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# WORLD BANK SUPPORT FOR SMALL STATES IN ADDRESSING ECONOMIC VULNERABILITY AND ENHANCING RESILIENCE

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**Abstract.** The World Bank takes seriously its supporting role in favour of small states. Since 1985, the International Development Association (IDA) has accorded special access to small island economies with per capita incomes above the normal IDA eligibility cut-off. This special treatment recognises a set of circumstances—including export concentration, limited domestic markets, limited skill base, isolation, and vulnerability to natural disasters and other shocks—faced by these states. Currently nine small island states qualify for this exception. Beyond this special access to resources for a number of small island economies, the World Bank stands ready to make available a wide variety of types of support to small states to help them build resilience. Examples of assistance include annual assessment of country policy and institutional performance, help with country-led donor coordination, trade-related support, disaster management and mitigation, commodity risk analysis, HIV/AIDS-related support, help on anti-money laundering and tax-related support.

## 1. Introduction

The World Bank takes seriously its supporting role in favour of small states. First, with regard to funding, the World Bank works to ensure that every developing member state has access to World Bank financial assistance, as long as that country's overall policy framework is adequate to support sustainable growth and poverty reduction. In that context, since 1985, the International Development Association (IDA), the concessional funding window of the World Bank, has accorded special access to small island economies with per capita incomes above the normal IDA eligibility cut-off. This special

[1] The views and interpretations are those of the author and do not necessarily represent the views and policies of the World Bank, its Executive Directors, or the countries they represent.

treatment recognises a set of circumstances—including export concentration, limited domestic markets, limited skill base, isolation, and vulnerability to natural disasters and other shocks—faced by these states. Currently nine small island states qualify for this exception (see World Bank, 2001).

Beyond this special access to resources for a number of small island economies, the World Bank stands ready to make available a wide variety of types of support to small states to help them build resilience. Examples of assistance include annual assessment of country policy and institutional performance, help with country-led donor coordination, trade-related support, disaster management and mitigation, commodity risk analysis and, if feasible, management, HIV/AIDS-related support, help on anti-money laundering, and tax-related support.

This chapter reviews eligibility for borrowing from the World Bank, through the International Bank for Reconstruction and Development (IBRD) at market terms, and through the International Development Association (IDA) at concessional terms. It summarises the coverage of and rationale for the Small Island States exception to IDA eligibility rules. The World Bank welcomes the efforts of small states to increase resilience to risks and this chapter highlights several areas of Bank support for small states that can help these states build their resilience.

## 2. Eligibility for Borrowing

Decisions on eligibility for borrowing from the World Bank (IBRD and IDA) are based on per capita income, social indicators, creditworthiness, and economic and social policy performance. Both IDA and IBRD graduation programs are flexible and decisions are reversible. For example, flexibility allows the avoidance of automatic graduation in cases when a country reaches the IBRD threshold of per capita income but has no access to international capital markets. It also allows the Bank to accommodate situations in which a country becomes non-creditworthy as a result of a shock such as a natural disaster or adverse external events. World Bank policies thus ensure that no countries, including small states, are graduated prematurely.

### *IDA Eligibility*

Eligibility for borrowing from IDA is of particular interest to small developing countries because IDA provides zero-interest, long-term loans and grants. IDA-eligible countries are the world's poorest countries and are home to 2.5 billion people, comprising half of the total population of the developing countries. Eighty-one countries are currently eligible to borrow from IDA. An estimated 1.1 billion people in these countries survive on incomes of less than $1 a day. Nineteen of the IDA-eligible countries have a population of less than 1.5 million people; the total population of these 19 countries is 8.5 million people. In fiscal year 2004 (ending on June 30, 2004), the operational cut-off for IDA eligibility was gross national income (GNI) per capita of $865. The so-called historical ceiling for IDA eligibility is $1,415. Countries that are not creditworthy for IBRD borrowing and have per capita incomes between the operational and historical ceilings may become eligible for IDA resources on an exceptional basis.

