and the government continue to employ innovative approaches that feature

(i) turnkey contracts using a fixed contract period, fixed contract price, and predefined quality standards;

(ii) a bidding process adapted to conditions—including single source selection and international competitive bidding that links bidder prequalification criteria to the size of the contract;

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**Box 3: Climate Proofing Transport Infrastructure in the Pacific**

The Asian Development Bank responds to climate change by proactively incorporating climate-proofing into project design. For example, the Second Road Improvement Project in Solomon Islands includes (i) watercourse crossings designed to survive higher floods and loads of river-borne debris; (ii) bridge abutments anchored to piled foundations to minimize the collapse of abutments and approach roads; (iii) river training to minimize the deviation of watercourses from their original path; (iv) strengthened protection for approach roads; (v) a raised road surface where a rising water table makes the road more flood prone, with protected side gradients protected to prevent erosion; and (vi) the rerouting away from the immediate foreshore of coastal sections of roads exposed to waves and tidal inundation.

The Road Network Development Sector Project in Timor-Leste built climate-proofing into road rehabilitation and maintenance by considering future climate data when reviewing engineering designs and plans and by making climate change adaptation part of the environmental management plan. The models developed through the project will influence the government’s road sector strategy.


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(iii) contracts that include incentive premiums as well as poor-performance penalties mirroring one another; and
(iv) outsourcing implementation by empowering the supervision consultant to certify payments against quality and schedule, without government involvement, while the government continues to make the payments.

**Box 4: Innovative Approaches in the Afghanistan Railway Project**

The 75-kilometer railway from Hairatan to Mazar-e-Sharif is now complete, and rail freight movements will soon commence between Uzbekistan and Afghanistan, opening a new transit route for exports from Central Asia. The $140 million project will benefit over 5 million people. The construction of the new railway line was originally expected to take 3 years. The turnkey contract finally fixed a delivery period of 12 months, but construction finished ahead of the schedule in 9 months. Recognizing the fragile environment of northern Afghanistan, the Asian Development Bank (ADB) adopted new approaches to help enable this expedient construction. ADB used a design–build contract modality to get the project executed, with a fixed price and delivery period along with premiums or penalties against time, budget, and quality standards.

To expedite construction and ensure international standards, the supervision engineer was given the responsibility to check construction schedules and quality standards without the day-to-day involvement of government ministries. Supervision consultants were given direct responsibility to certify payments to the contractor, issued by the government and authorized by ADB through a standby letter of credit. The implementing ministry was then able to focus on oversight and reporting. In addition, issuing a contract with substantial premiums and penalties made it worthwhile for all parties to perform.

The whole experience encouraged the government to outsource the operation and maintenance of the railway. The government will soon establish a railway authority for regulation, asset ownership, tariff setting, and standard setting. The government has plans to develop more than 2,500 kilometers of railway in the coming years following the same model.

Source: ADB staff.

38. **Private sector financing.** ADB has directly invested in Afghanistan’s private sector and helped attract other foreign investors in infrastructure and finance sector projects important to the country. In infrastructure, ADB has successfully financed the expansion of the first privately owned mobile telecommunications provider. Success was attributed to an innovative approach of leveraging partnerships among private entities and adopting successful business models from other emerging markets to cater to the unique needs of Afghanistan. ADB supported the development of the country’s finance sector by investing in its major commercial bank, despite the challenging environment in that sector (Box 5).

39. **Financing innovations.** To implement projects and harmonize aid, ADB’s adoption of innovative modalities is considered critical to implementing projects and harmonizing aid to achieve desired outcomes. The recently approved ADB-managed Afghanistan Infrastructure Trust Fund pools external resources to cofinance and complement ADB-assisted infrastructure projects. The fund provides an ADB-managed financing and implementation window, which is particularly useful to smaller aid agencies wishing to contribute to infrastructure development by tapping ADB’s competitive advantage, technical expertise, and sound fiduciary arrangements for implementing large infrastructure projects.

