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IDA18

REVIEW OF IDA'S GRADUATION POLICY

**IDA Resource Mobilization Department (DFIRM)
March 1, 2016**

ACRONYMS AND ABBREVIATIONS

Fiscal year (FY) = July 1 to June 30

ADB	Asian Development Bank
AfDB	African Development Bank
AfDF	African Development Fund
AsDF	Asian Development Fund
DSA	Debt Sustainability Analysis
EMBI	Emerging Market Bond Index
FSO	Fund for Special Operations
FY	Fiscal Year
GAVI	Global Alliance for Vaccines and Immunization
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
HDI	Human Development Index
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MTR	Mid-Term Review
OCR	Ordinary Capital Resources
OECD	Organization for Economic Cooperation and Development
PBA	Performance Based Allocation
PPG	Public and Publicly Guaranteed
PPP	Purchasing Power Parity
PRGT	Poverty Reduction and Growth Trust
RDB	Regional Development Bank
SDR	Special Drawing Right
WBG	World Bank Group
WDI	World Development Indicators

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EXECUTIVE SUMMARY

i. **This paper reviews IDA’s graduation policy based on the issues raised by Participants at the IDA17 Mid-Term Review (MTR) and the IDA17 Working Group on Long-Term Vision and Financial Sustainability.** *First*, it sets out the objective of IDA’s graduation¹ policy and describes its key elements. *Second*, it reviews possible adjustments to graduation criteria, including raising the GNI per capita cutoff and supplementing it with additional indicators. Third, the paper identifies countries set for graduation at the end of the IDA17 period and points to the importance of a transition mechanism. Fourth, it reviews ways of improving coordination within the World Bank and with external development partners for smoothing the transition. Finally, it sets out issues for discussion.

ii. **While this paper is focused on the next Replenishment period, it complements the ongoing longer-term discussion of the role of the World Bank Group (WBG), also referred to as the “Forward Look.”** The Forward Look is a discussion among the WBG shareholders and Management which aims to analyze, among other things, the evolution of IDA’s client base and profile over the medium-to-long term due to graduations, and to enhance the institution’s overall capacity and effectiveness in addressing pressing global goals and challenges over the next 15 years.

iii. **The paper’s key conclusions are as follows:**

- **IDA’s flexible and holistic graduation process has helped countries make a successful and lasting exit from IDA.** IDA’s graduation process is comprehensive and relies on a careful case-by-case analysis of relevant country-specific factors *in addition to* its GNI per capita and creditworthiness criteria.
- **IDA’s operational GNI per capita cutoff is set at an appropriate level and there is no pressing case for modifying it.** It shows that modifying the GNI cutoff would not alter decisions on graduation as they are based on creditworthiness and broader country-specific considerations *in addition to* the GNI cut off. In fact, a higher GNI cut off could have an unintended impact on IDA’s finances by delaying countries being classified as “gap” countries, where IDA lends at blend terms.² The paper concludes that indicators additional to GNI per capita are highly correlated with it, not as comprehensive, and not universally available.
- **Based on the current flexible and holistic approach, the paper identifies Bolivia, Sri Lanka, and Vietnam as qualifying to graduate at the end of IDA17 provided an appropriate transitional support mechanism can be put in place.** While graduation from IDA is a positive milestone, smoothing this transition is essential. Without appropriate transition arrangements, overall financing from the World Bank to these countries could be lower. In addition, uncertainty regarding global market conditions may have implications on the ability of these countries to tap into international capital markets

¹ In this paper, “graduation” refers to a country’s movement out of IDA’s concessional window – i.e., a country is no longer eligible for IDA’s concessional resources.

² IDA-only “non-gap” countries receive IDA allocations in grants and/or IDA regular term credits whereas IDA-only “gap” countries receive their allocation on blend terms, which result in higher reflows to IDA.

for their financing needs at a reasonable cost. Consequently, should IDA resources generated by leverage (see accompanying paper, “IDA’s Long Term Financial Capacity and Leveraging Options”) be unavailable to help smooth transition, delaying graduation or giving the affected countries access to a transitional support mechanism (similar to the one that India qualified for in IDA17) is needed.

- **Finally, the paper recommends a more coordinated approach within and outside the World Bank to smooth transition to non-concessional finance for IDA graduates.** For the World Bank, it notes that while there is a systematic engagement by the Graduation Task Force with the country teams, it could come earlier in the process (when the country becomes blend) to ensure that the authorities are prepared for graduation. Coordination with other multilateral and bilateral development partners could be further strengthened using existing mechanisms.

iv. **Staff welcomes Participants’ views on:** (i) the expected graduation timeline for Bolivia, Sri Lanka, and Vietnam at the end of the IDA17 period, subject to availability of a transitional support mechanism; and (ii) retaining IDA’s current flexible graduation policy.

I. INTRODUCTION

1. **This paper reviews IDA’s graduation policy and identifies countries that are set to graduate at the end of IDA17.** This paper’s near-term focus complements the Management’s longer-term “Forward Look” exercise (Box 1). In addition, this paper addresses issues raised by Participants at the IDA17 MTR and by the IDA17 Working Group on Long-Term Vision and Financial Sustainability. These are:

- Reviewing the operational threshold and whether the income criteria can be sufficiently supplemented with other development or finance indicators;
- Enabling more effective arrangements for countries transitioning from IDA to IBRD-only financing, including extending the transition period;
- Better understanding the “cliff” effect that reduces overall financing available to countries upon graduation from IDA – and whether this is unique to the World Bank financing;
- Achieving a more coordinated and gradual transition to non-concessional finance; and
- Improving coordination with Multilateral Development Banks (MDBs) and official bilateral creditors.

2. **The paper is structured as follows:** Section II summarizes IDA’s graduation policy. Section III reviews options for adjusting IDA’s graduation criteria. Section IV discusses Management’s review of the countries expected to graduate at the end of IDA17, and assesses readiness of remaining blend countries. Section V sets out how IDA will further strengthen coordination across the World Bank, and with other MDBs and official bilateral creditors to better support transition to blend status and eventually IBRD-only status. This section also outlines how IDA could continue supporting graduates through non-concessional IDA resources. Section VI sets out the issues for discussion.

Box 1. The Forward Look

A discussion of how IDA’s client make up and profile will evolve over the medium to long term due to graduations is taking place within the broader context of the Management’s “Forward Look” exercise. This exercise is currently being undertaken by the WBG shareholders and management to enhance the institution’s overall capacity and effectiveness in addressing the most pressing global goals and challenges over the next 15 years. This exercise examines the three interrelated challenges, i.e., changes in the external environment, the WBG’s ability to adapt to these changes, and its financial capacity.

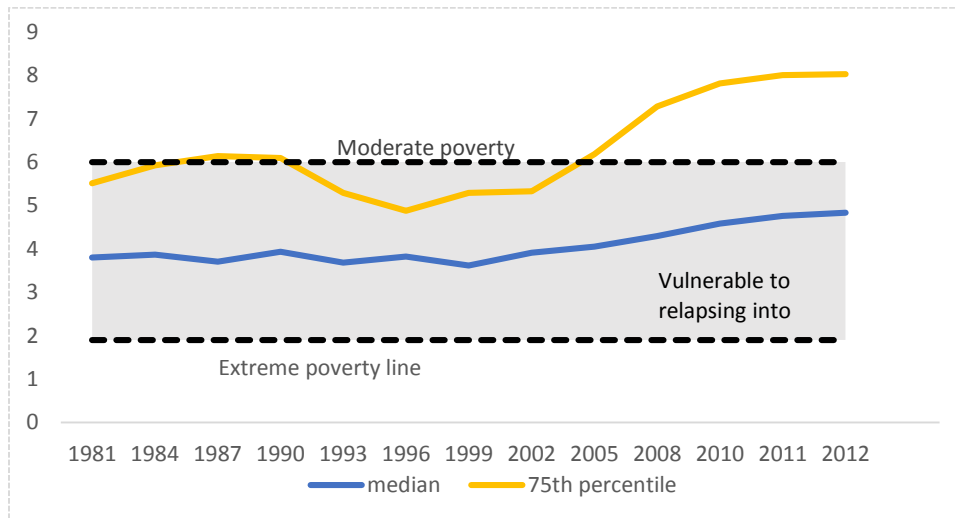
Against the backdrop of a changing external environment, the Forward Look exercise studies the profile of WBG clients, which is evolving over time: Middle- and High-Income Countries will gradually increase in number and the number of countries below the IDA operational cutoff will shrink, with a rising proportion of fragile and conflict-affected states. Responding to emerging global challenges will require actions on many fronts and across the income spectrum (e.g., creating jobs through private sector development; building human capital; improving competitiveness; fostering regional and global integration; diversifying production, revenues and exports; ensuring macro-financial stability; strengthening governance; adapting to and mitigating climate change; improving collective action in the pursuit of global public goods; preventing epidemics and pandemics; lessening the impact of fragility, conflict and violence).

II. IDA GRADUATION POLICY

3. **IDA’s flexible and holistic approach to graduation is in line with its objective to help countries make a successful and lasting exit.** From the outset, demand for IDA resources outstripped supply, creating the need for criteria to determine IDA eligibility. The underlying principles of the criteria are: (i) absence of creditworthiness; and (ii) concept of relative poverty, measured by GNI per capita below the IDA operational cutoff (US\$1,215 for FY16). In addition to these two technical criteria, the IDA graduation process has the necessary flexibility to allow for a careful examination of country-specific situations to determine whether or not a country is ready to graduate (also see IDA 2012 “Review of IDA Graduation Policy”).

4. **Retaining flexibility in graduation decisions is also important because countries remain vulnerable even when they exceed the per capita income cut off.** Many IDA-eligible countries with average per capita incomes above IDA’s operational cutoff have an average daily income³ in 2011 Purchasing Power Parity (PPP) terms within US\$1.90 (extreme poverty line) and US\$6 (moderate poverty line). A large share of their population are therefore at risk of relapsing into poverty when faced with shocks (Figure 1).

Figure 1. Daily Income Per-Capita of IDA Countries Above the Operational Cut-off
(In U.S. dollars in 2011 PPP terms)



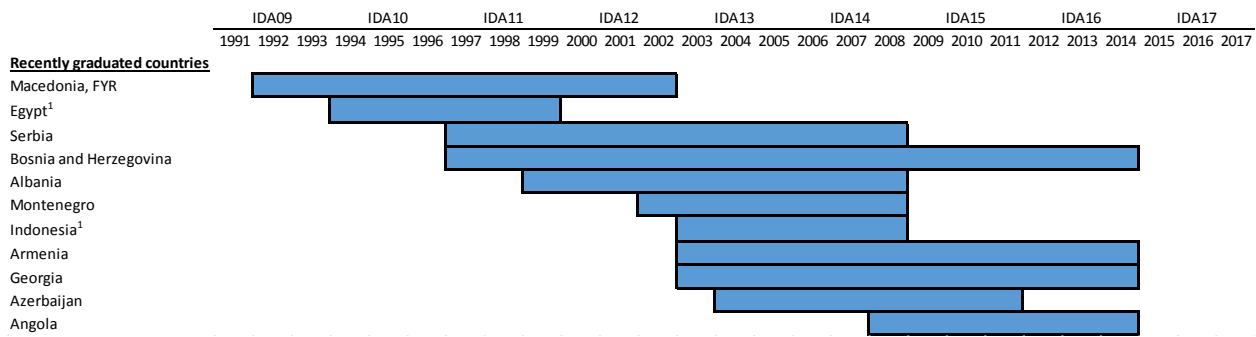
5. **The graduation process from IDA for any given country extends over several years (Figure 2).** Countries typically move from IDA-only non-gap, to IDA-only gap, to IDA-blend and then graduate to IBRD-only status.⁴ The steps are as follows:

³ Or daily consumption, according to the measurement used in the available household surveys.

⁴ Not all countries follow this path, for example, Equatorial Guinea graduated from IDA on an accelerated basis after substantial petroleum reserves were discovered, significantly improving its creditworthiness.