*Small Island States Exception*

Since 1985 IDA has accorded special treatment to small island economies which have per capita incomes above the IDA eligibility cut-off but have no or very limited creditworthiness, which limits or precludes access to IBRD borrowing. This special treatment was retained in subsequent agreements on IDA replenishment, including the current one, which covers the three-year IDA13 period ending on June 30, 2005. Eligibility rules for IDA14 will be considered and decided by IDA donors in 2004.

*Why the Exception*

The decision to grant to small island economies an exception to the GNI per capita eligibility criterion was based on the following considerations. First, it was stated, as a principle, that a member country of the World Bank Group should not be left without access to either IBRD or IDA funding, provided its policy performance is adequate. Second, it was recognised that small island economies with relatively high incomes share many of the problems of low-income developing countries including export concentration, limited size of domestic markets, high cost of infrastructure, limited skill base, and weak institutions.

In addition, it was determined that these economies suffer from certain circumstances particular to their size and geography such as vulnerability to natural disasters, isolation, lack of natural resources, and unavailability of commercial credit. This rationale for exceptional treatment was confirmed by the analysis and conclusions of the Commonwealth Secretariat/World Bank Joint Task Force on Small States (Commonwealth Secretariat, 2000).

*Evolution of Special Access*

Initially, special access to IDA lending was granted to six small island economies[2] through the end of the IDA8 replenishment period (fiscal 1990), with the expectation that these countries would gradually build up enough creditworthiness for limited IBRD borrowing by the end of that period and that their access to IDA resources would be temporary. Since then, one of the six originally eligible small island economies has stopped borrowing from IDA—St Kitts and Nevis graduated in fiscal 1994. When the small island exception was introduced it was also agreed that the Bank would monitor progress on creditworthiness and that other countries seeking the exception would be evaluated on a case-by-case basis. The small island exception was retained without any changes in the IDA13 agreement.[3]

*Small Island States with Special Access*

At present nine small island countries in Africa, Asia, and the Caribbean are eligible for IDA lending, though their per capita incomes have been above the operational cut-off in recent years (see Table 1).

**Table 1**
**IDA Small Island States Exception**

| Small State | GNI Per Capita US$ (2002) | As % of Operational Cut-off |
|---|---|---|
| Cape Verde | 1290 | 149 |
| Dominica | 3180 | 368 |
| Grenada | 3500 | 405 |
| Maldives | 2090 | 242 |
| Samoa | 1420 | 164 |
| St Lucia | 3840 | 444 |
| St Vincent/Grenadines | 2820 | 326 |
| Tonga | 1410 | 163 |
| Vanuatu | 1080 | 125 |
| *Memo items:* | | |
| Fiscal 2004 operational cut-off | 865 | |
| Fiscal 2004 historical cut-off | 1415 | |
| St Kitts/Nevis (graduated 1994) | 6370 | 736 |

Source: World Bank, March 2004

[2] Dominica, Grenada, St Lucia, St Kitts/Nevis, and St Vincent/Grenadines in the Caribbean, and Tonga in the Pacific.
[3] One of the proposals floated during discussions of IDA13 was to harden terms for small island states where per capita income is more than three-times the operational cut-off. This proposal, which would have affected only the better-off island states in the Caribbean, was not reflected in the final IDA13 agreement.

## 3. World Bank Support for Enhancing Resilience

In addition to the small island states exception with regard to funding, the World Bank welcomes efforts by small states to increase their resilience and works with them to support these efforts. This support takes a variety of forms (see World Bank, 2003). Major elements include the following: assessing country policy and institutional performance; country-led donor coordination to reduce the burden of small developing states in dealing with a large number of donors; trade-related support, including highlighting developing country issues to the international community; coordination of technical assistance, and advisory and lending support to countries concerned about the impact of trade liberalisation; disaster management and mitigation; commodity risk issues; impact of HIV/AIDS; anti-money laundering; tax policy and administration; and tax competition issues.

