IDA17

FOLLOW-UP ON IDA'S GRADUATION POLICY AND PROPOSAL FOR TRANSITIONAL SUPPORT FOR GRADUATING COUNTRIES

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Acronyms and Abbreviations

AfDB	African Development Bank
AfDF	African Development Fund
ADB	Asian Development Bank
ADF	Asian Development Fund
CAS	Country Assistance Strategy
CFA	African Financial Community
CPS	Country Partnership Strategy
DeMPA	Debt Management Performance Assessment
DSA	Debt Sustainability Analysis
FSO	Fund for Special Operations
FY	Fiscal Year
GAVI	Global Alliance for Vaccines and Immunization
GNI	Gross National Income
GNP	Gross National Product
HIPC	Heavily Indebted Poor Country
IDB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
LIC	Low-Income Country
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MIGA	Multilateral Investment Guarantee Agency
MTR	Medium-Term Review
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PBA	Performance Based Allocation
PREM	Poverty Reduction and Economic Management
PRGT	Poverty Reduction and Growth Trust
RDB	Regional Development Bank
SBL	Single Borrower Limit
SPPB	Special Private Placement Bond
WEO	World Economic Outlook
WBG	World Bank Group

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EXECUTIVE SUMMARY

i. **Following up on the IDA16 Mid-Term Review (MTR) discussion, this paper provides additional information on the countries expected to graduate at the end of the IDA16 period and presents a proposal for transitional support to IDA graduates.** At the IDA16 MTR meeting, Participants supported IDA's flexible approach to graduation, and expressed a willingness to consider transitional support from IDA for new graduates that meet well-defined criteria. Participants noted that graduation from IDA represents a milestone in a country's development path and should open up development financing options to a broader range of sources and borrowing instruments. However, it was noted that, in some cases, it could adversely impact a country's capacity to maintain development momentum if it leads to a significant lessening of available financing for that country.

ii. **The paper presents Management's assessment of the readiness for graduation of candidate IDA countries.** Based on this assessment, which in addition to the GNI per-capita and creditworthiness status of candidates looks at other relevant factors, Management expects that Angola, Armenia, Bosnia and Herzegovina, Georgia, and India will graduate at the end of the IDA16 period. Vietnam is not expected to graduate before the end of the IDA17 period, given its still low GNI per capita, vulnerability to shocks, and only recent access to IBRD lending.

iii. **The paper sets out the rationale and eligibility criteria for transitional support after graduation from IDA.** The paper proposes three criteria to govern access to transitional support from IDA: (a) GNI per capita below the historical threshold at the time of graduation; (b) a significant poverty agenda, as measured by poverty levels and other social indicators; and (c) a significant prospective reduction in available financing from the World Bank (WB) after graduation from IDA. Such support would thus be made available for new graduates that meet these three criteria and would help smooth the transition of graduating countries where access to WB financing is constrained.

iv. **The paper also details the proposed size, duration, financing terms and use of transitional support.** It is proposed that the size of transitional support to an eligible country be lower that the support it would have received had it remained an IDA borrower, but still significant. Accordingly, it is recommended that the magnitude of transitional support financing be set at two-thirds of the allocation the country would have received as an IDA borrower. To help in smoothing the transition, the paper also recommends to frontload the lending envelope by 20-30 percent in the first year of a replenishment period, and to backload this amount in the last year of a replenishment. This support would be provided on terms that are harder than those of IDA hard term lending but below the fixed rate equivalent of an IBRD loan. It is envisaged that financing for transitional support would come primarily from concessional partner loans. Transitional support for an individual country is expected to be endorsed by IDA Deputies for the duration of an upcoming replenishment period. Transitional support from IDA is expected to finance the poverty agenda of an eligible country as specified in the Bank's country assistance strategy (CAS).

v. **Based on the eligibility criteria described above, it is proposed that India be considered for transitional support during the IDA17 replenishment period**. Transitional support to India would allow the WB to maintain a meaningful engagement in a country which is home to one third of the world's poor, with a relatively low GNI per capita as compared to a number of other graduating countries, and a large poverty agenda. It would help mitigate a significant and rapid reduction in IDA net transfers upon graduation, which are estimated to become negative by FY15. It will also help address the overall reduction in WB net flows which are estimated to become negative in FY18. Transitional support would support India's poverty reduction agenda, particularly in the poorest states. Such transitional support recognizes the World Bank's important agenda in India to help it meet its poverty reduction goals, which are also crucial to reaching global poverty reduction goals.

vi. **To help manage the challenges and opportunities of graduation from IDA, a WB task force is being created that will provide advice to countries in their move to blend and eventually IBRD-only status.** The task force will provide advice to the authorities and the country teams when an IDA-only country becomes creditworthy for IBRD lending as well as to current blend countries. It will outline the implications of graduation to ensure that these countries are prepared for this milestone. Areas in which the task force would provide assistance include: guidance on ensuring a smooth path from IDA to IBRD on the financing side, including through frontloading/backloading IDA/IBRD resources to help mitigate the risk of a steep drop-off in resources from the WB upon graduation from IDA; spelling out the implications for the country of the implementation of the accelerated repayment clause at graduation and laying out the various options available if needed to design a payment schedule for accelerated repayments that is tailored to the country's repayment capacity; and advisory support for enhancing the country's access to financial resources from other sources.

I. INTRODUCTION

1. **At the IDA16 Mid-Term Review meeting, Participants supported IDA's flexible approach to graduation and expressed a willingness to consider transitional support from IDA for new graduates that meet specific criteria.** Building on an analysis of the group of countries that are expected to graduate in IDA17 and IDA18, this paper elaborates on country readiness for graduation and sets out specific graduation timing for each country. The paper also proposes a transitional support mechanism to help smooth the transition for new graduating countries where access to WB financing is constrained.

2. **The paper is structured as follows:** Section II provides a brief summary of the MTR discussion on graduation and developments since then. Section III lays out Management's decisions for the group of countries expected to graduate at the end of the IDA16 period. Section IV sets out the rationale and eligibility for transitional support, discusses country eligibility criteria and outlines the case for such transitional support for India in IDA17. This section also lays out the proposed size and duration of access to transitional support, the terms of support, and expectations regarding the use of transitional support. These elements could be retained for access to transitional support in future replenishments should new countries qualify. Section V discusses how the WB will work closely together to help countries in their move to blend and eventually IBRD-only status to manage the challenges and opportunities of graduation from IDA. Section VI concludes and sets out issues for discussion.

II. IDA16 MID-TERM REVIEW DISCUSSION ON GRADUATION AND RECENT DEVELOPMENTS

3. **The IDA16 MTR paper "Review of IDA's Graduation Policy" discussed the key elements that determine access to IDA resources and the criteria for graduation.** These eligibility and graduation criteria are constructed around two key elements, the concept of relative poverty as measured by Gross National Income (GNI) per capita below an agreed operational threshold,[1] and the absence of creditworthiness. The paper outlined developments in both criteria over time, as well as the increasingly differentiated terms of IDA financing to recognize varying stages of economic development in IDA countries. The graduation criteria are based on the assumption that the capacity to meet higher debt service costs of IBRD or market based financing increases as countries move along the development path and their national income rises. The paper noted that while the level of GNI per capita does not completely capture a country's level of development, it has been shown to be a useful indicator of relative poverty,

[1] The IDA "operational cutoff" refers to the IDA eligibility ceiling defined by a specific level of GNI per capita (US$1,195 for FY13), and is published annually in the Bank's OP 3.10 Annex D. IDA's eligibility threshold was initially based on the "historical cutoff" which was first set at US$250 in 1964. High demand for IDA resources in the early eighties and resource scarcity led to the second and lower operational cutoff in IDA8 (1989). Both the operational and historical cutoffs are reset annually on the basis of GNI per capita calculations in line with the Atlas conversion factor methodology. For more detail see IDA, "Review of IDA's Graduation Policy", October 2012.

and correlated with the likelihood of a successful graduation when comparing earlier graduates (pre-1980) with later graduates (post-1980). Other elements that distinguished early graduates from later graduates include their lower dependence on concessional resources and a more diversified economic base. Later graduates were more frequently dependent on commodity exports such as oil or agricultural products. These factors as well as a juxtaposition of circumstances, including poor macroeconomic management or over-borrowing, combined with a downturn in the global economy, account for why some later IDA graduates reversed back to IDA-eligibility.

4. **The MTR paper also discussed the difficulty in capturing aspects of poverty not directly captured by the graduation criteria**. It examined the feasibility of using alternative measures of relative poverty to complement the per-capita GNI criterion. It concluded that design issues hamper the ability to implement a social index to be used alongside the GNI per capita. As a result, the current criterion used flexibly and pragmatically, and taking into consideration all available information on a country's relative development and financing needs, should continue to guide graduation decisions.

5. **While acknowledging that graduation from IDA marks a major milestone in a country's development process, the paper discussed the financial implications of graduation to IBRD-only status.** New graduates need to adjust to lost IDA resources as well as lost resources from other development partners who link their concessional financing windows to IDA-only or IDA-blend status. New IDA commitments cease and disbursements from the existing pipeline are drawn down and gradually lead to negative net transfers from IDA shortly after graduation. At the same time, borrowing costs rise after graduation as countries access shorter maturity and higher priced lending. Graduates also need to meet the higher debt service payments to IDA associated with implementation of the accelerated repayment clause. The MTR paper noted that financing volumes from the WB could be lower after graduation than in the pre-graduation phase when both IBRD and IDA financing is available.

6. **Participants considered it appropriate that the process of graduation, which typically extends over some years, continue to be flexible, with the ultimate objective of a successful and lasting exit from IDA**. As such, graduation should continue to rely on a careful case-by-case evaluation of a country's circumstances. The transition from IDA-only to blend to IBRD-only status begins with a positive assessment of creditworthiness. Relatively poorer IDA borrowers are generally expected to have a somewhat longer transition period than countries that are well above the operational or even historical cutoff at the time when they become creditworthy. Individual factors (such as whether the country is facing a crisis that increases its vulnerability, debt sustainability concerns that may limit access to finance or dependency upon a single commodity) are also important in guiding decisions about the timing and path to graduation.

