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Understanding Drivers of Fragility in Asia and the Pacific

Asian Development Bank

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I. INTRODUCTION

1. In 2021, ADB published the *Fragile and Conflict-Affected Situations and Small Island Developing States Approach (FSA)* to outline the operational approach and action plan 2021-2025 on how ADB will achieve its Strategy 2030 objectives to improve ADB's engagement in FCAS and SIDS with the use of differentiated approaches. Differentiated approaches, based on understanding the causes and drivers of fragility and conflict, and the multidimensional aspects of risk and resilience factors in the specific FCAS and SIDS contexts, are crucial to more productive ADB operational engagement and DMC outcomes. The objective of this paper is to help ADB understand the drivers of fragility affecting its developing member countries in Asia and the Pacific.

2. FCAS and SIDS have experienced an increase in their populations' fragility and vulnerability because of the COVID-19 pandemic. Rising unemployment (with disproportionate effects on particular social groups such as youth and women), poverty, and food insecurity have exposed the risks that countries face when they have limited capacity and resilience to respond to such exogenous threats. Despite the differentiated contexts, similarities exist in many of the challenges these countries face and also in the required development responses. By assessing the underlying causes and drivers of fragility and conflict, this paper allows comparison and learning across ADB-classified FCAS countries.

3. While the FSA calls for a new FCAS classification methodology that reflects the regional characteristics of fragility and conflict, the 2022 Annual Evaluation Review (AER) also identifies the need to employ a more nuanced understanding of the institutional and socioeconomic fragility and conflict risks for the classification. The classification of FCAS is dynamic, and the causes or critical drivers of fragility, risk, and vulnerability are context-specific, classified under economic, structural and environmental, political and societal, and institutional drivers. The interaction and interdependence of these drivers in specific contexts generate multidimensional and complex risks. This paper serves as a complementary document for the proposed classification methodology to show the granularity of the fragility.

II. DEFINING FRAGILITY

4. ADB committed to using its FCAS and SIDS Approach (FSA)¹ to change its operations to develop differentiated approaches to working in FCAS and SIDS contexts. ADB approved the FSA in May 2021 and it outlines an operational approach and action plan (2021–2025) to achieve its Strategy 2030 objectives by adopting differentiated approaches to build resilience and improve development outcomes in FCAS, SIDS, and subnational pockets of fragility, including regional spillover effects.² The FSA is based on understanding the causes and drivers of fragility and conflict; and, using that understanding, to tailor development approaches to the contexts of FCAS and SIDS. Gender, minority, and social issues relevant to FCAS and SIDS contexts are key factors to be addressed by ADB in its projects and activities. While the FSA has achieved progress, there are continuing challenges with improving development outcomes and ADB's portfolio performance in these contexts. This is due to insufficient identification of

¹ ADB. 2021. *Fragile and Conflict-Affected Situations and Small Island Developing States Approach*. Manila.

² ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila

drivers of fragility, DMC capacity constraints, fragmented use of knowledge and analytical tools, limited delivery capacity; and insufficient flexibility with ADB procedures and practices.

5. The FSA is ADB's approach to address the effect of poor portfolio performance and lower levels of development and SDG achievement in FCAS and SIDS countries. The FSA found the core problem as inadequate differentiation in ADB approaches and support for the specific contexts of FCAS and SIDS DMCs. One of the causes of this is the inadequate knowledge, tools, and limited ADB coordination across themes and sectors to the respond to the specific contexts in these countries. The FSA named a number of sub-causes, including that existing risk assessment tools were not effective in these contexts and there was limited contextual understanding of key stakeholders. ADB needs to be better understand the constraints on FCAS, SIDS, and in subnational pockets of fragility in DMCs may not have either an FCAS or SIDS classification.³ A pocket of fragility is a defined area or region showing evidence of fragility that may not correspond with national boundaries.

6. Fragility is a combination of exposure to risk and insufficient coping capacity of the state, system, or communities to manage, absorb, or mitigate those risks. Fragility has many symptoms and can lead to violence, breakdown of institutions, displacement, humanitarian crises, or other emergencies. It puts the safety, security, and well-being of citizens of a country at risk of being negatively affected by a crisis or violent conflict or the potential to enter one.

7. Resilience is found when the state, system, community, or society demonstrates it can resist crisis, shocks, and setbacks. Resilience can take many forms, including showing an ability to absorb, accommodate, adapt to, transform, and recover from the effects of a hazard in a timely and efficient manner. This can be done through the preservation and restoration of its essential basic structures and functions through risk management.

8. The effects of fragility are multidimensional and the uncertainty in outcomes in such complex and dynamic environments require constant monitoring and adaptation. There is an interplay between the factors that lead to lower levels of development outcomes and SDG achievement. Fragility drivers can be overlapping and impact each other. For example, conflict, climate change, natural disasters, or a combination of them can lead to the forced displacement of communities that can put stress on the environment, government services, and cause tension in host communities. For the people themselves, displacement erodes their human capital indicators of education, health, and social protection, including making women may be more vulnerable to discrimination, trafficking, and violence.

III. DEFINING THE DRIVERS OF FRAGILITY

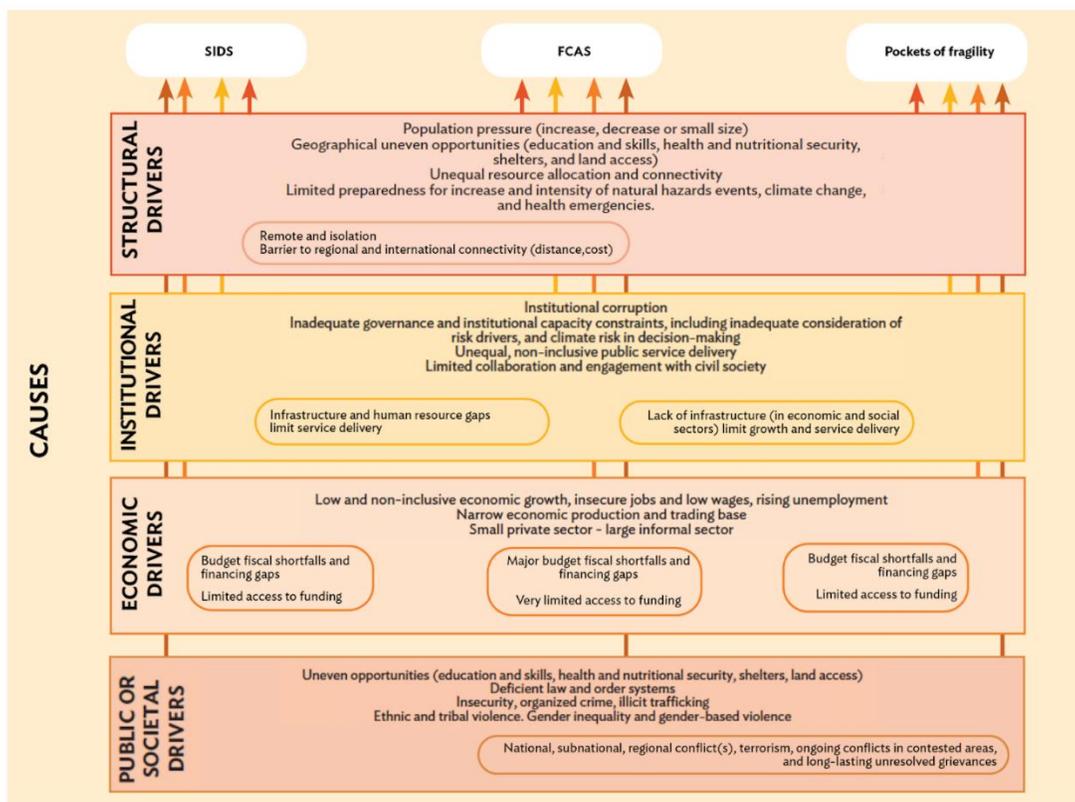
9. **The foundation of the FSA's problem analysis is structured around four broad classifications of drivers of fragility.** These are based on the OECD's classification.⁴ As outlined in Figure 1, the FSA lists these drivers or causes are *structural and environmental, institutional, economic, and political or societal*.⁵ Each can be highly variable and context specific. If adequately addressed, an element that is a driver of fragility can potentially become a source of resilience.

³ See *Strategy 2030*, ADB, Manila, July 2018, p. 13, para. 30.

⁴ See [States of Fragility 2015: Meeting Post-2015 Ambitions, Highlights, Revised Edition](https://www3.compareyourcountry.org/states-of-fragility/overview/0/), March 2015 and <https://www3.compareyourcountry.org/states-of-fragility/overview/0/>

⁵ See Problem Analysis, Appendix 4, ADB FSA 2021, p. 47.

Figure 1: Four Drivers of Fragility



Source: ADB. 2021. [Fragile and Conflict-Affected Situations and Small Island Developing States Approach](#). Manila.

A. Structural and environmental

10. *Structural and environmental drivers are those created by climate, demography, ecology, geography, geology, and location. They include vulnerability to often multiple factors, including agricultural fertility, distance, environmental sustainability, extreme weather, isolation, natural disasters, population, pollution, and access to water.*

11. **Population pressure can be a driver of fragility if it is increasing rapidly, for example, due to high birth rates, and a speed that outstrips the government's ability to provide adequate health and education services.** Growing populations increase demand for land, wood, and water, which when coupled with tenure insecurity or the absence of clear property rights, can lead to the over-exploitation of natural resources.⁶ Inward migration, especially if rapid and large influx of internally displaced people (IDPs), refugees or unregulated migrants can cause fragility by putting pressure of government services, infrastructure, and destabilizing labor markets. Rapid decreases in working age populations could be a driver of fragility. Excessive outward migration of working age people seeking improved livelihoods could

⁶ See, for example, Keijiro Otsuka, [Population Pressure, Land Tenure, and Natural Resource Management](#), ABD Institute Tokyo, March 2001.

lead to labor shortages or a brain drain, but could also be a source of some resilience through the inflow of remittances. The departure and arrival of sizeable groups of people fleeing conflict or climate-induced crisis would be a source of vulnerability to both origin and host communities. Agricultural productivity at the point of origin could fall and social tensions in the host community could rise. Inadequate land, water, and public funds could put the host community under environmental and fiscal stress. In some places, the small and decreasing populations could be the source of fragility, especially in SIDS, depriving communities of leaders, vital skills and tax revenues.

12. The uneven geographic distribution of opportunities could be a driver of fragility, especially in the areas of education and skills, health and nutritional security, shelter, and access to land. Fragility or resilience in education, health, shelter, land, sanitation, and water are interconnected. Inadequate educational opportunities lead to lower levels of human capital development, income earning opportunities, and economic activity. The desire to seek better education opportunities can also drive migration and create a brain drain as people seek learning elsewhere. Inconsistent health outcomes, poor sanitation, nutritional insecurity, and water scarcity simultaneously undermine education outcomes of children and undercut the well-being and economic activity of their parents. Inadequate shelter makes families vulnerable to seasonal elements and extreme weather. Without access to land for agriculture, it is a struggle for many rural areas to earn a decent livelihood that could afford them better access to education, improved healthcare, and decent shelter.

13. Unequal resource allocation and poor connectivity have multiple dimensions, including the distribution of governmental and natural resources. The poor distribution of funding or government resources can mean some regions will benefit more from the state expenditures than others with those areas that are most neglected having the potential to be more fragile. Natural resources such as fertile land, water, or deposits that can be exploited by extractive industries will determine economic opportunities, influence livelihoods, and influence fragility. The connectivity of one country or region to others, particularly areas of greater economic activity, can impact fragility. Connectivity can be through transport links such as air, rail, road, or sea links or through digital connectivity through satellite or undersea cable links to the internet.⁷ Increasing the speed, frequency, or decreasing the cost of all these types of connectivity will decrease isolation, promote economic development, and support the boost of government services.⁸

14. FCAS and SIDS are exposed to innate risks from their own natural environment. Changes in climate are altering the nature of some weather systems making them slower moving and resulting in higher levels of precipitation leading to unprecedented flooding. Small islands or other regions with low lying topography are vulnerable to rising sea levels. In other locations, new threats come extended dry periods, rain shadows created mountains or extreme winds of high intensity. Water scarcity can lead to low agricultural yields and poor health and hygiene. Topography can cause fragility as steep slopes are harder to cultivate and more at risk from erosion. In many FCAS and SIDS, geology can be a factor from poor soils and inarable land to the ever-present danger of earthquakes and volcanoes. These phenomena can cause loss of life, damage to private property and crops, and destruction of vital public infrastructure.

⁷ On internet connectivity see [Connectivity for Development](#), Seminar, ADB, 2 May 2019.

⁸ See, for example, John Garrity and Arndt Husar, [Digital Connectivity and Low Earth Orbit Satellite Constellations: Opportunities for the Asia and the Pacific](#), ADB Sustainable Development Working Paper Series, No. 76, April 2021.

Fragility is caused when a community is less able to prepare, mitigate, or recover from the risks posed by its location or environment.

15. SIDS have unique structural drivers of fragility due to their small size, remoteness, and isolation.⁹ As remote islands, they are significant barrier to regional and international connectivity not only in terms of the distance from their nearest neighbors and regional centers but also from the cost of bridging these gaps through air, sea, or communications links. As the pandemic showed, transport links can be disrupted by factors outside of the control of any one country. The cost of providing transport to remote communities is especially exposed to variations in fuel prices that are determined by global factors that any one individual SIDS has no control. The infrastructure associated with transport links is small scale and vulnerable to disruption from natural hazards such as cyclones, earthquakes, and volcanic eruptions. The same natural phenomena can damage severe communications from undersea cables or satellite uplinks.

B. Institutional Drivers

16. Institutional covers those drivers of fragility influenced by the action of the state that are the result of poor governance, deficient government policies or weak implementation. This includes the government's ability to provide adequate public services to its people that allow them to live healthy, long, and prosperous lives, including protecting them from environmental threats and natural hazards.

17. Institutional corruption covers a large range of illicit and illegal activities, but it typically involves using public power or position for personal advantage.¹⁰ It can drive fragility by diverting resources from public coffers to private hands, undermining the efficacy of government programs and policies. The bulk of evidence indicates that corruption generates far more costs than benefits, leading to resources being lost, squandered, or devoted to suboptimal uses driving fragility rather than promoting resilience.¹¹ High levels of corruption lead to low levels of tax collection, undermining budgetary self-sufficiency. ADB supports anti-corruption efforts in FCAS and SIDS as part of its support for competitive markets and efficient, effective, accountable, and transparent public administration.¹² Weak judiciaries and unaccountable police and security forces co-exist with high levels of corruption. FCAS and SIDS countries and contexts often lack rigorous anti-corruption laws and weak enforcement institutions that undermine the efficacy of governance, reduce citizens confidence in their government, and act as a break on private sector activity, including employment and investment. Over-regulation not only slows down private sector development but can create “gatekeeping” opportunities for corrupt officials, especially in the transport of commercial goods across borders.

18. Inadequate governance and institutional capacity constraints can lead to fragility because of the inadequate consideration of risk drivers, and climate risk in decision-making. Inadequate preparations by governments in the form of analysis, planning, mitigation,

⁹ See *Plan to operationalize the Strategy 2030 differentiated approach to fragile situations in the Pacific*, unpublished brochure, ADB, August 2018.

¹⁰ *Anticorruption: Our Framework Policies and Strategies*, ADB, July 1998, p. 9.

¹¹ [Anticorruption and Integrity: Our Framework Policies and Strategies](#), Second Edition, ADB, October 2010, pp. 33-34.

¹² *Ibid*, p. 20.

and disaster risk reduction exposes vulnerable countries or regions to greater fragility. Low levels of institutional capacity often show up in poor data collection in FCAS and SIDS countries leading to inaccurate, misleading, or tardy statistics. Irregular censuses and national statistics undercut efforts to use data to provide early warning and make monitoring progress on SDGs difficult with external support.

19. **Fragility can be caused by limited preparedness for increase and intensity of natural hazards events, climate change, and health emergencies.** These natural events may cause temporary and prolonged displacement. In some cases, climate-induced retreat is causing communities to make a permanent their relocation. Forced displacement is difficult to manage for FCAS and SIDS countries. It can be a source of tension in host communities that are ill-equipped to absorb new members and provide them with limited resources such as water, shelter, land, public services, and livelihood opportunities. The COVID-19 pandemic showed a lack of preparedness of many countries, the limits of public and human resources, and the precarious connections to neighboring and regional economies. ADB's Revised Disaster and Emergency Assistance Policy (RDEAP) stresses risk management begins with risk reduction. Disaster Risk Management (DRM) is an integral part of the development, and each DMC has a different risk and resilience profile. A resilient response requires timely planning and preparations in terms of creating laws, structures, and reserves that can be used when needed for relief, recovery, and reconstruction.¹³

20. **Unequal or non-inclusive public service delivery can leave some sectors or regions underserved leaving them with worse outcomes in agriculture, education, health, power, or other public infrastructure.** This not only leaves certain populations more vulnerable to internal and external shocks, but also feeds political frustrations and conflict. More resilient systems in FCAS and SIDS are able to address this fragility by funding and managing social safety nets, including programs like cash distribution to lower socio-economic groups, pensions, and disability support schemes. Keeping social protection in targeted to specific groups and in balance with a governments ability to pay for them is an important difference between resilience and fragility. Ending or defunding such programs without carefully transitioning beneficiaries can cause social frustration, tension, and unrest.

21. **Limited collaboration and engagement with civil society** can be evidence of governments that are not listening, unresponsive to community needs and less willing to address deficiencies identified by their own citizens.

22. **In SIDS, their remoteness and isolation can accentuate infrastructure and human resource gaps that limit service delivery.** In pockets of fragility, the lack of infrastructure can limit economic growth and impede service delivery to key social sectors.

C. Economic Drivers

23. *Economic fragility is caused by vulnerabilities stemming from weak economic fundamentals and/or a high exposure to macroeconomic shocks. These risks involve debt sustainability, public finance and fiscal space, labor market fundamentals, macroeconomic characteristics, the soundness of government policies for regulatory stability, and economic*

¹³ See as a reference, [Revised Disaster and Emergency Assistance Policy](#), ADB Policy Paper, September 2021.

inclusivity. They affect various levels of the economy from the government to business and households.

24. Low and non-inclusive economic growth, insecure jobs and low wages, and rising unemployment leave behind significant groups in FCAS and SIDS contexts causing fragility as they struggle to find livelihoods and pay for key services including education and health. Without reliable formal incomes, people struggle to contribute to resilience of public goods by paying for utilities such as electricity and water or contributing to government revenues through taxes. This element of the driver looks not only at the economic data to measure growth, but who benefits from it and how wealth is shared. The quality of jobs, their security, and the skill level determine whether employment is more fragile or resilient.

25. Countries, regions, and contexts with narrow economic production and trading bases are more fragile because exposure to only a small number of commodities, products, or services leaves them vulnerable to external shocks. If the range of locally produced goods is narrow, an economy can be fragile due to its dependency on imports and foreign currency fluctuations. ADB supports economic diversification projects across its portfolio as shifting an economy away from a single income source towards multiple sources from a growing range of sectors and markets can make it more resilient. In the context of climate change adaptation, UN Climate Change says it takes on a new relevance as a strategy to diversify away from vulnerable products, markets, and jobs toward income sources that are low-emission and more climate resilient.¹⁴ A focus on one agricultural commodity exposes the economy to shocks from extreme weather, seasonal variation, plant disease, or falls in global commodity prices. Similarly, dependency on a single extractive industry accentuates the risk posed by fluctuations in global markets driven by demand and supply factors outside the control of any one country. A narrow focus on services such as tourism, such as in many SIDS, exposes a country to setbacks when there are disruptions in international travel, such as during the pandemic, after a natural disaster, or at times of high fuel prices.

26. Fragility can be driven by a small private sector and large informal sector. ADB has long recognized that a dynamic private sector is crucial to long-term economic growth and promoting resilience through sustained poverty reduction.¹⁵ A dependency on government-supported employment places a burden on the budget and restrict public expenditures. Limited access to private banks or capital markets holds back private sector development. A small private sector does not create jobs, is unable to attract investment, and does not contribute tax revenues. The informal sector generates less economic benefits for the wider community as these jobs pay lower wages to workers, are less secure, offer few benefits, and result in little or no taxes to government.

27. Budget fiscal shortfalls and financing gaps are a particular challenge for the small economies of SIDS. Small or less developed countries with limited revenue raising capacity through narrow tax bases or restricted access to private capital markets have few fiscal tools at their disposal to implement government programs and plans. Misguided prioritization of mega projects paid for by borrowing when combined with poor public finance management. Inadequate tax policy can lead underfinancing of public expenditures. The accumulation of unsustainable levels of debt can require refinancing and international bailouts.

¹⁴ <https://unfccc.int/topics/resilience/resources/economic-diversification>

¹⁵ See Private Sector Development Strategy, ADB, March 2000.

28. **FCAS and SIDS have limited access to funding as with narrow production and trading bases, SIDS have fewer opportunities to raise revenues through royalties, charges, and taxes.** Smaller economies also do not have the same options to borrow funds that larger countries do. FCAS and SIDS countries have a higher-level of State-owned Enterprises (SOEs) that are often inefficient due to poor business practices, political interference, and limited re-investment of earnings. These fragilities are accentuated in pockets of fragility as authorities at the subnational level does not have the same abilities of national governments to borrow funds, raise taxes, impose charges, or levy excises. This constrains their response to the challenges of localized fragility that national level institutions of government may not be acknowledged or prioritize.

D. Political or Societal Drivers

29. *Political drivers of fragility are those factors resulting from political processes, inclusivity, and the relationship between the state and all its citizens. This includes the provision of safety and security from external and internal threats and the protection from crime and violence. Societal drivers of fragility are those that undermine social cohesion and relations between different groups, including women and men, at the regional, national, or subnational level.*

30. **Political or societal factors can drive fragility by leading to deliberate or unintentional differentiated implementation of policies or the neglect of certain sectors that create uneven opportunities across an FCAS, SIDS, or subnational pocket of fragility.** Denying regions or communities' equal resources can undermine their welfare and livelihoods by not giving them the opportunity to acquire education and skills, benefit from good health and nutritional security, live protected by adequate shelter, or secure adequate and access for agricultural, commercial, or residential purposes. Unequal distribution of public goods and livelihood opportunities can be a factor driving rural to urban migration and internal displacement. Some of these inequalities are deeply entrenched in cultural hierarchies, often with their origins in colonialism.

31. **Deficient law and order systems can manifest in a few ways.** Inadequate policing can add to fragility by creating insecurity. A lack of legal certainty, corruption, or the inability to enforce contracts adds to the cost of business and discourages investment. The manipulation of law and order institutions to maintain political power is a destabilizing and fragility inducing.

32. **Where the state fails to provide reliable law and order services, insecurity, organized crime, and illicit trafficking flourish, particularly in border regions where differentials between legal regimes, taxes, and tariffs create the incentives for smuggling, informal, and unregulated trade.** If the profits are significant, then organized crime is inevitable, which reinforces a negative cycle of undermining police, judicial, and customs and excise officers through institutionalized bribery and corruption. The trafficking of drugs, guns, and people are often done through the same networks with leakages of weapons and narcotics an inevitable consequence of this illicit trade. The increased intensity of each illegal activity adds to the fragility as control or demarcation disputes around illicit trade is a major driver of violence.

33. **Promoting and improving the status of women need to be pursued for reasons of equity and social justice and because it makes economic sense and is good development practice.**¹⁶ Gender inequality in the form of low levels of education and training,

¹⁶ See Gender and Development, Our Framework Policies and Strategies, Asian Development Bank, June 2003.

poor health and nutritional status, and limited access to resources not only depress women's quality of life, but also increases fragility by limiting productivity and hindering economic efficiency and growth. Public policies and investments that promote the development of women have economic payoffs in terms of higher economic growth rates; improved productivity; reduced health and welfare costs; low fertility, and infant and maternal morbidity and mortality rates; and increased life expectancy. Increased investment in women produces a healthier, better educated, and literate workforce, and provides a sound human resource foundation on which to build the economy. Gender-based violence (GBV) impacts the well-being and productivity of women, reduces their capacity to participate fully and equally in country's development. As a hidden obstacle to political, economic, and social development, GBV is a source of fragility.

34. **It has been long established that violence compromises economic growth and creates stagnation in all the indicators of human development.**¹⁷ Ethnic and tribal violence is one part of a wide spectrum of types of conflict that can drive fragility. This violence can long histories, be rooted in colonial injustices, and have multiple dimensions, including religion. Fragility, conflict, and violence are co-located with extreme poverty, acute food insecurity and lower incomes. Violence disrupted livelihoods, impacts energy and commodity market, and put additional stress on places already fragile due to other causes. Forced displacement is a common symptom of violence and when large numbers of people flee for their own safety or in search of security it transfers fragility to adjacent regions through the movement of internally displaced people (IDPs) and refugees to neighboring countries. Pockets of fragility from subnational and regional conflicts can take many forms, including separatism and terrorism.¹⁸ Ongoing conflicts in contested areas can be based on long-lasting unresolved grievances that date to the period of decolonization, including those caused by disputed borders

IV. MEASURING THE DRIVERS OF FRAGILITY

35. This paper uses the country performance assessment (CPA) to measure the drivers of fragility for a variety of reasons. First, the implementation of ADB CPA strictly follows the International Development Association (IDA)'s country policy and institutional assessment (CPIA) questionnaire, which is widely accepted by international financial institutions (IFIs). Second, by definition, fragility is about weak governance and institutional capacity. The CPA measures the country's policy and institutional framework, and its ratings are the core elements in the FCAS classification. Third, the CPA exercise covers all concessional-assistance (CA) eligible DMCs (Group A and Group B countries), as illustrated in Table 1, with an in-depth analysis.