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Box 5: ADB and Private Sector Development in Afghanistan

**Telecom Development Company of Afghanistan.** The Asian Development Bank (ADB) provided three rounds of financing to Telecom Development Company of Afghanistan (Roshan), totaling $130 million, to help the country’s first privately owned mobile telecommunications provider extend voice and data services to more than 5 million subscribers. Roshan offers products and services that are uniquely tailored to the needs of its clients: accessibility for women and rural populations, including women-only public call centers that provide the first-ever access to communication and internet services in an environment of ongoing gender segregation; innovative data services such as M-paisa for mobile money transfer; and TradeNet, which informs farmers of market prices through text messaging. Through its affiliation with the Aga Khan Development Network, Roshan has pioneered the use of telemedicine in Afghanistan, allowing local doctors to access medical expertise from top medical centers in the region.

Roshan is part of the Vodafone Partner Markets Program, which currently has equity interests in 31 countries across five continents and about 40 partner networks worldwide. This strategic partnership has enabled Roshan to better serve its customers by providing exclusive access to a wider range of products and services. Roshan customers can enjoy improved voice and data roaming in countries where Vodafone is active, and Vodafone will use Roshan’s state-of-the-art network to offer its customers roaming service while in Afghanistan.

**Afghanistan International Bank.** On 13 May 2004, ADB’s Board of Directors approved a $2.6 million equity investment in exchange for a 25% stake in Afghanistan International Bank (AIB). ADB’s decision to invest in AIB was driven by a vision to establish the first post-Taliban private commercial bank in Afghanistan, alongside a group of reputable Afghan business people with extensive contacts within and beyond the region.

Despite the challenging environment and the nascent nature of the finance sector, AIB is considered today, after 7 years of operations, to be a professionally managed bank that is independent, transparent, and up to international standards. It is regarded as the best training ground for young graduates who want to pursue banking as a career, equipping them with skills that will ensure a livelihood for themselves and their families. AIB employs over 350 Afghans, 20% of whom are women, with average age of 23. It is expected to achieve a return on assets of 1.6% (a run rate of 1.9%) and a return on equity of 17.9% (actual first 5 months results are 21.3%). Its Tier 1 capital ratio as of the end of 2010 was 23%. ADB’s role in supervising AIB is further evidenced through direct dialogue and meetings it has had with the regulator on issues such as a legal lending limit, hiring senior management, and the constitution of the board.


40. **Regional cooperation.** ADB supports the flagship Central Asia Regional Economic Cooperation Program, which includes Afghanistan and nine other countries across the region. The program promotes project-based cooperation in transport, energy, trade facilitation, and trade policy. To date, it has more than $15 billion in investments in these sectors, including building and upgrading 3,600 kilometers of roads and 2,000 kilometers of railways, as well as ports and priority border crossings. The program has also improved energy security, efficiency, and distribution throughout the region. Some key ADB-funded projects include the Uzbekistan–Afghanistan power interconnection, Tajikistan–Afghanistan power transmission interconnection

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(Box 6), Afghanistan ring road, Kandahar–Spin Boldak road, and Hairatan–Mazar rail link. Discussions are currently under way to finalize financing and implementation arrangements for the proposed Central Asia–Afghanistan–Pakistan power interconnection and Turkmenistan–Afghanistan–Pakistan–India gas pipeline project.

**Box 6: Promoting Regional Power Trade, the Regional Power Transmission Interconnection Ensures Energy Security, Economic Development, and Poverty Reduction**

Additional power is a prerequisite for economic recovery and stability in Afghanistan. The country faces energy insecurity, with per capita energy consumption at less than 1 million British thermal units per capita, a fraction of Pakistan’s 12 million, India’s 14 million, and the People’s Republic of China’s 35 million. Only 30% of the Afghan population is connected to public power supply, more than two-thirds of them urban residents.

