IDA'S NON-CONCESSIONAL BORROWING POLICY: REVIEW AND UPDATE

Resource Mobilization Department (FRM)

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ABBREVIATIONS AND ACRONYMS

AFDB	African Development Bank
ADF11	African Development Fund 11th resource replenishment.
AFESD	Arab Fund for Economic and Social Development
AsDF	Asian Development Fund
CFR	Collateralized with Future Receipts
CIRR	Commercial Interest Reference Rate
CAS	Country Assistance Strategy
CP	Completion Point under the HIPC Initiative
DAC	Development Assistance Committee
DeMPA	Debt Management Performance Assessment Tool
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
EITI	Extractive Industries Transparency Initiative
EMTA	Emerging Market Traders Association
GNI	Gross National Income
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
IsDB	Islamic Development Bank
LIC	Low Income Country
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
MTDS	Medium Term Debt Management Strategy
MVA	Modified Volume Approach
NPV	Net Present Value
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PPG	Public and Publicly Guaranteed
PEFA	Public Expenditure and Financial Accountability Program
PRGF	Poverty Reduction and Growth Facility
PSI	Policy Support Instrument

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Executive Summary

1. **Implementation of IDA's Non-Concessional Borrowing Policy (NCBP) has been moving well since the two-pronged policy was discussed by the Executive Board in July 2006.** Bank and IMF staff have carried out an ambitious program of outreach to raise awareness and encourage creditors to act in broad harmony with the Low Income Country Debt Sustainability Framework (DSF). In a complement to the creditor outreach activity, the Bank and IMF have also accelerated efforts to enhance borrowers' debt management capacity and the development of medium term debt management strategies. In addition a number of cases of non-concessional borrowing were discussed by management and appropriate IDA responses were determined on a case-by-case basis according to the methodology set out in the policy framework.

2. **The creditor outreach has had some success, but further dialogue is needed with a few remaining multilateral creditors, private creditors and non-OECD bilateral creditors.** The African Development Bank (AfDB), Asian Development Bank (AsDB), and the International Fund for Agricultural Development (IFAD) have all adopted grant allocation systems similar to that of IDA. Other creditors like the Inter-American Development Bank (IADB) take the risk of debt distress into account when determining the level of concessionality to offer to countries. The AFDB also introduced a new policy on non-concessional debt accumulation under ADF11 which is similar to the NCBP. The OECD Export Credit Group agreed to a set of principles and guidelines on sustainable lending that take the concessionality requirements of the Bank and the IMF into account. Outreach efforts to other bilateral, multilateral and commercial creditors have increased mutual understanding. The Bank and IMF have established dedicated webpages on their respective websites that make individual DSAs as well as Bank and IMF concessionality policies more easily accessible. In addition, email boxes have been established to respond to questions from creditors regarding the DSF and concessionality policies. The Bank will continue to seek outreach opportunities and improve dissemination.

3. **Given the limited scope of the Bank and IMF to influence lending decisions of other creditors, parallel capacity building efforts play an important complementary role.** A renewed focus has been on strengthening the capacity of borrowers to make sound borrowing decisions. The Bank has made important progress in training LICs to use the DSF. In addition the new Debt Management Performance Assessment (DeMPA) tool for assessing debt management capacity has been used in 17 countries thus far. This tool along with the DSF and the Medium-Term Debt Management Strategy tool under development will help inform borrowers of the risks and trade-offs in any financing they are contemplating, whether concessional or non-concessional. These tools also complement other Bank tools and technical assistance programs to help increase the efficiency of overall government expenditures, including PEFA assessments, tracking surveys, and fiscal space analyses.

4. **The country cases assessed to date under the NCBP show a range of responses under the policy, consistent with the parameters and the case-by-case approach set out in the framework document.** The cases were each very different and the responses in turn were tailored to the specific case. Thus far, there has been one exception (the case of Mali), two cases of hardening the terms (Angola and Ghana) to reflect the countries' increased

market access, and two preliminary exceptions (Mauritania and Rwanda) based on information provided thus far. The importance of sufficient and early information to make appropriate and timely decisions has been apparent in all the cases assessed to date.

5. **Implementation to date highlights the need for the NCBP to be part of a broader, proactive Bank engagement.** This engagement can take the form of capacity building in the area of project appraisal and developing projects that could ultimately be financed through traditional concessional financing, or even public private partnerships, in addition to capacity building to enhance debt management and improve reporting arrangements. The Bank's advice in the area of oil revenue management can also help resource-rich LICs with increased access to commercial finance increase predictability of oil revenues and help ensure that these resources and borrowing linked to these resources, contribute more broadly to poverty reduction.

6. **The early engagement of the Bank in providing assistance to governments in their public borrowing decisions and the continued outreach to creditors will hopefully help minimize the number of non-concessional borrowing cases that require an ex-post IDA response**. There is a tension between the funding needed to finance national development priorities and the desire to maintain debt sustainability. This can be reduced by sound fiscal management, improved absorptive capacity, ensuring that investments are made in high return projects and encouraging greater access to concessional sources of finance. Where concessional financing remains constrained, IDA is well placed as a partner in helping countries ensure that any non-concessional borrowing is used to finance priority development needs through investments that are structured to generate sufficient returns and to minimize debt distress risks.

7. **Moving forward, the Bank will continue to reinforce the primary role of the NCBP i.e., the prevention of a rapid reaccumulation of unsustainable debt while enabling a country to gradually access additional financing where this is appropriate.** Since concessional financing remains the most appropriate form of financing for most LICs, the Bank and IMF will continue their efforts to encourage all multilateral and bilateral creditors, in particular non-traditional creditors to act in broad harmony with the DSF. In parallel, the Bank and the IMF will also follow through on the work program of DSF training, debt management capacity building and developing medium-term debt management strategies. To improve the effectiveness of IDA's ability to engage countries contemplating non-concessional borrowing, IDA is prepared to be involved early on in helping countries to assess investment projects for their returns to investment and impact on debt sustainability.

I. Introduction

8. **The purpose of this note is to provide an update on the implementation of the Non-Concessional Borrowing Policy (NCBP) discussed by the IDA Board in July 2006, and distill lessons learned.** The NCBP was developed in response to donor concerns about non-concessional borrowing risks in grant-eligible and post-MDRI countries.[1] Debt relief and IDA grants increase the borrowing space and financing options available to recipients, thus presenting a challenge for recipients to manage that borrowing space effectively to increase growth and meet poverty reduction targets while maintaining debt sustainability. Given the risk that this may lead to a rapid reaccumulation of debt in LICs which are receiving grants or debt relief, the Executive Board of IDA approved the NCBP framework for IDA's response to non-concessional borrowing risks in grant-eligible and post-MDRI countries and asked staff to report back regularly on its implementation.[2]

9. **The two-pronged policy involves creditor outreach as well as measures aimed at borrowers to reduce the risk of overborrowing.** The first pillar of the policy, the outreach to other creditors, aims to encourage other creditors to incorporate debt sustainability considerations and the DSF into their lending decisions. The second prong of the policy involves measures aimed at borrowers, including enhanced capacity building efforts to help countries manage their debt and a renewed emphasis on improved adherence to reporting requirements. The second prong also involves the development of possible IDA responses (reductions in volumes, or adjustment of IDA lending terms) to non-concessional borrowing, taking into account, inter-alia, the impact of the borrowing on long term debt sustainability and the appropriate use of IDA concessionality in countries with increased access to commercial financing.

10. **The policy itself is complementary to other policies and tools that the Bank has in place to help countries maintain debt sustainability.** The Low-Income Country Debt Sustainability Framework (DSF) for instance is a joint tool developed and prepared by the Bank and the IMF to help borrowers maintain debt sustainability and guide creditors in their financing decisions. Additional capacity building in debt management and the development of medium term debt management strategy tools are key aspects of the Bank and IMF's efforts to help countries maintain debt sustainability. IDA and other Multilateral Development Banks in turn also use the DSF to tailor their own financing decisions, providing the most concessional grant resources for countries at greater risk of debt distress. The NCBP is designed to reinforce the measures taken by IDA and other creditors to help countries maintain debt sustainability. These measures could be significantly undermined should countries resort to non-concessional borrowing without strong assurances that this borrowing will achieve the commensurate growth needed for the loan repayment.