¹⁷ See *Conflict, Security, and Development*, World Development Report 2011, World Bank.

¹⁸ See, for example, Thomas Parks, Nat Coletta, and Ben Oppenheim, *The Contested Corners of Asia: Subnational Conflict and International Development Assistance*, The Asia Foundation, October 2013.

Table 1: Country Classification Decision Matrix

Creditworthiness	Per Capita GNI Cutoff		
	Below Per Capita GNI Cutoff	Above Per Capita GNI Cutoff	
		LDC	Other
Lack of	Concessional assistance-only (Group A)	Concessional assistance-only (Group A)	OCR Blend (Group B)
Limited	OCR Blend (Group B)	OCR Blend (Group B)	OCR Blend (Group B)
Adequate	OCR Blend (Group B)	OCR Blend (Group B)	Regular OCR-only (Group C)

GNI = gross national income, LDC = least developed country, OCR = ordinary capital resources.

Source: ADB. 2022. [Operations Manual Policies and Procedures: Classification and Graduation of Developing Member Countries](#). Manila.

36. World Bank Group (WBG) launched its CPIA in the late 1970s. Its criteria have evolved over time. In 2004, the World Bank set up an external panel to review the CPIA scores and methodology and streamlined the criteria to 16. For each criterion, the World Bank scores a country on a scale of one (low) to six (high). These 16 criteria are grouped into four clusters. Each of the four clusters equals 25 percent of the overall score. Within each cluster, all criteria are weighted equally. The World Bank then computes the overall score by figuring the average score of each cluster, and then by averaging the scores of the 4 clusters, as outlined in Table 2.¹⁹

Table 2: Criteria of County Policy and Institutional Assessment

CPA Criteria	Weight
Cluster A – Economic Management (25%)	
Macroeconomic Management	8.3%
Fiscal Policy	8.3%
Debt Policy	8.3%
Cluster B – Structural Policies (25%)	
Trade	8.3%
Financial Sector	8.3%
Business Regulatory Environment	8.3%
Cluster C – Policies for Social Inclusion (25%)	
Gender Equality	5%
Equality of Public Resource Use	5%
Building Human Resources	5%
Social Protection and Labor	5%
Policies and Institutions for Environmental Sustainability	5%
Cluster D – Public Sector Management (25%)	
Property Rights and Rule-based Governance	5%
Quality of Budgetary and Financial Management	5%
Efficiency of Revenue Mobilization	5%
Quality of Public Administration	5%
Transparency, Accountability and Corruption in the Public Sector	5%

CPA = country performance assessment, CPIA = country policy and institutional assessment.

Source: WBG. 2021. *CPIA Criteria 2021*. Washington, DC.

¹⁹ World Bank. 2021. *CPIA Criteria 2021*. Washington, DC.

37. In 2005, World Bank started to disclose the numerical scores for all CPIA criteria as well as the overall score.²⁰ In the same year, ADB began to publish annual CPA ratings, using IDA's CPIA questionnaire as the basis for the CPA. Since 2016, ADB has conducted the CPA exercises on a biennial cycle rather than annual for all concessional assistance countries to provide greater operational flexibility in the use of allocations.²¹ Likewise, in the same year, the World Bank began to carry out full CPIA assessments only once every three years, which were supplemented by minor updates in the middle years for IDA countries.²²

38. ADB CPA teams conduct CPAs for all concessional assistance eligible DMCs (Group A and Group B countries). The CPA team consists of the ADB country teams (representatives of the regional departments), the focal point (Strategy, Policy and Partnerships Department [SPD]), the regional coordinators, the technical group and working group (experts from Economic Research and Regional Cooperation Department [ERCD]; Office of Anticorruption and Integrity [OAI]; Portfolio, Procurement, and Financial Management Department [PPFD]; and Sustainable Development and Climate Change Department [SDCC]), and the review panel (chaired by the director general of SPD and comprising the heads of the regional departments, ERCD, OAI, PPFD, and SDCC). The CPA implementation follows these steps: (i) the country teams propose initial ratings which are supported by detailed write-ups, consult with national authorities about the preliminary assessments, and prepare an aide-memoire; (ii) the technical group recommends revisions to the write-ups or ratings to ensure consistency of the CPAs across countries; (iii) technical experts in the country teams again review the revised CPAs and then convey the revised assessments to the CPA working group along with their comments; (iv) the CPA working group submits its country rating recommendations to the review panel, based on the technical group's findings; and (v) the CPA review panel finalizes the country ratings and submits them for ADB Management approval.²³

V. USING THE DRIVERS OF FRAGILITY TO CLASSIFY COUNTRIES AS FCAS- HOW ADB MEASURES FRAGILITY

39. To more effectively support ADB operations in FCAS and SIDS, the FSA identifies the revision of FCAS classification as one of the nine priority changes in business processes and procedures, pointing out the need to explore greater granularity and show the interaction of the drivers of fragility in the classification methodology. Hence, the proposed classification methodology suggests using the average of CPA and CPIA four clusters instead of a whole. That is, the average of economic management (Cluster A), structural policies (Cluster B), policy for social inclusion and equity (Cluster C), and public sector management and institutions (Cluster D). Moving from the aggregate rating to a rating for each cluster will illustrate granular causes of fragility.

40. Economic management and government effectiveness are generally considered the most robust determinants of entry and/or exit in fragile and conflict-affected situations.^{24,25} By using CPA, this paper depicts a more granular picture of the drivers of fragility. To be specific, in terms of economic management, besides weak economic performance, high external debt and

²⁰ World Bank. 2021. *CPIA Criteria 2021*. Washington, D.C.

²¹ ADB. 2016. [Concessional Assistance Policy: Policy Paper](#). Manila.

²² World Bank. 2021. *CPIA Criteria 2021*. Washington, D.C.

²³ ADB. 2008. [Refining the Performance-Based Allocation of Asian Development Fund Resources](#). Manila.

²⁴ IMF. 2021. [Avoid a Fall or Fly Again: Turning Points of State Fragility](#). Washington, D.C.

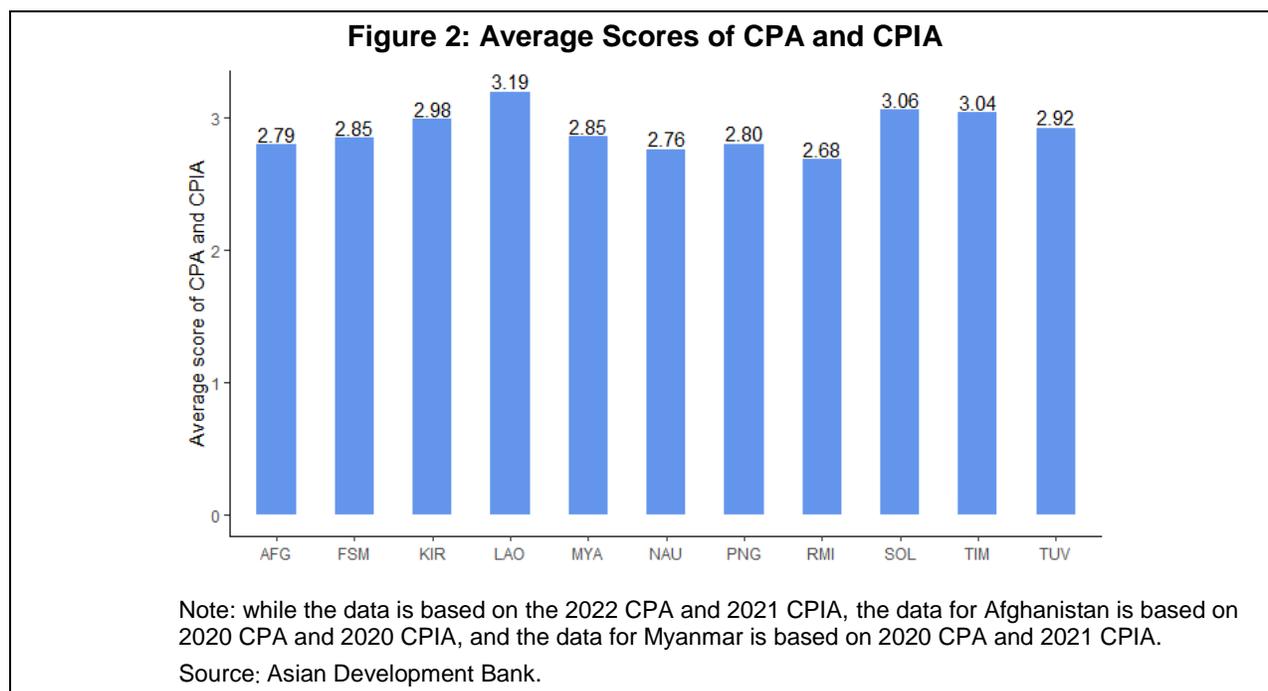
²⁵ ADB. 2022. [Annual Evaluation Review: Fragile and Conflict-Affected Situations and Small Island Developing States](#).

weak fiscal stability also have huge impacts on FCAS countries. Also, limited fiscal buffers make them vulnerable to external shocks. As to governmental effectiveness, FCAS countries tend to have weak institutional capacity in the aspects of quality of public administration, transparency and accountability, the protection of property rights, rule-based governance, efficiency of revenue mobilization, and budgetary and financial management. Further, weak domestic institutional capacity has led to limited implementation and enforcement.

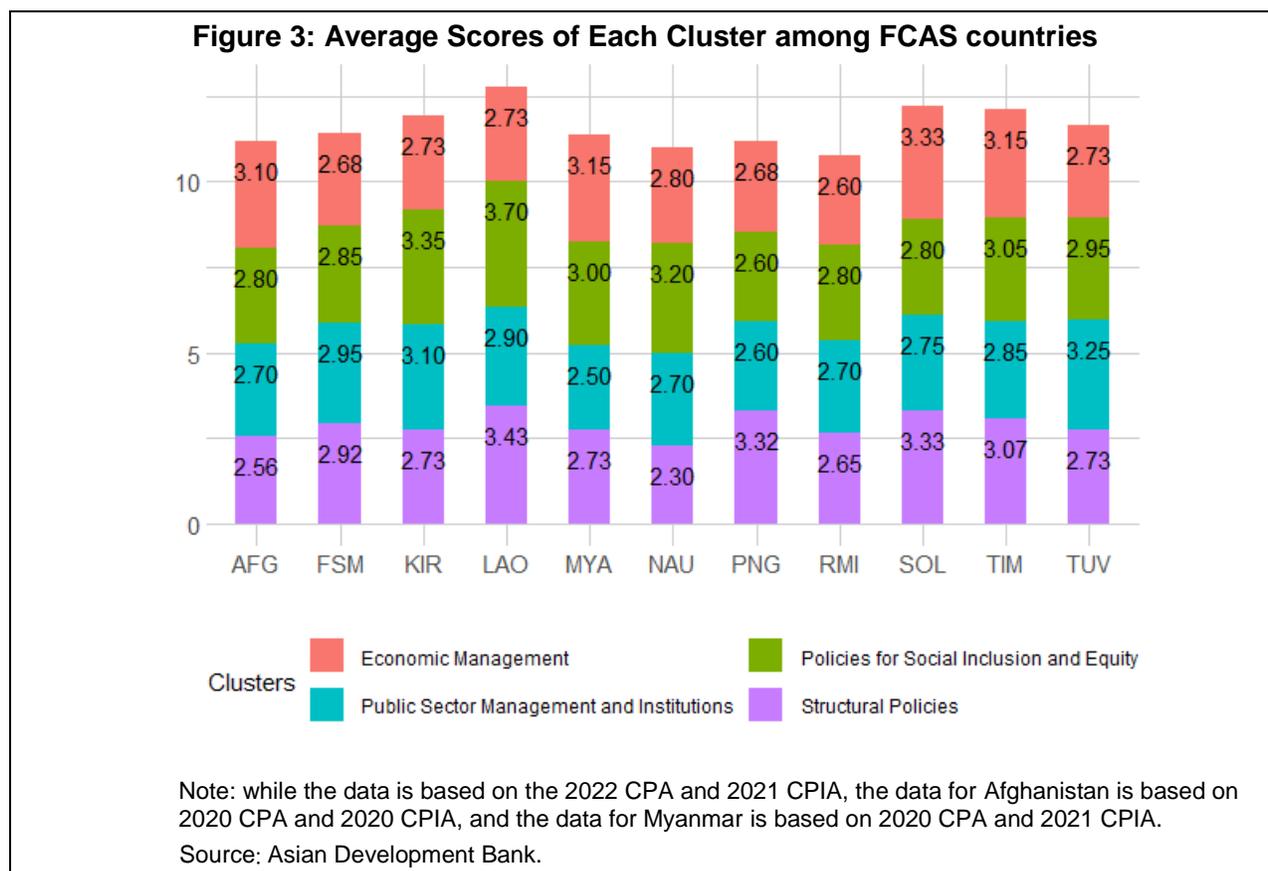
41. In addition to the economy and governance, this paper also emphasizes the importance of addressing structural limitations and enhancing political and social inclusion. Even though these countries have embraced free trade and an open economy, their business regulatory environments need to be improved by minimizing red tape and improving administrative efficiency. The financial sectors remain underdeveloped with limited financial access and small banking system, making foreign investment processing cumbersome and limiting private sector development. Natural hazards and climate change remain a challenge in these countries. Regarding political and social inclusion, gender inequality, lack of social protection framework, weak health and education development, and the failure to prioritize spending of public resources on vulnerable groups are all causes of fragility in FCAS countries to different extents. Besides, conflicts, natural disasters, and their spill-over effects such as forced displacement also affect the region.

VI. WHAT THE SCORES SHOW US ABOUT THE DRIVERS OF FRAGILITY IN ADB'S FCAS-CLASSIFIED COUNTRIES

42. The harmonization of ADB CPA and IDA CPIA ensures the robustness of the assessment from both regional and global perspective. Figure 2 shows the average scores of the current 11 FCAS countries with the latest data, mostly based on the 2022 CPA and 2021 CPIA.



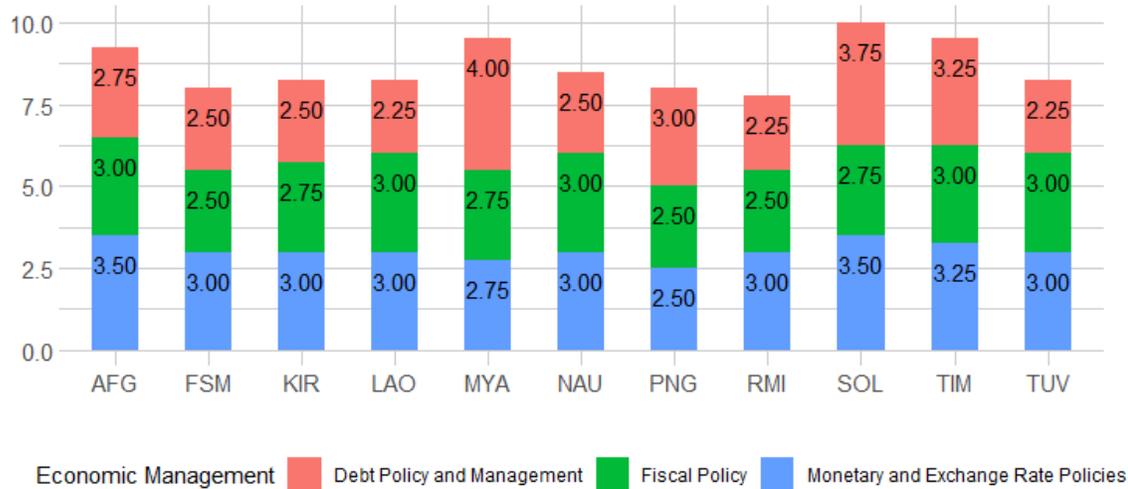
43. Figure 3 illustrates the average scores of CPA and CPIA clusters in the 11 FCAS countries. While economic management and public sector management and institutions are the most robust drivers of fragility in these countries, the impact of each cluster differentiates among countries. For instance, while Lao PDR has relatively high ratings on structural policies and policies for social inclusion and equity, most SIDS have relatively low ratings because many of them are isolated from the market, highly dependent on imported goods, lack of independent monetary policy, or facing complex disaster risks and/or climate change.



44. As outlined in Figure 4, on economic management, most FCAS countries are vulnerable to debt sustainability and fiscal stability. Many of them perform relatively fine in macroeconomic management, while having low scores on debt policy and fiscal policy. FCAS-SIDS are severely indebted because of the impacts of disasters and their high costs of recovery, further exacerbated by constrained fiscal space, limited revenue generation potential, and high costs of public services.²⁶

²⁶ ADB. 2019. [ADF 13 Replenishment Meeting – A Framework for Addressing the Financing Needs of Small Island Developing States](#). Manila.

Figure 4: Average Score on Economic Management

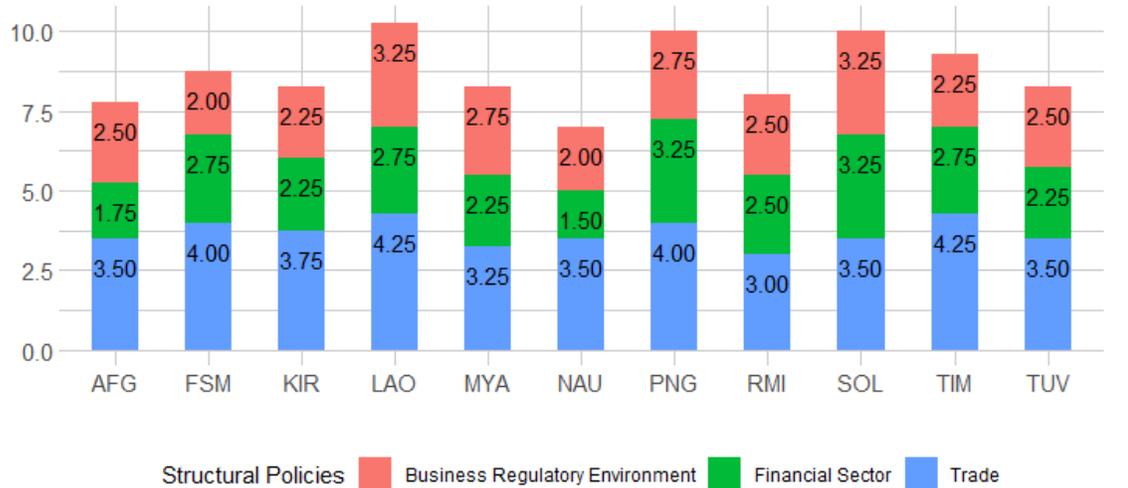


Note: while the data is based on the 2022 CPA and 2021 CPIA, the data for Afghanistan is based on 2020 CPA and 2020 CPIA, and the data for Myanmar is based on 2020 CPA and 2021 CPIA.

Source: Asian Development Bank.

45. As shown in Figure 5, on structural policies, FCAS countries face difficulties in terms of business regulatory environment and financial sector development. While these countries have a relatively good policy framework on trade regime and trade facilitation, their legal and regulatory environment hinders private business in investing and creating jobs. They also have limited financial sector development in terms of financial stability, efficiency and mobilization of financial sector resources, and access to financial services.

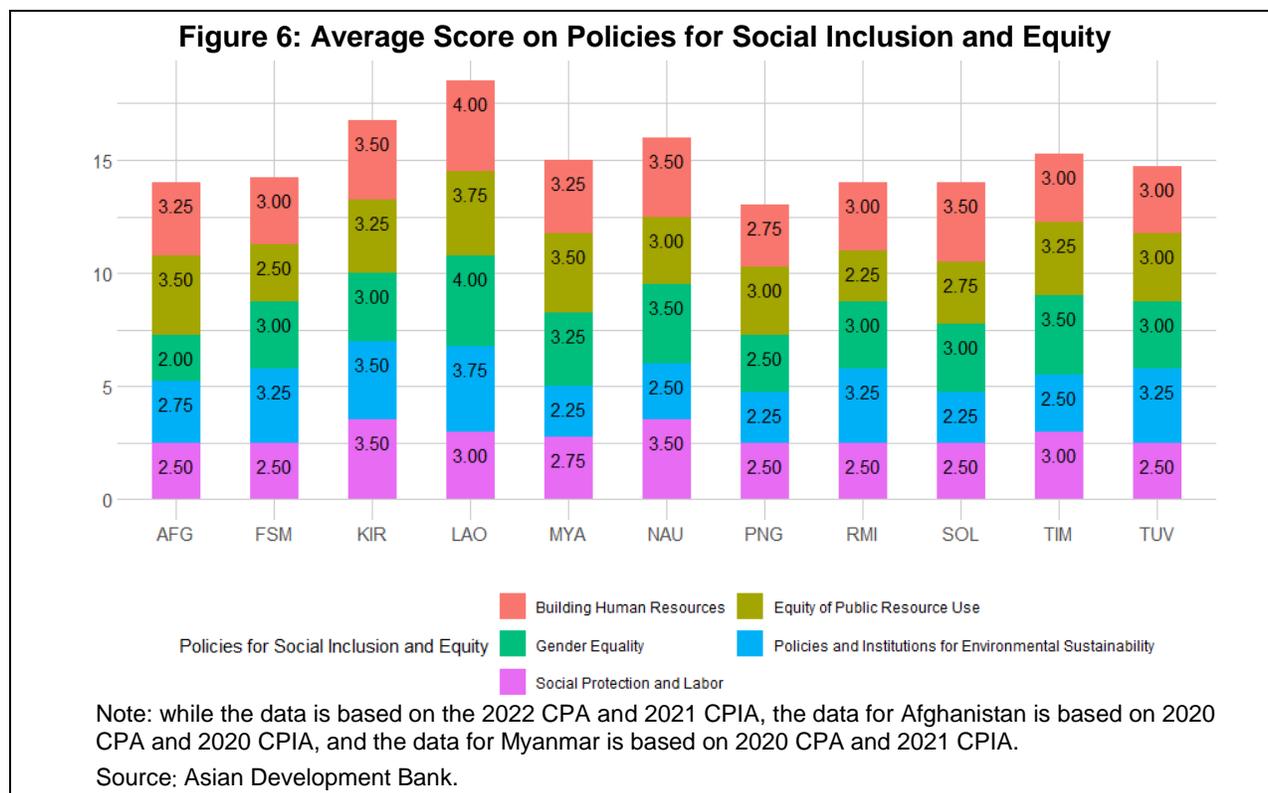
Figure 5: Average Score on Structural Policies



Note: while the data is based on the 2022 CPA and 2021 CPIA, the data for Afghanistan is based on 2020 CPA and 2020 CPIA, and the data for Myanmar is based on 2020 CPA and 2021 CPIA.

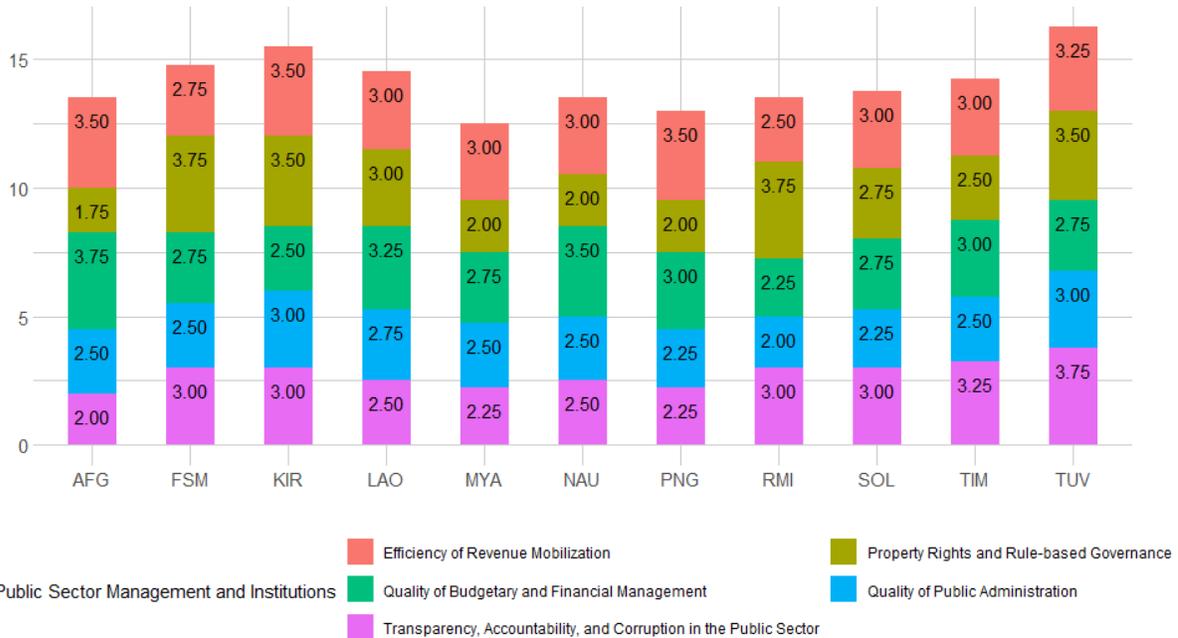
Source: Asian Development Bank.

46. Figure 6 shows that on the policies for social inclusion and equality, some FCAS countries perform fine in strengthening human resources with moderate access to and quality of health and education-related services, while many of them have challenges on environmental policies and institutions, gender equality, lack of equality of public expenditures on the poor and vulnerable groups, and weak social protection and labor policies.



