IDA17

IDA17 FINANCING FRAMEWORK

International Development Association
IDA Resource Mobilization Department (CFPIR)

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SELECTED ABBREVIATIONS AND ACRONYMS

AfDF	African Development Fund
DSAs	Debt Sustainability Analyses
DSF	Debt Sustainability Framework
EUR	Euro
FY	Fiscal Year
GBP	British Pound
GNI	Gross National Income
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IoC	Instrument of Commitment
IMF	International Monetary Fund
JPY	Japanese Yen
MDBs	Multilateral Development Banks
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
ODA	Official Development Assistance
PBA	Performance-Based Allocation
SDR	Special Drawing Rights
SLA	Straight Line Amortization
SSTTF	South Sudan Transition Trust Fund
US$	United States Dollar
WB-IMF DSA	World Bank-International Monetary Fund Debt Sustainability Analysis

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EXECUTIVE SUMMARY

i. **The IDA17 replenishment comes at a time of unprecedented opportunities and challenges.** The IDA17 period will cover the target date for the achievement of the MDGs and the launch of the post-2015 development agenda. It is a time of unprecedented opportunities for IDA countries to secure the gains achieved, seize emerging opportunities and confront new challenges towards transformative results for the poorest. At the same time, the replenishment takes place in the context of a challenging and uncertain external environment and tightened fiscal constraints for several partner countries, thus highlighting the importance of enhancing IDA's business model and value proposition to maximize its impact. In the companion "ask paper" for the second IDA17 replenishment meeting ("The Demand for IDA17 Resources and the Strategy for their Effective Use"), Management has presented five potential scenarios for the IDA17 replenishment based on the needs of IDA countries and a realistic assessment of how these scenarios can be financed. The scenarios provide a broad range of options ranging from a decline of IDA17 of 10 percent in nominal terms (16 percent in real terms) relative to IDA16, to incrementally higher scenarios, which would allow for more progress to be made to meet critical development priorities in IDA countries. This paper provides the financing options for IDA17 that would underpin these five scenarios.

ii. **To finance these scenarios, IDA17 will require a collective effort by all partners**, including contributing partners, IDA graduates, potential new middle income partner countries, IDA recipient countries and the World Bank Group. Management is seeking the guidance of IDA Deputies by presenting several potential scenarios (as was done in IDA16) rather than recommending a specific "ask" scenario. Based on the Deputies' feedback in the July 1-4 meeting, Management will present updated scenarios at the third replenishment meeting.

iii. **The financing volume of the IDA17 replenishment** will partly depend on the volume of new basic grant contributions from partners and their compensatory contributions for IDA's debt relief and grant compensation, and the volume of internal resources - including internal reflows, investment income, and transfers from IBRD's and IFC's net income. Additional funding could be generated through the introduction of a limited amount of debt funding and changes in IDA's lending terms for IDA-only countries.

iv. **Overall grant contributions in IDA17** under the five potential scenarios range from SDR20.0 billion to SDR21.6 billion (US$30.1-32.4 billion). At the lower end, it implies a decrease of 5.1 percent and at the upper end an increase of 2.4 percent. The variable portion represents basic grant contributions ranging from SDR14.7 billion to SDR16.3 billion (US$22.1 - 24.5 billion), net of the structural financing gap. The remaining part is the known portion for which partners are asked to provide resources as agreed under prior replenishments for covering IDA's cost of debt relief (HIPC, MDRI and arrears clearance) and grant principal forgone on grants in IDA17 totaling SDR5.3 billion (US$8.0 billion).

(in SDR millions)	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Basic Grant Contributions	14,691	15,121	15,552	15,889	16,270
% change over IDA16	*-5.7%*	*-2.9%*	*-0.1%*	*+2.0%*	*+4.5%*
Compensatory Items (MDRI, HIPC, arrear clearance and grant principle)	5,299	5,299	5,299	5,299	5,299
Internal Resources (excl. transfers)	7,233	7,238	7,457	7,688	7,727
Concessional Loans (excl. release of internal resources)	0	679	2,218	3,051	4,149
Other items (1)	2,441	2,913	3,003	2,876	2,709
Total Financing Framework	29,664	31,249	33,529	34,803	36,155
% change over IDA16	*-9.6%*	*-4.7%*	*+2.2%*	*+6.1%*	*+10.2%*

(1) Includes additional internal resources released through concessional loans (less the grant element of the concessional loans), carry-forward of unused IDA16 arrears clearance funding, and WBG transfers.

v. **The structural financing gaps in IDA's cost for debt relief and grants create a real financial risk for IDA.** Over time, a "structural gap" has emerged as targeted funding volumes were not fully met by actual partner contributions, resulting in total burden shares that do not sum to 100 percent. Because of this, the use of burden shares from previous replenishments to calculate compensatory contributions for debt relief and grants means that IDA is not receiving full partner compensation for such costs and represents a real financing gap for IDA. As with past replenishments, partners are strongly encouraged to scale up their HIPC, arrears clearance and grant financing burdens shares proportionally to close the gap. Management is also soliciting new contributions to reduce the MDRI financing gap and encourages the remaining partners to scale-up their MDRI compensation.