7. **Participants noted that graduation from IDA represents an important milestone in a country's development path, which typically opens a broader range of development financing options.** However, it was noted that, in some cases, it could adversely impact a country's capacity to maintain development momentum if it leads to a significant lessening of available financing for that country.

8. **Participants indicated openness to further explore the option of providing transitional support for new IDA graduates under well-defined criteria.** They also noted that the operational IDA cutoff is now 44 percent below the historical cutoff, and vulnerability to external shocks remains high for some graduating countries, while access to international financial markets and/or IBRD may be limited. Several stressed the need for financing options to smooth their transition from IDA borrowers to IBRD-only countries, including on harder terms. For such a transitional support, they asked for clear rules on eligibility, financing levels, lending terms and duration, while taking into account broader support from the World Bank.

9. **Since the IDA16 MTR, risks to the global financial and economic recovery have eased somewhat.** This is reflected in moderating projections of IBRD financing at the same time that the IBRD portfolio continues to perform well. IBRD's Exposure Management Framework (EMF) is designed to maximize country limits and the corresponding total potential exposure of the IBRD portfolio while ensuring that IBRD has sufficient credit-risk bearing capacity, its capital, to support the corresponding credit risks in the portfolio (see Box 1 on IBRD's Exposure Management Framework). In addition to maximizing IBRD's exposure limits through the EMF, there is also flexibility in managing these limits to respond to changing demand.

Box 1. The IBRD Exposure Management Framework

In FY09, IBRD introduced a new model-based exposure management framework (EMF) establishing the maximum IBRD portfolio consistent with IBRD's capital base and its distribution across individual countries, i.e., individual country exposure limits. Its purpose was to provide management with a tool to improve consistency in setting exposure limits across IBRD's diverse group of borrowing countries and to improve responsiveness in limits to changes in IBRD's internal and external environment. The new framework is consistent with IBRD's Board-approved capital adequacy stress test and Single Borrower Limit frameworks, and hence provides for a more efficient use of IBRD capital by linking exposure limits to available capital. Since its introduction, the exposure management framework has improved efficiency, consistency, and transparency in the IBRD capital allocation and limit setting process. It has also considerably improved flexibility and responsiveness to country demand as exemplified by IBRD's rapid response to the surge in demand from the global financial crisis in FY09-FY11. This reflects the fact that the exposure limits are flexible, and can be reallocated across countries if necessary to better adjust to an evolving distribution of countries' demand for IBRD financing as conditions change. Reallocations are processed through the model so that limits after reallocation continue to be consistent with IBRD's financial frameworks. It is important to recognize that the EMF is a management tool to help guide management's decisions: ultimately, the decision of whether or not to bring an operation to the Board rests with the Management Team.

Like the IDA allocation framework, the EMF takes into account country-specific development parameters. These parameters, and IBRD's projected available capital, are updated at least annually and new country limits, derived from updated country base allocations, are issued by management. Country base allocations are adjusted for credit risk, but the fundamental criteria of an individual country's allocation are population and GNI, weighted equally in the allocation formula. The adjustment for credit risk serves to calibrate allocations by criteria such as the strength and sustainability of macroeconomic policies and performance. It is also important to recognize that, unlike IDA, IBRD is a financial institution that raises most of its funds from the market and then passes on its low borrowing costs to its member countries. Therefore, IBRD, unlike IDA, must take into account credit risk considerations in its lending decisions.

10. **As a result of the developments described above, IBRD will likely have sufficient headroom to provide lending to those IDA countries expected to graduate at the end of IDA16 at levels that would prevent a significant reduction in World Bank assistance upon graduation, with the important exception of India.** A new Standard and Poor's methodology issued in late November 2012 for rating Multilateral Lending Institutions has reaffirmed IBRD's AAA rating and provided a favorable assessment of IBRD. IBRD staff will provide an oral update of any implications for IBRD lending that are relevant for IDA graduates at the first meeting of the IDA17 replenishment negotiations.

III. TIMING OF EXPECTED GRADUATIONS

11. **Management expects that Angola, Armenia, Bosnia and Herzegovina, Georgia and India will graduate from IDA at the end of IDA16 (i.e., at the end of FY14).** If current trends continue, Vietnam is expected to graduate at the end of the IDA17 replenishment period (i.e., at the end of FY17). This section provides an assessment of readiness for graduation for each candidate country. Annex 2 shows how these countries, as well as selected current and future blend countries, fare on a set of macroeconomic vulnerability indicators. The five countries that are graduating at the end of IDA16 all qualify for accelerated repayments under IDA's contractual accelerated repayment clause. The impact of this clause on each country is shown in Annex 3. [2]

Angola

12. **Angola's high GNI per capita and access to market-based financing will facilitate its transition to IBRD-only status at the end of the IDA16 period.** Despite Angola's still significant poverty incidence (estimated at 37 percent of the population) and poor social indicators, its GNI per capita (US$4,060) is significantly above both the IDA operational (US$1,195) and the historical (US$1,945) cut-off. Following Bosnia and Herzegovina, Angola has the highest GNI per capita among all graduating candidates. Furthermore, Angola is currently underutilizing its IDA allocation. A Country Partnership Strategy (CPS) covering 2013-2016 is under preparation, and in this document the country's creditworthiness for IBRD lending would be announced. In addition, the country has recently been able to attract significant financing from other sources, often at non-concessional terms. [3] Some of these loans are backed by future oil receipts.[4]

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[2] Since 1987, IDA has included an accelerated repayment clause in legal agreements of regular, blend and hard term credits that allows it to double the principal repayments of the credits (i.e., shorten the maturity) if the borrower's GNI per capita exceeds a specific threshold and the borrower is IBRD creditworthy. There were two clauses, under the old clause the GNI per capita threshold is met once a country has been above the historical cut-off for more than five years. Under the new clause the GNI per capita threshold is met once a country has been above the operational cutoff for more than three years. As with previous graduates, the acceleration clause can be flexibly implemented to adjust to a country's debt servicing capacity. Implementation of the acceleration clause will be discussed in detail with each country's authorities prior to graduation. For more information see IDA/R2012-0178, "Update on Acceleration of Credit Repayments to IDA", June 26, 2012.

[3] The majority of Angola's substantial medium- and long-term debt (estimated at close to US$20 billion at the end of 2012) is owed to private creditors, including consortia of commercial banks, as well as credit lines from

13. **Angola's macroeconomic performance in 2012 is bolstered by a recovery in oil production and a continuation of robust non-oil sector growth.** Real output in 2012 is expected to accelerate to 6.8 percent, the fiscal balance is likely to remain in surplus (6- percent of GDP) and gross international reserves are set to rise beyond 6 months of imports. External as well as public and publicly-guaranteed debt positions appear sustainable. Public sector debt is roughly 30 percent of GDP and total external debt hovers at around 20 percent of GDP.

14. **Angola meets the criteria for contractual IDA credit repayment acceleration, which will be implemented upon graduation.** As of December 31, 2012, Angola had US$420 million in outstanding IDA credits, of which about US$203 million (48 percent) include the old accelerated repayment clause and US$196 million (47 percent) include the new accelerated repayment clause. The remaining US$20.5 million date back to the period before the accelerated repayment clause was included in IDA credit agreements. Angola 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.

Armenia

15. **On the basis of its high GNI per capita and IBRD creditworthiness, Armenia is expected to graduate at the end of IDA16.** Armenia's GNI per capita (US$3,360) is nearly three times the IDA operational cut-off and significantly above the historical IDA cut-off. Although one of the poorest countries in Europe, the country has a poverty profile that is more closely aligned with middle-income country (MIC) status than with low-income country (LIC) status. It ranks high on the Human Development Index (HDI), and has made notable progress in poverty reduction. Literacy rates have reached close to 100 percent for adults 15 years of age and over, and malnutrition and mortality rates for Armenia are well below the average of the lower middle income country group.

16. **The graduation of Armenia was not pursued at the end of IDA15 because of its vulnerabilities to the weak global environment at the time.** Armenia has relied heavily on concessional resources to finance development needs. Going forward, it would need to rely on multilateral sources, including IBRD for continued support, and resources in the market to the extent these are available. Annex 1 shows the potential access to financial markets for Armenia (and other prospective graduates) as represented by credit rating agency ratings and recent bond issues when available. To date, Armenia has not accessed the external bonds markets and has a BB- rating from Fitch and Ba2 from Moody's.

17. **In terms of the current situation, Armenia is still facing macro vulnerabilities due to unique geopolitical challenges and a slow and fragile recovery after the global financial**

China (estimated at US$6.5 billion) that are backed by its oil resources (see for instance Economist Intelligence Unit assessment of Angola's credit risk).

[4] The continuation of this practice, should Angola borrow from IBRD, may raise issues of violation of IBRD's negative pledge clause (NPC). The NPC is established to protect the IBRD against the commitment of government resources, or the use of the government authority to mobilize resources, to enable other foreign creditors to obtain foreign exchange in preference to IBRD through the creation of liens or other priority interests.

crisis. The regional context remains fragile and external connectivity is limited due to closed borders with both Azerbaijan and Turkey, which adds to already high transportation costs. The economy is also negatively impacted by international sanctions on Iran. The overall unfavorable business environment has amplified the effects of the global financial crisis, which has reversed some of the progress made on poverty reduction.