*Country Policy and Institutional Assessment*

Small states are included in the annual Bank-wide process that examines and evaluates the quality of borrowing countries' policy and institutional frameworks in terms of their ability to foster sustainable growth and poverty reduction. Countries with good policies and institutions are likely to use development assistance effectively. Because the policy and institutional performance of small states has been at least as strong as that of larger countries, this helps justify external assistance, including that from the World Bank. In performing the assessments, World Bank country economists and sectoral specialists review indicators of performance in four clusters, namely economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions. The World Bank discusses the detailed results for all criteria in these four clusters with authorities in the borrowing countries. These discussions in small states are opportunities to identify areas for action for improving resilience.[4]

*Donor Coordination*

The World Bank is committed to helping small states reduce the burden on their inherently limited institutional capacity through improved donor coordination. There has been major progress on harmonisation of donor procedures, coming out of a High-Level Forum

[4] For a recent description of the CPIA ratings see Annex 1 of Additions to IDA Resources: Thirteenth Replenishment, September 17, 2002 accessible at http://siteresources.worldbank.org/IDA/Resources/FinaltextIDA13Report.pdf.

in Rome in 2003[5]. Heads of multilateral and bilateral aid agencies committed themselves to identify ways to amend procedures to facilitate harmonisation, to deliver aid in accordance with country priorities and systems, and to help countries build capacity to take the lead in coordinating donor harmonisation (see OECD, 2003). Jamaica is among the initial group of partner countries taking the lead in this initiative. There also has been progress in the Pacific region. The Pacific Islands Forum Secretariat hosted a workshop in October 2003 at which 13 countries, five regional organisations, and 15 donor agencies discussed an approach to harmonisation in island states in the region. Follow-up work is planned.

*Trade*

Progress on trade issues is a critical requirement for enhancing the resilience of small states. In this regard, the Doha round of trade negotiations is of major importance. A successful round will contribute significantly toward efforts by developing countries to meet the Millennium Development Goals. As noted by many speakers at the Malta Workshop on Vulnerability and Resilience of Small States (March 2003), small states are structurally dependent on trade: the average share of exports (including services) in GDP of small states is often more than 100 percent, nearly three times the average share in all developing countries. The World Bank has made a concerted effort to keep issues of importance to developing countries at the centre of the Doha agenda. Among the specific topics on which the World Bank has focused in its recent analytical work and policy advice is trade in services which is of growing importance to many developing countries, including small states (see Mattoo and Sauve, 2003).

In addition, the Bank plays a leading role in the Integrated Framework (IF) for Trade-Related Technical Assistance to least-developed countries, which includes several small states. The IF is a multi-agency, multi-donor programme that assists the least developed countries in coordinating technical assistance on trade matters and expand their participation in the global economy, thereby enhancing their economic growth and poverty reduction strategies. The participating agencies are the IMF, ITC, UNCTAD, UNDP, World Bank, and the WTO. In parallel, the Bank provides similar support to other developing countries. For example, joint analytic work on trade is about to start in partnership with small island states in the Caribbean. More broadly, the Bank stands ready to support all developing countries to meet their concerns with regard to the impact

5 See www1.worldbank.org/harmonization/romehlf.

of trade liberalisation, including helping them assess the nature and magnitude of adjustments, providing policy option advice concerning institutional and policy changes, and providing financing as appropriate. The Bank is examining ways to enhance its lending authority to respond to the specific challenges posed by the Doha Development Agenda. The Bank also aims to mobilise additional donor resources for developing countries in this area.

*Disaster Management and Mitigation*

The World Bank is committed to working with small states to increase their resilience to natural disasters. Bank support to several Caribbean states in the wake of Hurricane Georges, now winding down, is one example. It dealt with both post-disaster and mitigation issues. Similar activities are ongoing in Tonga in the wake of Cyclone Waka, and mitigation activities are included in Bank-supported projects in Samoa and Kiribati, with the mainstreaming of climate change adaptation progressing well in Kiribati. In response to the experience with weather-related vulnerabilities, the catastrophe risk insurance project in the Caribbean can serve as a model for such an intervention; the Bank is working to extend this type of scheme in the Pacific.