11. **The NCBP's focus on non-concessional borrowing stems from the greater risks that such borrowing puts on debt sustainability.** As was pointed out in the October paper

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[1] For example, see April 23, 2006 Development Committee Communiqué, Washington, DC.

[2] See IDA, "IDA Countries and Non-Concessional Debt: Dealing with the 'Free Rider' Problem in IDA14 Grant Recipient and Post-MDRI Countries." IDA/R2006-0137, June 2006. This paper is now generally referred to as the Non-Concessional Borrowing Policy paper.

prepared on the role of IDA in helping countries ensure debt sustainability, large volumes of concessional financing could also increase debt distress risks.[3] However, for a given borrowing path, non-concessional borrowing yields a smaller net resource flow and worse debt dynamics than concessional borrowing. Non-concessional lending increases debt ratios more rapidly, and in general repayments are required more quickly, even though most investments require a long gestation period to yield returns. Hence while any borrowing, even on concessional terms, poses risks if the expected growth dividend does not materialize, non-concessional financing poses a greater risk to debt sustainability.

12. **A key building block of the NCBP is the establishment of minimum concessionality requirements for grant-eligible or post-MDRI IDA-only countries, complementing the concessionality requirements of the IMF.**[4] The minimum grant element required under the NCBP is 35 percent or higher, should a higher minimum level be required under an existing IMF arrangement. This definition used by the NCBP follows the definition of concessionality adopted by the IMF for low-income countries in October 1995, and is similar to the definition used by the OECD export credit agencies (see Annex 5). IMF concessionality requirements apply only while a country has an IMF-supported program (PRGF or PSI), and not all IDA countries have an IMF arrangement. As of May 5, 2008, 27 of the 49 countries subject to the NCBP also had IMF-supported arrangements (see Annex 2). Countries subject to the Bank's non-concessional borrowing policy are required to maintain a minimum grant element of 35 percent even when they are no longer under an IMF arrangement.

13. **While the NCBP sets minimum concessionality requirements, it is not a blanket restriction on non-concessional borrowing.** When concessional financing is highly constrained, a tension arises between the need to finance key development priorities and the need to maintain debt sustainability. The policy acknowledges that under certain circumstances non-concessional loans can appropriately be part of a financing mix that helps promote economic growth. Although concessional financing remains the most appropriate form of financing for most LICs, the policy contains a set of specific criteria for a case-by-case assessment of situations where non-concessional borrowing may warrant an exception to the policy. This is described in detail in Annex 3.

14. **This paper provides an update on progress in implementing the two key pillars of the NCB policy, and lessons learned.** The paper updates the information provided in the paper on the role of IDA in ensuring debt sustainability, sent to the Board in October 2007, which included an update on progress in implementing the NCBP.[5] The paper is structured as follows: Section II provides an update on creditor outreach and the DSF; Section III provides an overview of progress made in capacity building for debt management; Section IV provides an overview of IDA's response in the country cases assessed to date under the

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[3] See IDA, "The Role of IDA in Ensuring Debt Sustainability: A Progress Report." IDA/SecM2007-0590, October 12, 2007.

[4] This excludes IDA "gap" countries which have been above the IDA per capita income cutoff for more than 3 years, and are no longer eligible for IDA grants. See Annex 5 for a detailed description of the concessionality calculations used in the NCBP.

[5] See IDA, "The Role of IDA in Ensuring Debt Sustainability: A Progress Report." IDA/SecM2007-0590, October 12, 2007.

NCBP; Section V discusses some of the lessons learned in implementing the policy; and section VI discusses next steps.

II. Update on Creditor Outreach and the DSF

15. **Since IDA is only one of many financing partners, debt sustainability is dependent on influencing the lending behavior of many creditors, both sovereign and non-sovereign and hence creditor outreach is vital.** IDA jointly with the IMF has continued outreach efforts on the DSF with nearly all major multilateral and bilateral creditors to low-income countries. This includes extensive outreach activities involving the Export Credit Group of the OECD, the Berne Union (of export credit insurers), all multilateral creditors that have also been involved in the HIPC Initiative, commercial creditors, and emerging market bilateral creditors.

16. **As a result of the outreach program, an increasing number of MDBs are incorporating elements of the DSF into their own financing terms.** The African Development Fund, the Asian Development Fund, and IFAD have adopted grant allocation systems that are almost identical to that of IDA, with a similar traffic light system and a modified volume approach. Following IaDB debt relief, the IaDB also takes DSF risk ratings into account in their new lending terms by combining their non-concessional ordinary capital (OC) lending resources with their concessional fund for special operations (FSO), to modulate the level of concessionality for LICs in line with the DSF risk rating. Given their historical share of borrowing from MDBs, these developments could potentially have an important impact on the trajectory of debt ratios in many LICs.

17. **An agreement was reached in December 2007 which provides a more active role for the major regional banks in the DSA process.** This agreement acknowledges the willingness expressed by these institutions to harmonize their lending practices broadly along the lines suggested by the risk assessments contained in DSAs carried out by Bank and IMF staff.

18. **The African Development Bank recently developed its own policy on non-concessional debt accumulation, in response to donor requests under ADF11.** The new AfDB policy mirrors IDA's policy, with two pillars: outreach to creditors and disincentive mechanisms at the borrower level.[6] This should help reinforce IDA's own policy, and provide a stronger incentive for creditors and borrowers to ensure that new borrowing is in line with debt sustainability.

19. **The OECD Working Group on Export Credits and Guarantees (ECG) adopted a set of sustainable lending guidelines in January 2008.** In a series of meetings and workshops that led to the adoption of the sustainable lending guidelines, the active participation of non-OECD creditors was encouraged by the ECG. The Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low-Income Countries, include an agreement to adhere to IDA and IMF

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[6] See African Development Bank, "Bank Group Policy on Non-Concessional Debt Accumulation", ADF/BD/WP/2008/09/Rev.1, 28 March 2008.

concessionality requirements in low-income countries.[7] The agreement is posted on the OECD website, and includes a comprehensive table on Bank and IMF concessionality requirements by country, which is updated for that audience on a monthly basis (reproduced in Annex 1). Bank and IMF staff will continue to engage with this group of creditors as they implement the newly agreed sustainable lending guidelines. At these meetings non-OECD creditors were encouraged to adopt a similar set of sustainable lending guidelines as those adopted by the OECD ECG. While the non-OECD creditors were not in a position to adopt the sustainable lending guidelines, they indicated their interest in continued collaboration with the international community in this area.

20. **Particularly important given the volumes of new financing from non-OECD bilateral creditors have been the discussions held with the major external financing institutions of these countries.** As outlined in the IDA15 paper on debt sustainability, constructive discussions have been held with China and India in particular leading to improved mutual understanding. In the spirit of cooperation and information sharing, an MOU was signed in May 2007 between the China Exim Bank and the World Bank. The MOU between the two institutions aims to "enhance their ongoing cooperation within their respective authority (including staff secondments, knowledge sharing and exchange on various aspects of development assistance, such as fiduciary and financial management, procurement, and environmental and social impact analyses)".

21. **A partnership has evolved since the signing of the MOU between the Bank and China Exim Bank.** This has included a broad set of discussions and training events to compare approaches to debt sustainability, fiduciary and financial management, procurement, environmental safeguard analysis and social impact analyses. Opportunities for coordinated financing are being explored, though no specific operation has yet been concretized. A first joint World Bank-China Exim Bank mission took place in March 2008 to explore possible collaboration on a regional transport and trade facilitation project in Ghana. A team from the Bank joined the West Africa Power Pool authorities for discussions in Beijing regarding investment in the power sector. The Government of Rwanda is also seeking joint World Bank – China Exim Bank support for agricultural development. In addition to exploring coordinated financing opportunities, a Staff Exchange Program is underway with two China Exim Bank staff members working in the Africa transport and energy divisions; Exim staff will also work in the Bank's East Asia region as part of the exchange. The Bank is also exploring cooperation prospects in East Asia and another secondment is being considered for the Sydney office to work on Pacific Island cooperation.