vi. **The level of internal resources available for IDA17 could be between 20 to 25 percent lower than IDA16.** For IDA16, the cumulative impact of three measures significantly increased the level of internal resources available for commitment authority (voluntary credit repayments, front-loading of credit reflows generated by applying differentiated blend lending terms and the implementation of the accelerated repayment clause for IDA graduates). While the IDA17 financing framework includes new measures that increase the total level of internal resources, the aggregate (of between SDR 7.2 to 7.7 billion) could be some 20 to 25 percent lower than the level of internal resources in IDA16.

vii. **Concessional loans could provide additional funding that would allow IDA to maintain or even increase its total funding envelope.** Additional resources from partner loans could offset the decrease in internal resources allowing IDA to achieve IDA16 or potentially higher funding levels without requiring large increases in grant funding from partners. Scenario 1 is the only scenario that would be financed without concessional partner loans. The other four scenarios would require additional funding from partners in the form of concessional loans or increased grant contributions for amounts ranging from SDR0.7 to 4.1 billion (US$1.1 to 6.2 billion) including the grant element of concessional loans. The concessional loans would also

provide bridge financing to alleviate liquidity constraints in the short-term, permitting the release of additional internal resources.

viii. **During the first IDA17 meeting in Paris, IDA proposed adjusting the future lending terms for IDA-only countries** by shortening the grace period and moving to a straight line amortization of principal. There was broad consensus among participants that revising the lending terms would benefit IDA by increasing IDA's internal resources available for new commitments, while maintaining a high degree of concessionality. At the same time, some participants, including Borrower Representatives, asked management to consider somewhat longer grace periods. Therefore, the proposed option from Paris has been further refined to reflect the tradeoff between concessionality and the commitment authority volume by synchronizing the effort of partners and recipients in each of the scenarios proposed.

ix. **The IDA participation option would help reduce aid fragmentation by allowing partners to finance existing IDA projects that meet their specific interest with comparatively low costs and risks.** Given the initial feedback received at the Paris meeting, it is proposed that this financing option be introduced on a pilot basis after the start of IDA17 to test it and refine its policy framework. A pilot participation program would allow IDA to understand the benefits of participations most valued by partners and clients and evaluate its cost implications.

x. **Guidance is sought from IDA Deputies on the following questions:**

- Do Deputies agree that the **financing scenarios** present a suitable range within which to discuss the financing framework for IDA17?

- What guidance can Deputies provide with respect to the need for additional funding to reduce the **MDRI financing gap**?

- Do Deputies support the **revision of lending terms** for IDA-only countries as illustrated in the financing scenarios?

- What are the Deputies' views on the options presented in this paper for **implementing concessional loans in IDA17?**

- Do Deputies support allowing partners to participate in **financing existing IDA projects** based on a limited initial pilot program to be developed after the start of IDA17?

IDA17 FINANCING FRAMEWORK

I. INTRODUCTION

1. **The IDA17 replenishment comes at a time of a challenging and uncertain external environment, which must be balanced against the significant needs in IDA countries.** Despite the difficulties, a strong IDA replenishment is needed to promote the World Bank Group's twin goals of eliminating extreme poverty and boosting shared prosperity in the poorest countries of the world and to provide leadership at the global level on pressing development issues.

2. **Given these circumstances, Management seeks guidance from Deputies on how to strike a balance between the fiscal constraints faced by many partners and the significant needs in IDA countries.** In this context, the accompanying "ask paper"[1] has presented a range of scenarios ranging from a decline of IDA17 of 10 percent in nominal terms (16 percent in real terms) relative to IDA16, to incrementally higher scenarios which would allow for more progress to be made to meet critical development priorities in IDA countries. This paper provides the financing framework for IDA17 that would underpin these scenarios.

3. **Grant contributions remain the primary source of funding for IDA and the paper provides various scenarios for partner grant contributions to the IDA17 replenishment.** These contributions are sub-divided into two categories: (i) contributions to HIPC, MDRI, arrears clearance and grant compensation, which are already agreed in the context of earlier negotiations. They are currently estimated to amount to SDR5.3 billion (US$ 8.0 billion) for IDA17, roughly the same amount as under IDA16; and (ii) basic grant contributions which amounted to SDR15.6 billion (US$23.4 billion) under IDA16.[2] Under the financing scenarios presented in the paper, basic grant contributions range from SDR14.7 billion (US$22.1 billion) in scenario 1 to SDR 16.3 billion (US$24.5 billion) in scenario 5.

4. **A number of measures were taken in IDA16 to increase the level of internal resources available for commitment authority; however, these measures will not be available at the same level in IDA17.** Management proposes to partially offset the decline in internal resources with new financing options. If endorsed by IDA Deputies, additional resources of SDR0.6 billion (US$0.9 billion) to SDR5.5 billion (US$8.3 billion) could be added through a combination of measures to introduce a limited amount of debt funding into the IDA17 financing framework and hardening of terms for IDA-only countries. The internal resource mobilization also assumes continued income transfers from IBRD and IFC, subject to available income and approval of the respective Boards. Management is making concerted efforts to support the IDA replenishment through a fair and wide burden-sharing. In this context, it is in contact with potential new contributing partners as well as existing contributing partners that are considering scaling-up their support.