*Commodity Risk*

The Bank continues to serve as a secretariat to the International Task Force on Commodity Risk Management in Developing Countries. The Task Force is working with smallholder producers in developing countries to assist in gaining access to international risk management markets to manage better price and weather risks. Though projects have not yet been piloted in small states, lessons learned from ongoing projects in other countries, such as the pilots under way in the coffee sector in Uganda, Tanzania, and Nicaragua, may prove useful. However, there are no simple solutions with regard to commodity price or output risk hedging. Additionally, these schemes may help to reduce the volatility of export earnings but do not normally affect the average level of earnings.

*HIV/AIDS*

The Bank is also committed to helping all member countries, including small states, increase resilience by dealing with vulnerabilities created by HIV/AIDS. Operations in Africa, including in Cape Verde, Djibouti, and The Gambia, and in the Caribbean, including Barbados, Grenada, St Kitts and Nevis, and Trinidad and Tobago have been approved, and the Bank is prepared to broaden this assistance as needed. In the Caribbean region, the Bank is implementing assistance under an Adaptable Program Lending (APL) project of $155 million (approved in 2001), and to complement this assistance, the Bank is now helping prepare a regional project with CARICOM, to put in place the Pan Caribbean Partnership Against HIV/AIDS. This will support critical region-wide actions aimed at broader and more effective prevention and treatment.

*Anti-Money Laundering*

Working with the Financial Action Task Force, the Fund and Bank developed a comprehensive methodology to assess anti-money laundering regimes and programmes to combat financing of terrorism. Starting in October 2002, as part of a yearlong pilot phase, the methodology was used in assessments under the Offshore Financial Centre and the Financial Sector Assessment Programmes. As of July 2003, small state members of the World Bank and the IMF originally included on the Financial Action Task Force's non-cooperative countries and territories list had made significant progress in remedying their weaknesses and had been removed from the list.

*Tax Policy and Administration and Tax Competition*

The Bank is also working with the global community to address tax policy, administration, and tax competition issues. These issues are of special importance in small states, given the size constraints on their tax administration systems. In July 2003, the Bank, IMF Fund, and OECD signed a Memorandum of Understanding to establish an International Tax Dialogue (ITD). Its purpose is to promote an effective international dialogue between governments, giving input of all countries—including small states—into the discussion of tax policy and administration issues. To facilitate exchanges "ITDWEB" (www.itdweb.org) went live in September 2003. In its support for individual small states, the Bank offers assistance with regard to tax policy and administration issues, helping countries improve their resilience.

*Other Members of the Bank Group*

This chapter has highlighted the support available to small states from the IBRD and IDA. It is important to mention the services in support of resilience measures available from two other members of the World Bank Group. The International Finance Corporation is the largest multilateral source of loan and equity financing for private sector projects in the developing world. It promotes sustainable private sector development primarily by financing private sector projects, helping private companies in the developing world mobilise financing in international financial markets, and providing advice and technical assistance to businesses and governments.

The Multilateral Investment Guarantee Agency (MIGA) provides support that can be of special interest to small states, many of which see problems in attracting the right amount and type of foreign direct investment. MIGA is the member of the World Bank Group designed to promote foreign direct investment into developing economies. MIGA fulfils this mandate and contributes to development by offering political risk insurance (guarantees) to investors and lenders, and by helping developing countries attract and retain private investment.

## 4. Conclusion

In conclusion, the World Bank sees many opportunities to support, along with other development partners, the efforts of small states to increase their economic resilience in order to meet the challenges they face—those faced by all developing countries but especially those unique to small states. In particular, we look forward to continuing, and deepening, our partnership with the Commonwealth Secretariat.

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