22. **Opportunities to reach out to commercial creditors are also being pursued.** Discussions have been held with representatives from investment banks to share information on the DSF. Bank and IMF staff also attended a meeting with the Emerging Market Traders Association in November 2007 to discuss the role for the private sector in financing African development post-HIPC. Based on these discussions commercial creditors communicated a desire for more information on the Bank and IMF concessionality policies, more widespread

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[7] See OECD Trade and Agriculture Directorate, Working Party on Export Credits and Credit Guarantees, "Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low-Income Countries", TAD/ECG(2008)1, January, 2008.

outreach on the DSF, greater access to country-specific data underlying the DSAs, and a formal process to respond to creditor inquiries about concessionality policies.[8] The Bank also made a presentation on the opportunities and risks in lending to LICs and IDA's role at the Paris Club's annual meeting with commercial creditors. Such exchanges afford opportunities to the Bank to learn more about the policies of other creditors, including their risk assessments and other factors that determine their lending decisions. It also enables improved information flows to these creditors.

23. **The Bank and IMF continue to seek ways to enhance dissemination of the DSF and to improve understanding of the Bank and IMF concessionality policies.** A dedicated webpage on the Bank and on the IMF websites provides ready access to each published DSA.[9] This site also provides easy links to various DSF policy documents and the DSF user's guide. As the NCBP applies to grant-eligible and IDA-only post-MDRI countries (see Annex 1), the list changes slightly from year to year and is posted on the external website. The IMF also updates the list of countries under IMF-supported arrangements regularly on its website.[10]

24. **Given that the level of concessionality is a key consideration, the Bank and IMF have also sought to provide clarity on the concessionality requirements of each institution.** The Bank and IMF utilize an identical calculation of concessionality to determine whether a particular loan contains the required minimum grant element. This calculation utilizes CIRR discount rates plus a margin to calculate the grant element (see Annex 5 for a detailed description of the grant element calculation). To facilitate understanding of this definition, a concessionality calculator is accessible on both Bank and IMF websites, along with relevant information on the Bank and IMF concessionality policies and definitions.[11]

25. **To help creditors in making lending decisions that take debt sustainability and concessionality requirements into account, the Bank and the IMF have established special email service accounts.** These e-mail accounts were established in response to requests from creditors (LendingToLICS@worldbank.org and LendingToLICS@imf.org). The e-mail accounts enable creditors to ask for clarification on the DSF, aspects of Bank or IMF concessionality policies, and the application of these policies in specific countries where creditors may be contemplating doing business. Over the last few months, staff has been responding to a steady stream of inquiries primarily from the Export Credit Group of the OECD stemming from commitments made under their sustainable lending guidelines.

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[8] Due to confidentiality issues surrounding the assumptions of key macroeconomic variables underlying the analysis in the DSAs and data provided by the authorities, Bank and IMF staff cannot directly share the detailed DSF spreadsheets for a particular country with creditors. However, the country has the prerogative to share its own country-specific data with creditors should they request it directly from the country.

[9] See http://go.worldbank.org/IKDY0HLKM0 and http://imf.org/dsa.

[10] The IMF publishes a list of PRGF-eligible countries along with their relevant minimum concessionality requirements under IMF-supported arrangements at http://www.imf.org/external/pubs/ft/dsa/dsalist.pdf.

[11] This website can be accessed via the World Bank external website by searching for "non-concessional", and via the IMF external website (http://imf.org/concessionality).

26. **As a result of the outreach program, the Bank has also clarified its approach to integrated financing packages.** The practice of creditors of combining various loans and grants into a joint package of assistance has been a feature that has been emphasized in inquiries to the Bank and IMF mailboxes. Similar to the practice at the IMF, the NCBP would look at the following factors in determining whether a financing package is integrated: (i) whether the various financing elements fund a project with an identical purpose; (ii) whether the disbursement schedules are inter-related; and (iii) whether there are cross conditions for entry into effect, availability of funds, etc. A financing package that includes a number of these elements is likely to be assessed as an "integrated package" for purposes of meeting the concessionality requirements, and the weighted grant element of the various components would be calculated. Annex 4 elaborates further on the treatment of integrated financing packages, and provides clarity on how the NCBP defines a public enterprise.

27. **While the outreach program has generally been successful, some creditors, including a few MDBs, are still offering non-concessional terms to many grant-eligible and post-MDRI countries.** While many of these loan offers have not led to the signing of non-concessional loan agreements, outreach efforts continue in an effort to convince all remaining multilateral creditors to offer grant-eligible and post-MDRI countries new financing that is consistent with the country's repayment capacity and allows the country to respect its concessionality obligations to IDA and the IMF. An agreement was reached with the Islamic Development Bank (IsDB) in December 2007 on a clear methodology for calculating the grant element of Islamic Financing, which may help reduce uncertainty and ensure that the terms offered by MDBs whose financing must meet Islamic Law, also meet the Bank and IMF concessionality requirements. At the upcoming July meeting of multilateral creditors to be hosted by the Bank, the DSF and the NCBP along with debt management will again be the key agenda items.

28. **The Bank will continue to explore increased opportunities for collaboration with all creditors.** The Bank will continue sharing data and offering technical workshops to familiarize creditors with the details of debt sustainability analyses and the non-concessional borrowing policy. Other creditors also have outreach programs similar to the Bank and IMF. For instance the AfDB will also enhance its dialogue with other creditors as part of its own non-concessional borrowing policy. Similarly, in 2007 and 2008, OECD Export Credit Agencies invited Non-OECD creditors to their semi-annual meetings where Bank and IMF staff were asked to make presentations on debt sustainability and concessionality.

III. Capacity Building in LICs to Manage New Borrowing

29. **The newly established Debt Sustainability Framework (DSF) for Low Income Countries is an important tool that helps identify debt-related vulnerabilities.** The Bank and the IMF have continued their efforts to build capacity in LICs to use the DSF over the past few years. As part of these efforts, the Bank, in partnership with the Fund and regional capacity building institutions, has organized a number of training workshops on the DSF. Country officials from most IDA-only borrowers have now attended these workshops. Recent workshops have been given in Mexico City, Accra, Dakar, Maputo, and Windhoek. As a result, these countries are in a better position to analyze the long-term impact of

alternative financing strategies and to communicate with donors, lenders, and other stakeholders using the DSF.

30. **The World Bank and the IMF are also scaling up their work program to help improve debt management in LICs**. This effort follows the discussion of the Bank-Fund paper on strengthening debt management practices at the Boards of both institutions.[12] The immediate work program has two components:

- **The Debt Management Performance Assessment (DeMPA)** tool, which is a diagnostic tool developed by the Bank for identifying strengths and weaknesses in debt management operations through a comprehensive set of indicators spanning the full range of government debt management functions. The DeMPA diagnostic tool was jointly developed by the Bank's PREM and Treasury departments, and the methodology was adapted from the Public Expenditure and Financial Accountability (PEFA) framework. To support countries in strengthening their debt management capacity, the DeMPA tool presents 15 debt performance indicators along with a scoring methodology. It is complemented by a guide that provides supplemental information on the use of the indicators, and can be used by all debt management practitioners.
- Technical Assistance in designing **Medium-Term Debt Management Strategies (MTDS)**, which comprises a toolkit for LICs developed jointly with the IMF, including a guidance note on the process of designing and implementing a debt management strategy in a LIC context, a template for strategy documentation, and quantitative cost-risk analysis tools. An MTDS draws from the existing DSF, and helps to operationalize a country's debt management objectives by outlining cost-risk tradeoffs in meeting the government's financing needs and payment obligations. Such a strategy would express the government's preferences with regard to cost-risk tradeoffs in the form of the desired composition of debt, and by describing the financing plan that the government intends to implement to achieve this composition. An MTDS would also have a strong focus on managing the specific risk exposure in the debt portfolio, analyzing potential variation in the cost of debt servicing, and assessing its impact on the budget.

31. **Implementation of the Bank's scaled-up work program on debt management is underway.** In the pilot phase the DeMPA tool was field tested in Albania, Guyana, The Gambia, Malawi, and Nicaragua. As of end-May 2008, Bank staff have undertaken 12 additional DeMPA assessments in LICs in addition to the 5 pilot assessments undertaken as part of the development phase of the DeMPA tool. The DeMPA tool and a guide to using the tool have been posted on the Bank's external website. The assessments will help pinpoint the weaknesses that need to be addressed through increased capacity building. Bank and Fund staff have now drafted the MTDS guidance note, designed the template for strategy

[12] See IMF and World Bank, "Strengthening Debt Management Practices – Lessons from Country Experiences and Issues Going Forward", April, 2007.

documentation and have an early version of the cost-risk analysis tool. This toolkit has been field tested in Bangladesh and Ghana and additional field tests will be carried out this calendar year. A joint Bank-Fund paper that reports on the implementation progress of this work program will be presented to the Boards of both institutions in early 2009.