5. **This paper is organized as follows.** Section II summarizes the original financing framework for IDA16, and describes the subsequent changes to the framework. Section III presents potential financing scenarios for IDA17, including the volume of partner contributions and internal resources under each scenario. Section IV then reviews the financing gap in MDRI, HIPC, arrears clearance and

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[1] "The Demand for IDA17 Resources and Strategy for their Effective Use".

[2] Original IDA16 Financing Framework as agreed at the start of IDA16.

forgone grant principal compensation. Section V is the follow up to discussions held in Paris in March 2013 on the new financing options, and Section VI presents the issues for discussion.

6. **The analysis in this paper is based on the financing model for IDA's long-term financial projections as discussed at the first IDA17 meeting in March 2013 in Paris**.[3] Data on debt relief provided by IDA are as of June 30, 2012, as provided in the most recent annual update to partners,[4] and on partner resources received for debt relief financing are as of March 31, 2013. These amounts will be updated based on the 2013 cost update which will become available in September 2013. Also, other financing estimates will be updated as the replenishment negotiations progress to reflect new information and revised assumptions. For ease of reference, IDA's SDR-based financial data are also provided in US$ equivalent terms in this paper.[5]

II. UPDATE ON IDA16 FINANCING FRAMEWORK

7. **The financing framework as originally agreed at the start of IDA16 was to provide SDR32.8 billion (US$49.3 billion) of total resources over the FY12-14 period** (see Table 1 below). This included SDR17.6 billion (US$26.4 billion) in new partner contributions, SDR3.5 billion (US$5.3 billion) of partner compensation for MDRI, SDR2.0 billion (US$3.0 billion) from IBRD and IFC transfers and SDR9.7 billion (US$14.6 billion) from internal resources (including resources from voluntary and contractual acceleration of credit repayments, and front-loading the use of reflows from hardening lending terms introduced in IDA16).

8. **The IDA16 financing framework was subsequently revised to SDR33.9 billion (US$50.9 billion).** This reflects the reduction in IDA16 internal resources to cover a funding shortfall by partner in IDA15 (SDR0.7 billion)[6] and a reduction in IBRD's contribution related to the South Sudan Trust Fund (SDR0.1 billion),[7] which were offset by carried forward balances from IDA15 for partner contributions pending the receipt of unqualified funding commitments (SDR1.1 billion),[8] and IDA15 project cancellation (SDR0.8 billion). Furthermore, this also reflects to a lesser extent additional partner contributions and the adjustments for hedging of non-SDR cash flows, primarily the partner contributions in national currencies.

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3 "IDA's Long Term Financial Capacity and Financial Instruments", paper prepared for the first meeting of the IDA17 replenishment.

4 "Debt Relief Provided by IDA Under the MDRI and HIPC Initiative: Update on Costs and Donor Financing", World Bank, December 2012.

5 Data for IDA16 are based on the IDA16 reference foreign exchange rate of US$/SDR 1.50233. Data for IDA17 use the average foreign exchange rate for the period from March 1, 2013 to May 15, 2013 of US$/SDR 1.50434. As agreed by IDA Deputies at the first IDA17 meeting in March 2013, the applicable reference foreign exchange rates for IDA17 will be based on the average daily exchange rates over a six month period from March 1, 2013 to August 31, 2013.

6 These shortfalls have been fully covered by partners during IDA16.

7 See "Establishment of a South Sudan Transition Trust Fund (SSTTF) and the Proposed Transfer of IBRD Surplus to the SSTTF," IDA/R2011-0195, May 25, 2011.

8 This consisted of outstanding IDA15 contributions or commitments from a number of partner countries (SDR0.7 billion - which were fully covered as expected during IDA16 as reflected in footnote 6) and items from IDA14 and prior replenishments where unqualified partner funding commitments were not received during IDA15 (SDR0.3 billion, of which SDR0.1 billion was received in IDA16), and corresponding pro rata contribution shares withheld by some partners (SDR0.1 billion).

Table 1: IDA16 Financing Framework (SDR billion and US$ billion)