47. Figure 7 indicates that on the public sector management and institutions, transparency, accountability, and the quality of public administration are the drivers of fragility for FCAS countries. Besides the transparency and the functioning of the core public administration, FCAS countries also face the challenges from property rights and rule-based governance, efficiency of revenue mobilization, and the quality of budgetary and financial management.

Figure 7: Average Score on Public Sector Management and Institutions



Note: while the data is based on the 2022 CPA and 2021 CPIA, the data for Afghanistan is based on 2020 CPA and 2020 CPIA, and the data for Myanmar is based on 2020 CPA and 2021 CPIA.

Source: Asian Development Bank.

VII. FRAGILITY INDEXES

48. Several fragility-, vulnerability-, and conflict-related indices or analytical frameworks are publicly available and regularly updated by international organizations, as outlined in Table 3. Nonetheless, the major constraint of using them as an analytic tool is the limited country coverage. Most indices do not fully cover countries in FCAS. These countries do not have the capacity to generate national statistics and data. Thus, international organizations face a number of challenges in collecting consistent and quality data. The second constraint of these indices is that the worldwide methodology may not sufficiently represent the fragility in ADB DMCs, especially for SIDS. They are isolated from markets, have very small economies, and limited institutional capacity to sustain public services. Further supplying public services is costly given the widely scattered geographic spread of the small islands. Given the two limitations mentioned above, pure quantitative analysis may not be practical in identifying drivers of fragility in the region.

Table 3: Relevant Fragility Indices

Type	Measurement	Organization	Characteristic
Fragility	Country Indicators for Foreign Policy (CIFP)	Carleton University (Canada)	- CIFP reflects three dimensions of countries (authority, legitimacy, and capacity). - The indicators include conflict intensity, government effectiveness, political stability, level of democracy, GDP per capita, education, and life expectancy.
	Fragile States Index (FSI)	Fund for Peace (US)	- FSI is updated every year. - FSI consists of four categories of indicators (cohesion indicators, economic indicators, political indicators, and

			social and cross-cutting indicators).
	INFORM Risk Index	European Commission	<ul style="list-style-type: none"> - INFORM Risk Index is updated every year. - INFORM Risk Index consists of three dimensions: hazard and exposure to natural disasters and conflicts, socio-economic vulnerability and vulnerable groups, and lack of institutional and infrastructure-related coping capacity.
	Multidimensional Vulnerability Index (MVI)	United Nations	<ul style="list-style-type: none"> - MVI is still under development. - MVI consists of five dimensions: economic vulnerability, environmental vulnerability, social vulnerability, structural resilience, and non-structural policy resilience.
	State Fragility Index (SFI)	Center for Systemic Peace (US)	<ul style="list-style-type: none"> - SFI is updated every three years. - SFI consists of eight indicators such as state effectiveness and legitimacy in the areas of security, politics, economy, and social welfare.
	Universal Vulnerability Index (UVI)	Commonwealth Secretariat	<ul style="list-style-type: none"> - UVI was launched in 2021. - UVI is composed of five dimensions: economic vulnerability, physical vulnerability, socio-political vulnerability, structural resilience, and non-structural resilience.
Conflict	Armed Conflict Location and Event Dataset (ACLED)	University of Sussex and Trinity College Dublin	<ul style="list-style-type: none"> - ACLED is updated monthly. - ACLED has six event types and 25 sub-event types. - All data are date-specific and geo-referenced to the town level.
	Global Conflict Risk Index (GCRI)	European Commission's Joint Research Centre (EC JRC)	<ul style="list-style-type: none"> - GCRI based on quantitative indicators from open sources with 24 indicators across 5 dimensions: political, security, social, economy, and geography and environment.
	Global Peace Index (GPI)	Institute for Economics and Peace (Australia)	<ul style="list-style-type: none"> - GPI is updated every year. - GPI is composed of 23 qualitative and quantitative indicators, including internal peace and external peace indicators. Each indicator may have a different measurement period determined by the data availability
	Security Level Area rating	United Nations Department of Safety & Security (UNDSS)	<ul style="list-style-type: none"> - Security Level Area rating is updated any time there is a significant change in the security environment. - Security Level Area rating consists of five categories: armed conflict, terrorism, crime, civil unrest, and hazards.
	Uppsala Conflict Data Program (UCDP)	Uppsala Universitet	<ul style="list-style-type: none"> - UCDP is updated every year. - UCDP is composed of three types of organized violence: state-based armed conflict, non-state conflict, and one-sided violence.
Displacement	Internal Displacement Index (IDI)	Internal Displacement Monitoring Centre (IDMC)	<ul style="list-style-type: none"> - IDI is updated every year. - IDI is composed of three dimensions: impacts, context, and policies and capacities.
Economic and environmental aspect	Average Annual Displacement (AAD)	Internal Displacement Monitoring Centre (IDMC)	<ul style="list-style-type: none"> - AAD measures the magnitude of future displacement by hazard types, such as cyclonic wind, earthquake, floods, storm-surge, and Tsunami, that a country is likely to experience.
	Economic and Environmental Vulnerability	United Nations Committee for Development	<ul style="list-style-type: none"> - EVI is updated every three years. - EVI is composed of two sub-indices (economic vulnerability index and environmental vulnerability index)

	Index (EVI)	Policy (UNCDP)	with eight variables.
	Global Climate Risk Index (CRI)	Germanwatch (Germany)	- CRI is updated every year. - CRI scores are calculated based on the number of deaths and the sum of losses caused by extreme weather events.
	World Risk Index	Bündnis Entwicklung Hilft and Ruhr University Bochum (Germany)	- WRI is updated every year. - WRI is composed of 27 indicators covering a wide range of developmental issues (poverty, infrastructure, health, education, gender, ecosystem, corruption, etc.).
	Multidimensional Fragility Framework	Organisation for Economic Co-operation and Development (OECD)	- OECD fragility framework is updated every two years. - OECD fragility framework consists of five dimensions: political, environment, economic, social, and security. Each dimension is composed of 8-13 indicators on risks and coping capacity.
Human capital aspect	Human Assets Index (HAI)	United Nations Committee for Development Policy (UNCDP)	- HAI is updated every three years. - HAI is composed of two sub-indices (health index and education index) with six variables.
	Human Development Index (HDI)	United Nations Development Programme (UNDP)	- HDI is updated every year. - HDI reflects life expectancy, years of schooling, and GNI per capita.
	Human Capital Index (HCI)	World Bank	- HCI was created in 2018 and updated in 2020. - HCI is composed of three components: survival, education, and health.
	Multidimensional Poverty Index (MPI)	UNDP and Oxford Poverty and Human Development Initiative (OPHI)	- MPI is updated every year. - MPI reflects health, education, and standard of living with ten variables.

Source: based on ADB. 2020. [ADF 13 Replenishment Meeting – Update on ADF 13 Resource Allocation Framework](#). Manila.

VIII. COUNTRIES OVERVIEWS

A. Afghanistan

1. Economic Drivers

1. **The political events of August 15, 2021, triggered a complex economic crisis, including the cessation of aid driving a sharp fiscal contraction, leading to collapsing demand and disruption to basic services.**²⁷ The combination of declining incomes and increasing prices has driven a severe deterioration in household living standards. According to World Bank's Afghanistan Welfare Monitoring Survey (AWMS) conducted in 2021, 70% of Afghan households had insufficient income to meet basic food and non-food needs. Large inflows of in-kind humanitarian supplies and USD cash through humanitarian channels have

²⁷ WBG. 2022. [Afghanistan Development Update: Towards Economic Stabilization and Recovery](#).

supported some economic stabilization.²⁸ However, drastic shift in government policy and lack of foreign investment, limited aid, and economic collapse have made falling into poverty much more of a possibility in Afghanistan.

2. **Afghanistan is classified as a high-risk debt distress country.** Afghanistan's public debt is currently low and highly concessional. This low level of public debt is due to previous debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative, additional debt cancellation from the Paris Club creditors, and little borrowing since then. Nevertheless, IMF assessed Afghanistan's risk of debt distress as high because of the shift in the financing mix, from grants to debt. A rapid decline in grant assistance combined with increased debt financing could increase the debt burden ratios (debt service-to-exports) in the long term.²⁹

2. Structural-Environmental Drivers

3. **The country's weak trade performance is mainly related to its underdevelopment, more than three decades of constant conflict and being landlocked.** Distance to be travelled overland and poor road infrastructure are major factors of costly transport. Afghanistan ranked 160/160 (the lowest on the list) economies on the World Bank's Logistics Performance Index (LPI) with a score of 1.95 in 2018. The average score for all economies was 2.87.³⁰ Afghanistan ranked 177 out of 190 economies on the Trading Across Border indicator of the World Bank's Doing Business Report 2020. The country performed poorly in terms of Time to export: Documentary compliance, Time to import: Documentary compliance, and Cost to import: Documentary compliance.³¹ Corruption, red tape, and other bureaucratic processes continue to remain significant risks for trade in goods and services.

4. **Low financial stability, weak financial sector efficiency, depth, and resource mobilization, and limited access to financial services.** According to IMF Country Report No. 21/138, the non-performing loans (NPLs) rose to reach 22% of total loans by end-2020.³² The rising NPLs and narrowing collateral markets and values portend a challenging period ahead. Saving mobilization and intermediation services to the private sector continue to be low. World Bank's 2017 Global Findex Survey shows that only 15% of adults have a bank account and roughly a third of all account owners have an inactive account.³³ The key challenges undermining the financial sector's performance include: (a) internal deficiencies and inefficiencies limiting the sector's ability to finance the economy, (b) weak contract enforcement framework, and deteriorating quality of existing loan portfolio, (c) deteriorating security environment with implications in terms of outreach and cost of credit, (d) weak credit infrastructure, (e) lack of confidence in the sector and low financial literacy and, (f) informality.

²⁸ WBG. 2022. [The World Bank in Afghanistan](#).

²⁹ IMF. 2021. [Islamic Republic of Afghanistan: First Review Under the Under the Extended Credit Facility Arrangement and Request for Modification of Performance Criteria-Press Release; Staff Report; and Statement by the Executive Director for Islamic Republic of Afghanistan](#). Washington, D.C.

³⁰ WBG. 2018. [Connecting to Compete 2018 Trade Logistics in the Global Economy: The Logistics Performance Index and Its Indicators](#). Washington, D.C.

³¹ WBG. 2020. [Doing Business 2020](#). Washington, D.C.

³² IMF. 2021. [IMF Country Reports 21/138 - Islamic Republic of Afghanistan: First Review Under the Extended Credit Facility Arrangement and Request for Modification of Performance Criteria-Press Release; Staff Report; and Statement by the Executive Director for Islamic Republic of Afghanistan](#).

³³ WBG. 2018. [The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution](#). Washington, D.C.

5. **Weak regulations of business operations.** The legal system plays a limited role in adjudicating commercial disputes. The lack of a law on Commercial Agency and unfair trials are major obstacles to the formal arbitration of commercial issues. The shortage of qualified legal practitioners and endemic corruption in the judicial system has made the arbitration process lengthy and costly. Instead, most traders prefer informal mechanisms to resolve their business disputes. According to World Bank's Doing Business 2020 report, Afghanistan ranks 181 on "enforcing contracts" indicators. Enforcing a contract takes 1,642 days and costs 29% of the value of the claim.

6. **Afghanistan is highly vulnerable to the impacts of climate change, and has serious environmental issues such as droughts, flooding, and deforestation.** Due to its geography, sensitivity to changing weather patterns, and an infrastructure unable to cope with global warming, Afghanistan is among the most climate-vulnerable countries in the world.³⁴ Natural hazards have perpetuated acute food shortages, taken lives, destroyed homes and displaced thousands. Over 1,000 people were killed in June 2022 following a deadly Earthquake affecting Barmal, Ziruk, Nika and Gayan in Paktika province, and Spera in Khost province.³⁵ In addition, drought affects more people than any other natural hazard in Afghanistan, costing the country billions in loss every year.³⁶ The severe drought affecting most of the country since early 2021 has crippled crop production and livestock, leading to critical food shortages.³⁷

3. Political-Social Drivers

7. **Low human capital development and deteriorative humanitarian situation.** Afghanistan has ranked 169 out of 189 countries on Human Development Index (HDI) in 2019, with 64.8 years of life expectancy at birth, 10.2 years of expected years of schooling, 3.9 years of mean years of schooling, and 2,229 GNI per capita. The HDI score increased from 0.469 in 2013 to 0.511 in 2019. The UN and NGO partners have delivered aid to over 23 million people as of June 2022. Humanitarian aid efforts, however, are unprecedented in scale with need of aid far outpacing available resources.³⁸ In 2021, the United Nations Development Program (UNDP) estimated that 97% of the population could fall into poverty by the middle of 2022.³⁹ By March 2022, that number had nearly been reached.⁴⁰ However, development efforts directed through traditional government channels run the risk of further supporting oppressive Taliban rule in Afghanistan.

8. **The gender equality remains low.** the Gender Inequality Index (GII), the country has ranked 157 out of 162 countries in 2019, with a value of 0.436 in 2019 – an improvement from 0.445 in 2016.⁴¹ The cultural and local barriers towards women's access to their basic human

³⁴ Chatham House. 2022. [Climate change must become part of the global agenda on Afghanistan.](#)

³⁵ International Rescue Committee. 2022. [Afghanistan earthquake: what we know so far, our response.](#)

³⁶ Aliyar, Q., Zulfiqar, F., Datta, A., Kuwornu, J. K., & Shrestha, S. 2022. [Drought perception and field-level adaptation strategies of farming households in drought-prone areas of Afghanistan.](#) International Journal of Disaster Risk Reduction, 72, 102862.

³⁷ Reliefweb. 2022. [Afghanistan: Drought - 2021-2022.](#)

³⁸ United Nations Assistance Mission in Afghanistan. 2022. [UN HUMANITARIAN COORDINATOR REAFFIRMS COMMITMENT TO MEETING LIFE-SAVING NEEDS AND SUPPORTING VULNERABLE COMMUNITIES ACROSS AFGHANISTAN.](#)

³⁹ UNDP. 2021. [97 percent of Afghans could plunge into poverty by mid 2022, says UNDP.](#)

⁴⁰ UNDP. 2022. [Millions of Afghan lives and livelihoods in danger without support, says UN Development Programme Chief.](#)

⁴¹ UNDP. 2020. [Human Development Report 2020: The Next Frontier: Human Development and the Anthropocene.](#) New York.

rights remained. Women in Afghanistan have limited access to financial services. Afghan women also face high barriers when accessing financial tools. What's worse, the strict interpretation of Islamic Law adopted by the Taliban heightens the risk of political violence targeting women and girls. Many women activists have been targeted specifically for their participation in the demonstrations in support of women's rights.⁴² Taliban's return to power has coincided with the systemic oppression of women and girls. Most girls' secondary schools have generally been closed since March 2021.⁴³ Women's movements have been restricted, dress is mandated, and types of employment which women enjoyed have been limited to a select few occupations.⁴⁴

9. The health system remains dangerously unprepared to handle any potential epidemic and pandemic threat, and the financing is largely donor driven. Afghanistan has ranked 145 out of 195 countries on the Global Health Security Index (GHS Index) in 2021, with a value of 28.8 compared to the global average of 38.9 out of 100.⁴⁵ This shows that the country's health system is least prepared for meeting future outbreaks such as COVID-19. According to the Afghanistan National Health Accounts (NHA) 2019, among the Current Health Expenditure (CHE), 77.0% comes from household out-of-pocket expenditure, 19.6% comes from donors, and only 3.4% comes from the central government.⁴⁶ Health care priorities are still largely donor-driven and there is limited financial protection. The United Nations Inter-agency Group for Child Mortality estimation and the Global Database on Child Growth and Malnutrition indicate that Afghanistan has a higher under-five mortality rate, maternal mortality ratio, and prevalence of stunting compared to the average of the 11 countries in FCAS.⁴⁷

10. Major disruption of social protection system and limited social safety nets to address the acute food insecurity, drought, conflict, insecurity and compounded economic shocks. With the change in authorities taking control of Afghanistan, most on-budget social assistance in the form of cash was severely reduced or canceled. Continuation of off-budget distribution of cash and vouchers has been facing challenges, such as lack of liquidity within the formal financial sector that is impacting operations of banks, mobile money operators, and remittance exchange companies. According to a phone survey done by the World Bank, access to social assistance is limited as only 8% households reported receiving some form of assistance.⁴⁸

11. The reforms on the public pension program remain suspended. After the fall of the government on August 15, 2021, the only social insurance instruments in place were two public sector pension schemes for civil servants and armed services officers offering old age, survivor, and disability pensions and work-injury benefits. However, due to the fiscal shock aftermath of the political crisis, these public pension programs remain suspended.⁴⁹

12. Increasing displacement, conflict, and violence. After the withdrawal of US troops from Afghanistan, the Taliban, a longstanding Islamic fundamentalist group, swiftly entered and

⁴² ACLED & APW. 2022. [Tracking Disorder During Taliban Rule in Afghanistan.](#)

⁴³ Amnesty International. 2022. [Afghanistan: Death in slow motion: Women and girls under Taliban rule.](#)

⁴⁴ Special Inspector General for Afghanistan Reconstruction. 2022. [Quarterly Report to the United States Congress.](#)

⁴⁵ Jessica A. Bell and Jennifer B. Nuzzo. 2021. [Global Health Security Index: Advancing Collective Action and Accountability Amid Global Crisis.](#)

⁴⁶ Ministry of Public Health of Islamic Emirate of Afghanistan. 2021. [Afghanistan National Health Accounts, 2019.](#) Kabul.

⁴⁷ United Nations Committee for Development Policy Secretariat. [Triennial review dataset 2000 - 2021.](#)

⁴⁸ WBG. 2022. [Afghanistan Social Protection Monitoring Bulletin.](#) Washington, D.C.

⁴⁹ WBG. 2022. [Afghanistan Social Protection Monitoring Bulletin.](#) Washington, D.C.

recaptured Kabul, the nation's capital in August 2021. The fighting of the Taliban triggered 72% of the 723 thousand IDPs reported in 2021, the highest figure ever recorded for the country, putting a strain on already overburdened public services. In addition, the country is suffering its second drought in four years. The total number of IDPs in 2021 due to conflict and violence is 4.3 million, while 1.4 million are driven by disasters.⁵⁰ The number of refugees and asylum-seekers from Afghanistan in neighboring countries as of 31 December 2021 is 2.3 million, increasing the pressure on host countries such as the Islamic Republic of Iran, Pakistan, Tajikistan, and Uzbekistan.⁵¹ The needs of IDPs and host communities are likely to continue to grow, as will the likelihood of further internal and cross-border displacement. On the other hand, according to ACLED, since the fall of Kabul, civilians have continued to be targeted by the Taliban (53%) and the Islamic State (6%), as well as by unidentified armed groups (39%). Civilians have been targeted for their profession, ethnicity, and religion, most notably, former government officials and security forces. Kabul, Nangarhar, and Kandahar have experienced the highest levels of reported violence targeting civilians.⁵²

13. **Personal and political freedoms are restricted.** According to the Freedom House “Freedom in the World 2022”, Afghanistan is classified as a “not free” country with a total score of 10 out of 100, consisting of the score of political rights of 1 out of 40, and the score of civil liberties of 9 out of 60. The Taliban reconstituted a Ministry of Vice and Virtue (MVV), which had enforced their interpretation of Sharia (Islamic law) under their previous regime. The new regime has also violently suppressed demonstrations, restricted private discussion perceived as critical of its rule, limited educational opportunities for female students, and targeted supporters of the former government.⁵³

4. Institutional Drivers

14. **The legal and judicial system remained weak and corrupt, aligned with weak legal framework for secure property and contract rights.** According to the World Justice Project “Rule of Law Index 2021”, Afghanistan ranked 134 out of 139 countries and jurisdictions in the rule of law based on the experiences and perceptions of the general public and in-country legal practitioners and experts worldwide. The low overall score is mainly caused by the corruption in the judicial and legislative branches, the lack of publicized laws and government data, the severe civil conflict which endangers the right to life and security, and the partiality of criminal system.⁵⁴ Due to the absence of a comprehensive system of property rights protection, private ownership of land in Afghanistan is still a complex legal issue.

15. **The quality of public administration remained low due to the decreasing political stability, government effectiveness, regulatory quality, rule of law, and the control of corruption.** Afghanistan has been one of the countries with the lowest percentile rankings of the Worldwide Governance Indicators (WGI). According to WGI 2021, Afghanistan's ranking decreased in political stability moving from a score of -2.57 and a percentile score of 0.95 in 2015 to a score of -2.73 and a percentile of 0.47 in 2020. The government effectiveness score decreased from -1.32 and a percentile score of 8.17 in 2015 to a score of -1.52 and a percentile score of 5.29 in 2020. The regulatory quality score decreased from -1.00 and a percentile score of 14.42 in 2015 to a score of -1.38 and a percentile score of 8.17 in 2020. The rule of law score

⁵⁰ IDMC. 2022. [Global Report on Internal Displacement 2022](#). Geneva.

⁵¹ UNHCR. 2022. [Afghanistan Situation Update - 1 June 2022](#).

⁵² ACLED & APW. 2022. [Tracking Disorder During Taliban Rule in Afghanistan](#).

⁵³ Freedom House. 2022. [Freedom in the World – Afghanistan Country Report](#).

⁵⁴ World Justice Project (WJP). 2021. [Rule of Law Index 2021](#). Washington, D.C.

decreased from -1.50 and a percentile score of 3.37 in 2015 to a score of -1.81 and a percentile score of 2.40 in 2020. The control of corruption score decreased from -1.34 and a percentile score of 6.25 in 2015 to a score of -1.48 and a percentile score of 5.29 in 2020.⁵⁵

16. Low transparency, accountability, and high corruption in the Public Sector. According to Transparency International's "Corruption Perceptions Index 2021", Afghanistan ranked 174 out of 180 countries with a score of 16 out of 100.⁵⁶ Afghanistan is facing the challenges on the accountability of the executive and other top officials to effective oversight institutions, the access of civil society to timely and reliable information on public affairs and public policies, state capture by narrow vested interests, and the integrity in the management of public resources, including aid and natural resource revenues.

B. Kiribati

1. Economic Drivers

17. Kiribati heavily relies on revenue from its sovereign wealth fund, fishing license fees, foreign aid, and remittances, which leads to volatile economic growth performance. Fiscal outturns in Kiribati are dominated by volatile revenues from tuna fishing. Fishing revenue, the bulk of which comes from fishing license fees, experienced an 18.7% contraction in 2020 and a further decline of 10.1% in 2021. Inflation is expected to accelerate to 5.0% in 2022 consistent with recent trends in international commodity prices and supply issues affecting the prices of imported food, fuel, raw materials, and other commodities.

18. The scarcity of economic and financial data hinders the analysis of the sectors to inform targeted interventions. Economic monitoring continues to be a challenge due to outdated data and limited capacity within the National Statistics Office to produce national accounts in a timely manner. The trade flow data and information is also limited.

19. The Revenue Equalization Reserve Fund (RERF), fishing revenues, and strong cash reserves are key fiscal buffers but are not immune to global market instability and volatility. While the government holds large financial assets, the economy continues to face uncertainties due to reliance on external revenue sources and technical expertise to meet the infrastructure and social development gaps. In 2021 the country posted a fiscal deficit equal to 23.4% of GDP, driven by the government's COVID-19 response, particularly social protection spending for the vulnerable. Monitoring fiscal risks associated with social protection spending will continue to be critical going forward.

20. Despite that Kiribati has relatively low public debt, it remains at high risk of debt distress. In 2019, external debt is estimated at 20.5% of GDP, consisting of concessional loans mainly from ADB and Taipei,China. Although the external debt is currently low, it is unsustainable under the extreme shock scenario. The joint World Bank-IMF Debt Sustainability Analysis in 2019 considers Kiribati with a high risk of external and overall debt distress due to possible reversal of global market conditions, the impact of natural disasters and climate change, and contingent liabilities call for continued fiscal prudence.⁵⁷

⁵⁵ WGB. 2021. [Worldwide Governance Indicators](#). Washington, D.C.

⁵⁶ Transparency International. 2022. [Corruption Perceptions Index 2021](#).

⁵⁷ WBG. 2019. [Kiribati - Joint Bank-Fund Debt Sustainability Analysis: 2018 Update \(English\)](#). Washington, D.C.

2. Structural-Environmental Drivers

21. **Kiribati's geographic isolation, internationally and internally.** The remoteness raises the cost of doing business and public service delivery and has contributed to a large gap in the infrastructure needed for economic and social development. According to World Bank's Doing Business 2020 report, Kiribati's trading across borders score is 62.1 out of 100 (Regional average 71.6), just above Palau (61.0), Vanuatu (59.1), Samoa (57.8) and Solomon Islands (53.4).⁵⁸

22. **Kiribati is highly dependent on imported goods.** The market is small in Kiribati and competition is minimal. While Kiribati is not a member of the World Trade Organization (WTO), the government reformed the tax system in 2014 to replace import duties with VAT and excise taxes, all tariff rates have been reduced to zero. However, Kiribati does not apply anti-dumping or countervailing measures or safeguards. Risk management is labeled as partially implemented in 2021.⁵⁹ A surge in imports may threaten the domestic industry.