32. **In addition to the development of these tools, the Bank's Treasury Department also provides technical assistance in monitoring and analyzing financial risks in debt structures.** This work takes place at two levels; first through advisory work in collaboration with individual countries on demand, and second through knowledge dissemination, training, outreach and research. The advisory work involves the delivery of a comprehensive diagnostic for public debt management, usually in conjunction with a domestic debt market development diagnostic provided by the Financial and Private Sector Development Vice Presidency (FPD). Depending on demand, this is followed by detailed analysis on specific issues, reform plan development, and guidance on implementing the reform plans, often acting as a "sounding board". The Treasury Department also provides intensive, one-week workshops on designing and implementing government debt management strategies. It has undertaken research and produced papers and publications on institutional arrangement for debt management, linkages with macroeconomic policies and other relevant topics.[13]

IV. Update on Borrower Country Cases and Debtor Reporting

33. **The NCBP requires assessing each case of non-concessional borrowing on its own merits.** In certain circumstances non-concessional borrowing may be warranted if the financing unlocks a proven bottleneck to development, particularly in a strong-performing country. The elements that the Bank takes into consideration to determine the appropriate response are outlined in Annex 3. These include country specific factors such as the overall borrowing plans of the country, the impact of additional borrowing on the macroeconomic framework, the impact on the risk of debt distress, and the strength of policies and institutions. The loan-specific factors look at the development content of the loan and the rates of return, the equity stake of the lender, whether there are additional costs, and the overall concessionality of the financing package.

34. **In the last year, several new cases have been discussed by Bank Management in addition to the earlier case of Angola.**[14] As described in the NCBP policy document, the Bank has set out a process to assess non-concessional borrowing in countries subject to the NCBP. The process first establishes whether public or publicly-guaranteed non-concessional borrowing was contracted. Where such borrowing was contracted, country teams discuss the nature and the terms of the non-concessional borrowing with the authorities. An internal Bank note is then prepared and discussed by the NCBP committee which makes recommendations to management based on country-specific and loan-specific factors outlined in Annex 3. Once management has discussed and decided on the appropriate IDA response, the Board is informed of any disincentive mechanism before the next project for

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[13] See for instance World Bank (2007). *Managing Public Debt: From Diagnostics to Reform Implementation.*

[14] For more detail on the Angola case, see IDA, "The Role of IDA in Ensuring Debt Sustainability: A Progress Report." IDA/SecM2007-0590, October 12, 2007, pp 21-22.

that country is presented to the Executive Board. In two of the cases discussed to date (Angola and Ghana), management has agreed that there is a need for an IDA response and modified lending terms. In the case of Mali an exception to the policy was provided.

The Case of Mali

35. **Mali entered into a non-concessional external financing agreement with the Islamic Development Bank (IsDB) in July 2007 for about US$70.7 million, equivalent to about 1 percent of Mali's 2007 GNI.** The financing was to meet a critical need for additional electricity generation capacity to ease a short term crisis in the energy sector. The country agreed to share the financing agreements with the Bank in order to assess whether the loan could be granted an exception from a Bank response under the NCBP.

36. **At the country level, strong policies and institutions provide some confidence in Mali's ability to manage some modest levels of non-concessional borrowing for a critical economic need.** Mali is a relatively strong performer as measured by its CPIA (3.7 in 2007). According to a recently completed public expenditure and fiduciary assessment (PEFA), Mali was rated above average on some aspects of public financial management, including budget preparation. Mali has a good track record in macroeconomic management and prudent fiscal policy, and despite this exceptional occurrence, has committed to a prudent debt policy. The looming energy crisis and the shortage of concessional funds in FY08 to finance a quick response, was an extenuating circumstance in the decision of Mali to accept the financing from the IsDB. In addition, staff assessed the debt sustainability impact of the borrowing to be minimal, and Mali's low risk of debt distress will be unaffected.

37. **The project would to finance a 60 megawatt power plant, which is expected to generate sufficiently high economic and financial rates of return to justify the loan.** The agreement with the Islamic Development Bank is comprised of an interest-free loan of about $9.4 million, and a lease agreement of approximately $61.3 million. The overall grant element of the package was 8.4 percent compared to the minimum grant element required under the NCBP and the PRGF for Mali of 35 percent. However, the power plant is estimated to have a high economic and financial rate of return. The project also aims at avoiding power cuts and contributing to sustaining the current average real economic growth of 5 percent. Additional costs of the project include the cost of insurance, and the cost of fuel to run the power plant. After the 15 year lease, Mali will fully own the power plant.

38. **The strong justification at both the country level and the project level led the NCBP Committee to recommend granting an exception for the loan financing to the Management.** Management agreed that a waiver was justified due to: (i) Mali's urgent need for additional electricity generation capacity; (ii) the high expected economic and financial rates of return of the project; (iii) the strength of Mali's policies and institutions; and (iv) the modest size of the financing and the minimal impact on Mali's macroeconomic framework and debt sustainability. The IMF had also granted a waiver to Mali in the context of Mali's concessionality requirements under the PRGF arrangement.

The Case of Ghana

39. **Non-concessional borrowing in Ghana was assessed by IDA following the September 2007 Ghana issue of a $750 million Eurobond on international capital markets, and a $292 million non-concessional loan agreement with China Exim Bank.** The Eurobond was issued on September 27, 2007 with a ten-year bullet repayment of the principal and a fixed coupon of 8.5 percent. The China Exim Bank loan was signed on September 25, 2007, and carries an average interest rate of 6.1 percent with a 17-year amortization, and a zero grant element.

40. **A key consideration in IDA's response is the strength of Ghana's policies and institutions and the impact of the borrowing on the economy.** Ghana's CPIA at 4.0 in 2007 is in the top quintile of IDA borrowers. While Ghana's public financial management is assessed as being strong, Ghana's decision to borrow non-concessionally stems from the desire to increase public investments to sustain economic growth towards meeting the MDGs. In particular, the impetus to borrow was driven by the energy crisis which deepened in the second half of 2006 and early 2007. The authorities discussed their intention to access international capital markets with the World Bank as early as February 2007, and plans for a portion of the anticipated borrowing were included in the 2007 budget.

41. **Some uncertainty remains as to the potential returns to planned investments.** The 2007 supplementary budget allocated about $357 million from the bond proceeds to energy investments, with another $13 million set aside for road-sector investments, accounting for about 50 percent of the Eurobond proceeds. Investment plans were also outlined in the 2008 budget which included over $360 million of investments in the energy sector. Meanwhile, the China Exim Bank loan was dedicated to finance the construction of the hydroelectric power plant at Bui, which is expected to result in about 1,000GWh of annual generation, and a proposed installed capacity of 400MW. At this stage, however, the precise terms and conditions of this contract are unknown, and hence the project-specific rates of return cannot be assessed.

42. **The large size of the non-concessional borrowing contracted raised concerns regarding its impact on the country's debt distress risks.** The magnitude of the Eurobond issue and the China Exim Bank loan combined is equivalent to about 8 percent of Ghana's 2006 GNI. At the same time, however the impact of the borrowing on Ghana's most recent DSA is relatively limited primarily because the government's intention to borrow about $250 million per year between 2007 and 2009 and US$350 million per year thereafter on non-concessional terms was already included in the 2007 DSA. Under that DSA, Ghana's risk of debt distress rating is "moderate, albeit close to the low risk category".[15] The non-concessional borrowing contracted at the end of 2007 frontloaded the non-concessional borrowing plans outlined in the DSA and, in the absence of other adjustments to the DSA, shifted Ghana even further away from the low risk category.

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[15] Joint World Bank-IMF DSA, Ghana IMF Staff Report for the 2007 Article IV Consultation, May 7, 2007, p. 30.

43. **IDA Management took these factors into account in deciding that the terms of IDA's financial assistance should be on blend terms in line with Ghana's increased market access.**[16] Management agreed that while there is some evidence of economic merit to Ghana's non-concessional borrowing, the Government's increased access to market finance and its sizeable non-concessional borrowing in 2007 warranted reconsidering the terms of IDA's assistance. The response by Management to provide blend terms for Ghana recognized the increased access to market financing, but also recognized the country's strong policies and institutions, the urgent need for additional financing for power generation, the early discussions with the Bank on the country's search for additional concessional finance, and the importance of IDA's continued full engagement with Ghana as it makes important investment decisions.