Following the completion in 2008 of an Asian Development Bank (ADB)-assisted project to transmit power from Uzbekistan into Afghanistan, providing energy to 2.5 million residents of Kabul, the follow-on ADB-financed Regional Power Transmission Interconnection Project (Tajikistan and Afghanistan) will be operational from July 2011 to serve centers in northeastern Afghanistan. The project covers the construction of transmission lines linking Tajik hydropower stations to the Afghan border town of Sherkan Bandar, then continuing to Kunduz, Baghlan and Pul-e-Khumri. This line will supply major electricity demand centers, importing some 300 megawatts of clean and cheap hydropower surplus annually from Tajikistan. The net economic benefits of this regional cooperation project are estimated to be $114.1 million, 47% to Afghanistan and 53% to Tajikistan. It is a win-win example of providing reliable, affordable energy over the long term and can open up further business opportunities for regional trade.

Sources: ADB staff; ADB. 2006. Report and Recommendation of the President to the Board of Directors: Proposed Loans, Technical Assistance Grants and Administration of Loans to Afghanistan and Tajikistan for the Regional Power Transmission Interconnection Project. Manila.

41. **Commitment for long-term support to Timor-Leste.** ADB’s operational emphasis in Timor-Leste is to ease the transition from an economy led by the public sector to one led by the private sector. The primary focus is on infrastructure development, with complementary assistance in core specializations including finance, regional cooperation and integration, and education. ADB’s long-term commitment has been important to achieving development results. The achievements in the road transport subsector and in expanding microfinance through 10 years of support for the Institute for Microfinance, which became the Commercial Bank of Timor-Leste in July 2011 (Box 7), demonstrate ADB’s long-term commitment to the country’s development.

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27 The forthcoming CPS 2011–2015 for Timor-Leste will address four of ADB’s five core specializations, as identified in ADB Strategy 2020 (footnote 1).
Box 7: Long-term Commitment to Results Expanded Microfinance in Timor-Leste

The Institute for Microfinance in Timor-Leste was established in late 2001 with external funding under an Asian Development Bank (ADB) microfinance project. The objective was to provide financial and other services to the poor, with an emphasis on rural areas and women. The institute became the country’s largest locally owned financial institution. With only three branches in 2004, it has expanded its network, covering by August 2011 all 13 districts. Lending increased from $1.0 million in 2004 to $6.5 million in mid-2010, with a cumulative total of 40,417 loans disbursed and 34% of total value lent to women.

On 12 July 2011, the institute became the country’s first locally owned commercial bank, the Commercial Bank of Timor-Leste. It provides an important channel into rural areas for both finance and the government’s cash payments. The bank has a low rate of nonperforming loans, is profitable, and is financially sustainable. It has lifted the loan ceiling from $5,000 to $100,000. Microfinance products will continue. A business plan for the new bank was prepared with ADB support to guide the strengthening of the institution’s systems and capacity. ADB is helping to implement the new business plan and to train the staff of the new bank.


c. Results in Transitional Nepal

42. In response to the specific challenges of working in transitional DMCs, the ADB Nepal Resident Mission designed and implemented the peace-building tool as a pilot initiative and as part of the Nepal CPS, 2010–2012. The tool has facilitated understanding of potential social conflict and the development of appropriate mitigation when designing projects. It has also helped ADB focus on the potential for enhancing peace and social cohesion (Box 8). The tool may be used to monitor and evaluate projects. This has been initiated in two ongoing projects in 13 districts in the country.

d. Striving for Global Excellence in Fragile and Conflict-Affected Situation Work

43. The FCAS focal points in each regional department are led by the ADB focal point and act as a network for practitioners and interested parties to share knowledge on FCASs-related issues. An online resource center has been established in ADB. This contains various materials relating to FCASs including tools and guidelines, case studies, strategies and programs, and examples of projects from both within and outside ADB.