- IDA-only non-gap to IDA-only gap: countries that have been above the IDA operational cutoff for more than two years but are not yet deemed creditworthy for IBRD financing are classified as “gap” countries;
- IDA-only non-gap or IDA-only gap to blend: a positive creditworthy assessment by IBRD leads to reclassification of a country from IDA-only non-gap or IDA-only gap status to blend status (IDA/IBRD). The shift to blend status rarely occurs before a country reaches the IDA operational cutoff and IDA-only gap status. Once a country becomes blend, IBRD financing is phased in while IDA financing is gradually phased out; and
- Blend to IBRD-only: the process concludes with reclassification from blend status to IBRD-only, with no access to new IDA resources.⁵ The graduation process normally starts once a country is assessed as creditworthy and its income per capita has been above IDA’s operational cut off for at least three years. The actual “readiness” to graduate to IBRD-only status is based on an assessment of a country’s macroeconomic prospects, risk of debt distress, vulnerability to shocks, external debt and liquidity, political stability, levels of poverty and social indicators. On average, IDA countries remain in blend status for approximately two IDA Replenishment cycles. Graduation is usually set to occur at the end of an IDA Replenishment period.

Figure 2. Graduation Period for Recent IDA Graduates
(From first year above IDA operational cutoff to year of graduation)



Source: IDA.

¹ Reverse graduates.

6. **To be classified as blend, a country must first be assessed as creditworthy to borrow from IBRD.** Creditworthiness assessments are based on an evaluation of eight broad components: political risk, external debt and liquidity, fiscal policy and public debt burden, balance of payment risks, economic structure and growth prospects, monetary and exchange rate policy, financial sector risks, and corporate sector debt. This includes a comprehensive analysis of short-and-long term vulnerabilities facing the country and its links to the global economy. IBRD, in contrast to most private lenders, does not charge borrowers an individual risk premium and its loans have a much longer maturity. Therefore, its assessment of creditworthiness may differ from the market’s perception.

⁵ Graduates no longer have access to new concessional IDA commitments. However, past IDA commitments will continue to disburse as projects progress. Box 2 shows “Transitional Support” provided to India after graduation on an exceptional basis.

7. **In addition to losing access to new IDA concessional resources upon graduation, countries are also subject to accelerated repayment of outstanding credits.** As background, IDA credit agreements have included an Accelerated Repayment Clause since 1987.⁶ The Clause was amended in 1996, and now applies to the borrowers that have a GNI per capita above the IDA operational cut-off for three consecutive years and are creditworthy for IBRD. The Clause stipulates that principal repayments on outstanding credits to a particular borrower would be doubled provided that a five year grace period had elapsed. Instead of doubling the principal repayments, the borrower may request that IDA substitute an interest charge for some or all of the higher principal repayments, provided the new terms have a grant element equivalent to that resulting from doubling of the principal payments alone. IDA works with graduating countries and, when requested, provides them with options – modified principal and/or interest options – that in present value terms are equivalent to the principal option. Exercising the acceleration clause is subject to Board approval, after due consideration of the developments in the recipient country economy, including assessing the impact of the accelerated repayments of IDA credits on its debt sustainability. During IDA16 and IDA17, the accelerated repayment clause in qualifying IDA credit agreements was exercised for fifteen graduates.⁷

III. OPTIONS FOR ADJUSTING IDA’S GRADUATION CRITERIA

8. **In response to requests received during the 2015 Annual Meetings and the IDA17 MTR, this section reviews the criteria for graduation from IDA.** Countries graduating from IDA face both hardening of terms and reduction in financing that is not compensated by other sources (Kharas *et. al.*, 2014). Participants asked whether IDA’s operational cut off is set at an appropriate level and enquired about the implications of raising the cut off. They also asked if other variables could be considered to complement the income criteria.

9. **Despite challenges outlined in past reviews,⁸ the GNI per capita has proven to be a robust and useful indicator for the level of development.** Any revisions of the income threshold need to achieve the following: retain advantages of using the GNI per capita (frequency and relative reliability of data); ensure that concessional resources are reserved for the poorest countries; and maintain IDA’s financial sustainability. GNI per capita data are widely available and updated annually for all countries. The Atlas method⁹ used to calculate GNI reduces its

⁶ The original provisions called for a doubling of scheduled principal payments when the GNI per capita of the borrowing country has remained above the historical cutoff for five consecutive years subject to a minimum grace period of ten years. The Clause aims at enhancing IDA’s ability, through quicker recycling of resources, to concentrate its resources on countries most in need. See “IDA Financial Policy Review,” IDA/R87-26, March 12, 1987.

⁷ Albania, Angola, Armenia, Azerbaijan, Bosnia and Herzegovina, China, Egypt, Equatorial Guinea, Georgia, India, Indonesia, Iraq, Macedonia FYR, St. Kitts and Nevis, and the Philippines.

⁸ Past reviews (IDA, 2001) acknowledged that the income criteria does not fully reflect how equitably income is shared within a country and where a country stands with regard to non-income indicators of poverty. These reviews also explored the feasibility of introducing additional measures of relative poverty that would complement the per-capita income criteria (IDA, 2001). They noted several challenges: that consistent data were not available for IDA-eligible countries every year; that the construction of indices remains somewhat arbitrary; and that additional criteria could provide conflicting signals.

⁹ The Atlas conversion factor for any year is the average of a country’s exchange rate for that year and its exchange rates for the two preceding years, adjusted for the difference between the rate of inflation in the country and

volatility over time, and the use of market exchange rates makes the income criteria appropriate for assessing a country's external repayment capacity. In addition, the indicator does not require periodic rebasing (as required for PPP-based indicators) and, therefore, minimizes reclassification of countries based on methodology.

10. **Recent research explores whether higher thresholds could better represent a country's capacity to eliminate poverty or close their poverty gaps.** Some possible options are: (i) an indicative threshold consistent with an average income, which would in principle, allow a country to bring all its citizens to the lower-bound of the middle income category through redistributive policies (US\$3,560 in 2005 PPP); (ii) a level of income that would allow collecting additional revenues to close the poverty gap (US\$4,000 in 2005 PPP); (iii) the IDA historical cutoff (US\$1,985); and (iv) a threshold that would maintain the ratio to worldwide GNI constant (US\$1,835) (Table 1). Other options have also been explored (updating the operational cutoff with U.S. inflation or with the average inflation of the G20), but were not found to be very different from the current operational or historical cutoffs.

Table 1. Alternative Thresholds

Method	Source	Threshold 2005 PPP	Threshold 2011 PPP	Implied income per capita (in PPP terms)	Estimated equivalent in current U.S. dollar ¹	Equivalent GNI Atlas method in 2014 ²
Upper bound of poverty lines	Pritchett (2006)	\$10 a day		\$3,560 (2005)	\$2,643	\$3,365
			\$13-15 ³ a day	\$4,785 - \$5,475 (2011)	\$3,678 - \$4,244	\$3,754 - \$4,330
Income per capita consistent with domestic revenue capacity	Ravallion (2012)			\$4,000 (2005)	\$2,300	\$2,729
Historical cutoff						\$1,985
IDA cutoff to World GNI per capita constant over time						\$1,835
IDA operational cutoff						\$1,215

¹ It is calculated by applying the ratio of World GNI in per-capita in PPP terms to that in current U.S. dollars.

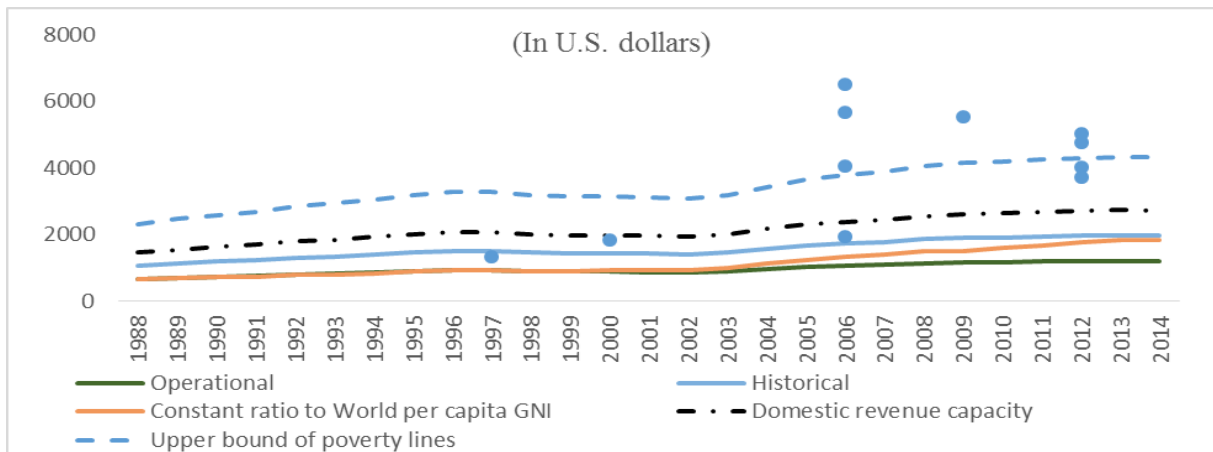
² Obtained by multiplying the estimated income in current U.S. dollars by the Special Drawing Right (SDR) deflator used to calculate the GNI per capita Atlas method.

³ The range corresponds to (i) the poverty line per person for a family of 4 in the U.S. (see US Department of Health and Human Services); and (ii) to the 2011 PPP equivalent of the US\$10 threshold in 2005 PPP, assessed to correspond to the lower bound of income for the middle class. It assumes the same proportional increase from the US\$1.25 a day to the US\$1.90 a day.

international inflation. The purpose of the Atlas conversion factor is to reduce the impact of exchange rate fluctuations in the cross-country comparison of national incomes.

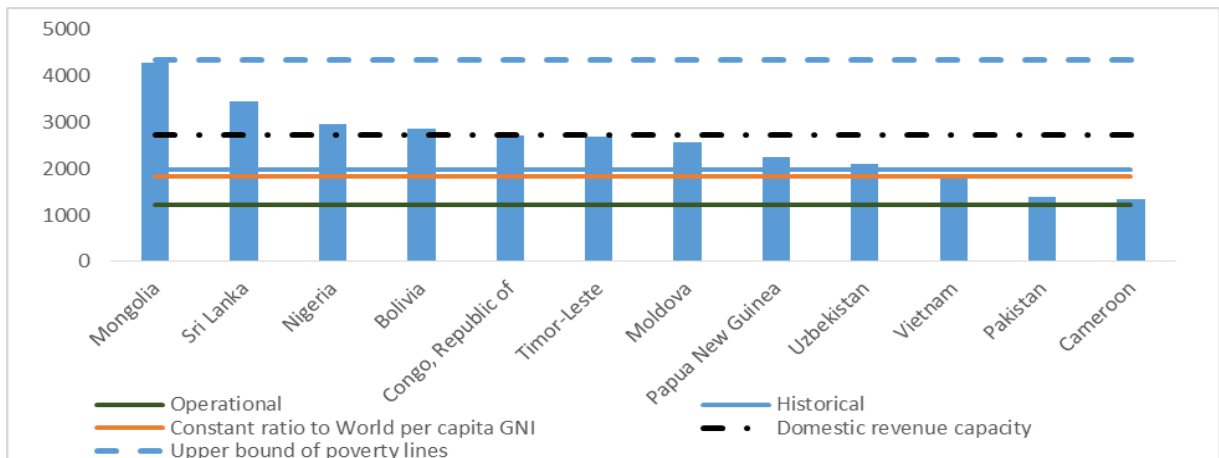
11. **Setting aside creditworthiness considerations, if the IDA cutoff were lifted to the alternative thresholds in Table 1, it would not have affected the timing of past graduations.** Income levels of the countries that graduated from IDA since FY90 were higher than the IDA operational cutoff in the relevant year. As Figure 3 shows, the historical IDA cutoff or the cutoff that would maintain constant IDA eligibility with respect to the world GNI would have limited effect on past graduation decisions. The figure also shows that only large increases in the IDA cutoff could have delayed some past graduations. If we consider the current blends against the alternative thresholds, we note similar results (Figure 4). Of the current eleven gap countries, eight have an income per capita that would fall below any proposed IDA revised cutoff. Therefore, based on current policies, many IDA gap countries would retain eligibility for standard IDA terms if the cutoff were raised.