44. **Additional steps are being taken by the Government and the Bank to ensure that the country's investment program addresses the country's infrastructure needs.** The Government of Ghana established a Project Finance Analysis (PFA) unit at the Ministry of Finance and Economic Planning to analyze, monitor, and evaluate new investment projects that the government deems eligible for support. The new unit will also be responsible for helping project sponsors leverage private financing by helping to set up Public-Private Partnership Agreements and Private Finance Initiative. The Bank team will support a strong program of technical assistance in the area of project appraisal and public private partnership. Ghana has participated in the DeMPA and the MTDS analytical exercise, based upon which the Bank team will strengthen arrangements and support for Ghana's capacity building efforts for debt management and reporting.

45. **The terms of IDA assistance to Ghana will be reassessed by the end of FY09.** A reassessment at that time should benefit from information on the eventual decisions of the government on the use of the remaining financing from the Eurobond issue and cost-benefit analyses for the intended investments. The reassessment will also take into account the volume and use of any additional non-concessional financing contracted in the intervening period.

Other Country Cases

46. **Mauritania signed two loan contracts on non-concessional terms, but was provided a preliminary exception to the NCBP on the basis of information provided to the Bank that the loans were being renegotiated on more favorable terms.** Two non-concessional loans were signed by Mauritania in 2007. The first loan from the Arab Fund for Economic and Social Development (AFESD) for about $129 million to finance drinking water in Nouakchott was provided with a grant element of 34.6 percent, just short of the 35 percent level.[17] An agreement in principle on more favorable terms led to an IMF waiver.

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[16] IDA blend terms imply a reduction in the maturity period from 40 to 35 years, while still keeping the ten-year grace period and the current service charges (0.75 percent). With these changes, the terms for IDA credits would carry a 57 percent grant element, compared to standard IDA terms, which are equivalent to a 60 percent grant element.

[17] For more on this borrowing, see IMF Islamic Republic of Mauritania: Second Review under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for a Waiver of Performance Criterion – Staff Report, November 5, 2007.

The second publicly-guaranteed loan from the IsDB for about $18 million aims to boost the electricity production capacity of SOMELEC, the national electricity company. Because the loan and lease package did not meet the minimum concessionality requirement under the IMF and World Bank policies, a supplemental grant from Japan that would be part of an overall integrated package of financing was agreed to in principle by the IsDB and Japan. On the basis of this a waiver of the performance criteria on non-concessional borrowing was also provided by the IMF Board.

47. **Rwanda was given an exception to the NCBP for $100 million in planned borrowing to finance an energy project from the Exim Bank of India on terms with a grant element of 40 percent.** Since IDA uses the same minimum concessionality requirement as that in the IMF program, in the case of Rwanda the PRGF program requires a minimum grant element of 50 percent, as does the NCBP. Where country authorities request a waiver of the performance criteria on minimum concessionality from the IMF, IDA currently has the flexibility to accept the IMF's waiver as per the NCBP document.[18] At the country's request, the IMF modified the performance criteria for Rwanda under the fourth review of the PRGF facility to include a non-zero ceiling for non-concessional borrowing from India Exim Bank at a grant element of 40 percent.[19] This proposed financing of the Nyabarongo hydro power project is projected to result in the production of urgently needed electricity at a cost of about 0.065 US$/kWh allowing Rwanda to gradually eliminate recurrent subsidies and reduce the electricity tariffs towards levels competitive on a regional basis. The World Bank has been involved upstream in this decision, and has made a positive assessment of the financial viability of the project and the fit within the least cost electricity generation expansion plan.

48. **Bank and IMF staff have been working closely with the Democratic Republic of Congo (DRC) authorities to assess the implications of a framework agreement between China and the DRC for $9.2 billion in financing on non-concessional terms.** The agreement calls for about $3 billion in lending for mining investments, $3 billion in financing for infrastructure investments, and an option for an addition $3 billion in infrastructure investments to be determined at a later stage. Early discussion with the authorities on the financing is aimed at determining whether an approach can be developed that would enable DRC to reach HIPC Completion Point and benefit from China's investment in critical, growth oriented projects. The IMF and Bank teams are learning more about the specific terms of the investment and the status of the infrastructure projects that will be financed by the loans. The findings of the joint Bank-Fund team will be used to assess the implications of the financing for DRC's debt sustainability.

49. **While other cases of potential non-concessional borrowing have come to the attention of country teams, there is still insufficient information on these cases to be able to assess them under the policy.** Because loans reported via the OP14.10 reporting

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[18] See IDA/R2006-0137, June 2006, p.11, "...such waiver could also be accepted by IDA for the purposes of classifying the concerned loan as an acceptable case of non-concessional borrowing".

[19] See IMF, Rwanda—Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Nonobservance of Performance Criterion and Modification of Performance Criteria, June 2, 2008.

obligation are reported on a case by case basis, many small non-concessional loans are identified that are in fact part of an integrated financing package that is concessional overall.[20] The media or country teams have been the source of reports on a number of cases of planned or actual borrowing in various LICs. Staff are following up with authorities on these cases. In some cases, such as in Tajikistan, the lending terms appear to meet the minimum concessionality requirements, while in other cases there is an ongoing dialogue between the Bank country team and the borrowing country to determine the nature of the financing.

Debt Reporting

50. **Debt reporting has improved somewhat as a result of increased efforts to encourage adherence to OP14.10.** A special Bank working group has been leading the efforts to increase adherence to reporting requirements under OP14.10 and increase the quality of these reports.[21] Only 16 IDA-only countries had not yet provided their annual reports under OP14.10 by the end of July, 2007. This adherence level was about two months ahead of reporting performance from previous years. Countries that were not compliant with the annual reporting requirement were informed that they are required to submit their end-2006 annual report or provide an acceptable action plan for such reporting before any new IDA operation can be presented to the Board. Subsequently five additional countries submitted acceptable reports, including one country which reported for the first time in almost a decade. By the end of May, 2008, 62 percent of IDA-only countries were compliant with debt reporting requirements and 23 countries had not yet reported. At this rate, we expect significantly increased compliance with the Bank's debt reporting requirements, as compared to end of July 2007. However, more progress is needed on quarterly reporting for IDA to have timely information.

V. Lessons Learned in the First Two years of Implementation

51. **The implementation of the NCBP over the last two years has generated a number of lessons despite the limited number of cases assessed to date.** The implementation of the policy has demonstrated the limitations of the NCBP, as well as its benefits. It has also demonstrated the need to look at IDA's response to non-concessional borrowing within the overall country dialogue and to recognize that it is only one policy instrument in helping countries to maintain debt sustainability. At the same time, the NCBP points to areas where the Bank can be proactive in helping countries interact with creditors and disseminating ongoing research and knowledge on issues such as the management of natural resource wealth and project evaluation.

52. **There are some limitations to the ability of the NCBP to affect policy decisions, in particular when IDA financing is small relative to other external financing sources and when information is inadequate.** The significant borrowing by Angola is an example

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[20] See Annex IV for more information on how to assess integrated financing packages.

[21] The first measures included increased scrutiny for countries ahead of Board presentation, and special reminder letters were sent out at the beginning of the year to all IDA-only countries. Where reports are incomplete or are internally inconsistent, a further dialogue with the country authorities takes place to correct the inconsistencies.

of a case where the response by IDA was unlikely to affect the decision to borrow. IDA's financing to Angola has historically been only a small proportion of Angola's overall external financing. The recent approval in the AfDB of a similar non-concessional borrowing policy to that of IDA will help improve the ability of the policies to affect borrowing decisions.

53. **At the same time, the NCBP may in itself lead to better financing terms.** The advanced reporting requirement introduced by the NCBP stipulates that countries report to the Bank their plans for non-concessional borrowing ahead of contracting the loans. The supplemental letter on Financial and Economic Data that is included in the signing package for all IDA Credit and Grant Agreements was revised to include this new requirement for grant-eligible and post-MDRI countries. This gives the Bank a chance to present the country with alternative financing scenarios and implications of such borrowing. As a result, several countries discussed with the respective Bank country team their desire to increase access to financing, and indicated that without additional concessional financing, they would consider commercial financing for important infrastructure investments. Country teams that are made aware of such borrowing plans have reminded the government of the minimum concessionality requirements, and engaged the government in a dialogue on available options to finance the investments. In this way, the NCBP concessionality requirements provide an incentive for governments to negotiate with creditors to secure more concessional financing terms.