44. Other initiatives that are expected to sharpen ADB’s involvement in FCASs are (i) the community of practice on public financial management or governance, which coordinates relevant information sharing and seminars within ADB; (ii) a forthcoming study by the Regional and Sustainable Development Department on ADB’s governance, policy, and public sector management, which will provide valuable insights to strengthen ADB’s institutional capacity for development work in FCASs; and (iii) joint work with the World Bank Institute on a political economy framework and with other development partners on conducting diagnostics, including assessment of country and sector governance risks.

Box 8: Using the Peace-Building Tool in Two Projects in Nepal

The peace-building tool helped identify, at the beginning of preparing the Kathmandu Valley Water Supply and Waste Water System Improvement Project, illustrative activities that may contribute to peace building: prohibiting child labor, inter-municipality meetings for sharing lessons, high-level political party meetings for ownership, and using mass media to inform citizens of progress and problems. Measuring results in peace building is challenging. Recommended monitoring indicators were the number of (i) households with victims of conflict served; (ii) women and ethnic minorities reached; (iii) consultation meetings conducted with all parties, beneficiary groups, and/or concerned organizations; (iv) social audits conducted; (v) jobs created or people employed; and (vi) households reached by the recycle, reduce, and reuse approach to waste management. The early preparation stage is an appropriate time to recommend indicators for a project’s results framework.

The preliminary stakeholders’ meeting with municipalities under the Integrated Urban Development Project helped sensitize municipal officials to the peace-building tool requirement, key issues of conflict, and appropriate project activities. The meeting provided a good opportunity to discuss the identification of victims of conflict as target groups for the project and the need to focus on the carrying capacity of municipalities affected by internally displaced people. The tool helped identify Banke District’s vulnerability to religious conflict and its local capacity for building peace by using the inter-religious committee to deal with potential disputes. The committee keeps abreast of internal religious issues, including South Asian events like court decisions on Babari Masjid in India and India–Pakistan cricket matches to ensure that such events do not damage Nepali religious harmony and security.

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Source: ADB staff

45. The development of a handbook for operational staff is another initiative to mainstream innovative engagement in FCASs. The handbook will capture tacit knowledge and provide practical examples of innovative, flexible, streamlined, and simplified approaches that are relevant to project processing and implementation in FCASs. The handbook will highlight sensitive aspects of project preparation and implementation in the context of FCASs, including analysis of the political economy.

C. Lessons

46. Lessons from the special evaluation study. The Independent Evaluation Department recently assessed ADB’s support to FCASs in 2007–2009. The study concludes that ADB’s approach to FCASs is relevant and that differentiated engagement is needed. Three key lessons are highlighted. First, a programmatic approach to FCASs is appropriate to make project processing and implementation more efficient. Operations in FCASs are likely to experience significant adjustments during project implementation.

47. Second, relaxing business processes and procedures does not offer a sound solution to avoiding delays in project implementation, because it can raise governance issues. A deeper understanding of the countries’ context and counterparts, better and simpler project designs, and consistent and longer-term commitment to working in the country are critical ingredients for efficiency and effectiveness. These factors, and a deeper understanding of the political climate, are critical ingredients for success.

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economy and its influence on project success, are seen as being more important than large resource transfers.

48. Third, many projects in FCASs have been effective. Establishing temporary mechanisms has been critical to helping projects achieve intended outputs and outcomes. Pooling funds through regional TA that benefits a number of Pacific DMCs has proved successful, augmenting country-specific resources.

49. The Independent Evaluation Department assessment identifies sustainable cost recovery as a critical issue for public utilities because of capacity constraints. It recommends that ADB further strengthen, and provide greater follow-through for, policy-based support; assist civil service reform and the privatization of SOEs; and strengthen public expenditure and financial management. Working with other partners and providing increased presence on the ground are also essential for development effectiveness.