18. **Armenia was hard hit by the global financial crisis, which brought an end to its rapid economic expansion over the previous decade**. The crisis led to sharp drops in remittances and investor sentiment, with the critical construction sector contracting by 40 percent in 2009 and the current account deficit widening from 1.6 percent of GDP in 2006 to 15.8 percent of GDP in 2009 despite a strong devaluation of the dram in March 2009 (20 percent). With a drop in real GDP totaling 14 percent in 2009, the double-digit output growth Armenia experienced pre-crisis turned in 2009 into one of the worst economic declines in the world following the financial crisis. Armenia responded to the crisis with a sizeable externally financed fiscal stimulus, which widened the 2009 overall fiscal deficit to close to 8 percent of GDP, and helped lift output growth over the short run. However, the significant drop in real growth in 2009 and the following slow recovery (GDP growth of 2.2 percent in 2010 and 4.7 percent in 2011) together with accelerated financing needs stemming from the stimulus more than doubled public debt to over 40 percent of GDP in 2011 from 16 percent in 2008. Although still at low risk of debt distress, the acceleration in the debt level has increased the country's vulnerability to a wide range of shocks, such as depreciation of the exchange rate or materialization of contingent liabilities, and reduced the fiscal buffer to respond to other shocks. Going forward, external imbalances remain a source of vulnerability, especially in light of ongoing weakness in the global economy, and continued uncertainties in Europe, Armenia's main trading partner. Barring further shocks, buffers remain at acceptable levels, with gross foreign reserves exceeding 4½ months of imports and adequate coverage in terms of external debt servicing costs.

19. **With limited access to financial markets, Armenia will need to rely on multilateral creditors including IBRD to support its reform program and to provide assistance for its infrastructure needs**. IBRD has indicated that it will be able to augment support to Armenia to prevent a significant reduction in overall WB support at the time of graduation. IBRD financing, like IDA financing, is coupled with the additional benefits of technical expertise and knowledge specialists to help countries build sound policies and successfully undertake structural reforms.

20. **Armenia meets the criteria for contractual credit acceleration.** As of December 31, 2012, the country had US$1,236 million in outstanding IDA credits, of which about US$741 million (60 percent) include the new accelerated repayment clause, and US$214 million (17 percent) include the old accelerated repayment clause. The remaining US$280 million in IDA credits (23 percent) do not include any accelerated repayment clause. Armenia meets the eligibility requirements under the old and new accelerated repayment clauses, as its GNI has exceeded the historical cut-off for more than five consecutive years, and it has been found creditworthy for IBRD.

Bosnia and Herzegovina

21. **With a GNI per capita of US$4,780 (four times IDA's operational cut-off) and IBRD creditworthiness, Bosnia and Herzegovina is expected to graduate at the end of IDA16**. Bosnia and Herzegovina also fares well on poverty indicators relative to the average low-income country. It ranks relatively high on the HDI, and most recent statistics indicate that less than 0.1 percent of the population lived on less than US$1.25 per day. Its literacy, maternal mortality and life expectancy rates put it well above the average for lower-middle income countries.

22. **The graduation of Bosnia and Herzegovina was not pursued at the end of IDA15 given its vulnerabilities to the weak global environment at the time**. Bosnia and Herzegovina also has fragile institutions and weak administration's capacity to implement public reforms and control government spending. The continued impact of the war remains substantial in terms of governance, social cohesion and sustained and strong economic growth. Institutional fragility and overlapping competencies between different government levels create also difficulties in controlling budget spending. These circumstances constrain the country's development prospects.

23. **On the macroeconomic front, the outlook is subdued**. Following a real output growth contraction in 2009 (2.9 percent) and a sluggish recovery in 2010-11 (averaging 1 percent), the economy experienced a mild recession in 2012 (real GDP growth is estimated at -0.7 percent) due mainly to weak external demand. Slow growth in the Euro zone further compounds the fiscal, competitiveness and unemployment challenges facing the country. The external current account deficit was 9.6 percent in 2011, and total external debt is estimated to have risen to over 50 percent of GDP in 2012. This said, gross international reserves are comfortable at about 4 months of imports. A recently agreed IMF Stand-by Arrangement with Bosnia and Herzegovina focused on fiscal consolidation aims to support the country's efforts to maintain fiscal discipline, advance public sector reforms to reduce the size of the government and improve the composition of expenditure, and safeguard financial sector stability.

24. **Given its limited access to financial markets and current vulnerabilities, Bosnia and Herzegovina has relied on concessional resources to finance development needs** and would need to continue to rely on continued support from multilateral creditors, including IBRD, for financial support upon graduation from IDA. IBRD has indicated that it will be able to augment support to Bosnia and Herzegovina to prevent a sharp drop in WB resources at the time of graduation.

25. **At graduation, Bosnia and Herzegovina will be expected to accelerate its repayments of IDA credits, as it meets the criteria for contractual credit acceleration.** As of December 31, 2012, it had US$1,193 million in outstanding IDA credits, of which US$652 million (55 percent) include the new accelerated repayment clause, while US$157 million (13 percent) of Bosnia and Herzegovina's credits include the old clause. The remaining US$383 million in IDA credits do not include any accelerated repayment clause. Bosnia and Herzegovina meets the eligibility requirements under the old and new accelerated repayment clauses, as its GNI has exceeded the historical cut-off for more than five consecutive years, and it has been found creditworthy for IBRD.

Georgia

26. **Georgia's GNI per capita, at US$2,860 in 2011 has exceeded the IDA operational cutoff since 2004 and exceeds the historical cutoff.** Considering Georgia's robust growth performance and solid external buffers, risks of reverse graduation seem remote and Georgia is expected to gradate at the end of the IDA16 period. The graduation of Georgia was not pursued at the end of IDA15 given its vulnerabilities to the weak global environment at the time. Georgia's prudent macro management has also enabled the country to access international markets, which provides an alternative financing source to that of multilateral creditors, including IBRD. Poverty and social estimates show Georgia to be in a position similar to Armenia, although its poverty headcount is higher at 15 percent of the population. Like Armenia, Georgia also has geopolitical challenges impacting transportation costs and weakening its competitiveness.

27. **Despite weak economic performance in Europe, Georgia's external position has proved relatively resilient since the financial crisis.** After a decline in real output of close to 4 percent in 2009, growth performance bounced back to over 6 percent per year through 2012. In 2012, growth was broad based, and particularly strong in manufacturing, tourism, and the financial sector. This performance is expected to continue over the medium term. However, the external current account deficit is a source of vulnerability and reached 12.7 percent of GDP in 2012. At the same time, FDI inflows, which fell sharply after the 2008-09 crisis, declined further in 2012, reflecting weak investor confidence in the region, and covered less than half the current account deficit. Gross international reserves are slightly less than 4 months of imports, while reserve coverage of short term external debt (at remaining maturity) was close to 130 percent in 2012. The main vulnerability stems from the expectations of shrinking buffers over the medium term reducing Georgia's ability to absorb shocks.

28. **Under two consecutive IMF programs, Georgia's fiscal deficit narrowed substantially from 9 percent in 2009 to an estimated 3.5 percent of GDP in 2012, while public debt continued to decline.** With privatization receipts financing part of the fiscal deficit over the past four years, and a rebound in output growth, public debt continues its downward trend. Barring any major shocks, public debt is projected to be below 30 percent of GDP by 2015.

29. **The improvement in macroeconomic fundamentals has been recognized by rating agencies and markets, which led to upgrades in 2011 to BB- by both Fitch and S&P.** In parallel, the spread on a US$500 million 10-year Eurobond narrowed to 260 basis points in January 2013 from a peak of 570 bps in October 2011. The sovereign issuance was followed by two 5-year bond issuances undertaken by Georgian Railways (June 2012) and the Oil and Gas Corporation (May 2012), amounting to US$500 million and US$250 million, respectively, albeit at a rather high 7.75 and 7.125 percent coupon.

30. **Georgia meets the criteria for contractual credit acceleration.** As of December 31, 2012, it had US$1,295 million in outstanding IDA credits, of which about US$825 million (64 percent) include the new accelerated repayment clause, and US$176 million (14 percent) include the old clause. The remaining US$293 million in IDA credits do not include an accelerated repayment clause. Georgia will meet the eligibility requirements under both the old and the new

accelerated repayment clauses by FY14, as its GNI will have exceeded the historical cut-off for more than five consecutive years by then, and it has been found creditworthy for IBRD.

India

31. **India, with a long history of cooperation with both IBRD and with IDA is expected to graduate at the end of IDA16.** As was pointed out in the MTR paper, India has had uninterrupted access to IBRD since 1948**,** has now reached the point where its income level has been above the operational cutoff for 3 years. With a GNI per capita of US$1,420, and established IBRD creditworthiness, India is expected to make a successful and lasting exit from IDA. India's graduation from IDA is a testament to the progress that India has made, including by growing its economy at an annual average rate of 7.3 percent over the last decade. Life expectancy in India has more than doubled from 31 years in 1947 to 65 years in 2012. India has achieved the first MDG by halving the population of people living on less than US$1.25. Nevertheless, India remains home to one third of the world's poor and is expected to need access to transitional support from IDA after graduation. This issue is further discussed in Section IV, in the context of Management's proposal to provide transitional support.

32. **After graduation, India will be expected to accelerate its repayments to IDA, as it meets the criteria for accelerated credit repayments.** As of December 31, 2012, it had US$26.4 billion in outstanding IDA credits, 47 percent of which (US$12.5 billion) include the new accelerated repayment clause, 24 percent (US$6.3 billion) include the old accelerated repayment clause, and 29 percent (US$7.6 billion) are not subject to acceleration. India is expected to meets the two eligibility requirements under the new clause by FY14: its GNI per capita will have exceeded the operational cut-off for more than three consecutive years, and it has been found creditworthy for IBRD. As a result, India will be expected to accelerate its repayments of credits under the new clause starting in IDA15. India's GNI per capita is still below the historical cutoff, so it is not yet eligible for contractual credit acceleration under the old clause.[5]

Vietnam

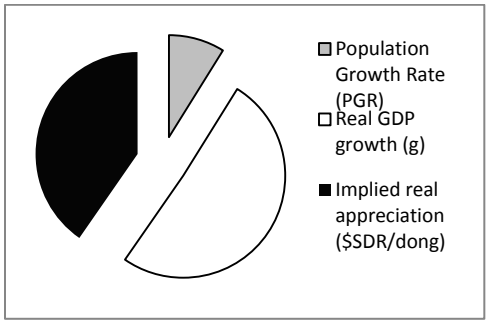
33. **With its still low GNI per capita (US$1,260), vulnerability to shocks and only recent access to IBRD lending, Vietnam is expected to graduate at the end of the IDA17 period (i.e., FY17), if current trends continue.** Vietnam's GNI per capita (US$1,260) exceeded the IDA operational cut-off for the first time in FY13. Much of its recent increase was driven by a steep real exchange rate appreciation after 2007 following its WTO membership, thus this indicator should be viewed with caution (see Figure 1 which shows a breakdown of the individual factors that contributed to the increase in GNI per capita calculated in accordance with the Atlas methodology). Vietnam was declared creditworthy for IBRD and received its first IBRD loan only in FY10. Also, persistent macroeconomic instability since then has made it extremely difficult for the country to access international capital markets.