23. **The financial sector is limited in size and scope of operations.** Kiribati uses the Australian dollar (AUD) and does not have independent monetary and exchange rate policies. The fiscal policy provides the sole macroeconomic policy lever to preserve external balance and price stability. ANZ Kiribati is the only commercial bank in Kiribati with a joint venture between ANZ and the government, which largely serves the public sector. The Ministry of Finance and Economic Development faces challenges to manage its dual role as a regulator and main client of banking services in Kiribati.

24. **There are challenges in business regulation and access to credit due to the lack of expertise and technologies.** The capacity to monitor and screen the banned companies is limited. Also, there is a need to streamline the business registration system. Starting a business remains slow, costly, and administratively cumbersome. World Bank's Doing Business 2020 report shows that Kiribati's score of ease of starting a business is 78.4 out of 100, lower than the regional average of 83.9.⁶⁰ The procedures to enter and exit is still costly. The legal framework to address anti-competitive conduct exists, but enforcement is not effective. Landowners are major obstacles to private sector development in urban areas. The process to register property is costly and only I-Kiribati⁶¹ are permitted to have private land ownership. Foreigners and corporations cannot buy and sell land.

3. Political-Social Drivers

25. **Despite the overall gender equality has improved, violence against women and gender differences in property and inheritance remain.** When it comes to constraints on freedom of movement, laws affecting women's decisions to work, laws affecting women's pay, and constraints related to marriage, Kiribati gets a perfect score of 76.3 in 2022, higher than the East Asia and the Pacific average of 71.9.⁶² However, in Kiribati, 67.6% of women have reported experience of physical or sexual violence by an intimate partner in their lifetime. The

⁵⁸ WBG. 2020. [Doing Business 2020](#). Washington, D.C.

⁵⁹ UN Global Survey on Digital and Sustainable Trade Facilitation. 2021. [Digital and Sustainable Trade Facilitation: Global Report 2021](#).

⁶⁰ WBG. 2020. [Doing Business 2020](#). Washington, D.C.

⁶¹ The native people of the nation are the I-Kiribati, who are ethnically Micronesians. The I-Kiribati speak an Oceanic language, Gilbertese, but English is also an official language.

⁶² WBG. 2022. [Women, Business and the Law 2022](#). Washington, D.C.

proportion is highest in the region, followed by Papua New Guinea (67.5%), Fiji (64.1%), Solomon Islands (63.5%), and Vanuatu (60.0%).⁶³ Besides, women are disadvantaged compared to men in the ownership and control of the land. According to the Laws of Kiribati revised edition 1998 Chapter 61 Subsidiary legislation paragraph 10 Distribution of an estate where there is no will, if an owner has more than one spouse then the eldest son of the first spouse will be the administrator, or if there is no son by the first spouse but only daughters then the eldest daughter will be the administrator.⁶⁴

26. Majority of the population receive basic health services but some inequalities in access exist. The government is the sole provider of health services in Kiribati and services are free. There is no private health care sector. Health centers and clinics in the outer islands have limited services due to the limited access to electricity, running water, sterilization and infection prevention and control supplies. There are health financing constraints and public finance issues related to the lack of technical expertise and unlinked accounting systems and databases.⁶⁵ Kiribati lags behind most of the Pacific Island countries in terms of health performance indicators, such as high infant mortality rates. Also, the non-communicable diseases like diabetes, cancer and cardiovascular diseases are major issues in the country. The COVID-19 outbreak further stretches the already overwhelmed health system.

27. The civil society participation is weak and their activities are donor driven. There are few NGOs in Kiribati and their participation is minimal since they are donor driven with specific activities. There is a lack of sustainability once the donor funding reaches the end of its operational period. NGOs are struggling financially and lack technical expertise to assist in specialized social areas that the government needs partnership with. The only two NGOs that are active are the Kiribati Family Health Association (KIFHA) and the Kiribati Climate Action Network (KiriCAN).

28. Kiribati is vulnerable to the climate change and natural hazards and the legislation on environmental sustainability is limited. Issues include internal displacement caused by coastal erosion, loss of biodiversity caused by rising temperatures, and saltwater intrusion to ground water caused by sea water rise. The Kiribati government has declared a State of Disaster for the entire country.⁶⁶ PM2.5 air pollution, population exposed to levels exceeding WHO guideline value (% of total) in Kiribati was reported at 100 % in 2017.⁶⁷ The main sources of fresh water, rainwater and shallow unconfined groundwater are vulnerable to contamination from poor sanitation systems and facilities. Solid waste and pollution also affects coastal fisheries which are already under threat from over-fishing, mining, and coastal erosion. The solid wastes are transported to the landfill as there are no recycling facility.

4. Institutional Drivers

29. Legal framework is comprehensive, but obstacles exist in terms of the access to judiciary system. Law and regulations need interpretation by the legal aids to ordinary people as they are all written in English. Understanding the legal rights and access is still limited

⁶³ Henrica A.F.M. Jansen. 2019. [kNOwVAWdata – measuring prevalence of violence against women in asia-pacific](#).

⁶⁴ [Laws of Kiribati – Revised Edition, 1998](#).

⁶⁵ The difficulties are to collect data from outer islands that often send in a plane that can sometimes delay for weeks. The plane is also used for the cash salary delivery to teachers located on the outer islands.

⁶⁶ RNZ. 2022. [Kiribati govt declares state of disaster due to severe drought](#).

⁶⁷ WBG. 2022. [PM2.5 air pollution, population exposed to levels exceeding WHO guideline value \(% of total\) – Kiribati](#).

especially to those living on the outer islands and those have limited knowledge on the legal system. Outer islands usually do not have lawyers or qualified judges.

30. **The stock of arrears is not highlighted in the budget total expenditure, and the actual expenditure deviated from budgeted expenditure by a large amount.** Most of the arrears are accumulated over the years because of missed payments, delayed in claims by the SOEs, lack of reconciliation, poor data from both sides, etc. Since the payments are not made at the end of a budget period, the next year's budget cannot incorporate them, and the new administration cannot expense previous arrears as it will affect its operational budget for that year. The deviations of actual expenditure from budget expenditure also make it difficult to ensure that the budget is implemented in a controlled and predictable way.

31. **Modest human resource management and lack of data collection capacity in the public sector.** Kiribati salaries are among the lowest in the region and they are not competitive to attract skills from outside the country. This affects the morale and productivity of the workforce. Besides, some of the state-owned enterprises' board members are still selected on political affiliation instead of being merit-based. The institutional responsibilities for data collection, analysis, and reporting in the sectors are occasionally weak or unclear as most of the ministries do not have good databases, except the Ministry of Health and the Ministry of Education.

C. Lao PDR

1. Economic Drivers

32. **A rising inflation comes from higher commodities and depreciation of local currency against key trading partners while domestic demand was weak during pandemic.** External factors, including the impact of war in Ukraine, containment measures due to the coronavirus disease, and rising fuel and food prices, coupled with low foreign reserves made average inflation for the first half of 2022 into a historical high at 11.3%. The Bank of the Lao PDR (BOL) allowed the official exchange rate to depreciate more than its official band, causing prices of imported goods to rise, especially petroleum products and construction materials. The kip depreciated by an annual average 7.6% against US dollar in 2021 due to strong demand for foreign exchange for external payments including debt services since a large share of debt is held in foreign currencies. In the parallel market, the rates of depreciation were more volatile which made the gap between the two market widening by 10.8% for dollar as of 30 June 2022. The parallel market Lao kip–US dollar exchange rate premium reflects the foreign exchange demand-supply mismatch and heavy regulatory pressure imposed by the BOL on foreign exchange shops aiming at stabilizing spreads and limiting provision of foreign exchanges to only essential goods.

33. **The medium-term macroeconomic framework is at risk with limited fiscal space due to rising public debt.** The macroeconomic policy framework is in place, but the implementation is less effective with policy inconsistencies. Public debt levels have increased considerably since 2019, which jeopardizes macroeconomic stability.⁶⁸ Limited fiscal space constrained the government's response to the COVID-19 pandemic. Critical health and education expenditures have fallen while debt amortization requirements have grown. Fiscal

⁶⁸ World Bank. 2022. [Lao PDR Economic Monitor Reports - April 2022: Restoring Macroeconomic Stability to Support Recovery](#).

related imbalances have been addressed mostly through temporary measures such as administrative spending cut or cuts in public investment with high long-term returns rather than seeking treat of debt through options such as the G20 debt service suspension and initiative. Policy responses to shocks are often delayed and only marginally effective in absorbing shocks.

34. Lao PDR continues to face a high risk of external debt distress and the debt-to-GDP ratio is expected to remain elevated in the medium term due to slow economic recovery and sharp devaluation of the kip. IMF Debt Sustainability Analysis issued in 2019 assessed the Lao PDR's risks of external and public debt distress as high.⁶⁹ The recent publication of public debt 2021 showed that the public debt-to-GDP climbed from 68.6% in 2019 to 87.9% of GDP in 2021. A sharp increase came from the inclusion of guaranteed loans and domestic debt. However, the external public debt remained at 61.9%. Total public external debt-to-GDP in 2021 was \$10.2 billion (61.9%), of which around 50% was borrowed from PRC. In the absence of debt relief, meeting public debt service obligations will remain very challenging. Coordination between debt management and other macroeconomic policies remains weak. There is no thorough assessment of the financial terms of proposed loans and no annual external borrowing plan is published. Information sharing between MOF and BOL on current and future debt transactions and central government cash flows is rare.

2. Structural-Environmental Drivers

35. The trade regime is relatively free while there are non-tariff measures issued by commerce agencies and ministries. Since 2015, the government has launched many regulations to protect the public, business operators, and consumers, ensuring people's safety, national security, and environmental protection.⁷⁰ The government continuously simplified its tariff structures. The establishment of the Non-Tariff Measures Review Sub-Working Group in 2014 is considered an effective review process mechanism where all relevant nontariff issues are discussed.

36. The banking sector is vulnerable to shocks in the medium term. The banking sector has continued to expand with a moderated growth of credit, albeit the credit growth has been driven by the public sector borrowing to refinance debt. The capacity of BOL to supervise and enforce the implementation of prudential norms is not yet sufficient. Also, there is no interbank money market to adjust long and short cash position. To hedge against kip depreciation, the private borrowers have preferred to hold foreign currency, which caused dollarization to increase from 50.7% in 2020 to 54.4% in 2021. Given the kip devaluation and limited access to foreign exchange, a large share of foreign currency-based loans (more than 50%) can pose risks to the banks.

37. Few barriers remain to entry of businesses while cumbersome and lengthy licensing procedures in some sectors and inconsistent implementation of legislation remain. Provincial Facilitation for Investment and Trade Index report 2019 shows that the average time required to complete the registration process shortened from 27 days in 2017 to 17 days in 2019. However, this is higher than the mandated 10 days for obtaining enterprise registration certificate in accordance with MOIC Decree No.0023 on Decision on Enterprise Registration, dated 9 January 2019. Regulations on ownership and financial disclosure exist but are not always enforced effectively. The procedure of registering property may take longer in

⁶⁹ IMF. 2019. [Lao People's Democratic Republic: 2019 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for Lao PDR.](#)

⁷⁰ Sitthideth, P. 2019. [Non-Tariff Measure: Lao People's Democratic Republic.](#) Jakarta: ERIA.

case of registering newly allocated land and may involve informal charges. As of financial disclosure, only 11 companies are listed in the stock exchange with regular disclosure of their annual financial reports to the public and posted them on their own website.

38. Lao PDR is vulnerable to climate change impact and has moderate institutional capacity on environmental sustainability. Lao PDR is particularly vulnerable to extreme climate events and climate change impacts, particularly floods and droughts, due to its tropical setting, its high dependence on climate-sensitive natural resources, and its low adaptive capacity.⁷¹ Besides, this country faces issues related to air pollution risk due to the rapid increase in the number of vehicles, polluted water in major urban areas where a high volume of untreated wastewater is discharged directly into the environment, and a lack of clear institutional and regulatory framework for solid and hazardous waste management.

3. Political-Social Drivers

39. While women may have equal rights, disparities remain in the realization of those rights and a substantial gender gap remains, particularly in relation to economic participation and paid employment. 63.5% of enterprises had male majority ownership, only 36.5% had female majority ownership. It also noted that women receive 10% lower earnings on average than their male counterparts in similar occupations and locations, and with similar qualifications, in the private sector. It has also been reported that 61% of women work with their families for no pay, compared with 25% of males, which means that women have less time to commit to paid activities. The impact of COVID on businesses find that women are more negatively impacted by COVID-19 as they tend to work in sectors and family businesses hard-hit by the virus and their unpaid household work burden increased, leaving less time for engaging in learning or economic activities.⁷²

40. Government expenditure on health is low and the quality of health services needs improvement. Due to deteriorating performance on revenue collections, the government's expenditure share of GDP is low and the GDP share of spending on health is less than 3%, which is low when compared to regional peers. The share of the external funding and out-of-pocket payments remain high. In 2019 the share of domestic government expenditures of total health expenditures was 36.4%, external funding (donors and non-government organizations) was 22.5%, and out-of-pocket payments remain high at 40%.⁷³ Although public and private health facilities and cover more than 90% of the population, the quality of services needs improvement and inequity in accessing the services exists. Limited funding, and capacity of health staff, weak planning, budgeting, and public financial management resulted in ineffective and inefficient management at central, provincial and district level. The consistency and the quality of the health-related data still need to be improved.

41. There is sustained progress toward SDG 4 on primary school enrollment, but gaps at secondary and tertiary levels persisted and general government expenditure on education remains low. The government has allocated a budget of 15.3% of total national expenditures for education sector in 2021 against the target of 17% indicated in the education law. The reasons are deteriorating performance on revenue collections in 2019–2021. The 2021 Voluntary National Review states that the majority of children are not well-prepared for school and are not adequately learning, which has led to the lack of knowledge and skills for continued

⁷¹ World Bank and Asian Development Bank. 2020. [Climate Risk Country Profile](#).

⁷² USAID. 2021. [Final Report: USAID/Lao PDR COVID-19 Assessment](#).

⁷³ MOH. 2022. [Preliminary Findings of the Lao National Health Accounts Report FY 2019](#). Vientiane.

education in key technical fields including for the construction, furniture, plumbing, electrical, and automotive industries.

42. The coverage of social protection is low. The country spends only 0.7% of GDP on social protection, much less than its peers. The 2021 Voluntary National Review reported that the coverage of social protection system in the country is not adequate. According to the Lao Bureau of Statistic's 2020 economic census, only 1.7% of private enterprises reported that they participate in social security or pension schemes for employees, with fewer women-led enterprises. Only 12% of the population are covered by at least one social protection program, while 100% of civil servants is covered by the social security program. Private social security and health insurance coverage is still limited to about 20% of the total employees in the private sector. At present, only employees and workers who join the social insurance program receive unemployment benefits when they lose jobs. In 2021, more than 51,000 workers who lost jobs because of the COVID-19 pandemic restrictions received unemployed supports.

43. Social assistance is prone to mistargeting outside the target beneficiaries as implementation involves so many stakeholders in different levels. Institutional arrangements are in place, although its operation and management is not efficient due to a shortage of qualified and experienced staff and thin capacity of the Ministry of Labor and Social Welfare (MLSW), causing implementation to be weak. MLSW is in charge of social protection as a whole, while elements of the program are implemented by different ministries including Ministry of Public Health, Ministry of Agriculture and Forestry, Ministry of Natural Resources, and MOES. Therefore, consolidation of the budget is a challenge. Since social safety net programs have been implemented in different ministries and local administrative, coordination is quite weak even though an official mechanism has been established. Further, Lao data monitoring of the social safety net is fragmented. Individual ministries monitor their respective social safety net activities and report to the central government and National Assembly annually.

44. There is no specific social safety program to support the elderly. Pension and old-age savings schemes mostly exist in the formal sector. Old age pension covers only 6.3% of the elderly population,⁷⁴ a large portion of which are former government civil servants and small number of retirees from private companies. The pension is about 60% of the basic salary, which is not adequate for the current high living cost. Fortunately, old age people in Lao culture norms are taken care by their children, rather than rely on formal pension benefits.

45. Moderate human trafficking and gender violence exist. Lao trafficking victims, especially from the southern region of the country, are often migrants seeking opportunities abroad whom traffickers exploit in labor or sex trafficking in destination countries—most often Thailand and China.⁷⁵ Another issue that has received more visibility is violence against women. The 2021 Voluntary National Review reported that women are vulnerable to violence and trafficking. The proportion of ever-partnered women and girls aged 15 years and older who report having been subject to physical and sexual violence by partner/non-partner was 20.2%.

4. Institutional Drivers

46. There are deviations of actual expenditure from budget, and the budget control is deficient. In respond to lower revenues, the government has been managing its spending to

⁷⁴ World Bank. 2022. Social Protection Review. Lao PDR.

⁷⁵ US Department of State. 2021. [2021 Trafficking in Persons Report](#). Washington, D.C.

contain the fiscal deficit. As a result, actual expenditures have tended to be lower than budgeted expenditures. Some rules and procedures may be excessive in budget control, while controls may be deficient in areas of minor importance. Rules are complied with in a significant majority of transactions, but the use of simplified or emergency procedures in unjustified situations is an important concern.

47. Complex laws and administrative regulations provide room for interpretations of the tax rules and procedures. Lao PDR's tax base is broad, although domestic revenue performance has deteriorated since the onset of the COVID-19 pandemic. Tax revenue was estimated at 11.2% of GDP in 2020 and 12.4% of GDP in 2021, both of which are below pre-pandemic levels. Revenue losses from tax exemptions remain moderate, with approximately 60% of estimated losses due to exemptions granted for large infrastructure and resource projects. Tax officials themselves have limited qualifications or certifications in relevant fields for providing technical assistance to businesses in terms of complying with tax regulation. Tax negotiation practices were found to be widespread throughout all provinces, with nearly 70% of enterprises reporting that it was common to negotiate taxes.

48. Processes to support compliance with laws and regulations remain lengthy, judicial outcomes uncertain, and enforcement weak. Protection of property rights improved, while contract enforcement remains lengthy. In 2020, the government published the revised Law on Land. While restriction on the ownership rights of foreigners toward land remains unchanged, the revised law allows immovable properties to be owned and invested in by foreign nationals. Transparency and access to information remains an issue, with much of the data is still not in an integrated database and records may be paper-based. Enforcement of mortgages is complicated by the legal protection given mortgagees against forfeiture of their sole place of residence. Outside urban areas, land rights can be even more complex due to unclear ownership and communal titling. Doing Business 2020 ranks the Lao PDR at 161 in terms of contract enforcement among 190 economies. The indicators on enforcement of judgment, and trial and judgment have deteriorated over time.

49. Quality of public administration remains limited. The Worldwide Governance Indicators, in terms of government effectiveness, showed Lao PDR's percentile rank at 22.6 in 2020 from 25.0 in 2018. In terms of rule of law, its percentile rank was 20.7 in 2020 from 18.6 in 2018. The State Inspection Authority (SIA) investigates use of public funds, including by civil servants, and reported that since 2016 inspectors scrutinized 2,000 out of 5,542 state investment projects and found that 1,119 people, including 127 state officials and 246 business executives, had been involved in the misappropriation of funds.⁷⁶ The SIA reported that since 2016, a total of 3,690 Party members (including 440 women) have been disciplined over incidences of corruption and other forms of misconduct.

50. Transparency, accountability, and corruption in the public sector need improvement. The Lao PDR ranked 128th place out of 180 countries assessed in 2021 on Transparency International's Corruption Perception Index (CPI) 2021, with its score reported at 30 out of 100. The percentile rank of the Lao PDR on "voice and accountability" as per the World Bank's Worldwide Governance Indicators 2020 was 3.4 out of 100, with no improvement over the last 10 years. In general, the media remains controlled by the party through the Ministry of Information and Culture. The public is restricted in freely expressing antigovernment sentiment and related opinions, including through public protests, demonstrations, and online

⁷⁶ Vientiane Times. 2022. [Thousands of Party members disciplined over corruption.](#)

criticism. The Lao PDR ranks 172nd of 180 countries in the 2021 World Press Freedom Index. The check and balance needs to be strengthened. Despite being bureaucratically independent from the government Cabinet, the Lao judiciary is still subject to government and political interference. The Lao PDR does not have an ombudsman or a constitutional court. Although a commercial court system exists, most judges adjudicating commercial disputes have little training in commercial law. There are relatively few lawyers, many judges lack formal training and experience, and laws often remain vague and subject to broad interpretation.

D. Marshall Islands

1. Economic Drivers

51. **RMI remains highly vulnerable to external shock.** The digital currency and other related initiative introduce potentially significant macroeconomic, financial stability, and financial integrity risks. In 2022, the IMF highlights the concerns of the initiatives such as the digital currency SOV as a second legal tender, the Digital Economic Zone (DEZRA), and the newly enacted Law on Decentralized Autonomous Organizations.⁷⁷ Faced with frequent power and network outages, the country's infrastructure and could hamper the issuance and wide-spread use of the SOV potentially excluding remote and most vulnerable parts of the population.⁷⁸

52. **Long-term fiscal sustainability remains challenging in RMI.** RMI is highly reliant on grants, which accounts for more than half of RMI's annual budget. According to World Bank data, RMI is the third-highest recipient per capita of overseas development assistance in the world, with 3,093 US dollar net official development assistance in 2020, slightly lower than Palau and Tuvalu. The RMI needs to adjust to the annual decline in United States Compact of Free Association grants, which are currently set to phase out and will end on 30 September 2023. Of a \$242 million annual budget in 2022, about 66% was funded by bilateral and multilateral donors, with approximately 43% of this representing Compact and US Federal grants.

53. **RMI remains at high risk of debt distress.** The 2021 Debt Sustainability Analysis indicates that RMI Debt is sustainable but remains at high risk of debt distress.⁷⁹ Vulnerabilities are exacerbated by the lack of fiscal buffers, volatile investment return on the Compact Trust Fund⁸⁰, climate change shocks, and the continued concentration in consumer loans.^{81,82} As most of RMI's debt is reaching the end of the grace period, debt service obligations are increasing and becoming significant compared to previous years. External debt of the SOEs is at higher interest rates and shorter terms and thus incurs a proportionately higher service commitment.

⁷⁷ International Monetary Fund (IMF). 2022. [IMF Staff Completes Virtual Staff Visit to the Republic of the Marshall Islands](#). Washington DC.

⁷⁸ IMF. 2021. [Republic of the Marshall Islands. Staff Report for the 2021 Article IV Consultation](#). Washington, DC.

⁷⁹ IMF. 2021. [Pacific Island Countries – Summary of Recent IMF Debt Sustainability Assessments](#). Washington DC.

⁸⁰ The Compact trust fund (CTF) was established when the new Compact agreement was signed in 2003. The main purpose of the trust fund is to create an income stream to replace the US grants when the Compact ends in 2023. The trust fund is being funded through a combination of US grants and RMI contributions. Hence, the government would need to limit expenditures and build up a fiscal surplus to contribute to the CTF.

⁸¹ IMF. 2021. [Republic of the Marshall Islands. Staff Report for the 2021 Article IV Consultation](#). Washington, DC.

⁸² Consumer loans account for the dominant share (estimated at 58% as of FY2020) of total lending and are serviced directly through payroll deductions through allotments.

2. Structural-Environmental Drivers

54. **RMI does not have an independent monetary policy framework and the financial sector is small, with credit mainly in the form of small consumer loans.** Given the small size of the economy and its links to the US, full dollarization is recognized, while the money supply is not actively managed. The formal banking sector consists of the Bank of Guam, the Bank of the Marshall Islands, the government-owned Marshall Islands Development Bank, and the Pacific Island Development Bank. The banking sector is characterized by high intermediation costs and low levels of lending. There is limited competition, particularly in the commercial credit area. There is no credit union. However, informal credit is a widespread feature. Consumer loans account for the dominant share, estimated at 58% as of FY 2020, of total lending. Long-term lending is constrained by the land tenure system, which prevents banks from using land property as collateral. Access to financial services in remote areas is constrained by the limited access to technology.

55. **Inherent inefficiencies in the customs process.** There is no negative list of commodities that cannot be imported in the protection of local counterpart goods, nor quantitative restrictions on imports. However, importers face a relatively lengthy clearance process, with clearance required by several different government authorities. Import and export documentation and procedures are manual and paper-based. Custom collections are generally slow, laws and regulations are not always clearly published, and appeals are not common. Smuggling remains a serious concern.

56. **Private sector development remains challenging.** State intervention in commerce is strong, with numerous state-owned and controlled enterprises and corporations. Corporate governance regulations for domestic corporations are weak, ownership and financial disclosure are not encouraged, and mechanisms for stockholder protection are limited. Oversight of business activities is fragmented and gives rise to an inefficient regulatory system. Although there is a legislative framework to regulate business activities, most of these laws are largely dormant and ignored. In short, the private sector faces the following factors that continue to constrain ongoing business operations: (i) costly and time-consuming requirements for registration of non-resident labor and other procedures such as imports clearance, (ii) costly utilities and other inputs, (iii) lack of access to land for development, (iv) poor infrastructure, (v) poor transportation and communication, (vi) ineffective tax policy and administration, (vii) state involvement in commercial activities, and (viii) poor business-government relations.