Figure 3. Alternative IDA Cutoff Levels vs Recent IDA Graduates' Income Per Capita (at the time of graduation)



Source: IDA, Pritchett (2006); Ravallion (2012); and Bank's staff estimates.

Figure 4. Alternative IDA Cutoff Levels vs. Current Blend Countries' Income Per Capita (FY16)



Source: IDA, Pritchett (2006); Ravallion (2012); and Bank's staff estimates.

12. Changes to the IDA cutoff may not affect graduation decisions but will delay classification of countries to gap status – and, therefore, affect IDA’s financial sustainability.

A much higher cut off will delay the process of current IDA-only countries reaching gap status. IDA-only non-gap borrowers receive their IDA allocation in terms of grants and IDA regular term credits. IDA will not receive any reflows from grant commitments and the reflows received from IDA regular term credits are paid according to a much longer repayment schedule compared to blend terms (that gap and blend countries pay). Simulations show that if the cutoff were adjusted to a higher level, such as to historical cutoff (US\$1,985), loss of future internal resources (principal and interest income) due to higher allocation to grant and regular term credits and loss of future service charge income by FY35 would reach US\$8.9 billion. If the cutoff were adjusted to a level consistent with domestic revenue gap (US\$2,729), or significantly increased using the upper bound of poverty lines (US\$4,330), the losses would exceed US\$11 billion.

13. Any change to IDA’s income threshold would also have consequences beyond IDA.

Other multilateral and bilateral development partners determine access to concessional finance based on the income threshold for IDA eligibility. A number of regional development banks (RDBs), the IMF and large global funds (e.g., Global Alliance for Vaccines and Immunization (GAVI)) use the income threshold for IDA eligibility to define access to concessional resources (see Annex 1). Likewise, bilateral aid agencies tend to align their aid programs with a *country’s GNI per capita* relative to IDA’s operational threshold. Therefore, aid from bilateral donor countries is also lower after countries cross the IDA income cutoff (Knack *et al.*, 2014).

14. In addition to GNI per capita, a variety of indicators were evaluated (Table 2).

Table 2 compares the income indicator to other indices tracking countries’ performance with respect to the WBG’s Twin Goals (indicators for poverty and shared prosperity), human development, vulnerability to climate change, and domestic revenue mobilization (see Annex 2 for the full definition of the indicators). Poverty levels measured by the poverty headcount (a monetary measure of poverty) and the Multidimensional Poverty Index (which measures the lack of access to services, a non-monetary measure of poverty) confirm that most blend and gap countries have higher poverty levels than IBRD-only countries. Data from the Human Development Index (HDI) confirm findings of previous reviews of graduation criteria (see IDA 2001 and 2012) that many IDA countries, including blend and gap, have a moderate or low score. Many IDA-eligible countries are more vulnerable to and less ready to cope with climate change compared to IBRD-only countries, as measured by the resilience country index. There is also a large difference between blend and gap countries versus IBRD countries when considering the capacity to close the poverty gap through taxation and redistribution. Many blend and gap countries would require a marginal tax rate well above 60 percent (the highest level in European Union countries.)^{10 11}

15. In addition, a high degree of correlation was found among these alternative indicators; and compared to GNI per capita, data are of limited frequency and coverage. This makes GNI per capita a preferable option for graduation decisions.

For example, the HDI and the ND-GAIN (the University of Notre Dame Global Adaptation Index) are highly correlated with GNI per capita. Although annual poverty estimates are available for blend

¹⁰ See Immervoll (2004).

¹¹ Other indicators could be used to estimate the capacity of countries to self-finance poverty reduction. DfID (2016) for example calculates how many years countries will need to be able to self-finance poverty reduction.

countries, they are not available for 17 percent of IDA countries, including half of the small states. Data limitations are even more acute for marginal tax data, which are not available for 44 percent of IDA eligible countries. Under the current approach, while deciding on a country's graduation, WBG reviews all available information, including that on alternative indicators.

Table 2. Alternative Indicators to Be Considered at Graduation

	GNI per capita, Atlas method (current US\$, 2014)	GNI per capita, PPP (current international \$, 2014)	Poverty headcount (2012, 2011 PPP)	Multidimensional Poverty Index (MPI)	Per capita growth mean consumption/income, bottom 40% of population (%)	Human Development Index (2014)	Marginal Tax Rate (2010)	Economic Vulnerability Index (2014)	ND-GAIN rank (2014)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Blend									
Mongolia	4,280	11,120	0.4	3.7	..	0.73	9.0	37.5	69
Sri Lanka	3,460	10,370	2.5	..	2.2	0.76	69.7	25.0	96
Nigeria	2,970	5,710	51.7	30.3	..	0.51	100.0	37.3	147
Bolivia	2,870	6,290	9.1	8.9	10.1	0.66	11.5	32.1	121
Congo, Rep.	2,720	5,200	28.4	18.1	7.2	0.59	..	27.5	167
Timor-Leste	2,680	5,080	28.2	0.59	..	55.0	142
Moldova	2,560	5,500	0.3	0.3	5.0	0.69	97.5	..	81
Papua New Guinea	2,240	2,790	33.7	0.51	..	32.1	171
Uzbekistan	2,090	5,830	27.1	0.8	..	0.68	100.0	29.4	110
Vietnam	1,890	5,350	3.2	1.7	6.2	0.67	100.0	31.1	99
Pakistan	1,400	5,090	6.8	23.0	3.8	0.54	100.0	23.2	126
Cameroon	1,350	2,950	27.0	24.8	..	0.51	100.0	19.0	134
Gap									
Average	2,091	4,702	24.07	15.97	3.89	0.55	72.6	38.49	131
1st quartile	1,450	3,140	8.92	9.58	..	0.49	26.0	33.50	114
3rd quartile	2,370	6,170	34.16	22.76	..	0.61	100.0	46.68	148
IDA only¹									
Average	821	1,946	41.00	33.88	1.85	0.47	86.96	38.76	154
1st quartile	545	1,250	23.61	23.88	(1.84)	0.42	93.39	31.80	143
3rd quartile	1,058	2,548	55.56	45.85	5.04	0.51	100.00	45.80	170
IBRD only									
Average	8,314	15,111	5.53	3.22	3.19	0.73	25.82	29.95	82
1st quartile	4,870	10,185	0.15	0.44	1.15	0.69	1.63	22.10	53
3rd quartile	11,110	18,565	6.99	4.33	5.86	0.78	37.56	39.10	105
Correlation									
IDA	1.00	0.92	(0.58)	(0.63)	(0.24)	0.70	(0.65)	(0.20)	(0.69)
	1.00	0.89	(0.53)	(0.61)	0.32	0.80	(0.51)	0.20	(0.76)

Sources: (1),(2),and (5) World Development Indicators; (3) PovCal Net, The World Bank; (4) Alkire, S. and Robles, G. (2015); (6) UNDP; (7) Ravallion (2009); (8) UN DESA; (9) University of Notre Dame Global Adaptation Index.

Note: variables are defined in Annex 3.

¹ Excludes countries eligible under the Small Island Exception and Gap countries.

16. In conclusion, a modification of the current income threshold is unlikely to alter graduation decisions, which are broader and holistic in nature. However, even small changes to it would result in financial loss for IDA due to delays in classification to gap status. Only combined with an assessment of a country's readiness to graduate (which includes full access to IBRD financing), per capita income provides information for making graduation decisions. It is important, however, to retain flexibility on graduation decisions to ensure that countries are not graduated prematurely and make a lasting exit from IDA.

IV. GRADUATIONS FROM IDA AND REVIEW OF OTHER BLENDS

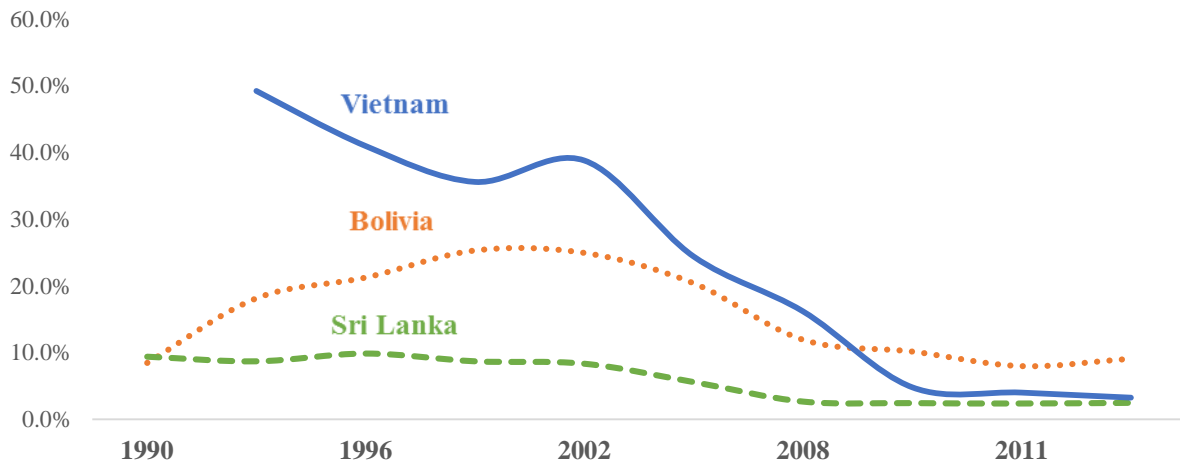
A. TIMING OF EXPECTED GRADUATIONS

17. **Based on the current flexible approach, Bolivia, Sri Lanka, and Vietnam meet technical criteria for graduation at the end of IDA17.** Strong and inclusive economic growth in the three countries led to significant poverty reduction and increased shared prosperity. Between 2002 and 2012, poverty headcount¹² declined by 16 percentage points in Bolivia; 6 percentage points in Sri Lanka; and 36 percentage points in Vietnam. During the same period, the income growth of the bottom 40 percent in Bolivia, Sri Lanka and Vietnam were 12.8 percent, 3.0 percent and 6.2 percent, respectively. In Bolivia and Sri Lanka, the income growth of the bottom 40 percent were above the average income growth of the total population. Growth prospects of all three countries remain favorable, with some country-specific challenges outlined in individual country discussions.

18. **In all three countries, there is need to smooth transition after graduation because they are otherwise projected to receive lower financing from the World Bank for a while upon graduation.** Decrease in available net transfers from the World Bank is expected to be particularly severe for Vietnam and moderately lower in the case of Bolivia. This is because of constrained IBRD financing¹³ and possible implementation of IDA's acceleration clause. In addition, uncertainty regarding global market conditions may have implications for the cost of external financing, as well as volumes needed by these countries. As a result, should IDA resources generated by leverage, as presented in the accompanying paper "IDA's Long Term Financial Capacity and Leveraging Options," not be available to help smooth the transition, there may be a strong case to delay graduation in the absence of an alternative transitional support mechanism.

Figure 5. Selected Indicators for Graduating Countries

Figure 5.A. Poverty Headcount at US\$1.90 a day in 2011 PPP



¹² Defined as share of population living with less than US\$1.90 a day in 2011 PPP.

¹³ IBRD has been facing an increase demand for lending in the recent past, reflecting deteriorating conditions in emerging economies coupled with an ambitious development agenda. In assessing its future overall lending headroom, IBRD takes into account the potential for additional demand as a result of the countries graduating from IDA to IBRD-only status.