34. **Vietnam has made remarkable progress in reducing poverty over the past two decades but regional disparities and vulnerabilities persist.** Relative to the poverty line of

[5] As India's GNI per capita has not yet exceeded the historical cut-off, it could not become eligible to accelerate credit repayments for those credits subject to the old clause before FY19.

US$1.25 per person per day (in 2005 PPP), the poverty headcount dropped from 63.7 percent of the population in 1993 to 16.9 percent in 2008 (equivalent to 14.3 million people).[6] The country is on track to meet most of the MDG targets.[7] However, many of those who have exited poverty remain susceptible to exogenous shocks (e.g., typhoons) - i.e., nearly 13 million Vietnamese are near-poor and vulnerable to slipping back to extreme poverty. Also, reaching the remaining poor is more difficult as they are more concentrated in isolated regions (e.g., West Northern Mountains region) and among ethnic minority groups. Moreover, the rate of poverty reduction has been slowing in recent years, owing to slower growth and macroeconomic instability, in particular high inflation which has hit households in urban areas particularly hard. While having made dramatic improvements in MDG coverage, challenges remain in terms of reducing severe malnutrition (especially among ethnic minority groups), providing access to clean water and sanitation (especially in rural areas), and attaining environmental goals. Furthermore, as one of the top five most vulnerable countries in the world, the country is exposed to risks from sea-level rise induced by climate change.[8]

Figure 1: 2007-2011 Compounded Annual Growth Rate in Vietnam: Contribution to GNI Per Capita (Atlas Methodology)



Source: IMF WEO Database, World Bank WDI Database and staff estimates.

35. **Vietnam remains vulnerable to external shocks**. Against the backdrop of deteriorating fundamentals, real GDP growth slowed markedly from 8.5 percent in 2007 to 5.3 percent in 2009. After recovering to 6.8 percent in 2010, economic growth remains subdued relative to pre-crisis levels, and was estimated to be 5.0 percent in 2012. Vietnam has had large fiscal deficits over the past three years, reflecting adjustments to Vietnam's wage bill in response to persistently high inflation rates. Fiscal risks are further heightened by weaknesses in the financial sector and state-owned enterprises. On the external side, the current account deficit ballooned from an average of 1.7 percent of GDP over 2000-2007 to almost 12 percent in 2008 due to sluggish external demand for exports in the wake of the global financial crisis before

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6 World Bank (2012), "Well Begun, Not yet Done" 2012 Vietnam Poverty Assessment pages 16-17.

7 World Bank (2012), "Well Begun, Not Yet Done". 2012 Vietnam Poverty Assessment, page 18.

8 Studies on the Mekong Delta, for instance show that this area, which is almost entirely 5 m below the sea level, is extremely vulnerable to sea level rises, which would threaten the region's agriculture and fisheries sectors. One study showed that close to 38 percent of the Mekong Delta would be below water if there were a 1 m rise in water levels. See IMHEN, Ca Mau PPC (2011), Climate Change Impact and Adaptation Study in the Mekong Delta Ca Mau Atlas, Institute of Meteorology, Hydrology and Environment (IMHEN), Hanoi, Vietnam.

narrowing considerably to a surplus (estimated at 5.0 percent in 2012). With foreign exchange reserves at 1.4 months of imports at end 2011, Vietnam's international reserves remain low by standard measures of reserve adequacy. Weak external buffers leave Vietnam vulnerable to a negative external shock, such as a sharper than-anticipated slowdown in Asian economies in response to an intensification of the European debt crisis or a growth slowdown in China. These considerations have resulted in recent downgrades by all major rating agencies. Vietnam has relied heavily on concessional resources to finance its development needs, and will lose access to most concessional financing windows upon graduation to IBRD-only status. Vietnam's concessional debt as a percentage of total external debt is high at 60 percent. IDA and IBRD as a share of total public and publicly guaranteed debt are also quite high at 23.9 percent, most of which is owed to IDA. Given these macroeconomic vulnerabilities, a possible reversal of graduation could not be ruled out at this time. Continued access to IDA funding until the end of IDA17 would contribute to more robust economic outcomes and reduce significantly the risks of reverse graduation.

Other Countries

36. **In addition to the countries discussed above, Management has assessed the readiness for graduation of a number of other blend and upcoming blend countries, some of which are getting close to meeting graduation criteria**. Current blend countries and upcoming blends assessed include Bolivia, Moldova, Mongolia, Nigeria, Pakistan, Papua New Guinea, Sri Lanka, Timor-Leste and Uzbekistan. The main reasons these countries are not considered ready for graduation at the end of the IDA16 period include one or more of the following: (i) only recent creditworthiness for IBRD (Moldova, Nigeria, Timor Leste and Bolivia); (ii) the short time period of IBRD eligibility and/or previous limits on access to IBRD resources (Mongolia and Sri Lanka); (iii) income still below (Pakistan) or only recently exceeding the IDA operational cutoff (Nigeria, Uzbekistan); and (iv) economic or other forms of vulnerability (Mongolia, Pakistan, Papua New Guinea, Uzbekistan, Sri Lanka, Timor Leste). Management will reassess their readiness for graduation during the IDA17 period and provide detailed assessments (like those provided above) at the time of the IDA18 replenishment discussions.

IV. RATIONALE FOR TRANSITIONAL SUPPORT

A. Eligibility Criteria for Transitional Support

37. **A number of IDA-eligible countries expected to graduate in the next few replenishments have expressed the need for financing options to smooth the transition from blend to IBRD-only status.** A particular concern has been on countries for which graduation from IDA would lead to a sharp drop in available financing from the WB while they still have significant poverty reduction needs and where such drop can adversely impact their capacity to maintain their development momentum. In this context, the provision of transitional support would enable these countries to continue to make progress towards the MDGs after graduation, and enable the WB to contribute to that progress. The transitional support instrument would complete the spectrum of financing options that IDA can provide to its varied client base. For

such transitional support, it would be important to set out clear criteria on eligibility and for the possible uses of such financing.

38. **A set of three criteria for eligibility to transitional support for new graduates is proposed**, as follows:

a) country's GNI per capita below the historical cutoff at the time of graduation; and
b) a significant poverty agenda, as measured by poverty levels and other social indicators; and
c) a significant reduction in new commitments/net flows from the WB after graduation from IDA.

39. **The first criterion, namely that the country's GNI per capita is below the historical cutoff, aims to ensure that IDA financing is retained for relatively poorer countries.** Linking the transitional support to the historical cutoff incorporates the expectation that countries above the historical cutoff have typically had several years of access to IDA resources after having been above the IDA operational cutoff for more than two years.

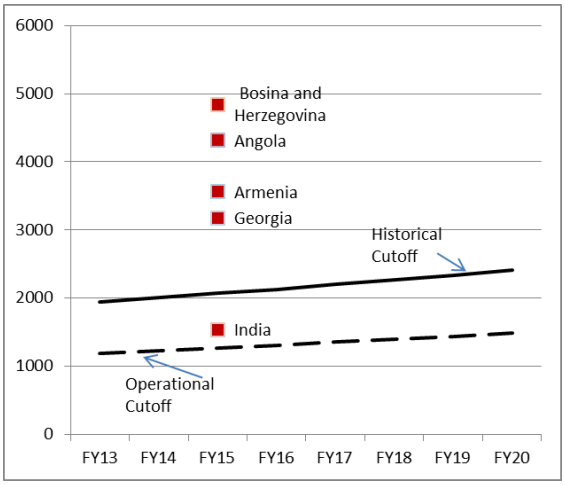
40. **The second criterion can be measured by a number of poverty and social indicators and assessing how the country fares on these indicators relative to other IDA borrowers.** These include the absolute number of poor and the incidence of poverty, progress towards the MDGs, a country's ranking on the Human Development Index, and significant regional disparities in income and poverty reduction. Where poverty indicators are a concern in a graduating country, IDA could, through transitional support, still help the country to reach those poor in lagging regions even where the country as a whole has been recently classified as IBRD-only.

41. **The third criterion would look at whether there would be a significant reduction in new commitments/net flows from the WB (**including the impact of the contractual IDA credit acceleration) which would constrain the WB's ability to help maintain the country's development momentum post-IDA graduation. Given the significant inter-year variability in commitment levels at the country level, the assessment would look not just at annual data, but also at replenishment-by-replenishment data.

B. Applying These Eligibility Criteria to Graduates for IDA17 and Beyond

42. **Based on the first criterion, only India would be eligible for transitional support in the IDA17 period (FY15-17).** Figure 2 shows that, of IDA countries currently expected to graduate at the end of the IDA16, only India would be below the projected historical cutoff line at the point of graduation. The other three countries in the ECA region as well as Angola already have GNI per capita well above the historical cutoff.

Figure 2: GNI/capita and IDA Operational Cutoff (Projections)



Source: WDI, IMF WEO, and staff estimates.

43. **Based on the second criteria, India would be eligible for transitional support in the IDA17 period.** Although Angola's poverty and social indicators would seem to satisfy the second criterion, particularly fertility, malnutrition, infant mortality and life expectancy, the country would not meet the first criteria. In the case of India, nearly one third of population (33 percent) lives on less than US$1.25 a day. By comparison, the share of people living in poverty is only .02 percent in Bosnia and Herzegovina, 1.3 percent in Armenia and 15 percent in Georgia. For some social indicators India fares well, but gender disparities are pronounced in a number of statistics. For instance, the literacy rate is 63 percent for the entire population, but only 51 percent for women, and both rates are lower than the LIC average. India's malnutrition rate of 47 percent of children under 5 years of age is also much higher than the LIC average. The infant mortality rate is much higher than the other graduation candidates, but is lower than the low-income country average. Table 1 provides a comparison of selected social indicators for countries expected to graduate at the end of IDA16.