54. **There are examples of countries that are seeking Bank advice when considering projects that would merit nonconcessional financing, including post-MDRI countries with low risk of debt distress and with strong policies and institutions.** In addition to scaling-up capacity building efforts on debt management, and helping to develop an MTDS toolkit, other financing options can also be pursued. For instance, the Bank can focus on ways to mobilize additional private capital to complement ongoing and planned public investments. It can also outline the menu of financing options from the Bank group, including guarantees from IDA and MIGA, investment financing (debt, equity and quasi-equity) from IFC, and IBRD enclave lending and enclave guarantees to provide additional support to a country's infrastructure development. In the context of public expenditure reviews (PERs) and assessments of fiscal space, the Bank can also provide advice on ways to seek efficiency savings in spending (reduce waste, improve efficiency, shift composition) and improvements in tax administration that may open up room for greater spending on infrastructure, and reduce the need for borrowing.

55. **The Bank has a broad toolkit of products to help countries improve debt sustainability prospects, and the NCBP and the DSF are only two elements of the Bank's broader engagement strategy, particularly in resource rich countries with easier access to commercial financing.** Technical assistance from the Bank can help build up countries' long term institutional and technical capacity to manage oil and mineral resources, and the related social and environmental impacts. The Angola Interim Strategy Note (ISN) for instance outlines the Bank's engagement with the government in policy dialogue and non-lending technical assistance in the petroleum sector. Technical assistance can also help improve transparency, promote private sector investment and generally improve the contribution of the mineral sector to the country's economic development and poverty

reduction. In Ghana, the Bank is providing technical assistance to review and upgrade the current framework for investment appraisal and PPPs, to ensure that Government resources are deployed in an optimal manner to maximize economic benefits. The Bank's involvement in the Extractive Industries Transparency Initiative (EITI), and encouraging countries to join EITI can also help ensure that wealth generated from natural resources contributes to a country's economic development by providing a framework for improved accountability and transparency of natural resource revenues.

56. **A close dialogue with the borrower ahead of the borrowing in question helps reduce the time needed for assessing cases of non-concessional borrowing.** From the initial indications from borrowing countries of the intention to borrow, or from the first media report of such borrowing, staff need to take on a significant degree of due diligence in interacting with the government to collect data on the project involved, and to analyze the nature and benefits of the borrowing in question. Once a draft is ready for discussion, the NCBP committee discusses the case, and the document is revised to reflect the NCBP discussion and recommendation before the Operations Committee makes a decision on the IDA response. The process tends to be time consuming and staff resource intensive. A close dialog with the country and an early sharing of information help facilitate a more efficient and more informed response.

57. **Availability of sector plans and feasibility studies including least cost solutions helps to make informed assessments.** The cost benefit analyses need to take into account a certain degree of uncertainty in the rates of return calculations for the projects being financed, but with reasonable assumptions they provide some comfort about the benefit of a proposed project. The cases of Mali and Ghana for instance produced calculations of internal rates of return in the power sector, while acknowledging that the results can vary substantively depending upon assumptions.[22] However, insufficient information on projects to be financed with non-concessional borrowing hampers the ability to assess rates of return and make a case for an exception.

58. **While IDA generally has responded to non-concessional borrowing after the borrowing has taken place, providing a preliminary upstream decision on the Bank's response to a borrowing plan affords more opportunities to work with the client to assess the benefits and risks of the envisioned borrowing.** Although IDA does not set non-zero ceilings for non-concessional borrowing (like the IMF), a borrowing country could request a preliminary determination of IDA's response under the NCBP as long as there is sufficient information on the nature and terms of the financing. IDA would look at the same elements identified in Box 3 of the NCBP paper (reproduced in Annex 3) in making its preliminary determination. With sufficient information upfront, this determination would in most cases hold once the final loan contract is signed, unless significant changes are made.

59. **Ghana is an example of a country that had engaged with Bank staff regarding their commercial borrowing plans quite far ahead of the actual borrowing.** This

[22] Among the assumptions that need to be made in power sector projects are: the rate of growth of electricity consumption; timing and assumed capacity of other projects in the pipeline; value of the energy generated with the new investment; assumptions regarding future tariff rates, assumptions regarding the price of oil, and assumptions about the hydrological risks.

afforded opportunities to staff to discuss alternative options for the country to consider, including enclave borrowing. It also started a dialogue with Ghana on project evaluation, and encouraged the Government to increase its debt management capacity. Even in cases where the Bank's assessment is not to provide an exemption to the policy, a preliminary upstream decision would give certainty to the client regarding the potential impact of the borrowing on their IDA allocations. This will also provide greater incentive for countries to report up-front their borrowing plans, and reduce the need for an IDA response ex-post. For strong performers, this would also be consistent with a gradual move in the direction of increased creditworthiness for post-MDRI countries at low risk of debt distress. This element of the policy is elaborated in Annex 4.

60. **Finally, further discussions are needed particularly with a few remaining multilateral creditors, private creditors and non-OECD bilateral creditors.** The DSF is a useful platform, along with the NCBP to further reach out to these creditors to encourage them to increase the concessionality of their lending in line with the DSF. A number of small cases of non-concessional borrowing come onto the radar screen of staff on an ongoing basis. Large framework agreements for public and publicly-guaranteed are reportedly being signed in select African LICs with non-OECD bilateral creditors, but staff generally has insufficient information on the terms and conditions (and status) of these agreements to be able to make a definitive assessment of concessionality. Country teams continue to have discussions on these agreements with the relevant governments.

VI. Next Steps

61. **Given the new landscape in many LICs post-MDRI, the Bank and IMF will continue their efforts in extending creditor collaboration to bilateral creditors, in particular non-traditional creditors.** As such the Bank will continue to pursue close collaboration with non-OECD bilateral creditors, and help to find ways to enhance South-South collaboration that leads to sustainable outcomes. The Bank will also continue to seek opportunities to reach out to the few remaining multilateral creditors that continue to provide non-concessional lending to grant-eligible LICs and post-MDRI countries. Finally opportunities to enhance the dialogue with commercial creditors will continue to be pursued, building on the dialogue already established.

62. **The Bank and IMF will also follow through on the work program of DSF training, debt management capacity building and developing medium-term debt management strategies.** This work is a natural complement to the creditor outreach program, and vital to ensuring that countries make informed decisions on the impact of borrowing plans on debt sustainability. Given the tradeoffs between financing development priorities and maintaining debt sustainability in countries where concessional financing is constrained, the DSF provides borrowers with important information on the potential impact of any envisaged non-concessional borrowing on debt sustainability.

63. **To improve the effectiveness of IDA's ability to engage countries contemplating non-concessional borrowing, IDA is prepared to be involved early on in helping countries to assess investment projects for their returns to investment.** IDA's significant sectoral experience and ongoing dialogue on the macroeconomic and growth strategy in most

LICs, places IDA well as a partner in helping countries ensure that any new borrowing for which concessional financing is not available, will generate sufficient returns to be able to finance the borrowing. At the request of a country, the Bank can make a preliminary assessment on the basis of draft loan agreements, and thereby provide borrowers greater certainty of the Bank's response. This helps to reinforce the primary role of the NCBP i.e., the prevention of a rapid reaccumulation of unsustainable debt while enabling a country to gradually access additional financing where this is appropriate.

64. **At the country level this requires a continued close collaboration with the IMF staff when setting non-zero ceilings for non-concessional borrowing.** Particularly for countries with PRGF arrangements, IMF staff usually consults Bank staff when countries request a non-zero ceiling for non-concessional borrowing for a particular purpose. There is a good basis for close coordination as both the IMF's concessionality policy and the NCBP use the same definitions of grant element, and have a harmonized approach to assessing the level of integration of financing packages. Early involvement with the Fund and thorough analysis of the merits of planned investments when non-zero ceilings for non-concessional borrowing are determined help ensure a coordinated approach to concessionality. This also minimizes the need for a time-consuming review process after borrowing has taken place.