	Source of Funds	IDA16 Agreed [1/]		IDA16 Revised[2/]	
		SDR bil	US$ bil	SDR bil	US$ bil
I.	**TOTAL PARTNER RESOURCES**	**21.1**	**31.7**	**21.1**	**31.7**
	Basic & supplemental contributions	15.8	23.7	15.8	23.8
	Compensation for HIPC	1.3	2.0	1.3	2.0
	Financing of arrears clearance operations	0.4	0.6	0.4	0.6
	Compensation for grant principal forgone	0.1	0.1	0.1	0.1
	Total Partner Contributions	**17.6**	**26.4**	**17.6**	**26.4**
	Compensation for MDRI (FY20-22)	2.6	3.8	2.6	3.8
	Compensation for MDRI carry forward (pre FY20)	1.0	1.4	1.0	1.4
	Total MDRI Compensation	**3.5**	**5.3**	**3.5**	**5.3**
II.	**TOTAL INTERNAL RESOURCES**	**11.7**	**17.6**	**10.8**	**16.2**
	Internal Reflows of IDA	6.6	9.9	5.8	8.8
	Contractual acceleration of credit repayments	1.2	1.8	1.2	1.8
	Voluntary prepayment (China and Thailand)	0.6	0.9	0.6	0.9
	Frontloading use of reflows from hardening lending terms	1.3	2.0	1.3	2.0
	IBRD Transfers	1.3	2.0	1.2	1.8
	IFC Transfers	0.7	1.1	0.7	1.0
	Carry Forward from previous replenishments/Other Funds - released			1.7	2.5
III.	**TOTAL FINANCING FRAMEWORK**	**32.8**	**49.3**	**33.6**	**50.5**
	Carry Forward from previous replenishments/Other Funds - unreleased			0.3	0.4
IV.	**TOTAL IDA16 COMMITMENT AUTHORITY**	**32.8**	**49.3**	**33.9**	**50.9**

Notes:
Amounts may not add up due to rounding
US$ amounts based on IDA16 reference exchange rate of US$/SDR 1.50233
1/ Original IDA16 financing framework agreed at fourth meeting of IDA16 replenishment meeting.
2/ IDA16 financing framework as of May 31, 2013 updated to reflect: additional partner contributions; use of internal resources to cover IDA15 financing shortfall and subsequent receipt of funds; funds released from project cancellations; IBRD's contribution to the South Sudan Trust Fund, carry-forwards from IDA15 and previous replenishments; and impact of updated contributions based on hedge exchange rates.

III. IDA17 POTENTIAL FINANCING SCENARIOS

9. **Management seeks the guidance from IDA Deputies on a range of potential scenarios which take into consideration IDA countries needs and the challenging external environment**. The IDA17 period will cover the target date for achievement of the MDGs and the launch of the post-2015 development agenda. It is a time of unprecedented opportunities for IDA countries to secure the gains achieved, seize emerging opportunities and confront new challenges towards transformative results for the poorest. In particular, a strong IDA17 replenishment will be critical to support IDA countries' efforts to maintain the growth momentum achieved in the last decade, confronting the challenge of rising inequality (notably gender), and addressing cross border challenges, including from climate change, fragility, natural disasters, food security and other shocks. It will also help IDA step up its involvement in fragile and conflict-affected states, as well as scaling up support for regional programs. At the same time, the IDA17 replenishment takes place in the context of a challenging and uncertain external environment and tightened fiscal constraints for several partner countries, thus highlighting the importance of enhancing IDA's business model and value proposition to maximize its impact.

10. **In the companion paper "The Demand for IDA17 Resources and the Strategy for their Effective Use"**, Management has presented five potential scenarios for the IDA17 replenishment based on IDA countries' needs and a realistic assessment of how these scenarios can be financed. The scenarios presented provide a broad range of options ranging from a decline of IDA17 of 10 percent in nominal terms (16 percent in real terms) [9] relative to IDA16, to incrementally higher scenarios which would allow for more progress to be made to meet critical development priorities in IDA countries. It should be noted that scenarios 1-3 represent a reduction in nominal terms from the level of the IDA16 revised financing framework (para. 8). The five scenarios present elements for discussion by Deputies on allocating IDA resources for different purposes and related trade-offs.

11. **To finance these scenarios, IDA17 will require a collective effort by all partners**, including contributing partners, IDA graduates, potential new middle income partner countries, IDA recipient countries and the World Bank Group. This paper presents an assessment of how the potential "ask" scenarios can be financed. Financing the volume of the IDA17 replenishment in this difficult fiscal environment will depend on contributing partners' funding decisions on: (i) the new basic grant contributions;[10] (ii) their compensatory contributions for IDA's debt relief and grants; and (iii) concessional partner loans. IDA graduates are being asked to increase IDA's internal resources through voluntary and contractual acceleration of their credit repayments to IDA. Potential new middle income partner countries are being asked to join the IDA global coalition. At the same time, IDA recipient countries would contribute to further increase IDA's internal resources available in IDA17, if the lending terms for IDA-only credits are revised as described in section III-F.[11] Other funding sources include internal resources, which consist of credit reflows, investment income, and transfers from IBRD and IFC.

12. **The scenarios, presented in Table 2 (see Annex I for financing scenarios in US$), highlight the importance of the concessional loan in the overall financing framework for IDA17.** Unlike in previous IDA replenishments, and the replenishments of other organizations, where partner grant contributions are the main variable to make the financing scenarios match the ask scenarios, for IDA17 the concessional loan is the key balancing driver. Only three items change across the scenarios: (i) the partner basic contributions, (ii) the concessional loans (and the accompanying internal resources available for release),[12] and (iii) the increase due to changes to the lending terms on future IDA-only credits. The concessional loans represent the largest component, which together with the additional internal resources available for release, assume a significantly larger portion as the target replenishment size grows, accounting for zero percent in the first scenario, to approximately 9 percent in the third, and for 14 percent in the fifth scenario.