Table 1: Selected Social Indicators for Countries Expected to Graduate at End of IDA16

Selected Social Indicators (latest available)

	GNI per capita, Atlas method (current US$)	Primary school enrollment rate (adjusted net, % of primary school age children)			Fertility rate (births per woman)	Life expectancy at birth, total (years)	Literacy rate (% of adults ages 15+)			Malnutrition prevalence, height for age (% of children under 5)	Mortality rate, infant (per 1,000 live births)	Poverty headcount ratio at $1.25 a day (PPP) (% of
		Total	Female	Male			Total	Female	Male			
Graduation candidates at end of IDA16												
Angola	4060	85.7	78.2	93.1	5.3	51	70.1	58.1	82.7	29.2	96.4	36.6 1/
Armenia	3360	81.6	82.5	80.8	1.7	74	99.6	99.4	99.7	20.8	15.6	1.3
Bosnia and Herzegovina	4780	89.9	90.6	89.2	1.1	76	97.9	96.5	99.4	11.8	6.7	0.0
Georgia	2860	98.4	..	..	1.6	73	99.7	99.7	99.8	11.3	18.3	15.3
India	1420	98.2	97.6	98.6	2.6	65	62.8	50.8	75.2	47.9	47.2	32.7
Memo:												
Low income	569	80.8	79.2	82.3	4.1	59	62.9	56.0	69.7	38.4	62.8	48.4
Lower middle income	1764	89.7	88.5	90.7	2.9	66	70.9	62.3	80.0	35.7	46.0	30.2

1/ Angola National Institute of Statistics estimate for the poverty headcount in Angola based on US$1 per day. Poverty headcount ratio unavailable for Angola in WDI.

* Countries expected to resume blend status or acquire blend status in their next CPS

Source: World Bank World Development Indicators database (WDI).

44. **There remain large pockets of poverty and subnational disparities in development outcomes in India**. It is estimated that 445 million people still live in absolute poverty, and the actual number of poor people increased in India's seven low-income states. In addition to the large share of the world's poor, about 50 percent of India's population that has just escaped this designation, remains vulnerable to a reversal to below the poverty line once again, which can happen as a result of a shock such as an illness, poor weather, or high inflation. India is also home to 1/3 of the world's illiterate population and suffers from high levels of malnutrition. Exclusion and inequalities for groups such as women, scheduled castes and scheduled tribes persist. How these issues will be tackled in the upcoming India CPS is discussed in Annex 3.

45. **Regarding the third criterion, of the five countries expected to graduate at the end of IDA16, only India currently faces a hard constraint on its access to WB resources as a result of the Single Borrower Limit.** India will also receive negative net flows from the WB very soon after graduating as a result of its long relationship with the World Bank and limited access to new IBRD financing going forward. The IBRD has the headroom to provide Armenia, Bosnia and Herzegovina and Georgia access to levels of IBRD financing that would prevent a significant lessening of available WB financing for these countries. For Angola, it would be difficult to make a case that it has any constraints in accessing resources. Angola's macro-economic position appears strong, and it has underutilized even its IDA resources in the past, and will have access to IBRD resources under the new CPS.[9] As indicated above, it has also accessed significant financing from outside the WBG backed by its oil resources.

46. **In the absence of transition support, WB lending volumes for India will fall significantly.** India remains constrained in its access to World Bank resources due to the need for IBRD to prudently manage concentration risk through the Single Borrower Limit (SBL) Framework. IBRD's SBL for India is presently US$17.5 billion and US$16.5 billion for the other SBL countries (see Box 2). As indicated earlier, India also meets the criteria for contractual IDA credit acceleration which would be triggered upon its graduation from IDA at the end of IDA16. Under the principal repayment option, India will need to increase repayments by on average US$500 million annually between FY15 and FY24. As a result, IDA net disbursements become negative in FY15, two years earlier than without acceleration.

47. **India has negotiated the purchase of IBRD Special Private Placement Bonds (SPPBs) that will, with India's own resources, increase the headroom for IBRD financing (see Box 2).** However, even with these bonds, India will need continued access to meaningful funding volumes from the WB to leverage financing, knowledge and innovation in support of the country's large poverty agenda.

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[9] Angola has been confirmed as creditworthy and is in the process of being formally reclassified from IDA-only to blend status. Board notification in a CAS/CPS or CAS/CPS progress report is usually required to make the formal reclassification, but Angola's new CPS has experienced several delays over the last few years.

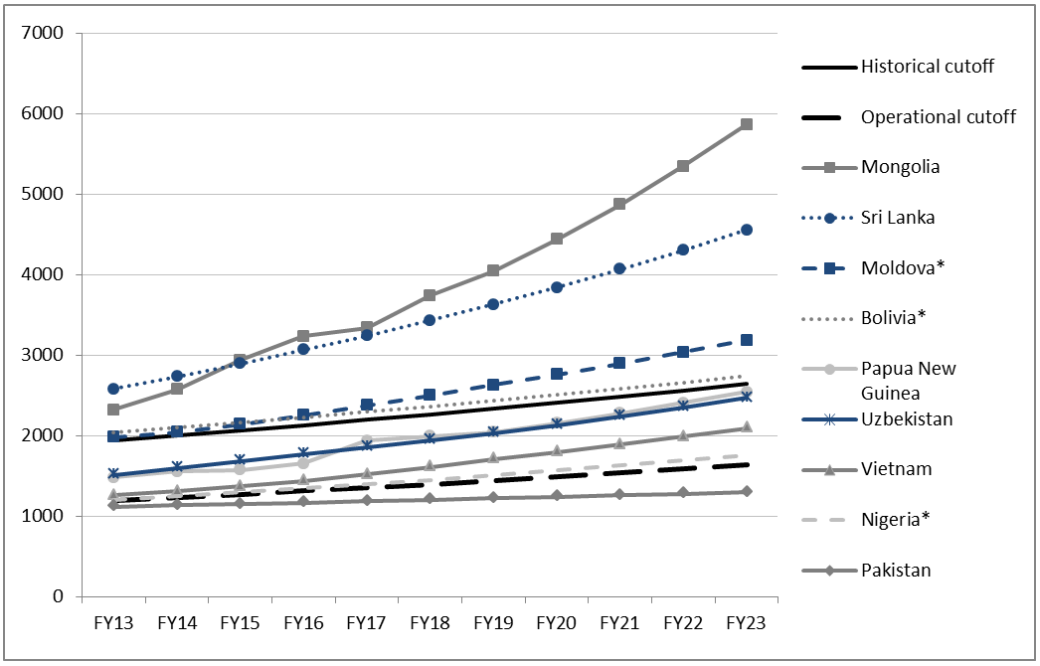
Box 2. IBRD's Single Borrower Limit and Special Private Placement Bonds

IBRD manages credit risk stemming from large exposures to borrowing countries through the **Single Borrower Limit (SBL)** framework. The level of the SBL is set at a nominal dollar value which is reviewed and approved annually by IBRD's Executive Board. Only IBRD's largest borrowing countries in terms of GNI and population that are also highly creditworthy have access to exposure levels equal to the SBL. Since a new methodology for evaluating potential SBL increases was approved by Executive Directors in FY05, the SBL has been increased three times, although never more than by US$1 billion in any one fiscal year. In FY11, the SBL was increased by US$1 billion for a fourth time, but only for one SBL country, India. This increase for India not only reflected the strong development case for India, given its large number of absolute poor, but also Executive Directors' concerns that an across-the-board increase in the SBL would crowd out lending headroom to non-SBL countries, many of which were still highly vulnerable as a result of the global economic and financial crisis. Even if management were to recommend, and the Board were to approve, a US$1 billion increase in the SBL for India, this would only translate into additional lending space of about US$500 million a year for three years – a small amount for a country of 1.2 billion people and as compared to the country's IDA allocation (US$4.7 billion for IDA16).

As India started reaching its Single Borrower Limit, the Bank looked for innovative ways to maintain a program of support that would meet India's needs. The purchase of **Special Private Bonds (SPPBs)** is an option for managing IBRD exposure to large borrowers close to the SBL. Under this framework, the Bank exposure to a country can exceed the SBL without additional risk to the Bank as exposure in excess of the SBL is protected by the purchase of an equal amount of SPPBs by the country. Thus, Bank exposure to a country could exceed the SBL on a gross basis but stay within the SBL on a net basis. As a result, the Bank does not have to hold additional capital for exposure above the SBL. The mechanism was first approved in 2003 when Bank exposure to China was approaching the SBL. In 2012, the Executive Directors approved the use of SPPBs by India. Lending under the SPPB framework will be capped at US$4.3 billion in excess of the SBL. Therefore, gross exposure to India would be capped at US$21.8 billion (US$17.5 billion + US$4.3 billion). On a net basis, however, it will remain within the SBL.

48. **Among current blends and upcoming blends, Vietnam, Nigeria, Pakistan, Papua New Guinea and Uzbekistan could potentially meet the income criterion for transitional support.** Figure 3 shows the trajectory of countries' GNI per capita for a select group of current blends and a few countries expected to become blends in their upcoming CASs. Although these forecasts are uncertain, they show that based on current per capita GNI projections, Papua New Guinea, Nigeria, Vietnam and Uzbekistan would remain below the projected historical cutoff for the next few replenishments, while Pakistan remains below the operational cutoff. Based on current information, Sri Lanka, Mongolia, Bolivia, Moldova and Timor-Leste are already above the IDA historical cutoff, and hence look unlikely to meet the eligibility criteria for transitional support on income grounds at the time of their graduation.

Figure 3: GNI Per Capita Projections for Selected Current and Upcoming Blends[1/]



Source: WEO projections, WBG calculations. Projections not available for Timor-Leste.