Annex 1: Grant Eligible and Post-MDRI Countries to which the Non-Concessional Borrowing Policy applies in FY09 [1/2/]

Red light (26)		Yellow light (14)	MDRI recipient and Green light (9)
Afghanistan	Haiti	Benin 3/	Cameroon
Burundi	Lao People's Democratic Republic	Bhutan	Ghana
Central African Republic	Liberia	Burkina Faso 3/	Madagascar
Chad	Myanmar 4/	Cambodia	Mali
Comoros	Rwanda 3/	Ethiopia 3/	Mozambique
Congo, Democratic Republic of	Sao Tome and Principe 3/	Guyana 3/	Senegal
Congo, Republic of	Solomon Islands	Kyrgyz Republic	Tanzania
Cote d'Ivoire	Somalia 4/	Lesotho	Uganda
Djibouti	Sudan 4/	Malawi 3/	Zambia
Eritrea	Tajikistan	Mauritania 3/	
Gambia, The 3/	Togo	Nepal	
Guinea	Tonga	Nicaragua 3/	
Guinea-Bissau	Yemen, Republic of	Niger 3/	
		Sierra Leone 3/	

1/ This list is updated annually and subject to change should other IDA-only countries qualify for IDA grants and/or MDRI. It includes all IDA-only countries which are currently eligible for IDA grants on debt-sustainability grounds, as well as post-MDRI green light countries. It excludes "gap" or "blend" countries which receive hardened or blend terms from IDA and are not eligible for IDA grants. Should a country's IDA-only status change mid-year, the list would be updated at that time to reflect the change.

2/ Timor-Leste is also subject to the policy given its eligibility for exceptional grants.

3/ HIPC Completion Point Country which has also qualified for debt relief under the MDRI.

4/ Inactive country in FY09. The traffic light shall be reassessed at the respective reengaging point based on debt sustainability.

Annex 2. List of Low-Income Countries Subject to the Non-Concessional Borrowing Policy of the IMF and/or IDA

Last update: May 5th, 2008

IMF and IDA	Minimum grant element (in percent)	IMF-only	Minimum grant element (in percent)	IDA-only	Minimum grant element (in percent)
Afghanistan	60	Albania	35	Bhutan	35
Benin	35	Armenia	35	Burundi	35
Burkina Faso	35	Cape Verde	35	Cambodia	35
Cameroon	35	Grenada	35	Comoros	35
Central African Republic	50	Honduras	35	Congo, Democratic Republic of	35
Chad	35	Moldova	35	Djibouti	35
Congo, Republic of	50			Eritrea	35
Cote d'Ivoire	35			Ethiopia	35
Gambia, The	45			Ghana	35
Guinea	35			Guyana	35
Guinea Bissau	50			Lao People's Democratic Republic	35
Haiti	35			Lesotho	35
Kyrgyz Republic	45			Mali	35
Liberia [2/]	100			Mongolia	35
Madagascar	35			Myanmar [1/]	35
Malawi	35			Nepal	35
Mauritania	35			Somalia [1/]	35
Mozambique	35			Solomon Islands	35
Nicaragua	35			Sudan [1/]	35
Niger	50			Tajikistan	35
Rwanda	50			Timor-Leste	35
Sao Tome and Principe	50			Tonga	35
Senegal	35			Yemen, Republic of	35
Sierra Leone	35			Zambia	35
Tanzania	35				
Togo [3/]	35				
Uganda	35				
Number of countries	27	Number of countries	6	Number of countries	24

[1/] Inactive countries, which would be subject to the non-concessional borrowing policy upon becoming active.

[2/] The program does not envisage any external borrowing.

[3/] A PRGF arrangement was approved on April 23, 2008.

Annex 3

Principles that would guide exceptions to non-concessional borrowing ceilings[23]

The concessionality benchmark proposed for the purposes of identifying breaches of the Non-concessional Borrowing Policy (NCBP) has been a proven benchmark in PRGF programs, and has served as a useful tool in that context to provide the borrower some "leverage" with the creditor in obtaining the best possible financing for a potential investment. PRGF programs normally contain a zero ceiling on allowable non-concessional borrowing in countries, and in exceptional cases PRGF programs may define a non-zero ceiling on non-concessional borrowing to accommodate a specific non-concessional loan.

Similar to considerations that feed into decisions on non-concessional borrowing limits in the PRGF, a number of country-specific and loan-specific factors would be taken into account in the NCBP to assess whether an exception to the zero-ceiling using the proposed benchmark is warranted. Although many proposed loans may have merit on specific economic or financial terms, the country environment in which they occur will strongly influence actual outcomes. There should be a favorable assessment at both the country-specific level and the loan-specific level to warrant an exception.

Country-specific:

- **Overall borrowing plans of the country.** A modest level of overall borrowing by the country on the basis of the DSA to accommodate a particular investment may warrant consideration. For such a consideration, clear reporting of overall borrowing plans is needed, and enhanced creditor coordination through the DSF would facilitate this possibility.
- **Impact of borrowing on the macroeconomic framework.** Whether or not the borrowing would have a deleterious effect on the macroeconomic framework would influence the consideration of an exception.
- **Impact on the risk of debt distress.** The current risk classification and whether or not the loan is likely to lead to a higher risk of debt distress will be a key consideration. Given their lower-risk of debt distress, and generally better performance, more flexibility is envisaged for "green light" countries. In addition, "yellow light" countries could benefit from somewhat greater (although still exceptional) flexibility than "red light" ones.
- **Strength of policies and institutions**, especially public expenditure management and debt management. As the fiscal space Board paper makes clear, policies and institutions in particular those governing the efficiency of public investment are critical.[1] Without these, even high return projects may fail to meet objectives.

Loan-specific:

- Development content and potential impact of the loan, i.e., investment will unlock a proven bottleneck to development as determined by analytical work such as a PER.
- Estimated economic, financial and social returns to investment of the project, weighted by the probability that the project will succeed.
- Lender equity stake in the project.
- No additional costs associated with the loan, i.e., collateralization, hidden costs.
- No other sources of more concessional financing are available.
- Concessionality of the overall financing package for a particular investment.

1/ See World Bank (2006). "Fiscal Policy for Growth and Development: An Interim Report", DC2006-0003, April 6.

[23] Based on IDA (2006), O*p. cit*. Box 3.

Annex 4: Elaboration of Select Elements of the NCBP

Defining public enterprises

1. **While the June 2006 paper outlined that concessionality requirements would apply to all external public and publicly-guaranteed debt (PPG), it did not include an explicit definition of public enterprise.** Staff has been using the same definition of PPG external debt as the DSF framework. According to the DSF framework, public and publicly guaranteed (PPG) external debt comprises (1) "External debt of the public sector, defined as central, regional and local government and public enterprises. Public enterprises subsume all enterprises of which the government owns 50 percent or more", and (2) "Public sector-guaranteed private sector debt". The Manual for the Debtor Reporting System further describes public enterprises as "Autonomous institutions such as financial and non-financial corporations, commercial and development banks, railways, utilities, etc. where (i) the budget of the institution is subject to the approval of the government of the reporting country; or (ii) the government owns more than 50% of the voting stock or more than half of the members of the board of directors are government representatives; or (iii) in case of default, the state would become liable for the debt of the institution."

2. **The definitions of public and publicly-guaranteed debt and public enterprises in the LIC framework and the DRS have been used in practice for the purpose of setting the parameters of IDA's concessionality requirements**. In general, where queries about a borrower's status as a public enterprise have been received, the LIC definition, supplemented where necessary by the DRS definition guided the determination of whether the enterprise in question is considered a public enterprise for the purpose of the NCBP. Other elements that guide the decision include, whether the entity is run at arm's length as a commercial company by foreign or private management, whether it is financially self supporting and whether it generates substantial revenues in hard currency. In all cases, if a direct government guarantee is provided for external lending to such an entity, the loan would be considered publicly-guaranteed.

3. **Should an IMF arrangement define exceptions to its concessionality requirements for a certain public enterprise in a country, the Bank would exempt that enterprise from the NCBP as well.** The IMF may set out specific exceptions to their zero ceilings on non-concessional borrowing through a Technical Memorandum of Understanding (TMU), which accompanies IMF arrangements negotiated with a country. In the TMU a public enterprise may also be exempt from concessionality requirements on a case-by-case basis. Since these exceptions may be in response to a particular need for borrowing at a given point in time, the Bank would exempt that enterprise from the NCBP as long as the TMU providing the exemption remains in effect.