50. The World Development Report and ADB’s approach to fragile and conflict-affected situations. The World Development Report 2011: Conflict, Security, and Development highlights the role security plays in national development and in breaking the cycles of fragility, violence, or their legacies. Countries suffering protracted violence tend to fall far behind in development, with poverty rates more than 20 percentage points higher, on average, than in other countries experiencing only isolated violence. The report notes that capable and legitimate institutions are crucial for enabling governments to mediate the stresses that otherwise cause repeated waves of violence and instability. However, true institutional transformation typically takes 15–30 years, as weak national institutions gradually become resilient to violence and instability. This process entails a sequence of transitions to transform countries’ political, security, and economic institutions.

51. The findings and recommendations of the report validate ADB’s 2007 approach paper on Achieving Development Effectiveness in Weakly Performing Countries (footnote 2). In a supplementary paper, Operationalizing the 2011 World Development Report, the World Bank outlines six priority themes for implementing the report’s recommendations: (i) focusing country assistance strategies more on fragility; (ii) strengthening partnerships on development, security, and justice; (iii) paying more attention to jobs and private sector development; (iv) realigning results and risk management; (v) reducing financing volatility; and (vi) striving for global excellence for FCASs work. Since its 2007 approach paper, ADB has been implementing most of these recommendations.

D. The Way Forward

52. To build on the work since 2007 and accelerate beyond the momentum gained thus far, ADB intends to further pursue its approach to FCAS engagement in the following manner:

(i) Sustain long-term commitments. Strategic planning that incorporates assessments of fragility and political economies will be strengthened during CPS preparation. The use of the MFF and a sector-based approach among other project modalities that provide long-term commitment to assistance will be further enhanced where appropriate, as in Afghanistan. Innovative approaches to implementation such as outsourcing, turnkey contracts, better contracting

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modalities, and the use of reliable supervision consultants are critical to doing things on time, within budget, and to high standards. Peace-building and state-building will be incorporated into project design and implementation with the end-view of long-term sustainability through capacity development in, for example, Nepal. ADB will also continue to strengthen its field presence in Afghanistan and Pacific DMCs.

(ii) **Concentrate on capacity development.** Development in FCASs depends largely on institutional and human capacity to perform core government functions. Capacity development will be incorporated in ADB’s various project modalities. Country performance assessment as a tool in FCAS diagnostics will be supplemented with macro and sector assessments and governance risk assessments.

(iii) **Intensify strategic partnerships.** Coordination among development partners in FCASs is strong and has further strengthened in recent years. Efforts will now focus on strengthening collaboration and cofinancing with development partners. ADB’s field presence in FCASs will be sustained and further strengthened through cooperation and resource sharing with major development partners, enhancing the participation of civil society and the private sector in development efforts, and strengthening ADB’s engagement in international dialogue on FCASs issues.

53. ADB’s 3-year workforce plan for 2010–2012 has strengthened staffing in support of FCASs. The number of staff in the Pacific Department is expected to increase by 25% over 2009, with half of these additional posts allocated in 2010. ADB’s local presence in Pacific countries will be strengthened through the provision of coordinator positions in 2010–2012. An additional 16 positions are planned for resident missions in Afghanistan and Nepal. Moreover, ADB staff will be trained in approaches relevant to FCASs, including all aspects of fragility and conflict (i.e., political economy analysis, policy dialogue, institutional reform, conflict resolution, and peace-building). Knowledge management on ADB’s approach to FCASs will be stepped up through (i) staff awareness campaigns, (ii) a FCAS handbook that provides greater clarity on FCAS business processes, (iii) a series of seminars on operations in FCASs, and (iv) publications on the impact and experience of ADB’s operations in FCASs.

III. **REQUEST FOR DONORS’ GUIDANCE**

54. Since the adoption of the 2007 approach, ADB has made significant progress in addressing some of the key challenges to achieving aid effectiveness in FCASs. However, challenges remain, and ADB needs to ensure that its operations explicitly address fragility issues through appropriate design and implementation under the ADF XI.