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[9] Inflation for the period is 6.6 percent.

[10] Under the MDRI replenishment, partners agreed to a contribution baseline, representing the floor for their future financial support to regular IDA replenishments. Partners agreed to continue to increase their contribution by the SDR inflation rate for subsequent replenishments.

[11] The lending terms for blend and so-called gap countries were hardened in IDA16 to include an interest charge and a shorter grace period and maturity. This has strengthened IDA's financial sustainability and helped create the opportunity to leverage IDA's grant funding through the potential inclusion of some debt funding in IDA's financing framework.

[12] The bridge financing provided by the concessional loan (structured with a 3 year drawn-down) would permit the release of additional internal resources.

Table 2: Financing of IDA17 Scenarios (SDR million)

IDA17 FINANCING FRAMEWORK (SDR million)		IDA17 Financing Framework									
Source of Funds	IDA16 Agreed [a/]	Scenario 1	% change	Scenario 2	% change	Scenario 3	% change	Scenario 4	% change	Scenario 5	% change
I. TOTAL PARTNER RESOURCES	**21,073**	**19,990**	***-5.1%***	**20,420**	***-3.1%***	**20,851**	***-1.1%***	**21,188**	***+0.5%***	**21,569**	***+2.4%***
Basic grant contributions	15,574	14,691	***-5.7%***	15,121	***-2.9%***	15,552	***-0.1%***	15,889	***+2.0%***	16,270	***+4.5%***
Supplemental contributions	230										
Compensation for HIPC (FY15-17)	1,320	1,585		1,585		1,585		1,585		1,585	
Financing of arrears clearance operations	381	423		423		423		423		423	
Compensation for grant principal forgone	56	281		281		281		281		281	
Total Partner New Contributions	**17,561**	**16,980**	***-3.3%***	**17,411**	***-0.9%***	**17,841**	***+1.6%***	**18,178**	***+3.5%***	**18,560**	***+5.7%***
Compensation for MDRI (FY23-25)	**3,512**	**3,010**		**3,010**		**3,010**		**3,010**		**3,010**	
II. TOTAL INTERNAL RESOURCES	**11,725**	**9,292**	***-20.8%***	**9,296**	***-20.7%***	**9,515**	***-18.9%***	**9,746**	***-16.9%***	**9,785**	***-16.5%***
Internal reflows	6,575	5,879		5,879		5,879		5,879		5,879	
Contractual acceleration of credit repayments	1,217	573		573		573		573		573	
Voluntary prepayments [b/]	592	181		181		181		181		181	
Frontloading use of reflows from hardening terms	1,314	601		605		824		1,055		1,095	
Internal Resources of IDA	**9,698**	**7,233**	***-25.4%***	**7,238**	***-25.4%***	**7,457**	***-23.1%***	**7,688**	***-20.7%***	**7,727**	***-20.3%***
IBRD transfers	1,310	1,360		1,360		1,360		1,360		1,360	
IFC transfers	717	698		698		698		698		698	
Total Transfers [c/]	**2,027**	**2,058**	***+1.5%***	**2,058**	***+1.5%***	**2,058**	***+1.5%***	**2,058**	***+1.5%***	**2,058**	***+1.5%***
FINANCING FRAMEWORK (without loans and carry forwards)	**32,799**	**29,281**	***-10.7%***	**29,716**	***-9.4%***	**30,366**	***-7.4%***	**30,934**	***-5.7%***	**31,355**	***-4.4%***
Concessional Partner Loans (net of grant element)		0		575		1,880		2,586		3,517	
Concessional partner loans (gross)			0		679		2,218		3,051		4,149
Internal Reflows - increase due to loans		0		575		900		900		900	
Carry Forward of Unused IDA16 Arrears Clearance Funding		383		383		383		383		383	
TOTAL FINANCING FRAMEWORK	**32,799**	**29,664**	***-9.6%***	**31,249**	***-4.7%***	**33,529**	***+2.2%***	**34,803**	***+6.1%***	**36,155**	***+10.2%***
Debt limit (25/5, 1.0%)		*4,582*	13.5%	*5,334*	15.0%	*6,071*	16.4%	*6,080*	16.2%	*6,139*	16.3%
Financing gap in MDRI compensation FY23-25		*262*		*262*		*262*		*262*		*262*	

Notes:
a/ Original IDA16 financing framework as agreed in the IDA16 Deputies' Report.
b/ For scenario 1 through 5, this represents the actual amount prepaid by Azerbaijan.
c/ The figures for IBRD and IFC transfers in IDA16 and assumed in IDA17 include investment income generated by a three year encashment schedule.