Figure 5.B. GDP Growth (%)

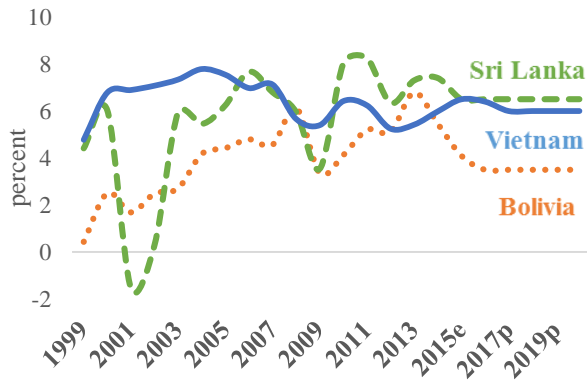


Figure 5.C. Reserves (months of imports)

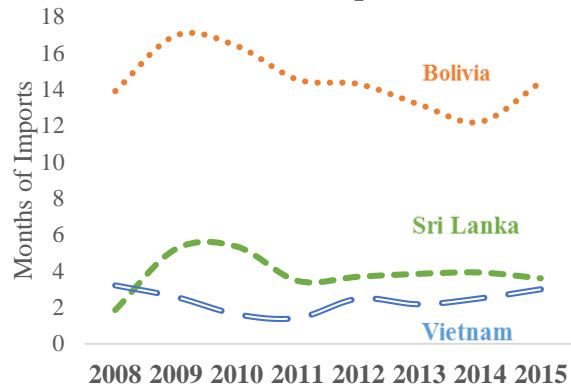


Figure 5.D. Current Account Balance (% of GDP)

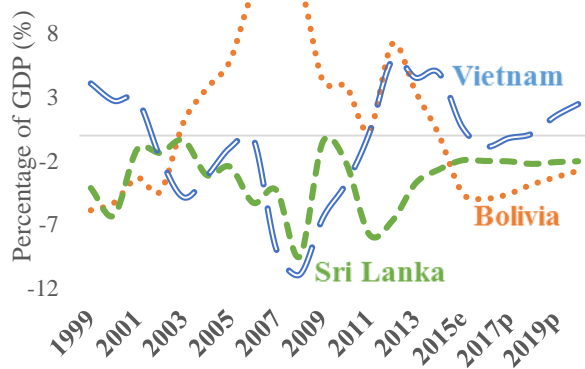
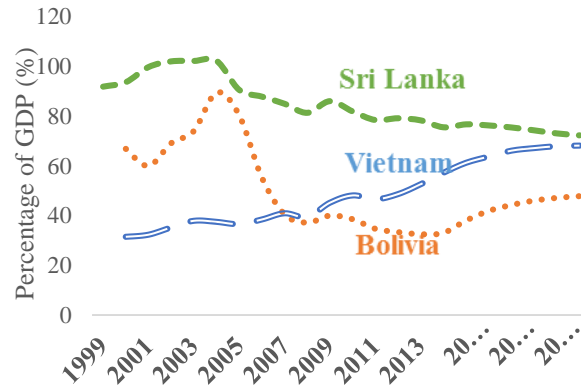


Figure 5.E. General Government Gross Debt (% of GDP)



Source: Poverty data are from the World Bank; macroeconomic data are from the IMF.

Bolivia

19. **On the basis of its GNI per capita of US\$2,830 and creditworthiness, Bolivia is expected to graduate at the end of IDA17.** Since 2002, Bolivia made progress in reducing poverty and inequality, outperforming many other Latin American countries. According to the country data, poverty decreased from 63 percent of the population in 2002 to 39 percent in 2014, and extreme poverty from 39 percent in 2002 to 17 percent in 2014. Poverty reduction was accompanied by a large decline in income inequality. Bolivia's Gini coefficient fell from 60 in 2002 to an estimated 49 points in 2013. Using harmonized data for the Latin America and the Caribbean Region, Bolivia achieved one of the region's largest reductions in poverty, second only to Ecuador. These improvements are mostly attributed to increased labor income resulting from higher growth, better commodity prices and real appreciation.

20. **Bolivia's real GDP growth moderated from a peak of 6.8 percent in 2013 to an estimated 4 percent in 2015, still among the highest in the region.** Inflation declined from 6.5 to 3.0 percent over the same period. On the other hand, lower gas export prices and robust domestic demand led to deficits on the current and fiscal accounts after many years of surpluses: the fiscal

deficit was estimated at 6.6 percent of GDP in 2015 while the current account deficit is estimated at 4.5 percent in 2015. Going forward, growth is expected to moderate converging to around 3.5 percent in the next few years, in a context of lower commodity prices, and deteriorating external and fiscal balances. However, thanks to ample external and fiscal buffers, Bolivia is likely to experience a soft landing and avoid larger slowdowns. International reserves amount to about 39 percent of GDP (or 15 months of imports) in 2015 and total public debt was below 40 percent of GDP (see Annex 3 for more details on the debt indicators).

21. **Bolivia's achievements are being threatened by the weak global environment.** Sustaining growth will require careful fiscal and macroeconomic management and adjustment to a lower commodity price environment, better management of natural resources and development of non-extractive and productive sectors. More importantly, the dependence of Bolivian economy on natural resources makes growth prospects vulnerable to potential production capacity bottlenecks in the coming years, notably in the gas sector. The limited public sector capacity to make required capital investments underlines the importance of attracting private investment. The current downturn in external economic conditions, notably the fall in gas prices, has already led the IMF to reduce the potential growth rate of the country to 3.5 percent per annum from a potential growth rate of 5 percent estimated two years earlier.

22. **Bolivia returned to the global credit markets with two bond issuances in 2012 and 2013.** Bolivia's emerging market bond index (EMBI) spread was around 270 basis points in January 2016. Bolivia's reliance on concessional official borrowing has declined from 82 percent of public external debt in 2005 to 63 percent in 2014. Bolivia has been a blend country since 2002, with limited access to IBRD until recently.

23. **Bolivia meets the criteria for accelerated credit repayments and is expected to accelerate its repayments to IDA upon graduating.** As of December 31, 2015, it had US\$634.6 million in outstanding IDA credits, 90.1 percent of which (US\$571.8 million) include the new accelerated repayment clause and 9.9 percent (US\$62.7 million) are credits on hardened terms that are not subject to acceleration. Bolivia meets the eligibility requirements under the new clause: its GNI per capita has exceeded the operational cut-off for more than three consecutive years, and it has been found creditworthy for IBRD. As a result, Bolivia is expected to accelerate its repayments of credits under the new clause starting in IDA18, subject to the approval by the Executive Directors.

Bolivia	SDR mil	Equiv US\$ mil	% of total
Outstanding IDA credits at December 31, 2015	457.9	634.6	100%
<i>Of which: Not subject to acceleration</i>	<i>45.3</i>	<i>62.7</i>	<i>9.9%</i>
<i>Subject to acceleration on old clause</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0%</i>
<i>Subject to acceleration on new clause</i>	<i>412.7</i>	<i>571.8</i>	<i>90.1%</i>

Sri Lanka

24. **Sri Lanka is creditworthy for IBRD, has a GNI per capita of US\$3,400 – more than twice the IDA cutoff – and is proposed to graduate at the end of IDA17.** Sri Lanka's economic growth averaged 6.7 percent a year during 2010-2014. This was on top of an average growth of 6 percent during the preceding five years. The national poverty headcount rate declined from 8.3 percent to 2.5 percent between 2002 and 2012, while consumption per capita of the bottom 40 percent grew at a rate of 3.3 percent a year, compared to 2.8 percent for the total population. Increases in labor incomes account for most of the reduction in poverty over the last 10 years. Other human development indicators are also impressive relative to regional and lower middle-income country standards. Sri Lanka has also succeeded in ending decades of internal conflict in 2009, although due to a lasting legacy of the conflict, the conflict-affected areas in the North and East continue to have pockets of significant poverty.

25. **Sri Lanka's near term growth remains fairly strong, but the outlook is subject to downside risks.** Economic growth continued at 5.6 percent in 2015, while headline inflation remained low. The external current account deficit is projected to narrow, due largely to lower oil prices. Official reserves declined from US\$8.2 billion to US\$7.3 billion by end-2015 due to monetary authority's currency defense, its commitment to facilitate foreign capital outflows in a relatively shallow foreign exchange market, repayments of a Eurobond in January and to the IMF. Sri Lanka recorded a fiscal deficit of 6.5 percent of GDP in 2015, higher than the targeted 4.4 percent of GDP. The public debt-to-GDP ratio is high at 77 percent of GDP and the country has a moderate risk of debt distress (see Annex 3 for more details on the debt indicators). Sri Lanka has one of the lowest tax revenue-to-GDP ratios in the world, reflecting a decline from 24.2 percent in 1978 to 10.7 percent in 2014. Low tax revenues combined with an expenditure profile that is largely non-discretionary has led to a lean, rigid budget with little room for critical development spending. Going forward, in order to bring debt back on a downward path, the country has to rely more on fiscal consolidation and securing financing on favorable terms to reduce the real interest rate on debt.

26. **Important challenges lie ahead for sustained development for Sri Lanka.** Despite low levels of extreme poverty, roughly one quarter of Sri Lankans are nearly poor, i.e., those living above the official poverty line (equivalent to about US\$1.50 per day in 2005 PPP terms) but below US\$2.50 per day in 2005 PPP terms. The living standards of the near poor are closer to those of the poor than those living above US\$2.50 per day. Although Sri Lanka has excelled in overcoming human development challenges typical of a low-income country, its service delivery systems in education, health, and other areas must now adjust to face new and changing demands typical of a MIC. Imperatives to improve social protection programs will increase owing to an aging population that has passed its demographic peak. Finally, given increasing affluence and information, there will be higher expectations from the state to facilitate growth, provide higher level of services, and demonstrate increasing responsiveness to a more demanding citizenry. Sri Lanka is entering a period of major reforms, with the change in government in 2015 triggering a firm commitment to reforms and new policy agenda to address structural issues.

27. **Sri Lanka has been regularly tapping bond markets since 2007.** Sri Lanka's EMBI spread was around 580 basis points in January 2016. Sri Lanka's reliance on concessional official

borrowing has declined significantly from 87 percent of public external debt in 2005 to 51 percent in 2014. Sri Lanka has been a blend country since 2012.

28. **Sri Lanka meets the criteria for accelerated credit repayments and is expected to accelerate its repayments to IDA after graduation.** As of December 31, 2015, Sri Lanka had US\$2,712.4 million in outstanding IDA credits, of which about US\$284.1 million (11 percent) include accelerated repayments under the old clause and US\$975.5 million (36 percent) include payments under the new accelerated repayment clause. The remaining US\$1,452.7 million (54 percent) are credits on hardened terms which are not subject to acceleration clause or credits that date back to the period before the accelerated repayment clause was included in IDA credit agreements. Sri Lanka meets the eligibility requirements under both the old and the new accelerated repayment clauses, as its GNI per capita has exceeded the historical cut-off for more than five consecutive years, and it has been found creditworthy for IBRD. As a result, Sri Lanka is expected to accelerate its repayments of credits under both the old and the new clauses starting in IDA18, subject to the approval by the Executive Directors.

Sri Lanka	SDR mil	Equiv US\$ mil	% of total
Outstanding IDA credits at December 31, 2015	1,957.4	2,712.4	
<i>Of which: Not subject to acceleration</i>	<i>1,048.3</i>	<i>1,452.7</i>	<i>53.6%</i>
<i>Subject to acceleration on old clause</i>	<i>205.0</i>	<i>284.1</i>	<i>10.5%</i>
<i>Subject to acceleration on new clause</i>	<i>704.0</i>	<i>975.5</i>	<i>36.0%</i>

Vietnam

29. **Vietnam's GNI per capita of US\$1,890 is above IDA's graduation threshold, and its graduation is built upon its creditworthiness, rapid growth, poverty reduction and shared prosperity.** Since implementation of reforms in late 1980s, Vietnam has sustained rapid economic growth rates that, over one generation, catapulted the country from being one of the world's poorest nations to middle income status. With GDP growth averaging 5.5 percent annually, real per capita GDP more than tripled between 1990 and 2015 which helped lift more than 40 million people out of poverty (under the national poverty line). Extreme poverty has been nearly eliminated and, using the national poverty line, poverty has been reduced to 13.5 percent. Unlike other fast growing economies in the region, Vietnam has not experienced major increases in income inequality, with its income Gini coefficient (0.39 in 2012) remaining substantially lower than China, Indonesia and Thailand. Social indicators have also greatly improved, underpinned by wider access to basic services including broad access to primary education, health care, and vital infrastructure such as paved roads, electricity, piped water, and sanitation.