3. Political-Social Drivers

57. **The brain drain and the lack of labor market regulation.** Preliminary reports from the Census 2021 show a 26% **drop** in the RMI population due to increasing out-migration to the US for employment opportunities and to gain access to better health care and education systems. Labor market regulations and controls are not extensive and private employers have a fairly high degree of flexibility in hiring and firing, except for restrictions on non-resident workers. There is a high public-private wage differential (average public wages are much higher than private wages).⁸³

58. **High rates of teenage pregnancy, gender violence, sex trafficking, and female participation in the labor market are key gender issues.** In 2016, 13% of the registered

⁸³ Radio New Zealand. 2021. [Marshall Islands census numbers show heavy out-migration](#). New Zealand.

births are from teenage mothers with the age of 19 or younger.⁸⁴ There are high levels of early marriage and gender-based violence. One in two women have experienced physical and/or sexual violence from an intimate partner in their lifetime.⁸⁵ The 2021 Trafficking in Persons Report shows that RMI is on the Tier 2 Watch List. Traffickers exploit East Asian and Marshallese girls in sex trafficking with foreign construction workers and crewmembers of foreign fishing and transshipping vessels that dock in Majuro.⁸⁶ Household Income and Expenditure Survey 2020 statistics show that there is 26.3% of women in paid work as a percentage of total working age group. Mean annual wages for full-time, year-round employed females in 2002 was \$7,595 compared to males at \$10,772; females earned 70 cents for every one dollar earned by males. After the 2019 elections, RMI has two women in its 33-seats Nitijela (parliament) for the 2020-2023 term. There is no female Chief Executive Officer currently at the State-Owned Enterprises, while the regional average is 13% of female CEOs.⁸⁷

59. Public resource use is unequal with regressive taxes and weak tax compliance. Significant inputs to health and education, with budgetary allocations totaling approximately 50%, have failed to produce high quality outputs and outcomes due to poor allocations within each sector as well as overall inefficient management of resources. Three major domestic national taxes (in terms of revenue) are import, income, and gross revenue taxes. Income taxes are generally low but highly regressive, with the average tax rate decreasing at higher income levels. Smuggling and underreporting of values of goods imports remain high. Customs do carry out inspections, but on a limited scale.

60. Non-communicable diseases and malnutrition are the main challenges in the country. Non-communicable diseases accounts for above 70% of all deaths in the RMI. The RMI hospital is overburdened with diabetes patients. However, the outer islands present a challenge for healthcare **delivery** and data collection, as well as being under-staffed, or shut, due to lack of adequate infrastructure. The RMI has one of the highest rates of tuberculosis (TB) incidence compared to other countries in the Region due to overly crowded and poor sanitation conditions. Nutrition is also a challenge due to limited land and very little food produced locally. RMI has a significant reliance on imported foods that are often processed, nutrient poor, and calorie dense.

61. RMI has no formal social protection strategy in place and has little social protection and assistance programs to help the poor and other vulnerable groups. Responsibility for the social sector is shared by the Ministry of Education, Ministry of Health and Ministry of Culture and Internal Affairs. However, there is no formal coordination arrangement between the different social protection programs although there is information sharing between key government agencies and partners. The need to centralize and coordinate is key to managing limited resources in an effective and impactful manner. There is a defined-benefit social security program that provides coverage to the formally employed. This program, however, misses a large population of informal workers, particularly in the outer islands.

62. Environmental issues continue to raise concern and institutional weakness remains. The RMI is facing the challenges of solid and hazardous waste management,

⁸⁴ ADB. 2020. [Marshall Islands Gender Equality Overview: Key Statistics For Informed Decision-Making in Celebration of Beijing+25](#). Manila.

⁸⁵ Henrica A.F.M. Jansen. 2019. [kNowVAWdata – measuring prevalence of violence against women in asia-pacific](#).

⁸⁶ US Department of State. 2021. [2021 Trafficking in Persons Report](#). Washington, DC.

⁸⁷ The Private Sector Development Initiative. 2021. [Leadership Matters. Benchmarking Women in Business Leadership in the Pacific](#). Sydney.

contamination of ground and rainwater supplies, destruction of coral reefs, pollution of coastal waters, extreme trends in sea level, accelerated coastal erosion, and a potential for over-exploitation of renewable and non-renewable resources. Environmental Protection Authority continues to be challenged by weak capacity, shortage of skilled staff and resources, insufficient attention paid to Ebeye and outer islands, weak investigation and enforcement capacity, and ineffective implementation of environmental impact assessments. Severe limitations on the government's access to land also leads to ad-hoc and politically expedient placement of infrastructure. With the influx of infrastructure projects under development partner funds, environmental impact assessments shortcoming will need to be highlighted and addressed.

4. Institutional Drivers

63. **There is no legal framework on how foreigners can access land in the RMI.** Traditional land ownership prevails for virtually all land, and this challenges land registration and general access to land for development. Under the Real Property Act, only citizens of the Marshall Islands can own land. Corporations cannot own land unless the corporation is wholly owned by RMI citizens. Formal property registration and rights is on a voluntary basis and not mandated by law. It is possible to lease land, but the process is often difficult due to the multiple title holders. Progress on the land registration process has been slow as many landowners continue to avoid registration out of skepticism and distrust.

64. **It is anticipated that a high volume of deportees from the US will be returning to the RMI once borders re-open.** RMI does not have a process in place to track or ensure smooth transition offenders deporting from the US. There is a growing concern among the RMI community members on public safety and the potential rise in crime rates, both violent and non-violent. Even though police forces are functional, they have critical shortages in basic skills. Enforcement of laws by police forces remain weak.

65. **Timeliness and accuracy of accounting and fiscal reporting is poor, and expenditure deviations from the approved budget are commonplace.** Obtaining accurate and up-to-date data continues to be an ongoing challenge in RMI. RMI public financial management roadmap identifies a new financial management information system (FMIS) as a priority area. With grant support from World Bank, the initiative for a new FMIS commenced in 2019. Implementation of the FMIS, however, is experiencing delays due to COVID-19. As of June 2022, implementation of the FMIS has not taken effect and may be delayed further to the following year or two.

66. **The RMI's national taxation system is narrowly based, regressive, anti-poor, open to evasion, poorly administered and generally non-conducive to economic growth.**⁸⁸ Tax reform efforts have been stagnant. Political support for passage of the tax reform legislation has not been successful in previous years primarily due to lack of appetite from the private sector, concerns raised by local governments, and possibly lack of tax reform knowledge base.

67. **Administrative structures remain fragmented with some areas of clear overlap in responsibilities.** Internal government processes remain time consuming and inefficient, with multiple decision layers and signatures required for basic procurement and other processes. Policy consistency and coordination remain critically weak, which has led to weak implementation. Policy conflicts are common, leading to confusion in the public and within

⁸⁸ IMF. 2021. [Republic of the Marshall Islands. Staff Report for the 2021 Article IV Consultation](#). Washington, DC.

government agencies. Ministers and Ministries tend to develop their own policies without coordinating with the Chief Secretary or Cabinet. This stems largely from the lack of clear and coherent policy frameworks both within most organizations and across the entire public sector.

68. **Checks and balances on executive power remain weak.** The concentration of power in the executive, weak checks and balances, and a weak culture of accountability allow for some state capture by narrow political interests. Not all resource allocations are done transparently, although the budget has grown to include some previously off-budget resource flows. Elected and other public officials often have private interests that conflict with their professional duties.

E. Micronesia, Federated States of

1. Economic Drivers

69. **Economic growth performance over the last ten years has been volatile.** There are limited natural resources for local production, consumption, and exportation, and limited capacity in all regions. With the border closure during the pandemic, FSM's economy contracted by 3.8% in 2020 and 1.2% in 2021 with the largest impacts on the private sector and public infrastructure development projects. Infrastructure buildup is often delayed due to land issues. In most of states, the government has little or no land and must get permission from landowners to build and improve basic infrastructures such as roads, schools, and health centers. Cultural traditions can also cause delays in development projects such as the difficulty to secure land for public projects.

70. **Achieving long-term fiscal sustainability remains the most urgent concern.** The economic provision from the special compact agreement with the US is set to expire in 2023 with ongoing negotiations for a 3rd agreement. Compact grants at around 20% of GDP are projected to be replaced by investment returns from the Compact Trust Fund (expected to be around 11% of GDP), a substantial reduction in revenues. The current tax system generates very little revenue, with revenues largely reliant on US grants and fishing license fees. Fishing license fees collected from foreign fleets operating in the FSM's waters generate about 1.5 times the revenue collected from taxes. Further, collections from corporate income tax on foreign firms domiciled in the FSM provide windfall tax revenues, although subject to large volatilities. The fiscal policy framework needs to be strengthened to address the external shocks such as the volatility in international food and fuel prices, the global financial and economic crises that reduce the asset base of the US-FSM Compact Trust Fund, and the public crises like the pandemic.

71. **Th public debt is manageable but there is a high risk of debt distress in the long-term.** Government debt consists almost entirely of external debt. The debt-to-DGP has fallen from 54% in 1995 to 15.2% in 2021. Although the level of debt remains sustainable, the joint World Bank-IMF Debt Sustainability Analysis in 2021 considers FSM with a high risk of external and overall debt distress⁸⁹, since the country needs to rely on borrowing to close the financing gap left by the potential expiration of the economic provisions of the Compact, as well as higher spending requirements in response to future shocks, including natural disasters and health emergencies similar to COVID-19.

⁸⁹ WBG. 2021. [Federated States of Micronesia - Joint World Bank-IMF Debt Sustainability Analysis \(English\)](#). Washington, D.C.

2. Structural-Environmental Drivers

72. **FSM is a small island country that is highly dependent on the US.** FSM is isolated from the rest of the world. Even though there are no export taxes, the cost of transportation to and from FSM is expensive. Since the US dollar is the official currency of the FSM, there is no monetary policy, and the deposit rates are largely determined by US conditions.

73. **Foreign investment processing is cumbersome due to the complex decision-making processes.** Foreign investment remains regulated at the state level, with licensing procedures lacking uniformity, making it cumbersome for potential foreign investors looking to start a business across all four states. Strict restrictions on foreign ownership of land and business hinder the entry of foreign investment. The complex decision-making processes, rooted in the loosely federated political structure and the geographical distances between the country's small island states, make it difficult for policymakers to coordinate, and achieve consensus on national reforms and programs.⁹⁰

74. **The FSM banking system is small and underdeveloped.** FSM's banking system consists of two commercial banks – the Bank of FSM and the Bank of Guam – both of which are subject to FDIC supervision, and the FSM Development Bank. Although the non-performing loans (NPL) of commercial banks remain low at 1% of total loans in 2017, the NPLs of the development bank remain relatively high at about 8% of total loans. The finance sector is not fully regulated. There are small credit unions that are not subject to government oversight.⁹¹

75. **Private sector development is slow.** The economy has been dominated by the public sector, with a small private sector producing non-tradable goods and services mainly for domestic consumption. Private sector activity has been hindered by the country's geographic remoteness and dispersion. Limited room for the growth of wholesale and retail activities poses a challenge to the development of the private sector. The private sector credit was equivalent to 22% of GDP in 2017, which is significantly below the regional median. Lending to the private sector is very low, representing only 3% of bank deposits in FSM banks. The low rate of lending is due to credibility issues with private businesses often lacking the collateral⁹² and ability to provide sound financial statements.

76. **FSM is vulnerable to climate change and sustainability, and there is a need to improve enforcement of environmental laws and regulations.** FSM is vulnerable to extreme weather events such as storms and droughts. The fishery is vulnerable to oceanic change such as an increase in sea-surface temperature and ocean acidification. Sea salt deposition caused by tropical cyclones can devastate agriculture and cause corrosion of infrastructure.⁹³ Inadequate waste management services, dynamite fishing, dredging of reefs and accelerating coastal erosion, and dumping of chemicals and oils, remain to be addressed. Each state has an Environmental Protection Agency (EPA). However, there is no specific grievance system for environmental performance in place. None of the EPAs have issued any citations or

⁹⁰ ADB. 2019. [Pacific Finance Sector Brief: Federated States of Micronesia](#). Manila.

⁹¹ ADB. 2019. [Pacific Finance Sector Brief: Federated States of Micronesia](#). Manila.

⁹² Land tenure is complicated, and land is often not considered good collateral. Difficulty in the use of land as collateral remains a key constraint to enhancing access to finance. Foreign ownership of land is restricted. Some states also restrict land ownership to citizens and their descendants from their own state. As possession of land is legally and customarily closely tied with the origin of people, commercial banks are concerned about social acceptability of using land as collateral.

⁹³ WBG. 2021. [Climate Risk Country Profile: Micronesia \(2021\)](#). Washington, D.C.

successfully commenced proceedings for environmental offenses. The effectiveness of environmental regulations is limited by long-standing resource constraints particularly on staff capacity-building.

3. Political-Social Drivers

77. **FSM faces a population crisis with a 21% decline over the past 10 years due mainly to emigration.** Roughly one third of all FSM-born people live outside their island nation.⁹⁴ With the US-FSM Immigration provision under the Compact agreement, outmigration is high resulting in brain drain. The main reason for Micronesian emigration is the almost complete lack of economic development within the country.⁹⁵ Few employment opportunities and the decline in real wages result in further outmigration. Besides, only one state (Pohnpei) has a minimum wage for the private sector. There are no laws regulating work hours; no enforceable standards for occupational, safety, and health; and no unions or labor regulations for domestic workers.

78. **The quality of education and the survival rate, the total number of students in Grade 1 to those in Grade 8 and 12, is low.** In 2019, only 44% of teachers are qualified with only 16% certified. Most survival rates throughout the nation are considered low with females having slightly higher rate than males. Roughly 45% (39% male / 50% female) students reach Grade 8, while only about 20% (17% male / 25% female) students reach Grade 12.⁹⁶ Technical and vocational education and training (TVET) options are both limited and fragmented. TVET programs are discontinued due to lack of teaching staff and outdated equipment.

79. **Gender disparities exist in participation and remuneration in the labor force, land tenure, property ownership, and inheritance practices.** Most state communities (except in Yap) were traditionally organized along matrilineal clan lines. These customs were altered by colonial rule. The national and state constitutions provide legal status to some customary law and community practices that are discriminatory against women. In 2016, labor force participation rate for females was 48.6%, while it was 68% for males. Legislation that protects women from domestic violence and marital rape remains inadequate. Yap and Chuuk have not yet introduced specific legislation that provides protection for women against domestic violence. In 2014, 24.1% of ever-partnered women in the FSM experienced sexual violence over the past 12 months. Women participation in decision-making remains limited. No woman has been elected governor in any of the four states.

80. **Public resource use and labor policies do not target vulnerable groups.** A significant proportion of public service budgets go to public sector salaries, leaving little for inputs to service delivery obligations to those in hardship. At the national level, there are no clear and extensive programs directed to those in the large subsistence sector. Most social services are under the responsibility of state governments, which face chronic fiscal constraints. Participation of vulnerable groups in budgeting process is limited. The government has not formulated a social safety net policy and there is no formal welfare scheme for those outside the formal employment sector. National and state laws neither prohibit the worst forms of child labor, nor establish a minimum age or prescribe limits on hours or occupations for children

⁹⁴ Hezel, F.X. 2013. [Micronesians on the Move: Eastward and Upward Bound](#). Pacific Islands Policy Paper No.9. Honolulu, East-West Center.

⁹⁵ UN-IOM. 2016. [Migration in the Federated States of Micronesia: A Country Profile 2015](#).

⁹⁶ FSM Department of Education. 2019. [NDOE Education Indicator Report 2019](#).

employment.⁹⁷ There is no explicit right to organize labor, nor any dispute resolution mechanism.

81. **There is a need to improve health programs and services.** Poor nutrition is still a problem due to high consumption of imported unhealthy food. About 42% of all population are obese, well above the SDG global target of 30%. Poor access to basic services and limited access to clean water and adequate sanitation are still concerned. With limited number of health clinics, the prevalence of communicable diseases such as tuberculosis is rising and among the major causes of morbidity and mortality in the country. Furthermore, the stewardship and regulation in the health sector are fragmented, with often inconsistency and allocative inefficiencies observed across the federal and states level.

4. Institutional Drivers

82. **Jurisdictional boundaries are unclear and there are restrictions that vary from state to state regarding the rights of ownership.** The FSM Constitution has no supremacy clause, which creates two systems of law (federal and state) and can cause a potential for overlap. The judicial arm of the public service tends to be poorly resourced since there is a shortage of properly trained staff, which makes the legal processes at State level slow and costly. In terms of the rights of ownership, in general, foreigners cannot own land according to the national and state constitutions. Lease terms for properties are controlled at the state level and often limited to short periods. Long-term leases require the approval of the state legislature in some states.

83. **National development plans are not explicitly linked to the subsequent budgetary allocations.** The Strategic Development Program (SDP 2004-2023) is not integrated into the budget preparation. Budget preparation tends to be incremental and input-based, i.e., based on the previous year's budget instead of based on strategic priorities and budget performance data. Cabinet's input is limited to reviewing and approving the budget. The budget documents are not in the international standard government financial statistics (GFS) format and do not include key fiscal data. Furthermore, given that the presentation of budget documents is complex, it does not facilitate easy scrutiny by Congress and the public.

84. **The overall capacity of the public administration is modest.** State governments are responsible for major public services but have been constrained by declines in the real value of US compact grants, while the national government has benefited from higher revenues from fishing license fees and corporate income taxes. The FSM ranks in the 50th percentile in the Government Effectiveness dimension and 15th percentile in the Regulatory Quality dimension of the World Bank's World Governance Indicators as of 2020.⁹⁸ In national public service regulations, it is not clear whether the individual units operate with well-defined roles and responsibilities, nor whether the allocation of human resources to these units is commensurate with assigned responsibilities.

85. **Modest transparency and accountability in public sector.** The FSA has no government agency specifically assigned with responsibility for combatting corruption. There are no non-governmental "watchdog" organizations that monitor corruption.⁹⁹ There is no

⁹⁷ United States State Department. 2021. [2019 Country Reports on Human Rights Practices: Federated States of Micronesia](#).

⁹⁸ WGB. 2021. [Worldwide Governance Indicators](#).

⁹⁹ United States Department of State. 2021. [2021 Investment Climate Statements: Micronesia, Federated States of](#).

ombudsman. No information is available on political financing, degree of politicization of investigations or ability to bring claims against the state. The communal nature of political constituencies means that elected leaders and other public officials predominantly represent an extended family, and therefore often have private interests that interact with their professional duties.

F. Myanmar

1. Economic Drivers

86. **The combined effects of the February 2021 military coup and of COVID-19 have exacerbated the economic crisis in Myanmar.** The GDP growth rate in 2021 was -18.4%, whereas in 2022 the expected rate would be -0.3%. ADB also forecasts Myanmar's inflation rate at 8.0% in 2022 and 8.5% in 2023.¹⁰⁰ There is a sharp drop in income and employment throughout the economy. Domestic demand remains weak and supply restraints persist. Access to kyat liquidity, credit and foreign currency remains constrained. A sharp exchange rate depreciation in September 2021 has pushed up import prices across the economy, including fuel and other key production inputs, leading to higher transportation costs. Furthermore, power outages and internet disruptions continue to reduce the reliability of firms' and households' connectivity.¹⁰¹

2. Structural-Environmental Drivers

87. **The financial stability and financial sector efficiency, depth, and resource mobilization are to some extent vulnerable to shocks in the medium term.** IMF Country Report No. 21/23 has suggested devising a comprehensive strategy to address non-performing loans.¹⁰² As loan based on real estate collateral contributed a large percentage of total secured loans in Myanmar, any price shocks in real estate sector can bring a significant threat to the stability of financial sector. On the other hand, the effective mobilization of domestic saving for investment is hampered due to government controls. Deposit interest and lending rates set by the banks are not based on market conditions but are set administratively under the strict guidance of Central Bank of Myanmar (CBM).

88. **Myanmar is no longer able to benefit from the favorable international financing environment for developing countries.** Multilateral lenders have halted lending to the junta. ADB has temporarily put on hold sovereign project disbursements and new contracts in Myanmar effective 1 February 2021. Likewise, IMF refused to issue additional special drawing rights to the country in August 2021.

89. **The climate threat increases after the military coup.** The Global Climate Risk Index 2021 report ranks Myanmar as one of the countries that are most affected by the impacts of climate-related extreme weather events, such as storms and floods.¹⁰³ There is increasing concern that the junta will focus on cementing its control by intensifying lucrative but devastating

¹⁰⁰ ADB. 2022. [Asian Development Outlook \(ADO\) 2022 \(April 2022\)](#).

¹⁰¹ WBG. 2022. [Myanmar Economic Monitor – Contending with Constraints](#).

¹⁰² IMF. 2021. [IMF Country Report No. 21/23 – Requests for Disbursement Under the Rapid Credit Facility and Purchase Under the Rapid Financing Instrument – Press Release; Staff Report; and Statement by the Executive Director for Myanmar](#).

¹⁰³ Germanwatch. 2021. [Global Climate Risk Index 2021- Who Suffers Most from Extreme Weather Events? Weather-Related Loss Events in 2019 and 2000-2019](#).

policies of exploiting the country's vast natural resources. The suspension of international financing may cause problems for the climate resilience projects in Myanmar.

3. Political-Social Drivers

90. **The human capital development and gender equality remain low.** Myanmar has ranked 147 out of 189 countries on Human Development Index (HDI) in 2019, with 67.1 years of life expectancy at birth, 10.7 years of expected years of schooling, 5.0 years of mean years of schooling, and 4,961 GNI per capita. On the Gender Inequality Index (GII), the country has ranked 118 out of 162 countries in 2019, with a value of 0.478 in 2019. Female labor force participation rate of ages 15 and older was 47.5% while male was 77.4% in 2019.¹⁰⁴ Trafficking of women and girls remains serious in Shan and Kachin States. Females are vulnerable to being lured to China under false promises and sold into sexual slavery.¹⁰⁵

91. **The level of national, sub-national, and regional conflict in Myanmar is extremely complex involving dozens of armed actors.** In February of 2021, the Tatmadaw declared a state of emergency seizing control of all three branches of government effectively rejecting the results of the democratic election held in November of 2020. This action by the military sparked nationwide protests and civil unrest across the country. The Office of the High Commissioner for Human Rights (OHCHR) estimates that over 14.4 million people in Myanmar are now in need of humanitarian assistance. In March 2022, OHCHR announced grave concern for the future of Myanmar citing a “disproportionate response” and the military’s use of “indiscriminate force on armed and civilian groups”.¹⁰⁶ Nation-wide conflict has woven into subnational and regional conflicts making it both incredibly difficult to both count civilian casualties and identify the perpetrators involved.

92. **Rohingya refugee crisis causes severe displacement issue.** Lacking legal status, much of the displacement in Rakhine stems from violence committed toward the Rohingya, a stateless Muslim minority who have perpetually been subjugated to lower class citizens by local and national government policies dating back to the 1970s. Large scale displacement in 1978, 1991, 2012, and again in 2017 are a result of growing suspicion by the Buddhist-Rakhine and the Tatmadaw against the Rohingya ethnic minority. Both ethnic armed organizations and the military government have been responsible for violence against the Rohingya in Rakhine.¹⁰⁷ The Tatmadaw claim that armed ethnic groups such as the Rohingya Solidarity Organization (RSO) and Arakan Rohingya Salvation Army (ARSA) are a terrorist threat.¹⁰⁸ Forced displacement events occurred in 2017, after the Tatmadaw declared “clearance operations” in northern Rakhine. By August of 2018, an estimated 785,000 Rohingya had fled across the border into Bangladesh. The government of Bangladesh and dozens of international aid organizations, such as the United Nations Human Rights Commission (UNHRC), are providing support to the Rohingya refugee population living in semi-permanent encampments. Most refugees have sought shelter in Cox’s Bazar district of Eastern Bangladesh.

¹⁰⁴ UNDP. 2020. [Human Development Report 2020: The Next Frontier: Human Development and the Anthropocene](#). New York.

¹⁰⁵ Human Rights Watch. 2022. [Myanmar Events of 2021](#).

¹⁰⁶ UNHCR. 2022. [Interactive dialogue on the situation of human rights in Myanmar](#).

¹⁰⁷ Hossain, M. I., Ali, I., Azman, A., Ahmad, I., & Mehedi, N. 2021. [The Rohingya refugee crisis: A threat to peace and security in South Asia](#). The International Journal of Community and Social Development, 3(4), 353-371.

¹⁰⁸ Lee, R. 2021. [Myanmar's Arakan Rohingya Salvation Army \(ARSA\): An Analysis of a New Muslim Militant Group and its Strategic Communications](#). Perspectives on Terrorism, 15(6), 61–75.

4. Institutional Drivers

93. **The legal and judicial system remained weak and corrupt. Many judges and court officials have a military background.**¹⁰⁹ According to the World Justice Project “Rule of Law Index 2021”, Myanmar ranked 128 out of 139 countries and jurisdictions worldwide, falling six positions in global rank due to the deteriorations in constraints on government powers and fundamental rights.¹¹⁰ Corruption has remained a consistent feature at all levels of the court system.