A. Grant Contributions

13. **To satisfy the IDA17 financing needs, total partner grant resources excluding the MDRI compensation would need to equal between SDR17.0 billion to SDR18.6 billion (US$25.5-27.9 billion).** The basic grant contributions represent the variable portion, which range between SDR14.7-16.3 billion (US$22.1-24.5 billion), net of the structural gap.[13,14] Relative to IDA16, this represents a range of scenarios from a decrease of 5.7 percent in nominal terms in scenario 1 (a 12 percent decrease in real terms) to an increase of 4.5 percent in nominal terms in scenario 5 (a 2 percent decrease in real terms). The remaining portion is the fixed portion for which partners are asked to provide resources as agreed under prior replenishments for covering IDA's cost of debt relief under the HIPC Initiative, arrears clearances, and principal forgone on grants in IDA17. Specifically, these items include:

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13 Partner burden shares for IDA16 represented only 74.73 percent of the target amount, leaving a structural gap of 25.27 percent. Hence, this target funding in IDA17 would need to be scaled up to account for this gap. Table B in Annex I illustrates the scale up necessary in order to achieve full funding under each scenario.

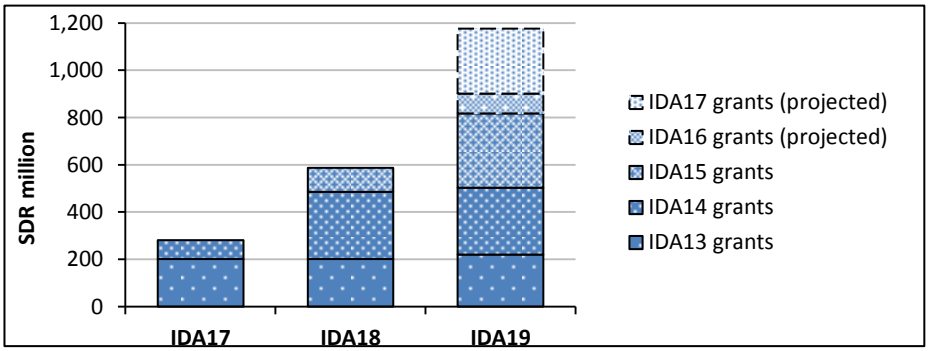
14 Embedded in the partner basic contributions in the financing framework is the grant element of concessional partner loans, which has been eliminated from the concessional loan amount (which is shown net of the grant element).

- **Compensation for HIPC costs**. IDA17 is the fourth replenishment during which partners will finance IDA's forgone credit reflows due to the HIPC Initiative. Under the current compensation arrangements, partner financing of HIPC costs occurs on a pay-as-you-go basis, over the 3-year commitment period of IDA replenishments. Over the IDA17 commitment period (FY15-17), partner contributions for HIPC costs are currently estimated to be SDR1.6 billion (US$2.4 billion).[15]

- **Financing of arrears clearance operations**. Starting in IDA15, arrears clearance operations formed part of IDA's overall financing commitments and were financed by partner contributions. Three countries have been in protracted arrears (Somalia, Sudan and Zimbabwe). Given the uncertainty about their re-engagement, we assume that potentially all three countries may become eligible for exceptional IDA support for arrears clearance during the IDA17 period (FY15-17). Taking into account an estimate of the probabilities of these countries clearing their arrears during IDA17, the availability of resources from IDA country allocations and partner and government resources with which to reduce the size of the arrears clearance needs, external funding of SDR0.8 billion (US$1.2 billion) could be required during the IDA17 period. This could be funded with the unused funding partners provided for arrears clearance in IDA16 of SDR0.4 billion (US$0.6 billion) plus new funding of SDR0.4 billion (US$0.6 billion).[16]

- **Compensation for principal forgone on grants**. Grant making began in earnest in IDA13. In IDA14, partners committed to replace forgone principal reflows due to the making of grants, on a pay-as-you-go basis.[17] IDA17 would be the second replenishment for partners to finance forgone principal reflows due to grants extended in the past replenishments. Partner contributions for grant principal repayments forgone are estimated at SDR 0.3 billion (US$ 0.4 billion) during the IDA17 period. Chart 1 illustrates the forgone principal repayments on grants over the next three replenishments.

Chart 1: Forgone Principal on Grants for IDA17- IDA19 (SDR million)



Notes:
Assumed IDA-only terms would be changed to 38-year maturity with 6-year grace period starting from IDA17, in accordance with scenario 3 of the Financing Framework.

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15 HIPC costs are estimated based on the cost update as of June 30, 2012. Final amounts will be based on the 2013 cost updates which will become available in September 2013.

16 Since the arrears clearance funds are handled outside the PBA envelope, at the end of IDA17, if the funds allocated during IDA17 will be in excess of the actual costs, the remaining funds will be carried over into IDA18. If the set-aside funding will be less than the required amount, the amount of the shortfall will be included in the arrears clearance request in the IDA18 replenishment.

17 "Additions to IDA Resources: Fourteenth Replenishment", IDA/R2005-0029, March 1, 2005.

14. **Grant contributions are encashed in line with the expected time profile of disbursements of credits and grants expected to be approved during the commitment period.** This practice ensures that partner contributions are drawn down by IDA on an "as-needed" basis. In past replenishments, partners have been given the option of providing their contributions on an accelerated basis, which generates a credit or a discount based on the present value of the accelerated encashment schedule versus the standard encashment schedule.[18] Many partners used the additional resources from accelerated encashments as a credit item, either to increase their own basic burden share, to cover a share of their costs under the MDRI replenishment, or to lower the overall structural financing gap in the replenishment.