30. **Vietnam's macroeconomic performance remains strong, but some downside risks remain.** Following several years of more moderate expansion, economic growth accelerated to 6.7 percent in 2015 (up from 6 percent in 2014, 5.4 in 2013 and 5.2 in 2012) driven by a combination of buoyant domestic demand and strong performance of export-oriented manufacturing. Inflationary pressures remain subdued benefitting from low commodity prices and stable core inflation. On the external front, Vietnam's exports, especially of manufactured goods, continue to expand rapidly, but a surge in imports, mainly of capital and intermediate goods is eroding the current account. Global financial market volatility spilled over into domestic markets, and capital

account pressures intensified in the second half of the year, with gross international reserves falling to less than 3 months of imports of goods and services. While the outlook for Vietnam is broadly favorable, downside risks arise from large fiscal imbalances and rising public debt, slow progress on banking and state-owned-enterprise reforms, weak external demand and global financial volatility. Large fiscal deficits in recent years have supported the economy, but at the cost of rising public debt (61 percent of GDP, from 47 percent in 2009, see Annex 3 for more details on the debt indicators). Vietnam’s risk of public and external debt distress is assessed as low, but delays in fiscal consolidation could potentially undermine debt sustainability. Debt service payments are a rising burden on the budget with interest payments accounting for 8 percent of Government revenue and large repayment needs on short-term domestic debt presenting refinancing risks. Finally, Vietnam is faced with the remaining poverty reduction agenda that is now largely a question of closing the gap in poverty and living conditions among marginalized groups. Moreover, as in other IDA countries, Vietnam’s gains in poverty reduction remain fragile, with many of those who recently moved out of poverty remaining close to the poverty line and hence susceptible to shocks.

31. **Vietnam has been increasingly accessing the financial markets.** Vietnam’s EMBI spread was around 330 basis points in January 2016. Vietnam’s reliance on concessional official borrowing has declined from 82 percent of public external borrowing in 2005 to 71 percent in 2014. Vietnam has been a blend country since 2010.

32. **Vietnam meets the criteria for accelerated credit repayments and is expected to accelerate its repayments to IDA after graduation.** As of December 31, 2015, Vietnam had US\$11.2 billion in outstanding IDA credits, of which about US\$1.1 billion (9 percent) falls under the old accelerated repayment clause and US\$10.1 billion (90 percent) falls under the new accelerated repayment clause. The remaining US\$23 million date back to the period before the accelerated repayment clause was included in IDA credit agreements. Vietnam is expected to meet the two eligibility requirements under the new clause by FY18: its GNI per capita will have exceeded the operational cut-off for more than three consecutive years, and its creditworthiness for IBRD lending. As a result, Vietnam is expected to accelerate its repayments of credits under the new clause starting in IDA18, subject to the approval by the Executive Directors. Vietnam’s GNI per capita is still below the historical cutoff, so it is not yet eligible for contractual credit acceleration of IDA credits that contain the old clause.

Vietnam	SDR mil	Equiv US\$ mil	% of the total
Outstanding IDA credits at December 31, 2015	8,083.2	11,201.2	
<i>Of which: Not subject to acceleration</i>	16.8	23.3	0.2%
<i>Subject to acceleration on old clause</i>	759.7	1,052.7	9.4%
<i>Subject to acceleration on new clause</i>	7,306.7	10,125.2	90.4%

B. REVIEW OF OTHER BLENDS

33. **The remaining nine blend countries (excluding the five countries that are under the small island economies exception) are not considered ready for graduation.** These countries are: Cameroon, Congo Republic, Moldova, Mongolia, Nigeria, Pakistan, Papua New Guinea,

Timor-Leste, and Uzbekistan.¹⁴ Management assessed each of these countries' readiness for graduation with a careful case-by-cases analysis of the vulnerabilities and challenges that these countries face, including the following:

- Cameroon, Republic of Congo, Mongolia, Nigeria, and Papua New Guinea are highly dependent on commodity exports and face significant headwinds due to low prices for commodity exports and increased short term risks;
- Cameroon, Republic of Congo, Nigeria, Papua New Guinea, Timor-Leste, and Uzbekistan have very high poverty headcounts, with Nigeria's poverty exceeding 50 percent, which is the highest poverty rate among all blends;
- Cameroon, and Mongolia face significant debt vulnerabilities as indicated by their high risk of external debt distress based on the latest Debt Sustainability Analyses (DSAs);
- Timor-Leste is a fragile state facing significant climate and economic vulnerabilities as evidenced by its Economic Vulnerability Index score, which is the highest among all blends;
- Cameroon, and Pakistan have only recently exceeded the IDA operational cutoff;
- Moldova is facing significant short term vulnerabilities and lacks market access.

34. **Table 3 below shows how all current blend countries fare on selected macroeconomic, social and structural vulnerability indicators.**

Table 3. Selected Indicators

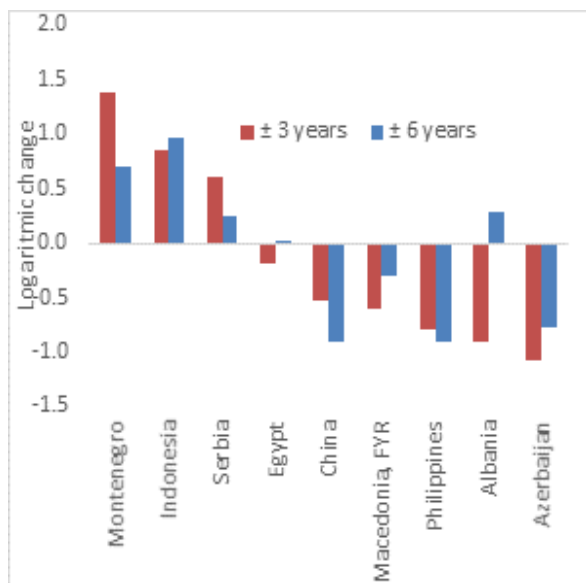
	GNI per capita, Atlas method (current US\$)	Poverty headcount ratio at \$1.90 a day (% of population)	Human Development Index (ranking out of 187)	Real output growth, average in %		Nominal public debt, in % GDP	Commodity exports as a percentage of GDP	Political Stability and Absence of Violence/Terrorism	Risk of Debt Distress	Average of the Worldwide Governance Indicators (-2.5 to +2.5)	The economic vulnerability index (EVI)
	2014	2012	2014	2012-14	2015-18	2015	2012/2013	2014	latest	latest	2014
1. Graduation candidates in IDA18											
Bolivia	2870	9.1	119	5.8	3.7	38.0	40.5	31.6	low	-0.9	32.1
Sri Lanka	3460	2.5	73	7.0	6.5	76.7	5.3	35.0	moderate	-0.7	25
Vietnam	1890	3.2	116	5.6	6.2	61.2	24.0	46.1	low	-0.8	31.1
2. Other current blend countries											
Cameroon	1350	27.0	153	5.3	5.4	32.2	13.5	14.1	high	-1.1	19
Congo Republic	2720	28.4	136	4.7	4.4	57.5	65.5	33.5	moderate	-1.1	27.5
Moldova	2560	0.3	107	10.6	4.2	44.8	..	42.2	low	-0.8	..
Mongolia	4280	0.4	90	10.6	4.2	81.5	38.0	77.2	high	-0.7	37.5
Nigeria	2970	51.7	152	5.3	4.4	11.9	39.1	5.3	low	-1.3	37.3
Pakistan	1400	6.8	147	3.8	4.6	64.7	2.8	3.4	na	-1.1	23.2
Papua New Guinea	2240	33.7	158	7.4	5.4	33.6	37.0	33.0	low	-0.9	32.1
Timor-Leste	2680	28.2	133	4.5	5.2	5.8	0.4	37.4	low	-1.0	55
Uzbekistan	2090	27.1	114	8.1	6.8	11.6	..	36.4	na	-1.2	29.4
Source:	WDI	WB	UN	WEO	WEO	WEO/WB	UNCTAD	WGI	WB/IMF	WB	UN

¹⁴ In addition, Kenya was declared creditworthy and is in the process of being officially classified as a blend.

V. MANAGING TRANSITION

35. **While graduation from IDA is a positive milestone, there are a number of challenges in managing a country’s transition to IBRD-only status.** Countries may experience a fall in overall financing from the World Bank in the years immediately following graduation from IDA. This reduction in volumes is also accompanied by a hardening of terms from IDA blend terms to IBRD terms (Annex 4). Of the nine countries that graduated from 1999 to 2011,¹⁵ six countries experienced a decrease in average per capita commitments from the World Bank in the three years after graduation compared to the preceding three years. This reduction in commitments was then slightly reversed only in two countries in a six-year period before and after graduation from IDA (Figure 6). Four of these countries also experienced reduction in net transfers (disbursements net of amortization and interest payments) from the World Bank in the three and six years after graduation (Figure 7).

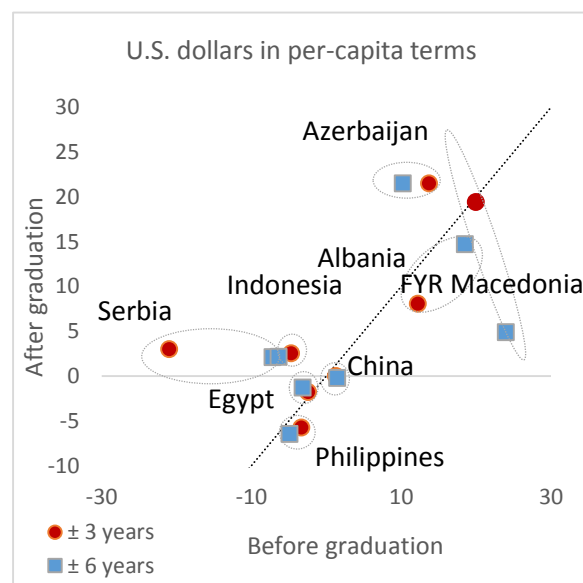
Figure 6. Change in WB Commitments before and after the Year of Graduation from IDA



Source: World Development Indicators (WDI) and staff estimates.

Note: Change, in logarithmic scale, of the average of per-capita commitments calculated over the 3 (6) years before and after the year of graduation. In constant 2010 U.S. dollars.

Figure 7. World Bank Net Transfers before and after the Year of Graduation from IDA



Source: WDI and staff estimates.

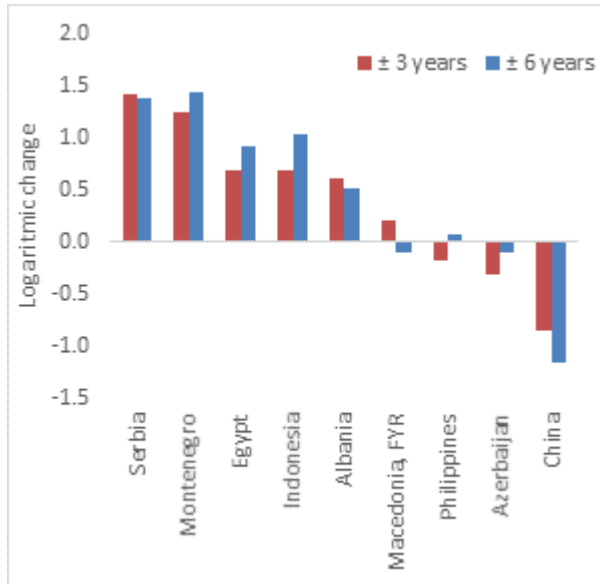
Note: Average of per-capita net transfers calculated over the 3 (6) years before and after the year of graduation. In constant 2010 U.S. dollars. Net transfers are calculated as disbursements net of amortization and interest payments.