55. ADB seeks donors’ guidance on continuing to apply the approach in FCASs it adopted in 2007, with the three key thrusts—(i) sustaining long-term commitments, (ii) concentrating capacity development on core government functions, and (iii) intensifying strategic approach—and its efforts to further improve various elements of the approach.
COUNTRIES IDENTIFIED AS FRAGILE AND CONFLICT-AFFECTED SITUATIONS, 2007–2010

<table>
<thead>
<tr>
<th>Developing Member Country</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<td>✓</td>
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<td>✓</td>
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<td>Federated States of Micronesia</td>
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<tr>
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<td>Tuvalu</td>
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<td>Uzbekistan</td>
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<td>Vanuatu</td>
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\(^a\)The Asian Development Bank no longer conducts country performance assessments on Azerbaijan.


[www.adb.org/ADF/PBA/annualreport.asp](http://www.adb.org/ADF/PBA/annualreport.asp)
## ADB LENDING AND GRANT ASSISTANCE, 2007–2010

($ million)

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<tr>
<th>Modality</th>
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<th>2009</th>
<th>2010</th>
<th>Average</th>
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<td><strong>Assistance to FCASs</strong></td>
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<td>ADF loans</td>
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<td>95.0</td>
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<td>ADF grants</td>
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<td>394.1</td>
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<td>360.4</td>
<td>50.0</td>
<td>63.0</td>
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<td><strong>Subtotal</strong></td>
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<td>776.6</td>
<td>539.1</td>
<td>476.8</td>
<td>653.9</td>
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<tr>
<td><strong>ADB Assistance to All DMCs</strong></td>
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<td></td>
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<tr>
<td>Total ADF loans and grants</td>
<td>2,412.2</td>
<td>2,497.0</td>
<td>3,121.6</td>
<td>3,180.0</td>
<td>2,802.7</td>
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<td>Total OCR loans</td>
<td>7,400.0</td>
<td>8,360.0</td>
<td>11,020.0</td>
<td>9,250.0</td>
<td>9,007.5</td>
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<td>Grants from other special funds</td>
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<td>13.0</td>
<td>15.0</td>
<td>14.5</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>9,842.2</td>
<td>10,857.0</td>
<td>14,154.6</td>
<td>12,445.0</td>
<td>11,824.7</td>
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</table>

Assistance to FCASs as a percentage of total lending to DMCs (percentage)  

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<td>4</td>
<td>4</td>
<td>6</td>
</tr>
</tbody>
</table>

ADB= Asian Development Bank, ADF= Asian Development Fund, DMC= developing member country, FCASs= fragile and conflict-affected situations, OCR= ordinary capital resources.

Source: Asian Development Bank annual reports.
ADF=Asian Development Fund, DMC= developing member country, FCASs= fragile and conflict-affected situations.

Source: Asian Development Bank annual reports.

ADF=Asian Development Fund, DMC= developing member country, FCASs= fragile and conflict-affected situations.

Source: Asian Development Bank annual reports.
Appendix 2

FCASs = fragile and conflict-affected situations, FSM = Federated States of Micronesia, Lao PDR = Lao People’s Democratic Republic, PNG = Papua New Guinea.

Source: Asian Development Bank estimates.

**Figure A2.2: Share of Technical Assistance Grants Going to Fragile and Conflict-Affected Situations, 2007–2010 (%)**

Not FCASs 92%

FCASs 8%

Solomon Islands 9%

Timor-Leste 27%

Tuvalu 2%

Uzbekistan 4%

Vanuatu 4%

Afghanistan 16%

Nauru 0.3%

FSM 1%

Palau 2%

Nepal 10%

Marshall Islands 1%

Lao PDR 6%

Kiribati 3%

Azerbaijan 2%

Azerbaijan 14%