94. **The quality of public administration remained low in terms of political stability, government effectiveness, and rule of law.** Myanmar has been one of the countries with the lowest percentile rankings of the Worldwide Governance Indicators (WGI). According to WGI 2021, in 2020, Myanmar’s percentile rank is 9.91 in political stability, 14.42 in government effectiveness, 28.37 in regulatory quality, 10.58 in rule of law, 27.88 in control of corruption, and 21.74 in voice and accountability.¹¹¹

95. **The transparency and accountability in public sector is limited.** According to Transparency International’s “Corruption Perceptions Index 2021”, Myanmar ranked 140 out of 180 countries with a score of 28 out of 100.¹¹²¹¹³ According to the Freedom House “Freedom in the World 2022”, Myanmar is classified as a “not free” country with a total score of 9 out of 100, consisting of the score of political rights of 0 out of 40, and the score of civil liberties of 9 out of 60.¹¹⁴

G. Nauru

1. Economic Drivers

96. **Phosphate exports, Regional Processing Centre (RPC) operations, and the fishing license fees as the main sources of revenue.** The primary deposits of Nauru phosphate are nearly depleted, and the agricultural potential is limited. Limited domestic export potential aside from phosphate. However, Nauru has considerable ocean resources in its exclusive economic zone. The public sector is predominant in the economy. The government’s revenue base is narrow and volatile and consists primarily of revenues associated with the Regional Processing Centre (RPC) for asylum seekers and the sale of offshore fishing licenses. One of the major development challenges is to manage windfall revenue to maintain the fiscal stability, and to build an economic future that maximizes people’s sustainable living standards. According to World Bank data, Nauru is the forth-highest recipient per capita of overseas development assistance in the world, with 2,608 US dollar net official development assistance in 2020, lower than Palau, Tuvalu and Marshall Islands. In recent years, the government has borrowed from the EXIM Bank of Taipei,China to support the Nauru Phosphate Corporation and purchase a replacement plane for Nauru Airline. This external debt is paid off through grants from Taipei,China and therefore does not pose an exchange rate risk.

¹⁰⁹ The Conversation. 2021. [Aung San Suu Kyi trial: how Myanmar’s judicial system is stacked against the deposed leader.](#)

¹¹⁰ World Justice Project. 2021. [Rule of Law Index 2021.](#) Washington, DC.

¹¹¹ WGB. 2021. [Worldwide Governance Indicators.](#)

¹¹² Transparency International. 2022. [Corruption Perceptions Index 2021.](#)

¹¹³ The corruption perception index uses a scale from 0 to 100. 100 is very clean and 0 is highly corrupt.

¹¹⁴

97. **The country is addressing the debt sustainability.** For several years, ADB has rated Nauru as facing a high risk of debt distress. Nauru's external debt mostly consists of the defaulted yen bonds issued in the late 1980s, while the domestic debt is mainly related to Bank of Nauru's liquidation in the early 2000s during the country's economic downturn. The government has since used fiscal surpluses to reduce some legacy debts, including the settlement of the Firebird debt,¹¹⁵ and some repayment of domestic debt related to the liquidation of the Bank of Nauru. The reduction in public debt from the equivalent of 61.4% of GDP in 2020 to 27.1% in 2021 leads the IMF to assess that Nauru's debt was sustainable under current policies.¹¹⁶ Besides, in 2022, a medium-term debt management strategy 2022-23 was approved to ensure that the financing needs of the government are met on a timely basis, with borrowing costs as low as possible and consistent with a prudent degree of risk.

2. Structural-Environmental Drivers

98. **Given the limited local production, Nauru is one of the most import-dependent countries in the world.** Nauru is not a member of the WTO. Although Nauru has no exportation taxes, the customs duty has increased in recent years. The increase in tariffs in 2020-21 was primarily aimed at reducing the consumption of products with public health costs, such as high salt & sugar content items, kava, alcoholic beverages, cigarettes and vapes. Since there is no sales tax in Nauru, tariffs act as de facto sales tax as nearly all consumption items are imported.

99. **Nauru does not have a financial system in place.** Nauru had a tumultuous financial history, including the collapse of the state-owned Bank of Nauru and the Nauru Phosphate Royalties Trust in the late 1990s. The government and the Bendigo and Adelaide Bank hereby signed an Agency Agreement in 2015 to operate an agency model of the bank in Nauru.¹¹⁷ As a result, all regulations and anti-money laundering activities comply with Australian banking law. There could be cases in the future that Nauru-specific risks are not adequately covered by the foreign regulatory framework. Besides, there are no credit or insurance products. The financial sector remains underdeveloped and the small size and limited institutional capacity for establishing and managing a central bank. The lack of lending products means the sector plays a minor role in mobilizing resource for economic development. Further, there is no independent monetary or exchange rate policy because the Australian Dollar is used as legal tender. Nauru faces constraints on cross-border transactions with limited ability to conduct international transactions in non-AUD currencies.

100. **The regulatory framework for business is underdeveloped.** Nauru's small size, remoteness, and diseconomies of scale result in high operating costs limit opportunities for private enterprise and employment creation and impede efforts to provide basic public services. State-owned enterprises (SOEs), which receive significant fiscal support, likely crowd out some private sector activity which is also hampered by poor infrastructure. As Nauru's private sector is limited, the public sector comprises 63 percent of the local labor force.¹¹⁸ SOEs control electricity and water delivery, airline, postal, internet services, the nation's only port, the fishing

¹¹⁵ In March 2021, the government settled with the U.S.-based hedge fund, Firebird, on the defaulted Yen Bond debt of \$41.6 million. Under the terms of the settlement, Firebird agreed to a payment of AUD 4 million in exchange for all their bonds and an indemnity against legal actions on previous court orders or future claims against the government.

¹¹⁶ IMF. 2022. [Republic of Nauru: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Nauru](#). Washington, D.C.

¹¹⁷ The Government of the Republic of Nauru. 2015. [Nauru formalizes agreement to set up banking agency in Nauru](#).

¹¹⁸ Republic of Nauru. 2021. [2021-22 BUDGET – BUDGET PAPER NO.2](#). Yaren.

and marine authority, phosphate mining, land rehabilitation, services related to the RPC, etc. The business environment is weakened by expensive foreign business visas and a limited legislative framework for foreign investment, limited employment law, limitations in land sale and leasing, and the absence of formal lending services by the Bendigo Bank Agency. The levels of regulation and enforcement are generally low. The National Sustainability Development Strategy of 2019-2030 highlights improvements in the business environment as a key national priority.

101. Nauru is vulnerable to climate change even though the country has an extremely stable climate. Nauru is warming and is expected to warm throughout the 21st century. Coral bleaching is therefore a significant risk to the country's ecology and economy. The sea level near Nauru has been rising at a faster rate than the global average.

102. The achievement of the sustainable development strategy is limited. Nauru's first National Sustainable Development Strategy (NSDS) came into effect in 2005. However, the 2016 review of the NSDS indicated that only 25% of the NSDS milestone activities had been implemented, largely because of a lack of funding, lack of staff capacity, weak coordination, unclear goals, and land issues.¹¹⁹

3. Political-Social Drivers

103. While the government has strengthened legislative and policy frameworks and has allocated resources to achieve women's empowerment, gender equality remains limited. On the security side, according to the 2014 Nauru Family Health and Support Survey, nearly half of ever-partnered women experience physical and/or sexual violence by partners in their lifetime. About 68% of women who experienced partner violence never go to formal services or authorities for help.¹²⁰ On labor force participation aspect, women working in the private sector do not have a similar entitlement. Societal pressures, lower wages, and the country's general poverty limit opportunities for women.¹²¹ On the health and education aspect, the adolescent pregnancy rate in Nauru is among the highest in the Pacific at 92.3 per 1,000 females aged 15-19 during 2015 to 2017.¹²² Adolescent pregnancy contributes to low attendance in school. On the land access side, although Nauru is historically a matrilineal society, the United Nations Committee on the Elimination of Discrimination Against Women (UN-CEDAW) has highlighted that the current land ownership system does not guarantee women equal rights to land ownership and inheritance, despite the fact that households headed by women account for more than one-third of all households.¹²³

4. Institutional Drivers

104. The legal framework for property rights and governance is generally weak. Nauru has no legal framework for international arbitration. There is a lack of foreign investment law and implementing regulations. Legal services are reliant on expatriate legal professionals, while expatriate staffing recruitment were affected by travel restrictions during the pandemic. Besides, challenges with the weak land tenure process are increasing, especially with the growth in the

¹¹⁹ Republic of Nauru. 2019. [Nauru Voluntary National Review on the implementation of the 2030 Agenda](#). Yaren.

¹²⁰ Nauru Ministry of Home Affairs. 2014. [Nauru Family Health and Support Study](#). Yaren.

¹²¹ United States State Department. 2021. [2021 Country Reports on Human Rights Practices: Nauru](#).

¹²² Nauru Bureau of Statistics and Pacific Community. 2019. [Nauru Vital Statistics Report 2015-2017](#). Yaren.

¹²³ Committee on the Elimination of Discrimination Against Women. 2017. [Concluding observations on the combined initial and second report of Nauru](#). Geneva.

public housing scheme constructions that reduce the land available for economic activity and other essential public infrastructures.

105. **The policy-based budgeting is relatively weak.** The Nauru institutions are under-resourced and supported by foreign technical advisors. The budget preparation process is relatively short and has limited personnel capacity to properly prepare and review budget proposals. Budget proposals may not closely link to national and sectoral plans, except for health and education due to donor requirements.

106. **Tax revenue is vulnerable to a further RPC scale-down.** Nauru's reliance on external sources of revenue raises concerns about fiscal stability. Also, due to the tax-free income threshold, the bulk of domestic taxes are levied on and paid by expatriate workers and businesses related to RPC. As most Nauru citizens do not have experience in paying taxes, policy changes on tax administration would require careful communication to engender taxpayer compliance.

107. **Public administration faces challenges in ensuring a merit-based system and the limited channels for private sector participation in policy implementation and development.** The government is the major employer in the country and personal networks are ever-present. The Heads of Department in the public service and the board members of SOEs are often politically appointed. This practice interrupts sector development priority with the change of government. Absenteeism in the public sector is also a challenge. On the other hand, policy and regulation formation tends to be top-down and little policy flows up from the public service.

108. **Modest transparency and accountability in the public sector.** According to WGI 2021, Nauru's governance scores in rule of law and control of corruption are considered weak with a negative score of -0.75 and -0.46 in 2020.¹²⁴ The delay in the ombudsman appointment¹²⁵ and the increasing discretionary budget for the Nauru Housing Scheme¹²⁶ shows the little transparency and accountability in the public sector.

H. Papua New Guinea

1. Economic Drivers

109. **PNG's economy in the last five years has remained sluggish, dragged down by a series of adverse external shocks.** These shocks include a decline in commodity prices, reversal of capital flow associated with the completion of the PNG Liquefied Natural Gas project construction phase, a severe drought, a major earthquake, and the COVID-19 pandemic. In 2022, spillovers arising from Russia's invasion of Ukraine as the war weighs on global confidence in foreign investment and adds further pressure on PNG's inflation through higher food and energy prices. Also, the monetary and exchange rate policy framework has been

¹²⁴ WGB. 2021. [Worldwide Governance Indicators](#).

¹²⁵ Leadership Code Act 2016 aims to ensure good governance and ethical conduct. Its provisions cover conflicts of interest, and misuse of public assets, resources and funds. However, the Office of Ombudsman as mandated in the Leadership Code Act is yet appointed.

¹²⁶ The Nauru Community Housing Scheme is the largest component of the government's social assistance. However, the budget allocation is not consistent over the years. From 2021 to 2023, the budget amounts are \$14.9 million, \$28.0 million, and \$7.0 million separately. There is criticism that public funds may be diverted for private use.

inadequate to mitigate the effects of internal or external shocks. PNG's de jure exchange rate regime is floating, but de facto the Kina is classified as crawling peg, which has impeded exchange rate adjustment and contributed to the foreign exchange (FX) shortage. The central bank actively intervenes the FX market through the selling of FX to defend the Kina from depreciating out of concerns over its effect on imported inflation, reflecting the reluctance of authorities to allow the Kina to adjust freely to contain import-driven inflation during the pandemic. As of December 2019, Kina was estimated to be 20% overvalued by around 11% to 18%.

110. PNG is facing the fiscal risks of significant increase in deficits and debts, and the personnel cost management. The IMF note that PNG remains at high risk of debt distress, and that PNG's vulnerability to export shocks, such as COVID-19, climate and other natural disasters, point to serious downside risks to the debt outlook.¹²⁷ The total public debt as a share of GDP increased from its 2019 level of 41.5% to 49.2 % of GDP in 2020. At the same time, the GoPNG faced substantial budget deficits over the last two years, with deficits of -8.9% of GDP in 2020 and -6.7% in 2021. While the increase in debt to GDP and deficits can be attributed to the sharp decline in GDP resulting from COVID-19 and the attendant loss of revenue, expenditure growth has also been a large contributor. The GoPNG notes personnel cost management as a key fiscal risk in the 2022 Budget. Personnel costs in 2021 are 12.4% higher than in 2019, despite government initiatives to deal with the problem, and are now around 30% of total expenditure.

2. Structural-Environmental Drivers

111. While PNG is ranked as an open economy under the IMF's classification, the logistic service remains weak. The most recent World Trade Organization (WTO) trade policy review of PNG concluded that PNG has no anti-dumping, countervailing or safeguards legislation of significance. Therefore, The IMF's Trade Restrictiveness Rating regarding tariffs and non-tariff barriers is 1 on a scale of 1 to 7 with 1 indicating the most open trade regime. However, PNG has stagnated in performance when measured by the World Bank Logistics Performance Index (LPI). In 2018, the country ranked 148 out of 160 countries surveyed; a downgrade from the rank of 105 in 2016. This is due to weak customs efficiency, infrastructure, international shipments, logistical competence, tracking and tracing and timelines.

112. Competition in the banking sector remains limited and the access to financial services remains particularly difficult in rural areas. The barriers to entry in the supply of banking and financial services in PNG is considered high and to certain extent, inhibit entry. Weak competition in the PNG banking sector stems, at least in part, from the market being concentrated and segmented. Bank of South Pacific (BSP) has approximately 65% market share, significantly higher than 55% in 2012, indicating its dominance in the sector. The next two largest banks (ANZ and Westpac) tend to operate in comparative more narrow market segments. On the other hand, due to the geography and demographics, access to financial services remains difficult in rural areas. Bank of Papua New Guinea estimates that in June 2016, 37% of adults had an account at a formal financial institution.

113. Business regulations are burdensome, with limited private freehold land. Although trade freedom is strong, investment freedom and financial freedom are exceptionally weak.¹²⁸

¹²⁷ IMF. 2022. [Papua New Guinea: Request for a Staff-Monitored Program; and Staff Report.](#)

¹²⁸ The Heritage Foundation. 2022. [2022 Index of Economic Freedom.](#)

The 2022 index of economic freedom indicates that PNG is ranked 26th among 39 countries in the Asia-Pacific region, and its overall score is below the regional and world averages. Regulatory uncertainty, security/law and order was rated as the top business impediment in the 2022 PNG 100 CEO Survey. Licenses, permits and approvals, many time-bound, are issued for various activities by different central government departments and agencies, as well as provincial and local level governments (e.g., in the case of trading licenses). There are bottlenecks in the procedures and long delays affect entry of a business into a market or result in unlicensed businesses operating illegally. Businesses are also adversely affected by the slow work permit and visa processing for expatriate staff. Compliance systems including taxes and customs are burdensome for businesses. Financial reporting and disclosure requirements for companies and other commercial entities are relatively weak and are very poorly enforced. Also, Land in PNG has traditionally been in the customary joint ownership of clan groups, which usually provides for access to land to all members of the clan. Customary land ownership is usually undocumented and land boundaries are not delimited, making it difficult to lease or purchase land or use land as collateral. Currently around 97% of land in PNG is owned by customary landowners. Of the remaining 3% of land (around 600,000 ha) is in private freehold, with the rest owned by the government which acquired it from customary landowners in the past. Foreigners cannot own land in PNG but can hold leases. The pool of noncustomary land is growing slowly and the process of releasing even state-owned land for development is complicated, causing shortages of land.

114. **PNG is highly vulnerable to the effects of climate change, and there have been significant challenges in managing environmental sustainability.**¹²⁹ PNG faces high levels of disaster risk driven by moderate levels of exposure to flood, drought, and cyclone, but particularly by its lack of coping capacity.¹³⁰ The Conservation and Environment Protection Authority Act 2014 was enacted and came into effect in parallel with the Environment (Amendment) Act 2014 which in amending the Environment Act 2000 enabled the creation of the Conservation and Environment Protection Authority (CEPA). However, CEPA continues to struggle with weak capacity, shortage of skilled staff and resources, and insufficient financing in its operations. There is limited access to information. Cross sectoral coordination is weak and can be attributed to poor communication channels and a lack of accountability. Legislation for specific sectors is also compromised with a lack of follow-up regulations, enforcement and monitoring with inconsistency in its application.

3. Political-Social Drivers

115. **There are challenges for women and girls particularly in gender-based violence, labor-force and political participation, and access to resources.** Violence against women, including female genital mutilation, trafficking, or sexual harassment, is common. About 10 to 13 cases of gender-based violence are reported weekly.¹³¹ Common acceptance of customary laws including paternal rights over children, among others, harshly impinge on the rights of women as individuals. Divorces usually end up with most of the women leaving the home without acquiring family assets and savings including facing difficulties in securing child custody. Polygamous marriages can exacerbate gender-based violence. The 2021 Trafficking in Persons Report puts

¹²⁹ Climate Change and Development Authority in PNG. 2022. [PNG Intended Nationally Determined Contribution \(INDC\) under UNFCCC](#).

¹³⁰ WBG. 2021. [Climate Risk Country Profile – Papua New Guinea](#).

¹³¹ Papua New Guinea Post Courier. 2021. [Domestic Violence Affecting Lives of Girls, Women in PNG: N'Dranou](#). Port Moresby.

PNG is on the Tier 2 Watch List.¹³² In terms of labor force and political participation, PNG is ranked 125 out of 128 countries, at the close bottom of the 2012 Economist Intelligence Unit's Women's Economic Opportunity Index. More than 80% of PNG's population rely on subsistence farming and it is common to see large number of women participation in subsistence farming. In the formal sector, women's participation in the labor force is low. The share of women in wage employment in the non-agricultural sector was only 5.3%, the lowest in the Pacific region. Also, in October 2021 there was not a single woman among the 111 members of the National Parliament nor among the Cabinet Ministers. Of the 6,190 ward seats and 319 local-level government seats, only 120 were held by women.¹³³ More girls are entering the education system while the participation for females in tertiary and technical vocational education remains low. Topographical challenges, lack of health care services and low level of education, and lack of income limit accessibility to antenatal health care by women. More support is needed to reduce the disparity gap by rural women to maternal and antenatal healthcare.

116. Violence and crime continue to pose a serious law and order problem in PNG. According to the Worldwide Governance Indicators, PNG ranked in the 20 percentiles on political stability and absence of violence in 2020.¹³⁴ The lack of accountability for police violence persisted in PNG, and weak enforcement of laws criminalizing corruption and violence against women and children continued to foster a culture of impunity and lawlessness. Police performance and morale have been further eroded by poor working conditions and substandard accommodation, as well as by factionalism and corruption within parts of the organization. Police violence continues, especially targeting those suspected of crimes. Between September 2018 and January 2019, 133 police have been investigated and 42 arrested. Violence ranges from regular crime in major towns due to high unemployment and social uprooting, to inter-clan and ethnic violence in rural and sometimes in peri-urban parts of the country over lands, royalties from natural resources or blood feuds. Port Moresby, the capital, has for years ranked among the most dangerous cities in the world, and a short-lived economic boom added to inequalities and incentives to engage in crime.

117. Though the majority of the population is receiving basic health services, high inequities in access to quality care exist. Program coverage in poor urban and rural areas is weak, and utilization of services is constrained by physical barriers to access and shortages of health workers. The rural health system has been impacted by a highly decentralized and fragmented system of health financing and delivery, resulting in shortages or stock-outs of medicines and other equipment/provisions in health facilities for significant periods of time. Public funding targets some of the key public health priorities, and financial protection exists, but the poor are not well-targeted, and out-of-pocket expenditures remain high for the poor and other disadvantaged groups.

118. Education sector has been under resourced. Government expenditure committed to education remains one of the lowest proportions among Pacific Island Countries. Education share of the government budget has been decreasing in the past few years, dropping from 9.4% in 2016 to 8.7% in 2017 and even further to 8.5% in 2019 and 5% in 2020. Also, the improvement of the teaching quality is needed. The provision for in-service training and development is limited and largely ad hoc due to inadequate funding. In the past, the

¹³² US Department of State. 2021. [2021 Trafficking in Persons Report](#). Washington, DC.

¹³³ UN Women. 2022. [About UN Women Papua New Guinea](#).

¹³⁴ WGB. 2021. [Worldwide Governance Indicators](#).

government relied heavily on donors to finance teachers' in-service training. Budget allocation for this work remains inadequate.¹³⁵

119. **Lack of a comprehensive social protection system.** According to UNDP, 38% of PNG's population still lives below the poverty line.¹³⁶ Some social safety programs have been developed, but they are mostly small government programs and/or NGO/donor-driven programs. The lack of social protection system makes coordination of social protection programs very challenging. Social protection programs are being developed and implemented by non-government organization, civil society organizations, and faith-based organizations including different sectors of the government. Available data of 2012 indicates that the breadth of coverage of social protections only counts 1.9% of the population, just a little bit higher than Vanuatu (0.9%) and greatly lower than the average of 18.9% of the Pacific countries. For example, the minimum wage targets the need of all employees in the private sector, however not all employees benefit from this policy due to exemptions for employees in agriculture sector, and for employers who do not have the financial capacity.

4. Institutional Drivers

120. **The judiciary effectiveness is low.** PNG's judiciary has historically generally considered to be impartial: courts have ruled against the government and important politicians. Courts are underfunded and short-staffed. Because of bureaucracy, limited financial and human capacity, and the lack of political will, pervasive corruption and nepotism often go unpunished.¹³⁷ There is an extensive network of village court magistrates across rural and urban areas. Although they are not equipped to handle criminal or other serious cases, they are responsible for a wide range of cases, using a process based upon traditional law and justice.

121. **Public administration remains weak and ineffective.** PNG ranked in the 19 percentile on government effectiveness in the 2020 Worldwide Governance Indicators.¹³⁸ Mechanisms for coordination between different central government agencies and between the central and subnational government exist and various policy challenges are being addressed through high-level inter-departmental groups, but these are often not effective at an operational level. Despite the increase in size of the public service, most public servants' salaries have declined in real terms, with wage rises not keeping pace with living costs. The rapid increase in the civil service happened at the expense of its quality and effectiveness, pushing skilled staff towards the private sector.

122. **Transparency and corruption issues remain significant in public sector.** Boundaries between public and private sectors are not very well defined. Regulations on political financing are weak, and recent funding allocations have exacerbated the need for transparency. Politicians are funded by sectional interests and by the manipulation in the use of public funds. The Corruption Perception Index (CPI) 2021 score for Papua New Guinea is 31 and is ranked 124 out of 180 countries.¹³⁹ According to the Global Corruption Barometer, 96%

¹³⁵ The Papua New Guinea National Research Institute. 2022. [Spotlight – The Challenges Teachers in Papua New Guinea Continue to Face.](#)

¹³⁶ UNDP. 2022. [Briefing note for countries on 2021 Multidimensional Poverty Index – Papua New Guinea.](#)

¹³⁷ The Heritage Foundation. 2022. [2022 Index of Economic Freedom.](#)

¹³⁸ WGB. 2021. [Worldwide Governance Indicators.](#)

¹³⁹ Transparency International. 2022. [Corruption Perceptions Index 2021.](#)

of people in PNG think that corruption in government is a big problem, and 57% of people were offered a bribe in exchange for their vote in the last 5 years.¹⁴⁰

I. Solomon Islands

1. Economic Drivers

123. **Solomon Islands remain a fragile and vulnerable economy to domestic and international influences.** The economy is based on primary commodities from forestry, agriculture, and fishing. Economic growth has been driven by expansionary fiscal policy, record high logging, and agriculture and fishing exports over the last two years. Yet, COVID-19 related restrictions, combined with Cyclone Harold, contributed to economic contraction of 3.4% in 2020. Pandemic-related disruption and temporary civil unrest that damaged infrastructure contributed to economic contraction of an estimated 0.5% in 2021. Restrictions on trade and travel also delayed infrastructure projects that rely on imports and foreign labor. Also, the IMF assessed that the external sector position in 2020 was moderately weaker than suggested by medium-term fundamentals and desirable policies; and the real exchange rate was overvalued, which could be addressed by more frequent reviews of the currency basket.¹⁴¹

124. **While non-essential public services were scaled down to contain expenditure amidst falling revenue, the fiscal deficit has widened, and fiscal buffers fallen.** Revenue and grants fell to 30.9% of GDP in 2021 from 39.4% in 2018, while expenditure was contained at 34.0% of GDP in 2021, down from 38.5% in 2018. The 2022 Budget indicates an overall fiscal deficit of 7.3% of GDP. Fiscal buffers are low which increases the vulnerability to further shocks. The IMF estimates the government's narrow cash balance has been below one month of recurrent spending since 2019.¹⁴² The capacity of fiscal policy to allocate resources for critical infrastructure and services is weakened by the country's geographic dispersion, strained capacity, and weak revenue trends. The provision of public goods, especially infrastructure in rural areas, is generally insufficient to support inclusive growth over the medium-term, although significant investment has taken place since the end of the civil conflict in 2003.

125. **Public debt is low but is projected to rise in the medium term to finance public infrastructure and persistent fiscal deficits.** The current public debt accounts for 11.8% of GDP in 2020. However, the IMF projects the debt-to-GDP ratio will reach the government's nominal debt threshold of 35% of GDP by 2029. Also, the current debt portfolio is vulnerable to foreign exchange rate risk due to the relatively high share of foreign currency denominated debt. The MTDS reports that Solomon Islands foreign currency denominated debt accounted for about 69.4% of the total debt portfolio.¹⁴³

2. Structural-Environmental Drivers

126. **Solomon Islands experiences major development challenges associated with the small size and remoteness from major markets, which are compounded by inadequate**

¹⁴⁰ Transparency International. 2021. [Global Corruption Barometer: Pacific 2021](#).