36. **However, not all graduating countries experienced a reduction in overall public and publicly guaranteed (PPG) debt flows after graduation.** Graduation from IDA is a recognition that a country can now access a broader range of market-based financing. A majority of the nine graduating countries referenced above experienced either an increase or only a marginal reduction

¹⁵ Five more countries, Angola, Armenia, Bosnia and Herzegovina, Georgia, and India, graduated in 2014. These countries are excluded from the analysis as no data are yet available beyond the year of graduation.

in overall commitments from official and private sources combined (Figure 8). In terms of total net transfers, two countries experienced a reduction in the six years following graduation from IDA, while net transfers increased in all other countries (Figure 9).

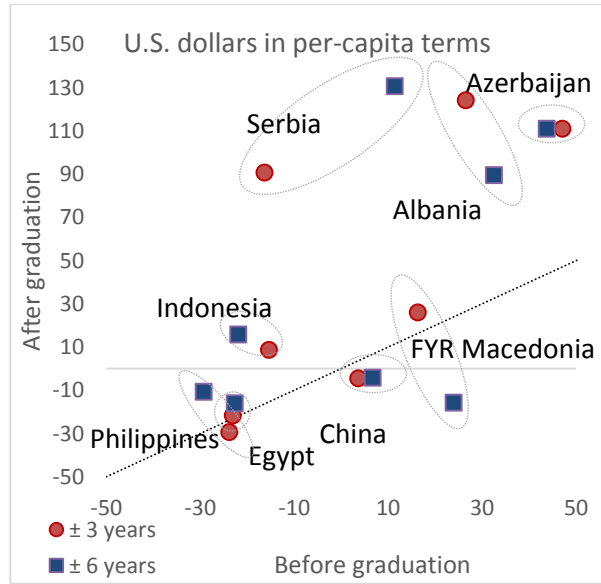
Figure 8. Change in PPG Commitments before and after the Year of Graduation from IDA



Source: WDI and staff estimates.

Note: Change, in logarithmic scale, of the average of per-capita commitments calculated over the 3 (6) years before and after the year of graduation. In constant 2010 U.S. dollars.

Figure 9. Total PPG Net Transfers before and after the Year of Graduation from IDA



Source: WDI and staff estimates.

Note 1: Average of per-capita net transfers calculated over the 3 (6) years before and after the year of graduation. In constant 2010 U.S. dollars.

Note 2: Markers left of the diagonal line mean higher NTR after graduation.

37. **The World Bank is strengthening efforts to address the drop in financing to graduating countries and further improving coordination with other creditors.** In IDA17, a special window of transitional support was made available to India to prevent a marked reduction in its access to World Bank resources as a result of its single borrower limit constraint (Box 2). New options for leveraging IDA resources are currently being explored that could provide a less ad-hoc solution to the issues faced by transitioning countries. To maximize available financing and avoid threshold effects, and without diverting concessional funds from IDA borrowers, IDA could provide, for a limited period, transitional support to new graduates using leveraged IDA resources to mitigate reduction in overall financing faced by some graduates. In addition, through the Graduation Task Force, the World Bank can strengthen coordination to ensure a smooth transition to IBRD-only status. Eventually, IDA can broaden the scope of existing mechanisms to enhance coordination with other multilateral development banks and official bilateral creditors.

Box 2. Update on Transitional IDA Financing for India

India was qualified for an exceptional allocation of SDR2.3 billion (approximately US\$3.5 billion at the IDA17 reference exchange rate) for transitional support during the IDA17 Replenishment period. Expanding the existing single currency pilot program, IDA was able to offer these funds at floating rate with an option to borrow the underlying currencies of the SDR basket. The transitional support aimed to smooth the transition from IDA by preventing a significant drop in World Bank financing with graduation at the beginning of IDA17. In line with a strategic shift outlined in the India Country Partnership Strategy, transitional IDA financing to India has amplified engagement in areas with deep poverty.

Of the nearly SDR1.4 billion (US\$2.0 billion) of IDA Transitional Support committed in FY15 and FY16, around US\$550 million has been devoted to improving education outcomes in the low-income states of Bihar and Madhya Pradesh. During the IDA17 period, a series of disaster recovery and risk management projects (amounting to over US\$1 billion) are also helping to build long-term resilience in areas that are highly prone to natural disasters. The Andhra Pradesh Disaster Recovery Project helped to restore and enhance the resilience of public services and livelihoods of communities affected by cyclone Hudhud. The remaining IDA17 transitional support has been committed to help bolster the rural livelihoods of poor people in Andhra Pradesh and Telangana and to support farmers in five low income states to use climate smart agricultural practices to adopt new soil, water and crop management techniques, reduce soil erosion, and improve agricultural yields.

Going forward, the Government of India has indicated interest in investing all of the remaining SDR0.9 billion (approximately US\$1.4 billion at the IDA17 reference exchange rate) of Transitional IDA financing for projects in low income and special category states.

A. IDA TRANSITIONAL SUPPORT

38. Leveraging IDA's equity and using the proceeds to provide additional non-concessional financing to IDA gap and blend countries is a potential new way of smoothing the path toward graduation. Graduations help free up IDA's concessional resources for the poorest. However, countries graduating from IDA currently face a number of challenges: loss of access to concessional resources, a possible decline in overall World Bank support, and potentially the triggering of IDA's credit acceleration clause, which may result in negative net transfers to the WB. Non-concessional IDA financing could help maintain IDA's ability to tackle pockets of poverty, smoothing the sudden potential decline in access to World Bank resources faced by some IDA graduates, and softening the trajectory of negative net transfers.¹⁶

39. For transitioning countries, a set of policy parameters still remain to be agreed upon with regard to their potential access to resources generated by IDA leveraging. For countries approaching graduation, the three parameters to be considered are: (i) what portion of a transitioning country's performance based allocation (PBA) to substitute with non-concessional resources (and whether that proportion should be tailored to the expected length of time that the country is expected to remain IDA-eligible);¹⁷ (ii) by how much the portion of concessional resources substituted with non-concessional resources would be increased in each subsequent

¹⁶ For further details, see accompanying paper on IDA's Long Term Financial Capacity and Leveraging Options.

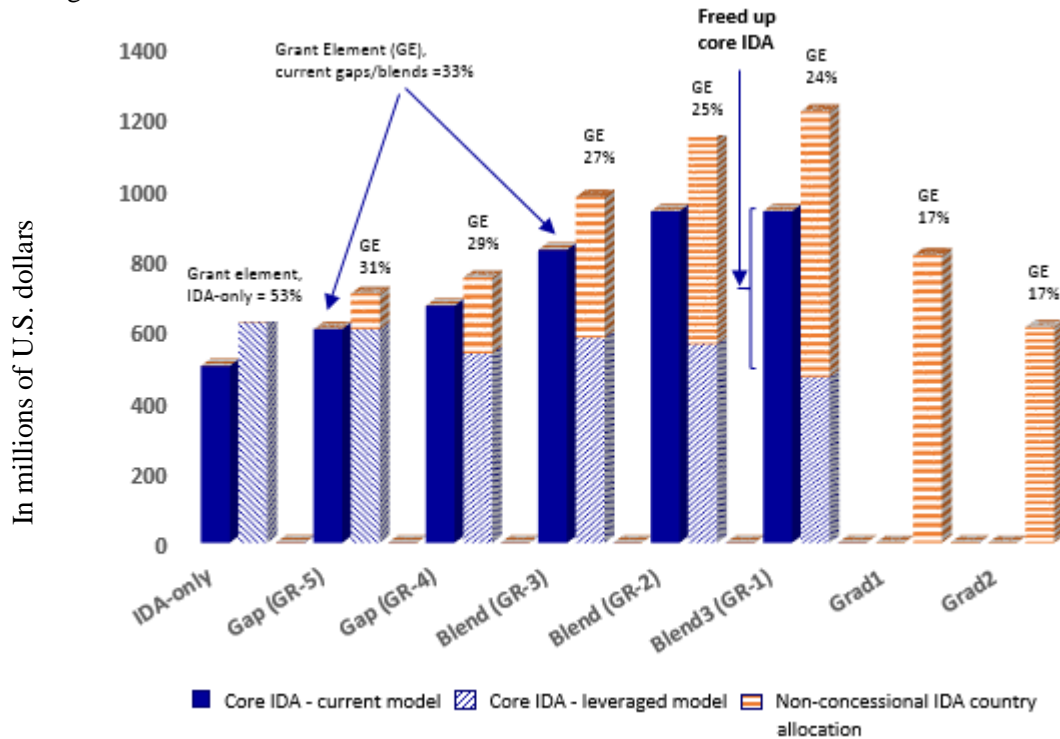
¹⁷ The freed-up resources would benefit remaining IDA-only non-gap countries.

Replenishment as a country approaches graduation;¹⁸ and (iii) by how much to top-up the substituted resources to make up for the loss in concessional support. For graduates, the two parameters to be considered are: (i) the portion of a country's (pre-graduation) PBA that a recent graduate should receive through the leveraging facility; and (ii) how long a graduate should be able to benefit from leveraged resources (i.e., how many Replenishment periods). The box below illustrates the notional flows in transition that are being discussed in the accompanying paper (see also footnote 16).

¹⁸ Operationally, PBAs for countries expected to graduate could be progressively reduced over a number of Replenishment periods and substituted with non-concessional resources.

Box 3. Stylized Transition of a Transitioning Country with and without a Leveraged IDA

For illustrative purposes, the graph below shows how non-concessional IDA financing could help smooth the path toward graduation for a typical IDA-only country. Under this possible scenario, gap and blend countries would receive non-concessional financing instead of an initially small but gradually increasing amount of core IDA resources. This would introduce a concessional continuity, shifting financing terms gradually from a 33 percent grant element to 18 percent. At the same time, graduates could receive non-concessional IDA financing that would be phased out after a pre-determined period of time (in this illustration, two Replenishments) after graduation to address the possible drop in WBG financing flows.



Note: GR refers to the graduation Replenishment, at the end of which a country graduates to IBRD-only

The transition would differ from one country to the next. In particular, the ability of non-concessional IDA resources to smooth the transition depends largely on the expected length of time before a country graduates. For countries graduating in the next Replenishment period, the ability of non-concessional IDA to smooth the transition is more limited than for those with a number of Replenishment periods before graduation, when the scope for gradually introducing non-concessional resources helps smooth the transition.

B. COORDINATION ACROSS THE WORLD BANK

40. A Graduation “Task Force” was created at the beginning of IDA17 to ensure a smooth path from IDA to IBRD, and help mitigate the risk of a steep decline in World Bank financing upon graduation from IDA. During IDA17, the Task Force met to discuss the potential graduations of Bolivia, Sri Lanka and Vietnam. The Task Force also provided information to country teams and through them, to clients on implications of IDA graduations, such as the implementation of the IDA accelerated repayment clause, application of the IBRD Negative Pledge Clause and a range of products that the World Bank offers to clients. Going forward, the

Task Force will have a deeper and more systematic engagement with the country teams *early in the process* (when the country becomes blend) to ensure that the authorities are prepared for graduation.

C. COORDINATION WITH OTHER MDBS AND BILATERAL CREDITORS

41. **Countries that will graduate from IDA, timing of graduations and any potential review of IDA's graduation policies will have implications for the development community as a whole.** Graduation policies of other multilateral institutions with respect to their concessional financing facilities are, for the most part, aligned with those of IDA. While past graduates did not experience a significant drop in *overall* external resources upon graduation from IDA, this may not be the case going forward as global liquidity tightens and financing conditions deteriorate.

42. **As a result, it is important for IDA to enhance coordination with other multilateral development banks and official bilateral creditors, broadening the scope of already established coordination mechanisms.** Graduation can be discussed at the MDBs and Multilateral Financial Institutions annual technical workshop where the WB, the Asian Development Bank (ADB), the African Development Bank (AfDB), the Inter-American Development Bank (IDB), the International Fund for Agricultural Development and the Caribbean Development Bank, meet annually to discuss the resource allocation systems used in each institution. In addition, IDA could also provide an update to the participants of the Organization for Economic Cooperation and Development (OECD) export credit meetings on graduation, and recent developments with regard to its graduation policy to help coordinate financing decisions among the largest bilateral aid agencies.