Notes:

1/ Includes all blends except those under the small island exception.

*Countries expected to have new or renewed access to IBRD in their upcoming CAS/CPS.

49. **While poverty data would need to be examined closer to the prospective graduations, among blends and upcoming blends, Nigeria's poverty and social indicators fare worse on most counts than the low-income average, while Pakistan and Papua New Guinea fare worse on a number of social indicators.** For instance 68 percent of Nigeria's population lives on less than US$1.25 per day relative to the low-income average of 48 percent (see Table 2). Many statistics including poverty headcount are not available for Papua New Guinea, but it fares worse than the low income country average on some of the social indicators such as malnutrition prevalence and literacy rates. Pakistan's poverty and social statistics are somewhat similar to India's. Pakistan's poverty headcount is 21 percent, and it fares worse than the low income country average on primary school enrollment, on literacy, especially of females, and prevalence of malnutrition. Vietnam's poverty headcount is 16.9 percent, but it tends to fare better than the low-income country average on several poverty and social indicators. In terms of access to resources, it is unclear at this point whether these countries would have access to the level of IBRD support needed to make a smooth transition, and this would have to be assessed closer to their actual graduation.

Table 2: Selected Social Indicators for Current and Upcoming Blend Countries

Selected Social Indicators (latest available)

	GNI per capita, Atlas method (current US$)	Primary school enrollment rate (adjusted net, % of primary school age children)			Fertility rate (births per woman)	Life expectancy at birth, total (years)	Literacy rate (% of adults ages 15+)			Malnutrition prevalence, height for age (% of children under 5)	Mortality rate, infant (per 1,000 live births)	Poverty headcount ratio at $1.25 a day (PPP) (% of
		Total	Female	Male			Total	Female	Male			
Current and upcoming blend countries 1/												
Bolivia*	2040	91.4	91.5	91.2	3.3	67	91.2	86.8	95.8	27	39	15.6
Moldova*	1980	90.6	90.2	90.9	1.5	69	98.5	98.1	99.1	11	14	0.4
Mongolia	2320	98.8	98.2	99.4	2.5	68	97.4	97.9	96.9	28	26	..
Nigeria*	1200	57.6	54.8	60.1	5.5	52	61.3	50.4	72.1	41	78	68.0
Pakistan	1120	72.1	65.0	79.0	3.4	65	54.9	40.3	68.6	43	59	21.0
Papua New Guinea	1480	..	..	..	3.9	63	60.6	57.3	63.9	44	45	..
Sri Lanka	2580	94.1	94.4	93.9	2.3	75	91.2	90.0	92.6	19	11	7.0
Timor-Leste*	2730	85.9	85.6	86.2	5.5	62	58.3	53.0	63.6	58	46	37.4
Vietnam	1260	98.1	..	..	1.8	75	93.2	91.1	95.3	31	17	16.9
Uzbekistan	1510	92.8	91.5	94.1	2.5	68	99.4	99.2	99.6	20	42	..
Memo:												
Low income	569	80.8	79.2	82.3	4.1	59	62.9	56.0	69.7	38.4	62.8	48.4
Lower middle income	1764	89.7	88.5	90.7	2.9	66	70.9	62.3	80.0	35.7	46.0	30.2

1/ Includes all blends except those under small island exception.

* Countries expected to resume blend status or acquire blend status in their next CPS

Source: World Bank World Development Indicators database.

50. **Whether transitional support for Vietnam, Nigeria or other countries is warranted in the future will depend upon a range of factors, including each country's development path, demand for IBRD and developments in the global economic environment.** As more countries graduate to IBRD-only status, and there is a greater concentration of higher risk countries, IBRD's financial capacity may become more constrained. Shocks affecting multiple countries simultaneously may also increase demand from IBRD countries as it happened during the global financial crisis. Should such a crisis occur when countries are close to graduating, then constraints to IBRD lending in these countries would need to be considered along with other eligibility criteria. Constraints are likely to be more binding in countries where IBRD is being asked to substitute for large lost IDA flows. A concerted WB effort to smooth lending by encouraging a frontloading of IDA and backloading of IBRD for upcoming graduates may help reduce the need for transitional support in the future. This is addressed further in section V on the future of the IDA graduation policy.

C. Transitional Support for Graduating Countries: Size, Terms and Purpose

51. **Transitional support from IDA would be available to eligible IDA graduates on an exceptional basis.** Since graduates would be classified as IBRD-only, they would require exceptional access to IDA. The financing of transitional support would be part of the overall IDA17 replenishment resources, and not set up as a separate window outside of IDA. Iraq in the aftermath of the Iraq war is an example where an IBRD country was granted exceptional and temporary access to IDA.[10]

[10] See "IDA's Role in Potential World Bank Lending to Iraq", IDA/SecM 2003-0549, October 17, 2003.

52. **It is proposed that transitional support be lower than the support a country would have received as an IDA borrower, but still significant.** Accordingly, it is proposed that the size of transitional support financing be set at two-thirds of the allocation the country would have received had it remained an IDA borrower. It is expected that the transitional support to graduates would be financed largely or in part from concessional partner loans to the extent they are available.[11] The terms of assistance for the transitional support would be harder than those of IDA hard term lending but below the fixed rate equivalent of an IBRD loan.[12] Transitional support for an individual country is expected to be endorsed by IDA Deputies for the duration of an upcoming replenishment period. The use of transitional support from IDA is expected to be aimed at tackling a country's poverty agenda as specified in its country assistance strategy.

D. Proposal for Transitional Support to India

53. **Given India's eligibility based on the outlined criteria, Management proposes that India receive transitional support from IDA for the IDA17 replenishment period.** This support would amount to 2/3 of the 11 percent of IDA resources that India would have received as an IDA blend country during the IDA17 period had graduation not taken place. The support provided would be on terms harder than those of IDA hard term lending but below the fixed rate equivalent of an IBRD loan. It is envisaged that financing for transitional support would come primarily from concessional partner loans. The transitional financing would be frontloaded by 20-30 percent in the first year, level with the average annual amount in the second year, and backloaded by 20-30 percent in the last year of the replenishment to facilitate a transition away from IDA lending. For illustrative purposes, the simulations for India use the IDA16 resource envelope, 2/3 of which would translate into transitional support of about SDR2.1 billion, and would have had an annual profile of SDR876 million in FY15, SDR701 million in FY16, and SDR525 million in FY17. This financing would provide an additional boost to help meet India's needs for significant WB financing to address its poverty reduction priorities and reduce the severity of IDA negative net transfers which are projected to start in FY15 (see Annex 3).

54. **A potential lending program for India illustrated in Figure 4 shows a significant drop in WB financing from the average financing levels that India received from the WB over IDA15 and IDA16.** This lending scenario is limited by the current SBL, is based on graduation at the end of IDA16, and includes the impact of the contractual acceleration of IDA credit repayments. It would provide a maximum envelope of about US$600 million a year in IBRD lending during the IDA17 period compared to an annual average of US$4.3 billion during IDA15 and IDA16. India has agreed to start purchasing Special Private Placement Bonds in FY14 to boost its access to World Bank financing. Use of these bonds would lead to an envelope of US$2.0 billion per year during the IDA17 period, the majority of which would be backed by India's purchase of SPPBs.

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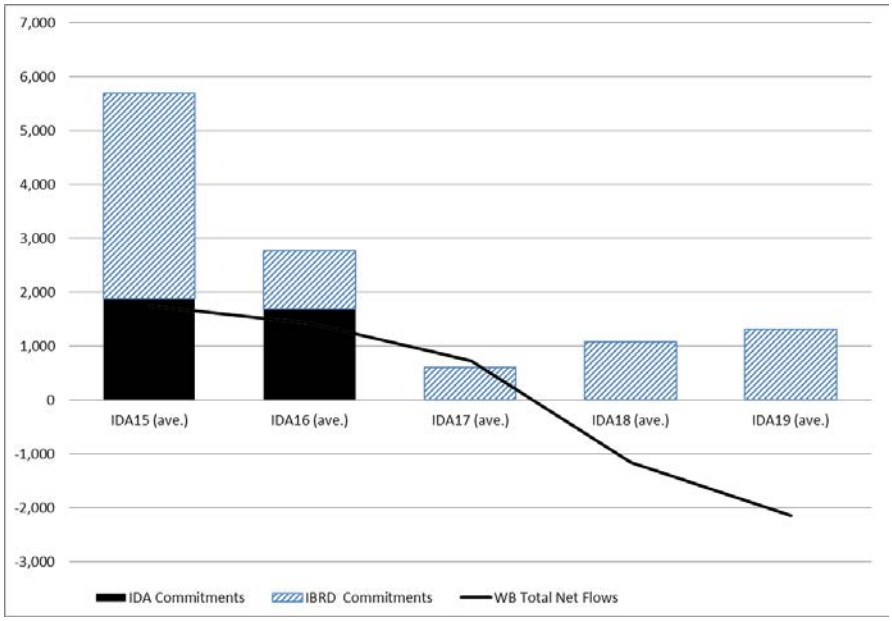
[11] For more information on concessional partner loans see "IDA's Long Term Financial Capacity and Financial Instruments" (forthcoming).

[12] In addition to the standard service and commitment charge of an IDA loan, the interest rate for IDA hard term lending is set at 200 basis points below the fixed rate equivalent of IBRD loans.