¹⁴¹ IMF. 2022. [Solomon Islands 2021 Article IV Consultation-Press Release; Staff Report; And Statement By The Executive Director for Solomon Islands](#). Washington, D.C.

¹⁴² Narrow cash balance is defined the sum of government deposits held at the central bank and the commercial banks minus unpaid payment orders and unrepresented checks.

¹⁴³ IMF. 2022. [Solomon Islands 2021 Article IV Consultation-Press Release; Staff Report; And Statement By The Executive Director for Solomon Islands](#). Washington, D.C.

domestic infrastructure. About 85% of the population of 652,000 is rural, living in widely dispersed villages of a few hundred persons. Solomon Islands exhibits high levels of trade openness, partially as a result of its dependence on imported goods. There are no significant non-tariff barriers, although the weak capacity of relevant authorities and a degree of red tape effectively represent barriers to trade. The export structure is highly concentrated in wood.¹⁴⁴ However, Solomon Islands will graduate from the Least Developing Country category in December 2024. The impacts of graduation are far reaching, but the tuna coconut and palm oil industry, specifically, are expected to be affected because of the estimated trade cost increase, which may arise through erosion of tariff preference by the EU and other markets.

127. The non-performing loans increase, accompany by high interest rate spreads. The access to financial service remains limited. The financial sector has a simple structure but is beset with inefficiencies. These are reflected by the small domestic market, inadequate infrastructure, the difficulty of securing collateral due to communal land ownership, and generally high transaction costs. Interest rate spreads have long been one of the highest among small states in the Pacific, with deposit rate of 0.5% and lending rate of 10.7% in 2020. The high lending rates reflected commercial banks' risk averse behavior to manage existing loan portfolios while assessing opportunities to provide additional loans, especially in times of major uncertainties associated with COVID-19.¹⁴⁵ Also, the IMF Article IV 2021 Consultation Mission stated that non-performing loans (NPLs) had been increasing from 11.8% in 2018 to 18.1% in 2021. The increase is caused by delays in government payments. With most of the population resided outside of the capital Honiara, and in the rural areas, it is imperative for access to finance to be available to individuals and SMEs. However, the private sector is constrained by commercial banks' caution, unclear and unregistered land rights, systemic difficulties in using most types of collateral for loans, lack of a clearing system outside Honiara, and large infrastructure gaps in terms of communication and transportation. Formal financial inclusion remains low at 34% in Solomon Islands with gender gap of 15%.¹⁴⁶

128. The country is dominated by state monopolies that provide basic services including electricity, water, airlines, and ports. The country has suffered from decades of poor SOE performance as SOE management was driven by political, rather than commercial, imperatives. Constraints to growth and private sector investment remain, including infrastructure gaps in energy, transport, and communications; underdeveloped labor skills; and land tenure issues. Operational licensing, permits, compliance and inspection requirements, including those related to taxes and customs, are moderately burdensome. For example, Solomon Islands operates a decentralized system where business licenses are issued by provincial authorities. The license fee collected depends on the business activity. Generally, a business will need to obtain several licenses to cover each of its business activities. Also, most land in Solomon Island, approximately 85%, is customary land. The remaining 15% is registered land. The Land and Titles Act provides the process for the conversion of customary land into perpetual and fixed term estates that can be used in a commercial setting. However, the system to obtain a perpetual estate or a fixed term estate over land is complex, time-consuming and does not necessarily result in the security of tenure that commercial enterprises need. In particular, the land acquisition process is not well-defined or centrally controlled by government. The

¹⁴⁴ United Nations. 2019. [Joint United Nations Workshop on Preparing for a Smooth Graduation from the Least Developed Countries Category](#). Geneva.

¹⁴⁵ IMF. 2022. [Solomon Islands 2021 Article IV Consultation-Press Release; Staff Report; And Statement By The Executive Director for Solomon Islands](#). Washington, D.C.

¹⁴⁶ UNCDF. 2020. [PoWER Women's and Girls Access and Agency Assessment: Solomon Islands](#).

legislation is also silent on important issues such as dealing with improvements at the expiry of a lease term.

129. Solomon Islands is extremely vulnerable to disasters caused by natural hazards, being subjected to cyclones, floods, landslides, storm surges, earthquakes, tsunamis, and droughts. Climate change will affect disaster risks through changes in climate hazards, as more extreme weather events are likely to increase in the future. The country is already experiencing higher temperatures, changing rainfall patterns, and varying frequencies of natural hazard events. In addition, increased ocean temperatures and ocean acidification are leading to coral bleaching and destruction of natural coastal barriers. Sea level rise is contributing to coastal erosion. These slow-onset climatic changes have increased the region's exposure and vulnerability to disasters brought about by climatic events such as tropical cyclones and storm surges. It is estimated that the country has incurred an average loss of US \$20 million per year as a result of earthquakes and tropical cyclones over the past years.¹⁴⁷

3. Political-Social Drivers

130. There are challenges for women and girls particularly in gender-based violence, labor-force, and access to resources. Sexual gender-based violence especially among women in Solomon Islands face widespread discrimination, gender-based violence and inequality. Approximately 64% of women reporting having experienced physical or sexual violence from an intimate partner at some point in their life.¹⁴⁸ Also, lack of parity in education, unequal legal rights and decision-making power and limited control of financial resources undermine women's economic participation. The 2013 Household Income and Expenditure Survey indicates that women's labor force participation for the population aged 15 and above stood at 83.9% compared to 87.9% for men.¹⁴⁹ Further, women are more likely than men to lose jobs and income due to COVID-19, with female heads of households more likely to report stopping work to care for an ill relative.¹⁵⁰ Women also have less access to bank accounts than men, with around 20% of women having a bank account compared to 32% of men.¹⁵¹

131. The alignment of public expenditure with national development priorities are generally unevenly aligned with poverty reduction priorities and little provision is made to target public expenditure to poor areas and people. The government do prioritize expenditure on health, education generally and rural education, and infrastructure maintenance. The Ministry of Health and Medical Services (average of 13% of the total ministerial allocation) and the Ministry of Education and Human Resource Development (32% of the total ministerial allocation) both received higher overall budgets in 2020 and 2021 budgets. However, in 2021 the provincial health budgets decreased by 10% from SB\$142.02 million, and the allocation to early childhood education decreased by 8% from SB\$56.3 million in 2020.

132. The formal social protection system is limited which constrained the government's ability to directly support the poorest. There is a Social Welfare Act, but no social protection strategy framework in place to implement it. The Social Welfare Division within

¹⁴⁷ United Nations. 2019. [Joint United Nations Workshop on Preparing for a Smooth Graduation from the Least Developed Countries Category](#). Geneva.

¹⁴⁸ Henrica A.F.M. Jansen. 2019. [kNOwVAWdata – measuring prevalence of violence against women in asia-pacific](#).

¹⁴⁹ International Labour Organization. 2022. [ILOSTAT Labour force participation rate \(%\) by sex and age](#).

¹⁵⁰ World Bank. 2020. [Solomon Islands High Frequency Phone Survey on COVID-19: Results from Round 1](#).

¹⁵¹ Central Bank of Solomon Islands. 2015. [SOLOMON ISLANDS NATIONAL FINANCIAL INCLUSION STRATEGY II \(NFIS2\) 2016-2020](#). Honiara.

the Ministry of Health and Medical Division provides assistance only during times of disaster, while orphans and destitute children mostly received care from their relatives. The country does not have a program national unemployment scheme or targeted benefits for the unemployed, disability citizens, young unemployed single mothers, and elderly citizens. In part, this is due to absence of an administrative capacity system to identify the poor, maintain records and implement the programs. It also reflects the importance of traditional social support systems. Ethnic group (wantok) links provide a form of social security as group members are expected to provide mutual support.

133. Political protests turned violent in Honiara in November 2021 following the diplomatic switch from Taipei,China to People’s Republic of China in 2019. While the security situation is now stable, the fragile nature of that stability demonstrated by the riots and looting broke out in Honiara and other parts of Guadalcanal in April 2019 and November 2021 demonstrates that external support is still very much needed. Australia, and other regional members of the Regional Assistance Mission to the Solomon Islands (RAMSI) especially Fiji, Papua New Guinea, and New Zealand, continue to support security and stability in Solomon Islands through a bilateral police capacity development program. These countries responded rapidly to the Prime Minister’s request to deploy military and police personnel to restore law and order in November 2021. This indicated that the government was not confident that the existing enforcement structures could adequately protect citizens and restore order.

134. Ethnic conflicts and conflicts over land tenure have been a major source of civil unrest. In 1998, the Solomon Islands experienced nationwide ethnic conflicts that contributed to the level of interstate violence. International consensus concluded that identity forging of the two larger islands Malaita and Guadalcanal occurred ousting marginalized groups. Unresolved tension brewed fear of isolation and political monopoly, eventually erupting into five years conflict and crisis.¹⁵² In 2003, peace accords were signed. International intervention, particularly from Australia and New Zealand, continue to mediate conflict in Solomon Islands through and after the signing. Another source of conflict is the land tenure. Most of the land in Solomon Islands is customary, whereby every member of a landholding entity, such as a tribe, clan, or family is vested with the rights to use and access it.¹⁵³ Customary tenure is governed by customary laws and oral tradition passed down from generation to generation. Non-owners usually have limited rights, such as right of use, easement, or right of way.

4. Institutional Drivers

135. The judiciary is independent, but a lack of resources makes the conduct of timely trials difficult and leads to weak enforcement of contracts and a large case backlog. Backlog of cases are especially at the local courts and land appeal courts whereby funding is cited as the major issue. For the High Court, there is also a backlog of cases, but mostly related to case management. To help reduce the backlogs, the number of judges should be increased.¹⁵⁴ Also, as a country of over 900 islands, access to the Solomon Islands legal system is very difficult for many Solomon Islanders. Residents of rural areas have limited access to the formal justice system.

¹⁵² Maebuta, J., Spence, R., Wielders, I., & O’Loughlin, M. 2009. [Attempts at building peace in the Solomon Islands: Disconnected layers.](#)

¹⁵³ Foukona, J. D., 2017. [Solomon Islands’ urban Land Tenure: Growing Complexity.](#) Australian National University. Canberra.

¹⁵⁴ SIBC. 2017. [High Court Noted Reduction in Case Backlog.](#)

136. **The budget preparatory process has been facing huge challenges due to the declining and unpredictable inflows of government revenue caused by the pandemic.** The deterioration of the fiscal position between 2018 and 2020 reflected broad-based declines across major revenue categories, most notably log export duties as well as additional COVID-19 spending. Although donor support and domestic borrowing helped finance the 2020 fiscal deficit at 2.4% of GDP, payment arrears reportedly re-emerged reflecting structural Public Financial Management (PFM) weaknesses and increased liquidity pressures. The cash balance remained well below the IMF 2021 Article IV Consultation Mission recommended minimum of two months of spending. There is still weak linkage between the policy statements limiting the meaningfulness of a medium-term perspective to budgeting. Development projects funded by donor partners may not be included in the Solomon Islands government appropriated budget. This makes sector analysis difficult, inhibiting assessments of the number of resources allocated to any sector and prioritization and allocation of forward expenditure as part of an effective planning and budgeting process.

137. **The overall performance of the domestic revenue collection efforts deteriorated with around 12% decline between 2019 and 2021.** Lower collections over the last two years were caused by the fall in logging and fisheries exports that were a result of lower global demand as well as the impact of COVID-19 containment measures on trade and activity related to tourism, infrastructure projects and domestic demand. Labor market conditions deteriorated, as reflected in the decline in the number of formal workers contributing to the National Provident Fund (NPF). Levels of outstanding debt and returns are high and deteriorating.

138. **Capacity constraints exist across the public service.** Internal management capacity of the central government is fragmented, business processes largely ineffective and/or not followed, and responsibilities frequently overlap within ministries. This often results in unnecessary delays and transactions costs for the government and, ultimately, inefficient service delivery. The latest global integrity report for Solomon Islands on public administration and professionalism was in 2012. It was reported that appointment to public service, despite rules to the contrary, is largely influenced by factors such as family and ethnic relationship, and/or political relationships. With insufficient manpower of only four staff members, the Police Corruption Squad has difficulties to clear the backlog of cases during the investigation period for the 50 members of parliament related to the scrutinization of the newly elected members of Parliament for any electoral fraud.

139. **Government accountability remains low.** The political system is dominated by local - rather than national – concerns and civil society influence is thin although there are some dynamic and effective civil society elements which contest public policy, particularly in Honiara. The lack of effective and equal public resource distribution was widely cited as a source of discontent that sparked two civil unrests in 2019 and 2021. The sudden decision by the Prime Minister to switch from Taipei, China to People's Republic of China was mostly not agreed by the one of the populous Province, Malaita. Taipei, China's aid to Malaita ceased causing economic disparities that angered the Malaitans towards the national government.

J. Timor-Leste

1. Economic Drivers

140. **Global volatility has impacted inflation.** The economic indicators are weakened along with the impact of the global COVID-19 pandemic and continued implementation concerns with internal capacity constraints. Restricted mobility from COVID-19 restrictions and high

government spending added to the upward pressure. Food and non-alcoholic drinks, contributing 54% to consumer price index (CPI) basket, drove inflation sharply with the rising global food prices. Likewise, the majority of the country's vegetable oil is from Indonesia and Indonesia's ban on palm oil exports in Q1 2022 impacted inflation and rationing in some shops.¹⁵⁵ Inflation in tradeable products was nearly seven times that of non-tradeable (8.9% vs 1.3%), implying that increases in international markets are driving the current surge in inflation, compounded by high transportation costs to reach Timor-Leste.

141. **Overvaluation of the currency constrains economic diversification.** Timor-Leste is a dollarized economy, with the US dollar as the official currency. The system limits the scope for independent monetary policy by the central bank and trends in major monetary aggregates are driven more by the global economy than national policies. With the appreciation of the dollar against Timor-Leste's key trading partners, the real effective exchange rate (REER) appreciated 6.5% year-on-year in 2021, amplifying a small 1% rise in 2020 and it is estimated that exchange rate in 2020 was overvalued by 32%. An overvaluation in the REER is a constraint to economic diversification and development of tradeable services such as tourism.

142. **Worsening position in the debt carrying capacity.** The IMF downgraded Timor-Leste's risk of debt distress from "low" in 2019 to "medium" in 2021 as debt-to-exports and debt-service-to-exports deteriorated. Under the revised IMF guidelines, Timor-Leste is rated as having weak debt carrying capacity, i.e., it has an ability to borrow up to 35% of non-oil GDP without undue risk of debt distress.

2. Structural-Environmental Drivers

143. **The financial sector is limited in size and diversity, and to some extent is vulnerable to shocks in the medium term.** There is limited competition in the banking sector. Banco Nacional de Comercio de Timor-Leste (BNCTL) is the only bank subject to the exclusive supervision by Banco Central de Timor-Leste (BCTL). BNCTL's weak risk management controls and exposure to political pressure to lend pose risks. Its state ownership raises potential risks of directed lending. Although BNCTL has grown, its asset base is small relative to the total assets of the Petroleum Fund, estimated at 9.5% in 2021, so it can easily be recapitalized through the annual budget. The non-bank finance sector lacks diversity in financial products and providers. Insurance companies have a small consumer base. There is no equity and bond markets, and no government bonds are issued.

144. **Private sector credit growth has been limited.** All loans are basically unsecured due to uncertainties regarding land tenure and the absence of a framework for use of movable property as collateral. Further, private ownership of land can only be granted to Timorese citizens. Unsettled disputes over ownership of land remain an issue. In the absence of secured collateral arrangement, commercial banks impose rigorous checks and documentation requirements on applications for credit, which most businesses are unable to meet due to poor accounting and lack of financial information. In the 2020 Quality Indicators identifies the lack of financial education with only 6% of adults know the definitions of basic financial terms such as rate, risk, inflation, and diversification.¹⁵⁶

¹⁵⁵ World Food Programme Timor-Leste. 2022. [Market Monitor Report: June 2022](#). Dili.

¹⁵⁶ Banco Central de Timor-Leste. 2021. [Financial Inclusion Report 2021](#). Dili.

145. **Legal frameworks are lacking for regulating competition, business exit, consumer protection, and business operations.** There is no legal framework to promote and regulate market competition and consumer protection laws are yet to be enforced. The absence of laws governing insolvency is a constraint to the orderly exit of businesses. Timor-Leste has no registered practice for, even though a draft policy paper and law were presented to Parliament in 2017 with no approval. The consumer protection law, approved by the National Parliament in 2016, remains yet to be implemented. Also, contract enforcement continues to be a key concern due to undeveloped legal and institutional infrastructure. Likewise, inefficiencies in the process for approving work visas for foreign workers create an unintended barrier to businesses, which struggle to recruit qualified manpower.

146. **Timor-Leste is at a high-risk of climate related disasters and lack of coping capacity, as seen by the severe flooding due to cyclone Seroja.** The country was ranked 16 of 181 countries in the 2021 World Risk Index, placing it in the highest risk category of disaster risk.¹⁵⁷ According to the Environmental Performance Index 2022, Timor-Leste was ranked 129 of 180 countries around the world, and 13 of 25 regional countries, with a score of 35.1 out of 100.¹⁵⁸ Timor-Leste's ranking in the top-third of at-risk countries is largely down to its lack of coping capacity and the levels of social vulnerability in its population, both of which are scored lower than most countries in the region.¹⁵⁹ There is a shortage of capable staff in both national and district offices and staff, generally, have limited experience or background in environment issues.

3. Political-Social Drivers

147. **There has been a decline in gender disparity, while gender-based violence and gender equality in employment remain a concern.** Timor-Leste saw significant improvements in its 2021 Global Gender Gap Report ranking, moving to 62nd from 135th and the 3rd most improved country year on year.¹⁶⁰ Besides, the proportion of women in Timor-Leste's Parliament (38%) has been the highest in the Asia-Pacific region. However, gender based violence remains a serious concern, with approximately three in five women aged 15-49 (58.8%) who had ever been in a relationship reporting that they had experienced physical and/or sexual violence by a male intimate partner at least once in their lifetime.¹⁶¹ Reporting to the criminal justice system remains low given that women often seek justice through traditional systems over the formal process due to limited knowledge of legal procedures and lack of transport and distance to the closest town where formal justice institutions are located.¹⁶² As for the labor force participation, garment and craft workers are dominated by females, while transport is dominated by males.¹⁶³ A much greater proportion of men are employees, be that in the government or the private sector. Women are more likely to be contributing family workers (without pay), or own-account workers (self-employed). Also, women occupy less than one quarter (23%) of management and decision-making positions.¹⁶⁴

¹⁵⁷ Bündnis Entwicklung Hilft. 2021. [WorldRiskReport 2021](#). Berlin. Washington, D.C.

¹⁵⁸ Yale Center for Environmental Law & Policy. 2022. [2022 Environmental Performance Index](#). New Haven.

¹⁵⁹ World Bank and ADB. 2021. [Climate Risk Country Profile: Timor-Leste](#). Washington, D.C. and Manila.

¹⁶⁰ World Economic Forum. 2021. [Global Gender Gap Report 2021](#). Geneva.

¹⁶¹ Henrica A.F.M. Jansen. 2019. [kNOwVAWdata – measuring prevalence of violence against women in asia-pacific](#).

¹⁶² International Women's Initiative. 2021. [Domestic Violence in Timor-Leste: Beyond the Legal Framework \(policy brief\)](#). London.

¹⁶³ Mata Dalan Institute. 2020. [The informal sector in Timor-Leste in the midst of COVID-19](#). Dili.

¹⁶⁴ Government of Timor-Leste and United Nations Population Fund. 2018. [2015 Census Gender Dimensions Analytical Report](#). Dili.

148. **The equity of public resource use is limited.** The non-availability of updated poverty data which makes impact assessment difficult. As a result, identification of the vulnerable groups such as the elderly, physically disabled, and widows for targeted assistance has been a concern. Social protection programs and sub-national transfers are not adequately targeted. The inadequate resource allocations hamper the general implementation of the national health and education strategies. Meanwhile, most revenues are sourced from the offshore oil and gas sector and donor grants, the low domestic revenue mobilization is a threat to fiscal sustainability.

149. **Access to health services is an issue due to geographic disparities.** As 70% of the population lives in rural areas in small, dispersed villages, access to health is an issue. For example, women in urban areas are nearly twice as likely to receive delivery assistance from a skilled provider than women in rural areas (86% versus 45%). Delivery assistance from a skilled provider varies dramatically by municipality, from a low of 20% in Ermera to a high of 85% in Dili.¹⁶⁵ Also, malnutrition in Timor-Leste is among the highest in the world with children suffering the highest levels of stunting and wasting.

150. **Education is limited by the budget and affected by the pandemic.** In 2021, the budgeted expenditure for education and related programs was \$119 million, or 6.1% of the budget. Expenditure on education as a proportion of total public spending remains below the internationally recommended level of 15%-20% to achieve SDG 4 on Education. Further, the extended lockdown impacts learning outcomes. Because of the pandemic, only 68% percent of students outside Dili and 41% of students in Dili continued studying on a daily basis during the school shutdown.¹⁶⁶

4. Institutional Drivers

151. **Property rights are still often based on informal and customary practices.** In general, disputes over ownership of land in Timorese communities are common, with competing claims from titles registered during the Portuguese colonial rule, Indonesian occupation, and Timorese independence. The Land Ownership Law is aimed at recognizing and granting first ownership rights over immovable property, but it also acknowledges the existence of previous ownership including informal customary rights, long-term possession, and formal rights previously granted by Portuguese and Indonesian administrations.

152. **Actual expenditures have been increasingly deviating from budget allocations and there are significant gaps between the high-level priorities and annual budget allocations.** In 2020 and 2021, actual expenditures deviated from budgeted expenditures by between 24% and 29% respectively. The impact of COVID-19 and related lockdowns also contributed to the deviations. Besides, the approval of supplementary budgets reduces budget credibility and puts added pressure on fiscal sustainability. The Parliament approved supplementary budgets in 2021 and 2022. In May 2021, the budget saw a \$135 million (7.1% of the original budget ceiling) increase. On the other hand, the link between policy and objectives remains weak. For example, education and health, and more recently agriculture, are considered priority areas but remain underbudgeted and received the same proportion of allocation each year.

¹⁶⁵ Government of Timor-Leste. 2018. [2016 Timor-Leste Demographic and Health Survey: Key Findings](#). Dili

¹⁶⁶ Government of Timor-Leste and United Nations Development Programme (UNDP). 2021. [Socio-Economic Impact Assessment of Covid-19 in Timor-Leste, Round 2, 2021](#). Dili.

Public sector capacity remains limited. Timor-Leste rates relatively poorly on government effectiveness. In the Worldwide Governance Indicators, Timor-Leste scored -0.8 on a scale of -2.5 to 2.5 in 2020, putting the country in the 19.23 percentile.¹⁶⁷ Shortcomings in operational efficiency reflect the ongoing development of technical skills and the challenge of creating a more performance-oriented culture in the civil service. Timor-Leste faces specific challenges relating to the relatively low level of educational attainment of the adult population and current public servants, and the close networks of familial ties that are present in a small and tightly knit society. Language skills present a challenge as many civil servants have limited ability to interpret laws and regulations that are published in Portuguese. Most laws are not published in Tetun.

153. **The justice sector remains fragile due to the lack of capacity in enforcing the law.** The 2020 Worldwide Governance Indicators put Timor-Leste in the 11.06 percentile in terms of rule of law.¹⁶⁸ The justice sector as a whole remains vulnerable to political interference. Language is a key issue in terms of ensuring accessibility because most laws are published in Portuguese which is spoken only by a minority of the population. In August 2020, the legislature passed a new anti-corruption law which entered into force on February 22, 2021. The Anti-Corruption Commission (CAC), prosecutors and courts have been investigating and accusing various politicians of crimes of mismanagement of public funds, manipulation of tenders, falsification of documents and corruption. However, according to CAC 2020 annual report, the adverse impact of the pandemic on the agency's ability to operate, making the CAC's fight against corruption more difficult.¹⁶⁹

K. Tuvalu

1. Economic Drivers

154. **Economic development relies on fishing revenues and foreign aid.** Tuvalu is the world's fourth smallest country in terms of land area, slightly bigger than Nauru in the region. Significant exposure to the effects of climate change, heavy reliance on imports for food and fuel, a narrow revenue base dominated by volatile fishing revenues, and dependence on foreign aid are the key factors inhibiting Tuvalu's macro-economic performance and development. Small local economy almost entirely dependent on highly volatile revenue from fisheries, sovereign trust fund (Tuvalu Trust Fund, TTF), licensing of dot.tv domain name, and external assistance. According to World Bank data, Tuvalu is the second-highest recipient per capita of overseas development assistance in the world, with 3,640 US dollar net official development assistance in 2020, slightly lower than Palau with 3,661 US dollar.

155. **The volatility of key revenue sources, narrow tax base and centrality of the public sector in the economy limit Tuvalu's ability to respond to shocks.** The Australian dollar serves as legal tender in Tuvalu and provides a strong nominal anchor, which is appropriate given the size of the economy and limited capacity to establish an independent monetary authority. However, it implies that macroeconomic policy for stabilization is reliant on fiscal policy. Achieving fiscal sustainability is the key challenge for the country. It requires prudent management of volatile and often unpredictable external revenue sources, such as fishing license fees; licensing royalties for the commercial use of the "dot.tv" internet domain name;

¹⁶⁷ WGB. 2021. [Worldwide Governance Indicators](#). Washington, DC.