VI. ISSUES FOR DISCUSSION

43. **Staff welcomes Participants' views on:**
- a. the expected graduation timeline for Bolivia, Sri Lanka and Vietnam at the end of the IDA17 period, subject to availability of a transitional support mechanism; and
 - b. retaining IDA's current flexible graduation policy.

Annex 1: Policies on Graduation from Concessional Financing – Selected International Agencies

This annex presents a review of the graduation policies of the concessional financing facilities of the IMF and three major RDBs (AfDF, ADB and IDB). It also includes information on the eligibility and threshold limits set by the GAVI for the grants it extends to developing countries.

The review confirms that the graduation policies of these agencies are, for the most part, closely aligned with those of IDA. Both the IMF and the RDBs employ an income criterion and a creditworthiness criterion, although IMF's criteria is articulated as market access, and the IMF also takes into account short term vulnerabilities. Creditworthiness is not a concern for GAVI since it does not make loans and it relies solely on an income criterion. In common with IDA, each institution regularly reviews and updates its income criterion to reflect changes in national income levels in recipient countries. The GNI per capita data used are based on the calculations made by the World Bank according to the Atlas methodology.

International Monetary Fund (IMF)

The IMF provides concessional lending to member countries under the Poverty Reduction and Growth Trust (PRGT) and the PRGT eligibility has been historically closely aligned with that of IDA. The framework for PRGT eligibility was established in 2010, and the framework together with the associated list of PRGT-eligible countries are reviewed by the IMF Board on a two-year cycle. The most recent review took place in July 2015. The review reconfirmed its broad alignment with IDA practices while “allowing scope for some differences in graduation criteria between the Fund and the World Bank given the different mandates of the two institutions.”¹⁹ As of end-May 2015, IDA and PRGT eligibility were aligned in all except five cases.²⁰

Similar to IDA, the concessional financing under PRGT is reserved for members that have low per capita income levels and do not have durable and substantial access to international financial markets. In broad terms, countries are expected to graduate (1a) if they have either a persistently high level of income or (1b) capacity to access international financial markets on a durable and substantial basis, and (2) they do not face serious short-term risks. Small countries and microstates are given special consideration on account of their particular vulnerabilities. See Box 4 below for specific criteria.

¹⁹ “IMF Executive Board Reviews Eligibility to Use the Fund’s Facilities for Concessional Financing for 2015”, IMF Press Release No. 15/369, July 31, 2015, <http://www.imf.org/external/np/sec/pr/2015/pr15369.htm>.

²⁰ Specifically, there are five countries that were not PRGT-eligible yet had some access to IDA resources. Kosovo has access only to IDA resources; Pakistan, Sri Lanka, and Zimbabwe have blended access to IDA and IBRD resources; and India has exceptional transitional support from IDA 17.

Box 4. Criteria for Graduation from PRGT Eligibility

Income Criterion: if the country's annual per capita GNI: (i) has been above the IDA operational cutoff (US\$1,215 for FY 2015) for at least the last five years; (ii) has not been on a declining trend in the same period; and (iii) is currently (a) at least twice the operational IDA cutoff, (b) at least three times the IDA operational cutoff for small countries; or (c) at least six times the IDA operational cutoff for microstates.

Or

Market Access Criterion: if the country has the capacity to access international financial markets on a durable and substantial basis, as measured by one of the following two alternative tests: (i) the existence of such capacity would normally be evidenced by public sector issuance or guaranteeing of external bonds or by disbursements under public and publicly-guaranteed external commercial loans in international markets during at least *three of the last five years* (for which qualifying data are available), in a cumulative amount over that period equivalent to at least *100 percent of the country's quota* at the Fund at the time of the assessment. External bonds and commercial loans issued or contracted in markets that are not integrated with broader international markets do not qualify. (ii) Country could also be deemed to meet the market access criterion if there were convincing evidence that the sovereign *could* have tapped international markets on a durable and substantial basis, even though the scale or duration of actual public sector borrowing fell short of the specified thresholds. This would be a case-specific assessment, considering such relevant factors as the volume and terms of recent actual borrowing in international markets and the sovereign credit rating.

Both tests of the market access criterion would take into account bonds/loans issued, contracted, or guaranteed by *non-sovereign* public sector debtors, where such a debtor's ability to access international markets is assessed to be an indicator of the sovereign's creditworthiness. As a further safeguard, countries would be considered candidates for graduation under the market access criterion only if: (a) their annual per capita GNI is above 100 percent of the IDA operational cutoff (based on the latest available qualifying data); and (b) their annual per capita GNI has not been on a declining trend during the last five years for which qualifying data is available (comparing the first and last relevant annual data).

And:

Absence of serious short-term vulnerabilities: In addition to meeting at least one of the above criteria, the country should not face serious short-term vulnerabilities. The assessment of these vulnerabilities will require, in particular, the absence of risks of a sharp decline in income, or of a loss of market access, and limited debt vulnerabilities, as indicated by the latest DSA, and a confirmation that overall debt vulnerabilities remain limited since such analysis.

The 2015 review proposed to enhance the graduation framework by: (i) making use of additional data sources in assessing that a country has durable and substantial market access; and (ii) limiting the application of the serious short-term vulnerabilities criterion so that it would not preclude the graduation of a country with income per capita exceeding the applicable graduation threshold by 50 percent or more.

Based on the criteria, in the 2015 review, Bolivia, Nigeria, and Vietnam are proposed for graduation, while Mongolia's proposed graduation depends on the proposed modification to the short-term vulnerabilities criterion. Eight other countries satisfy either the market access or income graduation criterion but face serious short term vulnerabilities, and are therefore not proposed for graduation – Grenada, Cabo Verde, Ghana, Guyana, Moldova, Republic of Congo, Côte d'Ivoire, and the Maldives.

African Development Fund (AfDF)

The setup of AfDB and its concessional financing window, the AfDF, is the same as IBRD and IDA. Similar to IDA, AfDF eligibility is based on two criteria: (a) per capita income (GNI) below a certain threshold (currently US\$1,215); and (b) the absence of creditworthiness that prevents borrowing from the AfDB's non-concessional window.

There are currently forty countries that are ADF eligible, covering the same IDA countries in Africa. Similarly, within the AfDF eligible countries, it has different groupings with differentiated financing terms. Its groupings are slightly different from IDA – AfDF has four groups, AfDF-only, AfDF-gap, blend, and graduating to AfDB. As part of the AfDF12 MTR, AfDF agrees to take a more pro-active approach towards graduation during the AfDF-13 period in order to free up more concessional resources for the poorest countries. As of May 2015, Cape Verde, Congo and Nigeria are under the “Graduating to ADB” group.

Similar to IDA, AfDF also has a transition framework to support a smooth, predictable and sustainable transition up to a period of 5 years. This period enables borrowers to continue to access concessional resources on hardened financing terms, introducing a gradual phasing out/phasing in, before completely moving to the non-concessional window.

Asian Development Bank (ADB)

Concessional lending at ADB is composed of Asian Development Fund (AsDF) grant resources and concessional ordinary capital resources (OCR). The criteria that govern graduation from the ADF mirror those of IDA and include income as measured by per capita GNP and debt repayment capacity. The income criterion is comparable to the one used for graduation from access to IDA resources and the process of determining creditworthiness for access to ADB's OCR follows much the same process as that of the World Bank. A three way classification is developed: Group A countries may access both ADF grants and concessional OCR; Group B countries may access both concessional and regular OCR; while Group C countries may only access regular OCR loans. As with IDA, the policies governing ADF eligibility are reviewed periodically during Replenishment rounds. Currently, 27 countries have access to concessional assistance during the ADF12 period, 13 of which receive grant assistance.

The latest reform in April 2015 combines the AsDF lending operations with the OCR balance sheet led to some adjustments of ADB's concessional lending policy. But it does not change the general principles governing concessional assistance including its eligibility and graduation criteria and its practices in managing the graduation process. A new Concessional Assistance Policy is developed to consolidate and adapt the relevant operational policies applicable to AsDF resources and the concessional OCR lending.

Inter-American Development Bank (IDB)

The IDB delivers its concessional financing through blending highly concessional resources from the Fund for Special Operations (FSO) and non-concessional resources from the Ordinary Capital (OC) account. FSO resources are directed at the poorest and least developed countries in the region

that are also IDA eligible countries: Bolivia, Guyana, Haiti, Honduras, and Nicaragua. In the case of Haiti all financial support is provided in the form of grants, through the IDB Grant Facility.

In the 2015-16 allocation, IDB Management proposes to update the eligibility threshold for FSO funding to take into account of inflation, applying the same criteria and methodology used in past cycles. The resulting lending eligibility threshold is calculated at US\$2,579 in 2009 prices. Since the estimated per capita GDP (average 2012-2013) for Paraguay (US\$3,734) and for Guatemala (US\$3,231) exceed the threshold, these two countries are no longer eligible for FSO lending.

Global Alliance for Vaccines and Immunization (GAVI)

The focus of the GAVI is on the world's poorest countries, and eligibility for support from the GAVI is determined solely on the basis of national income. From 2000-2005, all countries with a GNI per capita equal to or below US\$1,000 (based on World Bank 1998 calculations Atlas methodology) qualified for support. Seventy-five countries qualified for GAVI including Timor-Leste which was added to the list of eligible countries in 2002 when it became an independent state. The threshold was reset for 2006-2010 on the basis of the World Bank 2003 GNI per capita calculations Atlas methodology and as a result four countries, Albania, Bosnia and Herzegovina, China, and Turkmenistan, ceased to be eligible for GAVI resources and one country, Kiribati, was added to the list of eligible countries. In total, 72 countries were eligible for GAVI Alliance support during this period. Since 1 Jan 2011, the threshold is adjusted for inflation annually.

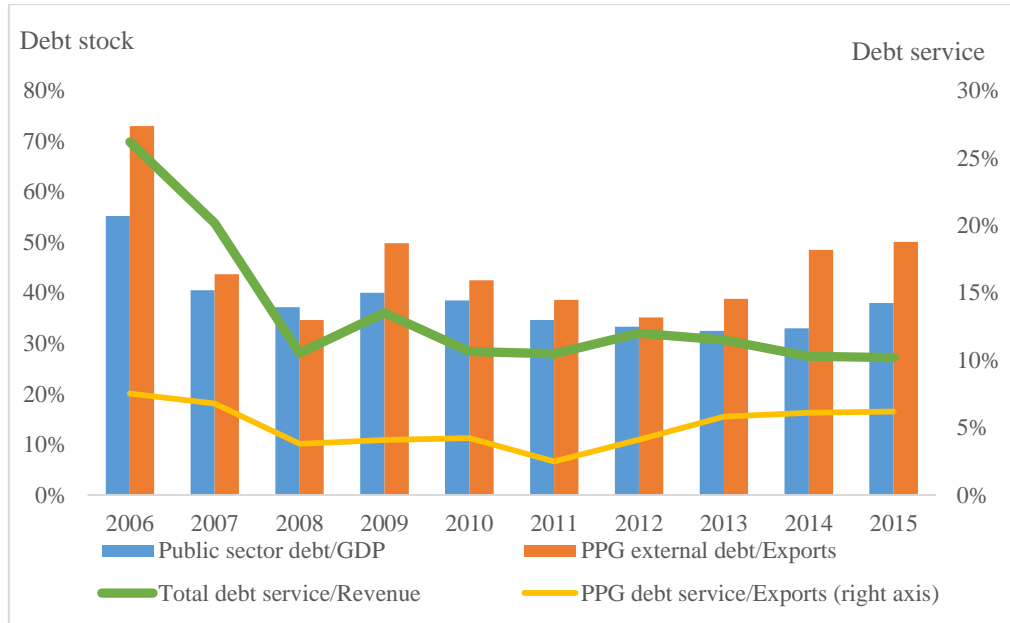
In June 2015, the GAVI Board adopted its new *Eligibility and Transition* policy. This states that countries' eligibility will be determined by their average GNI per capita over the previous three years. Today, 54 countries will be eligible to apply for GAVI support in 2016 based on a Gross National Income (GNI) per capita below or equal to US\$1,580 on average over the past three years, based on World Bank data. Countries whose average GNI per capita over the previous three years crosses the GAVI eligibility threshold enter the accelerated transition phase and start phasing out of GAVI support.