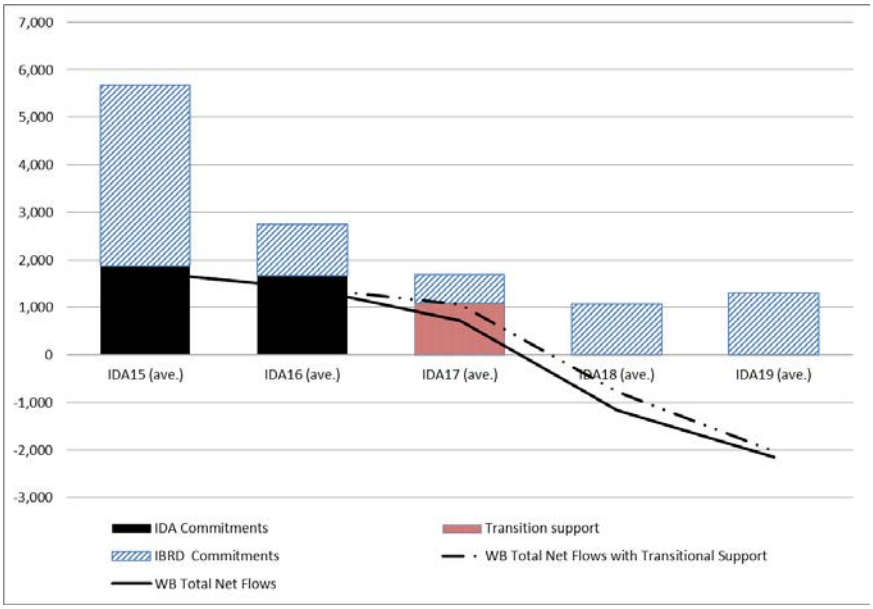
Figure 4: IDA and IBRD Lending to India and Net Flows without IDA Transitional Support



Notes: The term "net flows" refers to new disbursements minus principal repayments.
Chart does not show IBRD commitments potentially financed by the purchase of SPPBs.

55. **Transitional support could help address the significant reduction in financing that would occur during IDA17 after India's graduation.** Using two-thirds of the size of the IDA16 allocation as a reference in the simulation scenarios, transitional support would enable total IDA and IBRD lending volumes to reach US$1.7 billion per year on average during the IDA17 replenishment period (see Figure 5), and with the addition of SPPBs, lending volumes could reach an average of US$3.0 billion per year over the IDA17 period. Even with these levels of transitional support, negative net flows from the WB still start in FY18, driven by the existing pipeline of amortizing WB debt and lower new commitment levels going forward. The magnitude of this trough is softened slightly in a scenario that includes transitional support. The eventual amortization of India's IBRD portfolio will start freeing up resources that can be committed as new IBRD operations, but the lending levels beyond IDA17 are constrained at US$1 billion per year on average, slightly more if SPPBs are included, and net flows from the World Bank are forecast to be negative. While IDA transitional support would help to relieve the financing constraints over the coming CPS period, the Bank will need to develop innovative solutions to address the challenge of providing financing to support India.

Figure 5: IDA and IBRD Lending and Net Flows to India with Transitional Support [1/]



Notes: The term "net flows" refers to new disbursements minus principal repayments.
Chart does not show IBRD commitments potentially financed by the purchase of SPPBs.

V. A COORDINATED APPROACH TO NEW BLENDS

56. **The IDA16 MTR paper on the IDA graduation process highlighted a potential for a steep drop-off in resources as countries move from blend to IBRD-only status.** This has been exacerbated in recent years as some blend countries have frontloaded the use of WB resources and in some cases have received reallocations from IBRD to respond to the global crisis. As a result, at graduation countries may see a graduation "drop", i.e., a steep decline in financing volumes from the WB.

57. **To help manage the challenges and opportunities of graduation from IDA, a WB task force is being created that will provide advice to countries in their move to blend and eventually IBRD-only status.** While graduation from IDA is a positive milestone in a country's development path, there are a number of opportunities and challenges to managing the eventual transition to IBRD-only status. The task force will provide advice to country authorities and country teams when an IDA-only country becomes creditworthy for IBRD lending as well as to current blend countries. The task force will consist of staff from Concessional Finance and Global Partnerships – IDA Resource Mobilization Department (CFPIR), Corporate Finance and Risk Management – Credit Risk Department (CFRCR), Operations Policy and Country Services (OPCS) and other relevant Bank units and will provide advice and feedback to the country authorities and the country team at the time of creditworthiness, at the time of preparation of a new CPS, and ahead of impending changes in the country's lending status. It will outline the

implications of graduation to ensure that these countries are prepared for this milestone. Areas in which the task force would provide assistance are guidance on ensuring a smooth path from IDA to IBRD on the financing side, including with frontloading/backloading in the use of IDA/IBRD resources to help mitigate the risk of a steep drop-off in resources from the WB upon graduation from IDA; spelling out the implications for the country of the implementation of the accelerated repayment clause at graduation and laying out the various options available if needed to design a payment schedule for acceleration that is tailored to the country's repayment capacity; and support for enhancing the country's access to financial resources from other sources.

VI. ISSUES FOR DISCUSSION

58. Staff welcomes Deputies' views on the expected graduation timeline for countries identified as expected to graduate from IDA at the end of the IDA16 period.

59. Do Deputies agree with the criteria proposed for access to transitional support from IDA, the proposed size, terms and purpose?

60. Do Deputies agree that, based on the proposed criteria, India would be eligible to transitional support from IDA during the IDA17 period?

Annex 1: Access to Financial Markets for Select IDA Countries (as of January 31, 2013)

Country	Rating			Bonds Issues			
	Fitch	Moody's	S&P	Issue date 1/	Length	Amount (US$ Million)	Spreads (bps)
Countries expected to graduate at the end of IDA 16:							
Angola	BB-	Ba3	BB-	8/10/2012	7 Years	1,000	630
Armenia	BB-	Ba2					
Bosnia and Herzegovina		B3	B				
Georgia	BB-	Ba3	BB-	4/12/2011	10 Years	500	262.2
India	BBB-	Baa3	BBB-				
Other current blends and upcoming blends: 2/							
Bolivia*	BB-	Ba3	BB-	10/22/2012	10 Years	500	346.1
Moldova*		B3					
Mongolia	B+	B1	BB-	11/28/2012	10 Years	1,000	349.5
Nigeria*	BB-	Ba3	BB-	1/28/2011	10 Years	500	237.1
Papua New Guinea		B1	B+				
Pakistan		Caa1	B-	6/1/2007	10 Years	750	891.5
Sri Lanka	BB-	B1	B+	7/25/2012	10 Years	1,000	352.9
Vietnam	B+	B2	BB-	1/29/2010	10 Years	1,000	316.5

Source: Bloomberg
Notes:
1/ Latest.
2/ Includes all rated blends with exception of small island states (Uzbekistan and Timor-Leste are not yet rated by the major rating agencies).
* Countries expected to resume blend status or acquire blend status in their next CPS.

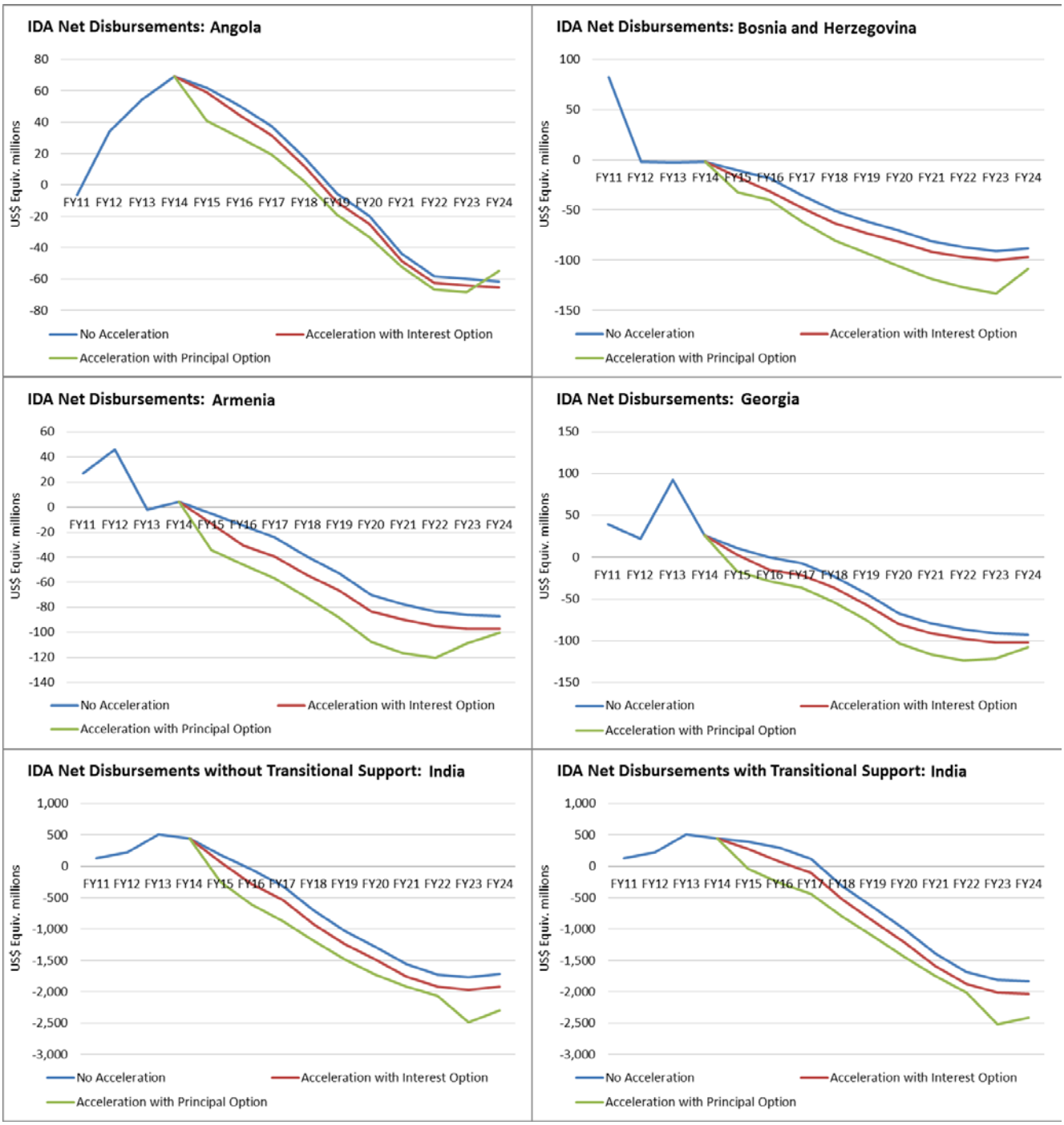
Annex 2: Selected Macroeconomic Indicators for Identified Graduation Candidates and other Current and Upcoming Blends [1/]