15. **Foreign exchange rates have a significant impact on the level of partner contributions, which are typically in national currencies**. At the first IDA17 meeting in Paris, Deputies agreed to use the daily average foreign exchange reference rates over the six-month period from March 1, 2013 – August 31, 2013 for purposes of converting national currency contributions to IDA17 into SDR equivalent amounts. The exchange rates of some currencies have significantly adjusted (see examples of the SDR currencies in Table 3) since IDA16. This will translate into different country efforts over IDA16 levels, based on the final exchange rate.

Table 3: Preliminary Foreign Exchange Rates

Currency	IDA16 Actual *Apr 1, 2010 - Sep 30, 2010*	IDA17 Reference period to date *Mar 1, 2013 - May 15, 2013 **
EUR/SDR	1.17198	1.15664
GBP/SDR	0.98810	0.98623
JPY/SDR	133.66996	145.89181
US$/SDR	1.50233	1.50434

* Used for IDA17 figures in this paper.

B. Compensation for MDRI Costs

16. **To replace IDA's forgone credit reflows due to MDRI, partners established a separate MDRI replenishment spanning four decades (FY07-44).** As a result, starting from IDA14, IDA's commitment authority is backed by two simultaneous replenishments: the funding that becomes available under the latest regular IDA replenishment and additional partner commitments provided under the ongoing MDRI replenishment. MDRI costs, related partner financing contributions, and their payment schedules are updated at least every three years, in conjunction with regular IDA replenishments. The last update of IDA's MDRI costs for financing occurred as of June 30, 2010 during the IDA16 replenishment discussions. For partners' financing pledges to IDA17, MDRI costs of IDA will be updated once again, as of June 30, 2013. This cost update will be provided to partners prior to the third IDA17 replenishment meeting.

17. **To preserve IDA's financial capacity following implementation of the MDRI, partners acknowledged the need to provide unqualified, firm financing commitments over a rolling decade, thereby matching the disbursement period of each future IDA replenishment.** Under the MDRI framework, partners recognized that the ability to provide binding financial commitments for the

[18] The standard encashment schedule and discount rate for IDA17 will be provided to Deputies prior to the third IDA17 replenishment meeting.

entire duration of MDRI varies from partner to partner, and committed themselves to make every effort possible to translate their qualified commitments in the outer, as well as earlier years, into as firm and far reaching financial pledges ("unqualified commitments") as allowed by their legislative processes. As per the original MDRI replenishment agreement: "*Participants encouraged IDA's donors to take all necessary steps in successive replenishments to provide firm financing on a rolling basis.*"[19] For the IDA17 replenishment, this entails the expectation that partners will provide unqualified, firm financing commitments up to FY25.

18. **For IDA17, the additional, firm financing commitments required for MDRI are estimated at SDR3.4 billion (US$5.2 billion)**.[20] Despite these actual costs, the financial framework includes SDR3.0 billion (US$4.5 billion) for MDRI to account for the following two factors: (i) cost updates from June 2010 to June 2012 resulted in a reduction in the MDRI costs for IDA16 of SDR0.2 billion (US$0.3 billion)—this amount is deducted from the IDA17 MDRI costs to compensate partners; and (ii) the MDRI financing gap of SDR0.3 billion for FY23-25 is excluded from the financing framework until IDA receives this amount from partners either through the scaling up of their burden shares or the contribution to MDRI by new partners.[21] Some partners have yet to unqualify their commitments up to FY22. A decision on whether to cut IDA16 resources for these amounts or to borrow against IDA17 internal resources has not yet been made, and any adjustment to the IDA17 financing framework is not reflected. A few partners have already provided up-front, unqualified financing commitments over the entire four decades of MDRI; these partners would not need to provide additional MDRI financing commitments during IDA17.[22]

C. Internal Resources

19. **The amount of internal resources made available for IDA17 impacts IDA's liquidity and its ability to fund disbursements on commitments made in past and future replenishments.** Under the Advance Commitment Scheme, credit reflows that will be received over the IDA17 disbursement period (FY15 to FY25) could be committed in advance of receipt so as to match the cash flows needed for disbursement in each year. As the 11-year disbursement period overlaps with multiple past and future replenishments, a portion of the reflows during the IDA17 disbursement period are required to fund disbursements made in previous and future replenishments. The level of internal resources available for IDA17 commitment authority is therefore based on long-term projections of IDA's cash flows to optimize the use of its resources.

20. **For IDA17, the amount of internal resources available under IDA's lending policies is currently estimated at SDR5.9 billion (US$8.8 billion), assuming no debt funding added into the framework.** This compares with internal resources in the original IDA16 financing framework of SDR6.6 billion (US$9.9 billion) which was subsequently revised to SDR5.8 billion (US$8.8 billion) after internal resources were allocated to cover the funding gap resulting from partner shortfalls during

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[19] "Additions to Resources: Financing the Multilateral Debt Relief Initiative," Resolution No. 211 adopted on April 21, 2006. See para. 19.(a) and 19.(b), page 5.