¹⁶⁸ WGB. 2021. [Worldwide Governance Indicators](#). Washington, DC.

¹⁶⁹ Bertelsmann Stiftung. 2022. [BTI 2022 Country Report – Timor-Leste](#). Gütersloh.

earnings from Tuvaluans working abroad as seafarers and seasonal workers; and development assistance. The revenue from fishing license fees rose from 22 percent of GDP in 2012 to 80 percent of GDP by 2018 but are inherently volatile and unpredictable, declining to 49 percent of GDP in 2019 before rising again to 56 percent of GDP in 2020. Also, the tax base is narrow and compounded by tax exemptions and weak compliance. Tax revenue averaged 13.6 percent of GDP over the 2019-2021 period.

156. The most recent IMF-WB Debt Sustainability Analysis (DSA) of July 2021 assessed Tuvalu at high risk of overall public debt and external public debt distress. According to Asian Development Outlook database and International Monetary Fund, Tuvalu's external public debt fell from 9.4% of GDP in 2019 to 5.5% of GDP at end-2020 on account of positive fiscal balances and the conversion of the \$2.4 million loan extended by Taipei, China in 2019 to a grant in 2020. Both external public and total public debt ratios are currently below their respective thresholds, but stock indicators are projected to breach them under the baseline scenario over the longer term due to the declining fishing revenues, elevated expenditures related in part to costs associated with vulnerability to natural disasters and climate change, and the uncertainties over the magnitude of future grant commitments from the development partners. There is no direct policy coordination between macroeconomic policies and debt management. Institutional arrangements for debt management are weak and limited by capacity constraints. At present the government does not have a centralized debt management system, and there is no specific debt unit at Ministry of Finance (MOF).

2. Structural-Environmental Drivers

157. The geographic smallness and isolation limit commercial opportunities, economic diversification, and private sector development. The country has a narrow domestic economic base that is dominated by the public sector. Public sector accounts for around two-thirds of GDP. According to Worldwide Governance Indicators, Tuvalu ranks in 34.62 on the regulatory quality aspects in 2020,¹⁷⁰ which suggests limited ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. There is limited regulatory framework and enforcement of private business operations such as ownership and financial disclosure. There are few foreign laborers in Tuvalu and the majority of these are contract labor engaged for specific projects.

158. Tuvalu heavily relies on the importation, while the collection of duties, taxes, and payment of refunds are performed manually, and routinely slow and cumbersome. Given the country's limited production base, Tuvalu relies heavily on imported foodstuffs, fuel and construction materials but goods and service exports are small leading to large deficits in merchandise trade. As a consequence, trade policy is primarily focused on public sector revenue generation. The customs department uses a risk management approach, but this has not been very effective. Inaccurate invoicing and underreporting of imports are thought to occur regularly. Basic customs import entries are done manually. Lack of capacity to analyze the available data is still a challenge.

159. The size and reach of financial markets remain small and unsophisticated compared to global standards. Tuvalu's financial system is concentrated. There are two banks: The National Bank of Tuvalu (NBT) and the Development Bank of Tuvalu (DBT). Further, the financial sector consists of the Tuvalu National Provident Fund (TNPf), a Western Union

¹⁷⁰ WGB. 2021. [Worldwide Governance Indicators](#).

agent, and a handful of small informal money lenders. NBT is the only bank authorized to conduct international transactions and as such the bank generates most of its profits from FX transactions, while it has a small lending portfolio of low quality. Limited economies of scale, high default rates, as well as a certain level of inefficiency are reflected in NBT's history of high interest spreads and expensive fees and commissions. In Tuvalu, the financial inclusion is limited. There is no national ID system, making the verification of borrowers' credit history challenging. Credit card facilities were withdrawn in 2005. There are no ATMs. Access to banking services requires in person visitation, and transactions are conducted using cash, which are challenging due to the geographical barriers.

160. Bank lending is constrained by high NPLs and insufficient risk management due to an inadequate supervisory framework. The 2021 IMF Article IV Staff Report highlights continuing challenges with the limited capacity of the supervisory body, the Public Enterprise Reporting and Monitoring Unit (PERMU) and the need to extend the supervisory framework to also cover TPNF. The 2021 Article IV report also provides updated financial soundness indicators which show an increase in gross NPLs to 15% in 2020, up from 13.4% in 2019 and 11.9% in 2018. The IMF has also noted that in addition to weak credit risk management and lack of business skills, a lack of bankruptcy framework and the inability to pledge land as collateral are also factors hindering bank lending.

161. Tuvalu is extremely vulnerable to the effects of climate change and natural disasters, including cyclones, droughts, and sea-level rise. The country experienced destructive cyclones, droughts, flooding from high tides and storm waves. Thus, building resilience is one of the strategic priority areas in its national strategy for sustainable development 2021-2030.¹⁷¹ Environmental Impact Assessment (EIA) systems exist but capacity is low. Monitoring and enforcement are not routinely undertaken due to lack of resources. Tuvalu continues to be heavily reliant on outside expertise provided by regional organizations such as the Secretariat of the Pacific Regional Environment Programme (SPREP), international consultants and other international development partners to process environmental permits.

3. Political-Social Drivers

162. There are significant gaps in access to economic opportunities and politics for women, and gender-based violence remain an issue. In 2016, the female labor force participation rate is low at 38.3% as compared to men's rate of 71.2%. Besides, the female unemployment rate is 16.2%, while the men unemployment rate is 4.6%.¹⁷² There is still no guarantee of gender equality in the Constitution. Participation by women in politics is generally low, hindered largely by their subordinate societal position and by traditional perceptions of women and men's role in society. The 16-member parliament includes one woman, out of two who ran in the 2019 parliamentary elections.¹⁷³ Also, Tuvalu does not recognize the crime of marital rape and while maximum sentences are provided by law for sexual offences, there is no provision for minimum sentences.¹⁷⁴ Around 36.8% of women have experienced physical or sexual violence by an intimate partner in their lifetime.¹⁷⁵

¹⁷¹ Government of Tuvalu. 2021. [Tuvalu - National Strategy for Sustainable Development 2021-2030](#).

¹⁷² International Labour Organization. 2022. [ILOSTAT Labour force participation rate \(%\) by sex and age](#).

¹⁷³ PACIFIC WOMEN in Politics. 2022. [Country Profiles: Tuvalu](#).

¹⁷⁴ UN Women. 2022. [Asia and the Pacific: Tuvalu](#).

¹⁷⁵ Henrica A.F.M. Jansen. 2019. [kNOwVAWdata – measuring prevalence of violence against women in asia-pacific](#).

163. **Public expenditures are not aligned with poverty reduction priorities due to the incapability of targeting vulnerable groups.** A few interventions are in place to assist identified vulnerable groups, but targeting is lacking due to a lack of data. Capacity and resource constraints in the Tuvalu Central Statistics Division hinder the regular collection and analysis of data on household welfare and poverty, leaving Tuvalu dependent on donor and development partner support to conduct data collection and analysis.

164. **The Government of Tuvalu put efforts in health sector, but the country has shown limited progress towards achieving the diet-related non-communicable disease (NCD) targets.** The Government is the main provider of health services and health care is free, as is the cost of approved medical treatment in Fiji, New Zealand, or India if appropriate treatment is not available in-country, through the Tuvalu Overseas Medical Referral Scheme (TOMRS). The TOMRS continues to be a major expense to government. The TOMRS remains a significant challenge for the health ministry because the scheme is draining resources that could be used in prevention and primary healthcare services. Tuvalu's obesity prevalence is higher than the regional average of 31.7% for women and 30.5% for men, with 59.9% of adult women and 51.5% of adult men living with obesity.¹⁷⁶

165. **Uneven distribution of education resources and moderate education quality.** Education is a priority sector in Tuvalu commands the largest share of the national budget, increasing from 13 percent in 2012 to 18.4 percent in 2019. It is also the biggest public sector employer. Education is free and compulsory for children ages 6-15. However, Tuvalu's Net Enrolment Ratio (NER) in secondary education is 58% (2017) lower than most of the Pacific and other small island states. Quality of education remains a challenge in Tuvalu. While most teachers in early childhood care and education and primary schools are certified (defined as a teacher who has undertaken specialized post-secondary teacher training), at the two secondary schools, only 70% (at Motufoua) and 36% (at Fetuvalu) of teachers are certified. Very few teachers have either a Bachelor or a Masters in Education. ECCE teachers are generally considered unqualified (not having a diploma, bachelors or masters) although 92% have a certificate in teaching. Also, funding and teacher management are highly centralized. There is no formal policy in place for teacher posting, and no incentives for teachers to be posted to the outer islands. As a result, there is a higher number of qualified teachers on the main island, Funafuti.

166. **Formal social protection is limited.** Tuvalu relies on traditional safety nets based on community and family linkages to support individuals in need. The informal social protection mechanisms are affected by external factors including emigration, the depopulation of outer islands, and the increasing the dependency ratio among those who remain. Traditional safety nets are rarely effective in dealing with shocks such as those emerging from climate change and natural disasters, and the associated loss of assets, disruption of livelihoods and reduction of income. Tuvalu is under pressure to narrow-target their social protection schemes. The ILO World Social Protection Report 2017–19 indicated that only 19.5% of elderly receive old-age benefits, which is lower than the regional average of 55.2%.¹⁷⁷ There are various shortcomings in Tuvalu's labour laws including the omission under the Employment Act 2008 of any particular period of annual leave or sick leave, and the omission of any protections for discrimination in employment based on sex, disability or age. The Tuvalu Employment Act allows the

¹⁷⁶ Global Nutrition Report. 2022. [2021 Global Nutrition Report](#).

¹⁷⁷ ILO 2017. [World Social Protection Report 2017–19 Universal social protection to achieve the Sustainable Development Goals](#). Geneva.

Commissioner to grant exemptions to the minimum wage. However, the Department of Labour has not set a minimum wage and there is consequently a lack of clarity around what an acceptable minimum wage might be. Likewise, while annual leave is mentioned in the Act it does not specify the number of days an employee is entitled to.

4. Institutional Drivers

167. **Limited technical skills and volatile revenue lead to the delay of report publication and the deviation of actual expenditures against original budget allocation.** Tuvalu continues to face challenges that naturally result from limited technical skills and a lack of scale in undertaking ongoing improvements in its public financial management (PFM) systems. There are too few people to complete all the functions required for a full PFM system and hence the government decided to pursue PFM reform priorities that can be accommodated given resource constraints. There is a significant delay in the publication of financial statements. Consolidated Government Financial Statements (including all ministries and decentralized units) are required under the Public Finance Act to be completed within 9 months of the end of the year. However, the Audit of the Financial Statements of the Tuvalu Whole of Government for the year ended 31 December 2019 were completed and submitted to parliament in July 2021. On the other hand, given the high reliance on donor funds, fishing license fees, and distributions from the Tuvalu Trust Fund the government is unable to exert a lot of influence or control over its revenue streams. The deviation of actual expenditures against original budget allocations for 2019 and 2020 were 11.0% and 14.0% respectively.

168. **Weak administration capacity to ensure quality of public administration.** Regulation quality management arrangements are limited. Cabinet decisions and presidential or ministerial policy announcements are sometimes dropped, changed or otherwise not implemented, or explicitly reneged on or reversed, during the term of a government. This generally reflects the adoption of overly ambitious strategies and programs, both at the political level, such as election manifestos, policy decisions, and at the level of public administration, like formulating planning documents, with aspirational agendas and targets. Also, the lack of manpower remains a challenge. There are only 9 staff in the tax administration department, plus a long-term technical advisor, leading to the weak tax administration. In addition, a broad base of data from which the government can evaluate its progress against plans is quite weak. Tuvalu's Statistical Capacity Indicator stood at 47.8 out of 100 in 2020, lower than the average of East Asia and Pacific with the score of 74.5.¹⁷⁸

¹⁷⁸ World Bank. 2022. [Statistical Capacity Indicator Dashboard](#).

APPENDIX: THE PROPOSED ADB FCAS CLASSIFICATION

1. The state's functional capacity has long been ADB's fragility definition. Therefore, the country performance assessment (CPA), as an analytical tool to assess country's policy and institutional framework, has played a key role in the FCAS classification system. ADB implemented and published its own classification methodology in 2007 and revised it in 2013 by harmonizing the CPA with the World Bank's country policy and institutional assessment (CPIA), as outlined in Table A1.

Table A1: The Evolution of FCAS Classification

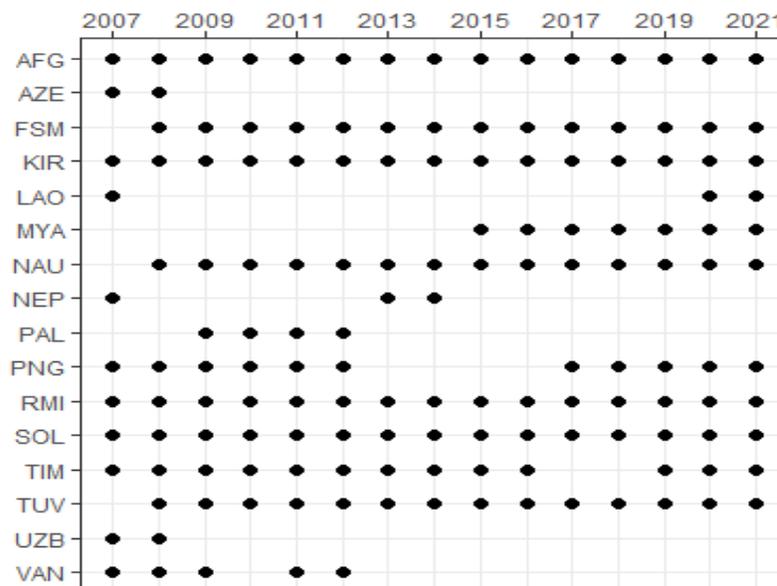
CPA-based Classification (2007–2012)	
(i)	Country is ranked in the fourth and fifth quintiles on country performance assessments for two of the most recent 3 years, or
(ii)	Country is considered to be in conflict or post-conflict and thus vulnerable.
Harmonized MDB Classification (2013–2021)	
(i)	The average of ADB CPA and World Bank CPIA is 3.2 or less, or
(ii)	The presence during the previous 3 years of a United Nations and/or regional peacekeeping or peacebuilding mission from such organizations as the African Union, the European Union, or the North Atlantic Treaty Organization (excluding border monitoring operations).

CPA = country performance assessment, FCAS = fragile and conflict-affected situations, MDB = multilateral development bank.

Source: Asian Development Bank.

2. Based on these two classification methodologies, 16 ADB DMCs have been categorized as FCAS since 2007. Of them, Azerbaijan, Nepal, Palau, Uzbekistan, and Vanuatu have graduated from the list, while 11 DMCs remain classified as FCAS, as outlined in Figure A1.1.

Figure A1.1: ADB Developing Member Countries in Fragile and Conflict-Affected Situations



CPA = country performance assessment, CPIA = country policy and institutional assessment, DMC = developing member country, FCAS = fragile and conflict-affected situations.

Sources: ADB. 2012. [Working Differently in Fragile and Conflict-Affected Situations – The ADB Experience](#). Manila; ADB. 2013. [Operational Plan for Enhancing ADB's Effectiveness in Fragile and Conflict-Affected Situations](#). Manila; ADB. 2022. [Annual Evaluation Review – Fragile and Conflict-Affected Situations and Small Island Developing States \(Appendix\)](#). Manila.

3. However, CPA as a whole does not illustrate the robust determinants of country-specific fragility. The FCAS and SIDS Approach illustrates that the classification of FCAS is dynamic, and the causes or critical drivers of fragility, risk, and vulnerability are context specific. The interaction and inter-dependency of these drivers in specific contexts generate multidimensional and complex risks. Similarly, the 2022 ADB Annual Evaluation Review calls for the classification system to employ a more nuanced understanding of the institutional and socioeconomic fragility and conflict risks DMCs face.¹ There is a need to explore greater granularity and show the interaction of the drivers of fragility in the classification methodology.
4. Also, public sector management (CPA Cluster D), also known as governance rating, is one of the most robust determinants of fragility. In defining fragility, both ADB and WBG underscore the features of weak governance and institutional capacity.^{2,3} AfDB and Caribbean Development Bank (CDB) also view fragility as the country's capacity to prevent, mediate, respond to, and recover from internal or external pressures. In addition, the weak governance rating is the commonality in FCAS countries. Figure A1.2 indicates that among the 11 FCAS countries, the average score of 2020 CPA public sector management is 2.94, lower than 3.01 of economic management, 3.06 of structural policies, and 3.13 of policies for social inclusion. Moreover, under the ADF performance-based allocation formula, public

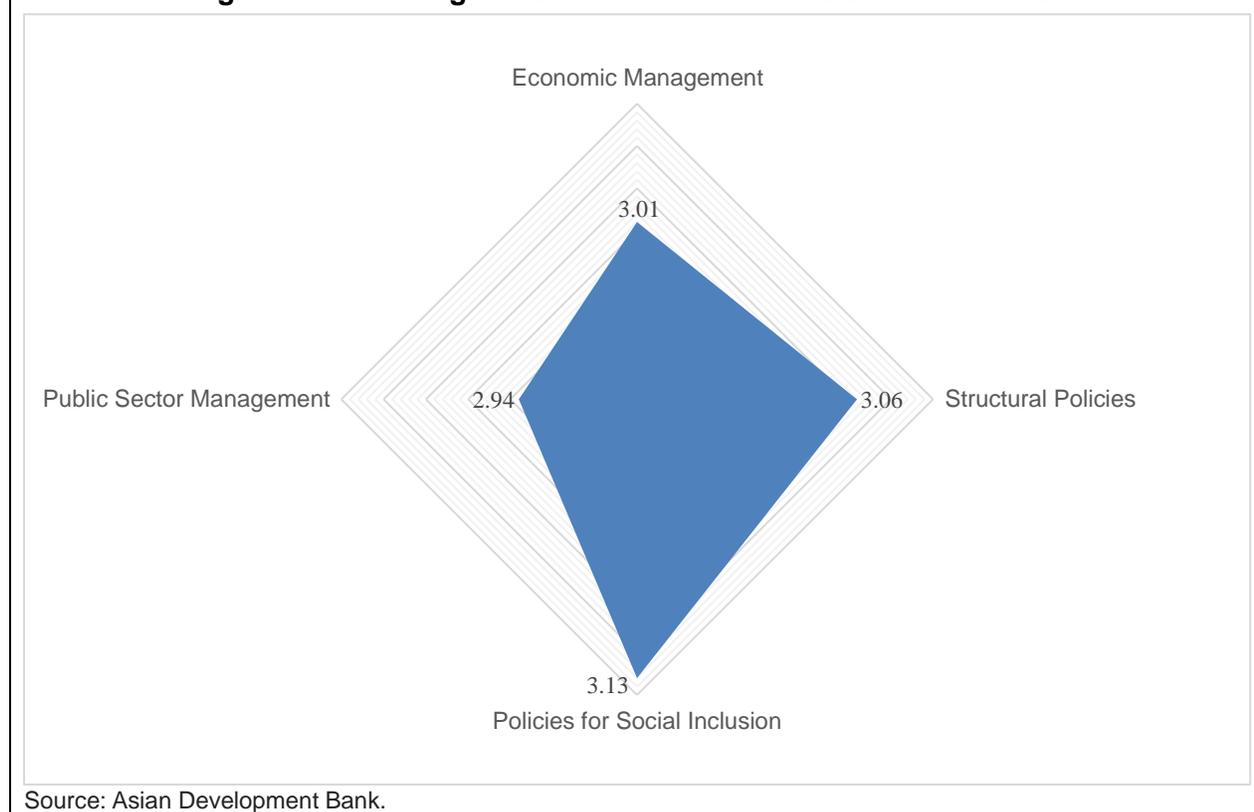
¹ ADB. 2022. [2022 Annual Evaluation Review: Fragile and Conflict-Affected Situations and Small Island Developing States](#). Manila.

² ADB. 2021. [Fragile and Conflict-Affected Situations and Small Island Developing States Approach](#). Manila.

³ World Bank. 2020. [World Bank Group Strategy for Fragility, Conflict, and Violence 2020-2025 \(English\)](#). Washington.

sector management has an exponential ratio of one, while the other three clusters share the same exponential ratio of 0.7. The performance-based allocation formulas for the WBG and the AfDB also put an emphasis on public sector management.

Figure A1.2: Average of CPA Clusters in FCAS Countries in 2020



5. Besides, forcible movement is not considered in the current classification methodology. Through its research into the drivers of fragility, the FCAS team has found mounting evidence that forced displacement is a critical indicator of a country's fragility. The WBG has recognized the outgoing cross-border displacement as a signal of political and security crisis if more than 2% of the country's own population has left the country. ADB also recognized this as it reflects the situation in Afghanistan and Myanmar. In addition, if either incoming cross-border displacement or internally displaced people makes up to 1% of the population in developing countries, the hosting countries have high pressure on resettlement issues such as their legal status, economic rights and services, access to social services, including health care, education, public housing, and access to justice, civil and political rights.

6. Moreover, ADB has recognized the differentiated nature and the interaction of fragility and conflict. The present harmonized list makes no distinction between fragility and conflict. However, countries find themselves in fragile situations without conflict. It is misleading to call these countries in fragile "and" conflict-affected situations. Since 2012, ADB has recognized the differentiated nature of fragility and conflict, providing distinct definitions, and highlighting their interplay.⁴ Conflict may be a cause, symptom, or consequence of fragility. Certain fragile

⁴ ADB. 2012. [Working Differently in Fragile and Conflict-Affected Situations: The ADB Experience](#). Manila.

situations are less associated with or dominated by conflict. When extreme, fragility can also be expressed in the form of conflict or the collapse of state functions. ADB has acknowledged the mutual causality of fragile situations and conflict-affected situations without giving priority to either of them. A country may find itself either in fragile situations or conflict-affected situations, or both

7. Further, there is a need to broaden the operational definition of “conflict-affected” based on the number of conflict-related fatalities. Conflict is a regional, national, or subnational situation involving armed parties.⁵ To operationalize violent conflict, there are a number of indicators being used, which include casualty, physical injury, destruction, use of weapons and personnel, and the number of forced displaced people.⁶ Since conflict events have different contexts, the most general and objective measure of conflicts is the number of casualties.^{7,8} Adopting data from the Armed Conflict Location & Event Data Project (ACLED) and the Uppsala Conflict Data Program (UCDP) ensures robust classification.⁹ The relative death toll in conflict reflects the seriousness of the conflict. Meanwhile, the absolute number of deaths is adopted to prevent bias in small populations. The FCAS team thereby has proposed the following methodology:

8. **Countries in fragile situations** include a range of countries facing weak governance and institutional capacity, economic and social insecurity, greater vulnerability to the effects of climate change and natural hazards, and in some cases political instability. These countries encounter different risks and have insufficient coping capacity of the state, system and/or communities to manage, absorb, or mitigate those risks.

- **A country is classified as fragile if it is:**
 - (i) a concessional assistance eligible country, and scores 3.2 or below in its average public sector management (Cluster D) rating; **AND**
 - (ii) in one or more of the following situations:
 - a. The average economic management (Cluster A) rating is or below 3.2;
 - b. The average structural policies (Cluster B) rating is or below 3.2;
 - c. The average policy for social inclusion (Cluster C) rating is or below 3.2;
 - d. Facing severe displacement issues, which are defined as:
 - More than 2% of the country’s own population has left the country and become internationally recognized as refugees in need of international protection; **OR**
 - More than 1% of the country’s own population is people internationally recognized as refugees in need of international protection; **OR**
 - More than 1% of the country’s own population is internally displaced.

⁵ ADB. 2021. [Fragile and Conflict-Affected Situations and Small Island Developing States Approach](#). Manila.

⁶ Trinn, Christoph & Wencker, Thomas. 2016. [Introducing the Heidelberg approach to conflict research](#). European Political Science.

⁷ Small Arms Survey. 2013. [Everyday Dangers - NON-CONFLICT ARMED VIOLENCE](#). Geneva.

⁸ Geneva Declaration. 2015. [Global Burden of Armed Violence 2015: Every Body Counts](#). Geneva.

⁹ The Armed Conflict Location & Event Data Project (ACLED) aims to capture the disorders and political violence in states, including targeted attacks on civilians and battles, spontaneous demonstrations, mass arrests and property destruction. The fundamental unit of observation in ACLED is event, with 6 event types and 25 sub-event types. Different from the event type, the Uppsala Conflict Data Program (UCDP) has a dyad and actor focus, dividing conflicts into three types: state-based conflict, non-state conflict, and one-sided violence.

9. **Countries in conflict-affected situations** are identified based on the number of conflict deaths in absolute terms and relative to their population, and the presence of peacekeeping operations.

- **A country is classified as conflict-affected if:**
 - (i) a United Nations Department of Peace Operation and/or regional peacekeeping mission (excluding monitoring operations) is present; **OR**
 - (ii) it has an absolute number of conflict deaths above 250 according to the Armed Conflict Location & Event Data Project (ACLED) and 150 according to the Uppsala Conflict Data Program (UCDP); **AND**
 - (iii) the relative number of conflict deaths per 100,000 population is
 - a. higher than 2 (ACLED) and 1 (UCDP); or
 - b. higher than 1 (ACLED) and 0.5 (UCDP), and more than double the number of casualties in the last year.