	GNI per capita, Atlas method (current US$)	Real output growth, average in %		Overall fiscal balance/general government net lending/borrowing, in % GDP		Nominal public and publicly guaranteed debt, in % GDP	Short term debt in % of total reserves	Current account balance plus net FDI, in % GDP	Total reserves in months of imports of G&S	Resource rich country - - RRC (yes/no)	Inflation rate, percent change	Net ODA received, in % of GDP	CPIA
	2011	2010-12	2013-16	2010-12	2013-16	2012	2011	2010-12	2011	2012	2010-12	2010	2011
Countries expected to graduate at the end of IDA16													
Angola	4,060	4.7	5.4	7.6	2.7	28.5	7.5	5.6	5.9	yes	12.9	0.3	3.0
Armenia	3,360	3.5	4.0	-3.6	-2.2	43.0	45.0	-7.6	4.2	no	5.9	3.5	5.1
Bosnia and Herzegovina	4,780	0.7	2.8	-3.3	-1.7	44.0	30.8	-5.5	4.2	no	2.7	3.0	3.9
Georgia	2,860	6.6	5.5	-2.4	-1.8	33.0	54.8	-5.2	3.8	no	5.3	5.5	4.7
India	1,420	7.3	6.5	-9.3	-8.8	66.0	26.1	-2.4	7.8	no	10.4	0.2	4.1
Other current and upcoming blends													
Bolivia *	2,040	4.8	5.0	1.1	0.4	34.5	5.3	6.8	14.5	yes	5.7	3.6	4.1
Moldova*	1,980	5.5	5.2	-2.1	-1.0	28.0	96.6	-6.0	3.7	no	6.7	7.5	3.8
Mongolia	2,320	12.2	11.5	-4.0	-1.3	57.0	9.8	16.6	3.5	yes	10.7	5.4	3.2
Nigeria *	1,200	7.5	6.7	-2.3	2.0	18.0	11.4	7.5	4.0	yes	12.0	1.0	4.2
Pakistan	1,120	3.3	3.4	-6.2	-6.0	58.0	14.3	-0.1	4.2	no	11.6	1.6	3.1
Papua New Guinea	1,480	8.1	9.3	0.4	-0.9	23.0	2.8	-6.4	5.4	yes	7.1	5.5	4.0
Sri Lanka	2,580	7.6	6.6	-7.0	-5.2	81.0	28.4	-3.8	3.5	no	6.9	1.2	3.1
Timor-Leste*	2,730	.	.	46.2	.	0.0	0.0	50.0	166.0	yes	.	9.2	3.3
Uzbekistan	1,510	8.1	6.3	5.7	1.5	9.0	.	.	.	yes	11.7	0.6	3.9
Vietnam	1,260	5.9	6.6	-3.7	-3.0	48.5	73.6	4.0	1.4	no	12.0	2.9	4.2
Source:	WB OP3.10	WEO	WEO	WEO	WEO	DSAs	WDI	WDI (BoP)	WDI	IMF	WEO	WDI	WB

1/ Includes all blends except those under the small island exception.

*Countries expected to resume blend status or acquire blend status in their next CPS.

Annex 3: The Impact of Credit Acceleration on IDA Net Disbursements (Net Transfers) in Expected Graduates [1/]



1/ The term net disbursements refers to new disbursements of IDA, less principal payments, interest payments and service charges. This concept is also referred to as net transfers, and differs from the concept of net flows (disbursements less principal repayments only). Exposure in IBRD for instance is affected by net flows, but not by interest payments or charges.

Annex 4: The Focus on Poverty Reduction in India's Upcoming Country Partnership Strategy

1. **The upcoming India Country Partnership Strategy (CPS) aims to target poorer states and special states with the largest pockets of poverty** to bring them up to the levels of the rest of the country in order to maximize the impact on poverty reduction and foster more inclusive growth. The CPS, expected to be discussed by the Board in April 2013, points out that India has had a strong partnership with the World Bank Group over its long history of engagement.[13] The Indian government has emphasized its view that this partnership helps achieve transformational service delivery and higher service standards, enables new innovation to be built into development projects, and helps leverage financing from central as well as state government and other development agencies, while also catalyzing private sector financing. As a guiding principle of its "Finance Plus" approach, the government of India has called for a rebalancing of the World Bank portfolio toward more state-level activities, especially low income and special category states. The CPS argues that the growth and poverty reduction dividends are highest in the low income states where poverty elasticities are lower, growth is lower and development less inclusive.

2. **There are 7 low-income states in India whose state level GDP falls below the India average.** Those low-income states comprise 44 percent of India's population but 59 percent of the poor population. About 211 million poor people live in the low-income states. In Uttar Pradesh, with a population the size of Brazil, 38 percent of the population of 200 million is poor; in Bihar 53.5 percent of the population of over 100 million is poor; while in Madhya Pradesh 26 million poor people represent about 37 percent of the population of 73 million (see Table 1).

Table 1. State Gross Domestic Product (SGDP) for Low Income and Special Category States

Low Income States				Special Category States			
	Population (mn)	**% Poor**	**SGDP per capita, US$**		**Population (mn)**	**% Poor**	**SGDP per capita, US$**
Bihar	103.8	53.5	294	Assam	31.2	37.9	536
Chhattisgarh	25.5	48.7	695	Himachal Pradesh	6.9	9.5	1,267
Jharkhand	33.0	39.1	589	Manipur	2.7	47.1	569
Madhya Pradesh	72.6	36.7	555	Meghalaya	3.0	17.1	866
Odisha	41.9	37	676	Mizoram	1.1	21.1	883
Rajasthan	68.6	24.8	666	Sikkim	0.6	13.1	1,715
Uttar Pradesh	199.6	37.7	436	Uttarakhand	10.1	18	1,233
Total	**545.1**	**39.5**	**494**	**Total**	**55.5**	**29.5**	**792**

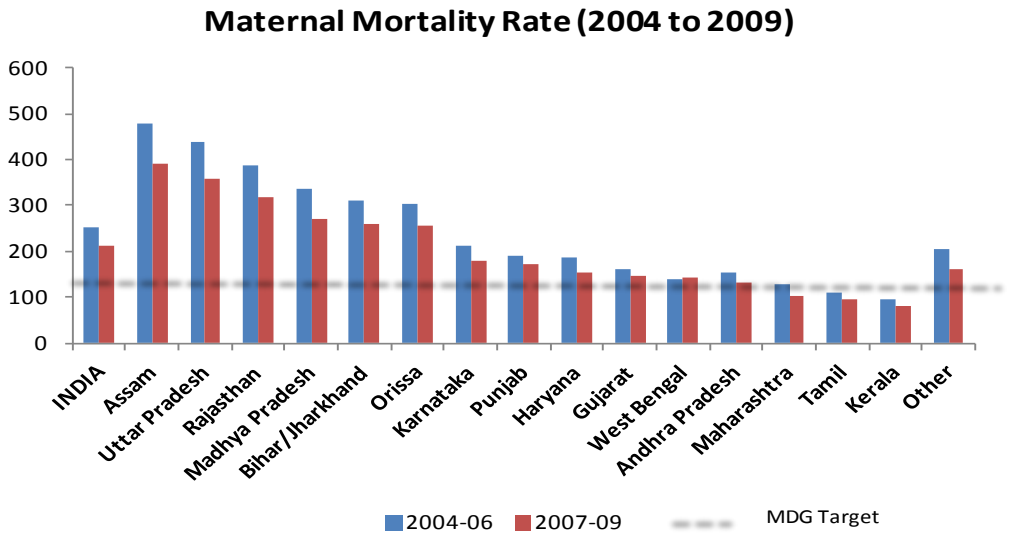
Source: Census 2011, Planning Commission for poverty figures in 2009-10, CSO for SGDP in 2010-11.

Notes: SGDP PC has been converted from INR to US$ using the period average exchange rate from IMF's IFS.
Total SGDP per capita, US$ = the population weighted average of the group.

[13] See "A Collaborative Partnership: India and IDA", Government of India, Ministry of Finance, Department of Economic Affairs, 2012.

3. **The low-income states have much farther to go in reaching the MDGs and for many indicators they fare worse than many of the poorest IDA-only countries.** An example is the case of maternal mortality where the poorest states are far from reaching the MDG goal, while a few of the wealthier states have already met it (see Figure 1).

Figure 1: Maternal Mortality Rate in India by State and MDG Target



Source: Office of Registrar General of India, 2011

4. **The CPS stresses the importance of a strong WBG portfolio of support for projects targeted at India's poorer states and regions to accelerate poverty reduction and boost shared prosperity.** Under the new CPS, the approach for engaging low-income states will build on lessons learned from successes and failures during the previous CPS period. Specific activities will build on the approach already adopted in Bihar which combines extensive capacity building, technical assistance and analytical work that underpins lending operations. Activities will also rely on local knowledge, particularly in the context of state-level political economy. The World Bank and IFC are adopting a "synergy by design" approach and hence IFC lending over the CPS period is also expected to focus its investments and advisory program in the low-income and northeast states. IFC support over the CPS period is expected to average US$1 billion in lending to the private sector annually. Also, a concerted effort is ongoing by the World Bank and the Government of India to improve portfolio management and accelerate project implementation. In this context, the Government with the World Bank staff has identified key bottlenecks for project implementation and is working with project managers to remove them. Regular portfolio reviews are being held at the state and sector level and at the level of risky and slow-disbursing projects, leading to time-bound action plans, agreed disbursement targets, and close follow up, and where needed projects are being restructured. Around 30 restructurings were completed in FY12 alone. While in the short-term this has led to a drop in new IBRD commitments during the IDA16 replenishment period as teams have focused on improving the existing portfolio, it is expected to lead to more effective and speedier implementation of projects.