Integrated Financing Packages

4. **In the context of the NCBP, questions have been raised regarding the possibility of measuring concessionality at the level of the overall financing package rather than at the loan-by-loan level.** While the non-concessional borrowing policy generally assesses concessionality on a loan-by-loan basis, the policy paper mentions that "Whenever warranted

in terms of a case-by-case analysis, the relevant measure could be ....the overall concessionality of a financing package for a particular investment, rather than the grant element of each individual loan provided for that particular investment."[24] As a result, in a number of cases the overall concessionality of integrated financing packages for particular projects has been used for the purpose of the NCBP. A number of recent inquiries by creditors to the LendingToLICs@worldbank.org mailbox have requested clarification of this policy.

5. **As described in the main paper, the NCBP adopts the same methodology as the IMF to determine whether a financing package can be considered integrated, for the purposes of measuring overall concessionality**. If the IMF has an active program in place, the Bank would continue to rely on the IMF to make a determination of whether the financing package is sufficiently integrated. If the IMF does not have an active program in the country concerned then the Bank would make its own determination regarding the integrated nature of a financing package. A preliminary assessment can usually be made based on draft agreements, but a final decision would require copies of the final contracts. Hence where an IMF-supported arrangement is not in place, countries would need to agree to share the draft agreements and final contracts with Bank staff when they request the Bank to assess the integrated nature of a financing package.

6. **Where IDA is involved in a financing package that includes other donors and creditors, this same definition of an integrated financing package would be used.** In two recent projects, a multilateral creditor whose terms are non-concessional, is being requested by Governments to fill project financing gaps along with concessional partners including IDA and the AfDF. Allowing a non-concessional lender to co-finance a project with IDA in a country that is subject to IDA's non-concessional borrowing policy may lead to the possible perception of preferential treatment of that non-concessional creditor. For such cases, and particularly where IDA grants may be involved, the clear and transparent methodology as described above would help reduce any perception of a conflict of interest for the Bank.

7. **At the same time, a decision on an integrated financing package that includes IDA as a creditor is subject to a somewhat more stringent approval process.** In general, if the country has an IMF program in place with concessionality requirements, then again the Bank would rely on the IMF's determination of whether the financing package is integrated. In the absence of an existing IMF arrangement in the country where the determination is sought, then the Bank would make a determination based on the criteria described above. The decision would be made by the NCBP committee via a virtual review. To avoid the perception of conflict of interest, the region proposing the integrated package would recuse itself from the NCBP committee's decision.

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[24] See IDA, "IDA Countries and Non-Concessional Debt: Dealing with the 'Free Rider' Problem in IDA14 Grant Recipient and Post-MDRI Countries." IDA/R2006-0137, June 2006, paragraph 27.

Upstream determinations of IDA's response under the NCBP

8. **IDA generally has responded to non-concessional borrowing ex-post, on a case-by-case basis.** Box 3 of the NCBP paper is reproduced in Annex 3, and outlines the country-specific and loan-specific elements that are taken into consideration when determining the appropriate IDA response, including the possibility for an exception to the policy. At the country-specific level, these elements include the overall borrowing plans of the country, the impact of the borrowing on the macroeconomic framework, the impact of the borrowing on the risk of debt distress, and the strength of policies and institutions, particularly in the area of public expenditure and debt management. At the loan specific level the elements include the development content and potential impact of the loan, the economic and financial returns to the project along with risk factors, the lender equity stake, additional costs associated with the loan, access to concessional financing and overall concessionality.

9. **Unlike IDA, the IMF can include non-zero limits on non-concessional borrowing in some IMF-supported arrangements.** This enables the country to incur some new debts up to a specified ceiling which do not meet the minimum grant element requirement set out in the program. In general the specific borrowing that would take place under these non-zero limits is pre-identified by countries during discussions with IMF staff at the time of negotiating the PRGF arrangement. It is then the responsibility of the borrower to ensure that the projects funded under the non-zero limits do not breach the ceilings established. Once non-zero limits are established under an IMF arrangement, the IMF does not assess the specific projects funded under these limits.

10. **Although IDA does not set non-zero ceilings for non-concessional borrowing, a borrowing country can in principle request an upstream determination of IDA's response under the NCBP as long as there is sufficient information on the nature and terms of the financing.** Where an IMF arrangement is in place and a non-zero ceiling has been negotiated under this arrangement, then IDA could agree to also exempt the country from concessionality requirements under the NCBP up to the ceiling limits.[25] This would be consistent with a gradual move in the direction of increased creditworthiness for post-MDRI countries at low risk of debt distress. However, for countries without an IMF arrangement in place, the country could also request an upstream preliminary determination of the IDA response based on the same criteria used for the ex-post assessments. An upstream determination would need sufficient information to assess the country-specific and loan-specific elements outlined in Annex 3. Once all the relevant information is available, the Bank could provide a preliminary assessment until the actual loan contracts are signed and shared with IDA staff.

[25] On a case-by-case basis, based on an assessment by the Bank.

Annex 5: Concessionality and Calculation of Grant Element under the NCBP

Concessionality is a measurement of the "softness" (or grant element) of a credit, reflecting that the credit is extended at terms below market terms. A grant has 100 percent concessionality. For a credit, concessionality is the difference between the nominal value of the credit and the present value of the debt service as of the date of disbursement, expressed as a percentage of the nominal value. Whether a loan/credit is concessional or not depends on the minimum concessionality level set out. The Development Assistance Committee (DAC) of the OECD first introduced the concept and defined concessional credits as those with 25 percent or more grant element calculated at the discount rate of 10 percent. To date, the OECD uses this definition to determine official development aid.

The concept of the minimum concessionality level has evolved, and a loan is now typically considered concessional if it contains a minimum grant element of at least 35 percent. In the mid-1990s the OECD export credit agencies refined their concessionality definition for export credits. The "Arrangement" set out the minimum concessionality at a grant element of 35 percent (and at 50 percent if the beneficiary country is a least developed country), calculated using a discount rate applicable to the currency of the transaction (i.e. a currency-specific commercial interest reference rate, CIRR). For operational purposes, the IMF employs a methodology similar to the OECD export credit Arrangement in calculating the appropriate level of concessionality in relation to its performance criteria under IMF-supported arrangements.

IDA's NCBP has harmonized with the IMF definition of concessionality. The minimum grant element required for a loan to be considered concessional under the NCBP is 35 percent, or higher should a higher minimum level be required under an existing IMF arrangement. The concessionality level under the NCBP is calculated using the following parameters:

(i) The discount rate is the relevant CIRR + margin, as follows:

The length of maturity	Margin	Relevant CIRR
Less than 15 years	0.75	6-month average
From 15 years up to but not including 20 years	1.00	ten-year average
From 20 years up to but not including 30 years	1.15	ten-year average
From 30 years and above	1.25	ten-year average

(ii) The discount rate of a given loan is the rate in effect at the time of notification.
(iii) The calculation uses the face value of the loan, including both the disbursed and disbursed amounts.
(iv) The overall concessionality level of a financing package is determined by multiplying the nominal value of each component of the package by the respective concessionality level of each component, summing the results, and then dividing the sum by the aggregate nominal value of the components.
(More details on the calculation of the concessionality and a tool to calculate concessionality are available at http://siteresources.worldbank.org/IDA/Resources/GrantElementCalculator.htm).

The IMF and NCBP calculation of concessionality level differs in two respects relative to the OECD Arrangement. First the OECD takes six-month average CIRRs, as in general export credits carry a maturity of less than 15 years, while the IMF and IDA's NCBP uses six-month average CIRRs for a loan with a maturity of less than 15 years and ten-year average CIRRs for a loans with a maturity of 15 years or longer. Second, when calculating the concessionality level of a bilateral loan, the IMF (and IDA's NCBP) uses the face value of the loan instead of using the nominal value of the debt (i.e., including both the disbursed and undisbursed amounts).

Sources:
1/ Glossary of Key Terms and Concepts. From the "Development Co-operation Report: Efforts and Policies of Members of the Development Assistance Committee".
2/ IMF, 2003, External Debt Statistics: Guide for Compilers and Users – Appendix III, Glossary, IMF, Washington DC.
3/ Dipplelsmann, R. and A. Kitili (2004), "Concessional Debt," IMF Committee on Balance of Payments Statistics, Balance of Payments Technical Expert Group, Issues Paper No.29, p. 3.