Annex 2: Additional Indicators

Variable name	Definition	Source
GNI per capita, Atlas method	GNI per capita, calculated in national currency, converted to U.S. dollars using the Atlas method of conversion, which applies a conversion factor that averages the exchange rate for a given year and the two preceding years, adjusted for differences in rates of SDR inflation.	World Development Indicators (http://databank.worldbank.org)
GNI per capita, PPP	GNI per capita converted to international dollars using 2011 purchasing power parity rates so that an international dollar has the same purchasing power over GNI as a U.S. dollar has in the United States.	World Development Indicators (http://databank.worldbank.org)
Poverty headcount at \$1.90 a day	Percentage of the population living on less than \$1.90 a day at 2011 international prices. Note that five countries – Bangladesh, Cabo Verde, Cambodia, Jordan, and Lao PDR – use the 2005 PPP exchange rates and poverty lines.	PovCal Net, The World Bank (http://iresearch.worldbank.org/PovcalNet)
Multidimensional Poverty Index	It an adjusted headcount indicator that measures the incidence and breadth of those who are deprived along 3 dimensions: health, education, and standard of living. The multidimensional headcount ratio measures the incidence of multidimensional poverty by comparing the number of all those that are multi-dimensionally poor to the total population. The intensity of poverty denotes the proportion of indicators in which they are deprived. The MPI is obtained by the product of the multidimensional headcount ratio and the average intensity of poverty.	Alkire, S. and Robles, G. (2015). “Multidimensional Poverty Index 2015: Brief Methodological Note and Results.” Oxford Poverty and Human Development Initiative, University of Oxford, Briefing 36.
Per capita growth mean consumption/income, bottom 40% of population	Annualized average growth rate in per capita real consumption or income of the bottom 40% of the population in the income distribution in a country from household surveys over a roughly 5-year period. Mean per capita real consumption or income is measured at 2011 and 2005 PPP. See Box 1.1 in the Global Monitoring Report 2015/2016 (http://www.worldbank.org/en/publication/global-monitoring-report) for a detailed explanation.	World Development Indicators (http://databank.worldbank.org)
Human Development Index	The HDI is a composite statistic of life expectancy, education, and income per capita indicators, which are used to rank countries into four tiers of human development: Very High (above 0.8); High (above 0.7); Medium (above 0.55); and Low (below 0.55).	UNDP (http://hdr.undp.org/en/content/human-development-index-hdi)
Marginal Tax Rate	Defined as the marginal tax rates, on the people with income about \$13 in 2005 PPP terms, needed to close the poverty gap with respect to the extreme poverty line.	Ravallion (2010)
Economic Vulnerability Index	It measures the structural vulnerability of countries to exogenous economic and environmental shocks. The EVI contains eight indicators, which are grouped into various sub-indices: population, remoteness, Share of agriculture, forestry and fisheries in GDP, Share of population in low elevated coastal zones, under five mortality rate, victims of natural disasters.	United Nations Development Policy and Analysis Division (http://www.un.org/en/development/desa/policy/cdp/ldc/ldc_criteria.shtml)
ND-GAIN Country Index	A project of the University of Notre Dame Global Adaptation Index, it summarizes a country's vulnerability to climate change and other global challenges in combination with its readiness to improve resilience.	University of Notre Dame (http://index.gain.org/)

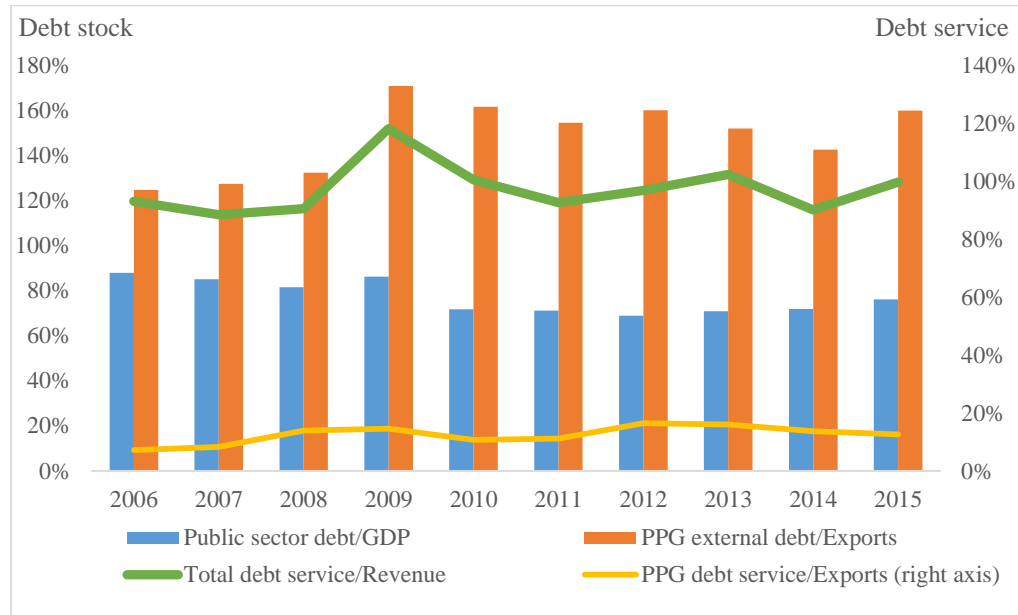
Annex 3: Graduating Countries: Debt Indicators

Bolivia



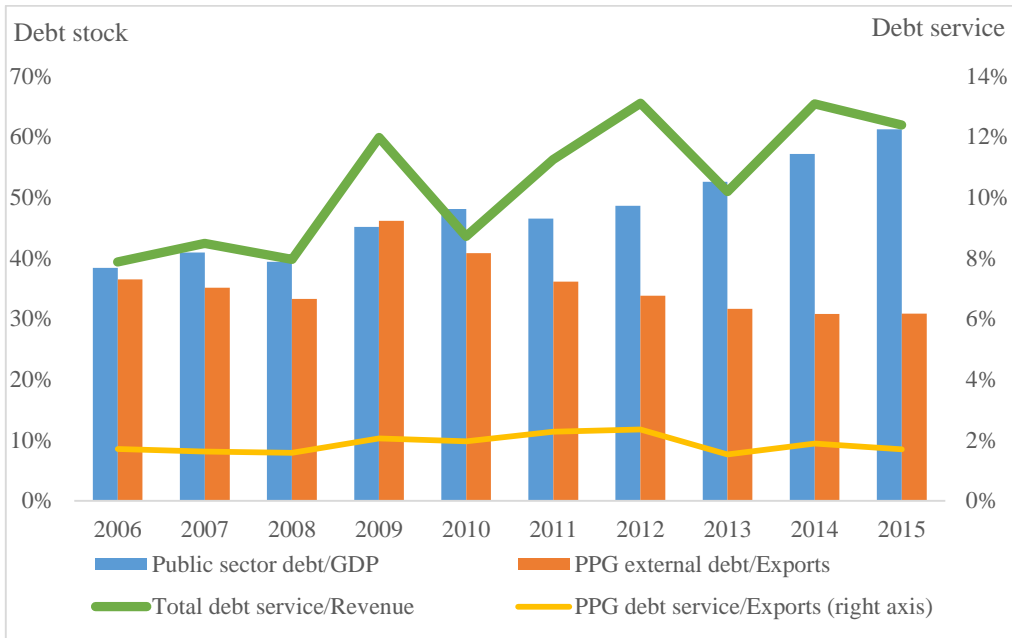
Source: Country authorities; and IMF and World Bank staff estimates.

Sri Lanka



Source: Country authorities; World Bank staff estimates; Economist Intelligence Unit.

Vietnam



Source: Country authorities; and IMF and World Bank staff estimates.

Annex 4: Lending Terms of IDA (Terms Applicable for FY16)

Instrument Type	Recipient Countries	Maturity/Grace	Principal Repayment (yrs)	Current Charges	Interest Rate	Grant Element @5% Disc Rate ^{8/}
Grant	"red-light" IDA-only (100%) and "yellow-light" IDA-only (50%)	Grant	None	none (but 20% volume discount on country allocation)	none	100%
Regular-Term Credit	"green-light" IDA-only (100%) and "yellow-light" IDA-only (50%)	38/6 yrs	3.125% pa	75bps service charge + 0 bp commit.charge ^{2/9/}	none	53%
Regular-Small Island	Small island countries	40/10	2% pa yrs 11-20, 4% pa yrs 21-40	75bps service charge + 0 bp commit.charge ^{2/9/}	none	61%
Blend-Term Credit	Blend countries & countries with GNI pc above IDA cut-off (US \$1,215) ^{1/} for 2 years	25/5 yrs	3.3% pa yrs 6-15, 6.7% pa yrs 16-25	75bps service charge + 0 bp commit.charge ^{2/}	1.25% ^{9/}	33%
Hard-Term Credit	Blend countries (excl.small island blends receiving regular IDA credits)	25/5 yrs	3.3% pa yrs 6-15, 6.7% pa yrs 16-25	75bps service charge + 0 bp commit.charge ^{2/}	1.08% ^{3/9/10/}	34%
Transitional Support	India	25/5 yrs	5% pa	75bps service charge + 0 bp commit.charge ^{2/}	2.21% ^{4/9/10/}	20%
Scale-up Facility Option 1	All current IDA clients assessed as being at either low or moderate risk of debt	24/5 yrs	5% pa yrs 6-14, 5.5% pa yrs 15-24	25bps front-end fee + 25 bps commitment fee ^{6/}	3.09% ^{5/9/10/}	19%
Scale-up Facility Option 2	distress with projects approved by the Executive	27/8 yrs	5% pa yrs 9-17, 5.5% pa yrs 18-27	25bps front-end fee + 25 bps commitment fee ^{6/}	3.39% ^{5/9/10/}	18%
Scale-up Facility Option 3	Directors before the end of the IDA17 period	30/9 yrs	4.7% pa yrs 10-23.5, 4.9% pa yrs 24-30	25bps front-end fee + 25 bps commitment fee ^{6/}	3.53% ^{5/9/10/}	18%
Guarantees	IDA-only countries	depends on project loan	not appl.	75bps guarantee fee + 0 bp stand-by fee ^{2/} + Initiation & processing fee ^{7/}	not appl.	not appl.

Notes:

- 1/ Operational cut-off for FY16.
- 2/ The commitment charge is reset annually within a range of 0 – 50 bps. The grant element is calculated using the FY16 rate of 0 bps. The guarantee stand-by fee is set at the same level as the commitment charge on credits.
- 3/ The interest rate for hard term credits is determined annually based on the fixed rate equivalent of IBRD interest rates less 200 basis points.
- 4/ The interest rate for transitional support credits is determined quarterly based on the fixed rate equivalent of IBRD interest rates less 100 basis points. Table presents the rates for FY16 Q3.
- 5/ The indicative rates for the proposed Scale-up Facility credits. The rates are determined quarterly based on the fixed rate equivalent of IBRD interest rates. Table presents the indicative rates for FY16 Q3.
- 6/ The Scale-up Facility credits follow IBRD pricing; they are subject a one-time front-end fee of 25 bps and a commitment fee of 25 bps.
- 7/ IDA guarantees for private sector borrowers are subject to an initiation fee of 15 bps or US\$100,000 (whichever is higher) and a processing fee of up to 50 bps of the principal amount. The processing fee is assessed on a case by case basis and can either be waived or increased in exceptional cases.
- 8/ The methodology is in consistency with IDA's policy on non-concessional borrowing by grant-eligible or MDRI-recipient countries. This exercise assumes that the loan amount is fully disbursed.
- 9/ Single currency option is available for these instruments.
- 10/ Represent fixed rate available. Floating rate option is also available for these instruments.

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