[20] MDRI costs are estimated based on the cost update as of June 30, 2012. Actual amounts will be based on the 2013 cost updates to be provided prior to the third IDA17 replenishment meeting.

[21] As partners have committed to compensate IDA on a dollar-for-dollar basis, the unfunded costs related to MDRI will be shown as a below the line item, however unlike in IDA16 they are excluded from the financing framework until such time as funding has been secured.

[22] This includes Canada, Ireland, Kuwait, Luxembourg, Portugal, the Russian Federation and South Africa.

IDA15.[23] As highlighted in Table 2, adding a limited amount of concessional loans will permit the release of between SDR0.6 and 0.9 billion of additional internal resources. This is due to the fact that IDA16's resources were front-loaded, restricting core liquidity in the initial years of IDA17. The additional liquidity provided by the 3 year drawdown schedule of the proposed concessional loan alleviates this liquidity constraint in the initial years and permits greater commitment of IDA's internal resources.

D. Contractual Acceleration of IDA Credit Repayments

21. **Financing Agreements for credits approved after 1987 include a clause that allows IDA to accelerate credit repayments once a borrower meets specified GNI per capita and creditworthiness thresholds.** The accelerated repayment provision doubles the repayment amount due on each semi-annual repayment date. The clause provides that IDA's Board of Executive Directors consider a borrower's economic development before the clause is exercised. The GNI per capita threshold was originally set as exceeding the historic cut-off (US$1,945 for FY13) for five consecutive years (the 'old clause'), but in 1996 it was lowered for new credits approved to exceed the operational cut-off (US$1,195 for FY13) for three consecutive years (the 'new clause').

22. **The accelerated repayment clause can be implemented flexibly based on eligible countries' debt servicing preferences through either the principal option (the default option) or the interest option**. Under the existing loan agreements of qualifying credits, once a country reaches the eligibility thresholds, IDA can modify the repayment terms requiring the country to double its principal repayments ('principal option') - i.e. the maturity of eligible loans would be shortened. Alternatively, the country can request that the original amortization schedule be retained and pay an interest charge based on the outstanding balance at a rate that would result in the same net present value as accelerating the repayments ('interest option'). Although the present value over the life of the loans would be the same under either option, the impact on IDA's liquidity and projected IDA17 commitment authority would be different.

- Impact on IDA's cashflows: Under the *principal option* the credit reflows are front-loaded through the doubling of principal repayments on eligible credits – i.e., IDA receives the repayments more quickly. Since the outstanding balance is repaid more quickly, recipients pay a lower service charge over the remaining life of the credit.[24] Under the *interest option*, the amortization schedule remains the same, so there is no front-loading benefit for IDA. Instead, IDA receives additional interest income over the remaining life of the credit.

- Impact on IDA17 Commitment Authority: The difference in the cash flows of the principal option versus the interest option impacts the potential increase in internal resources included in the financing framework for IDA17. The *principal option* provides the greater immediate benefit to IDA because it front-loads principal repayments. Under the *interest option*, the increase in commitment authority is limited to the additional interest income that IDA would receive during IDA17. However, this income would be available over a longer time period and generate additional resources for future replenishments. Since in nominal terms acceleration candidates benefit from lower service and interest charges under the principal

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[23] *"Annual Review of IDA16 Commitment Authority Framework (FY12-FY14)",* IDA/R2012-229, October 12, 2012. As for April 30, 2013, the partners have covered these shortfalls, and the full amount has been released for commitment.

[24] It should be noted that the reflows would be on-lent for new commitments, so IDA would continue to earn the service charge income on new credit disbursements.

option and remaining IDA recipients benefit immediately from higher commitment authority, candidates are encouraged to select the principal option where possible.[25]

23. **The contractual acceleration clause was first implemented in IDA16 and the additional credit reflows were front-loaded into the financing framework.** In IDA17, there are nine countries that exceed or are expected to exceed the GNI per capita threshold, are creditworthy for IBRD borrowing, and have outstanding IDA credits subject to an accelerated repayment clause: Angola, Armenia, Azerbaijan, Bosnia and Herzegovina, Egypt, Georgia, India, Iraq, and the Philippines. The Board of Executive Directors has already approved the exercise of the accelerated repayment clause for Azerbaijan effective January 1, 2013. Azerbaijan elected the principal option, which provides the greater immediate benefit to IDA's remaining recipient countries in terms of the additional IDA17 commitment authority that is generated. Table 4 shows that if all the eligible countries' qualifying credits repayment schedules are accelerated when eligible (the majority of candidates in FY15)[26], the accelerated receipt of reflows would increase the internal resources available for IDA17 commitment authority by at least SDR 0.6 million (US$ 0.9 million).[27] This compares with the increase in internal resources available in IDA16 of SDR 1.2 billion (US$ 1.8 billion) from exercising this clause for seven graduates eligible at that time: Albania (selected interest option), China (selected principal option), Egypt (selected principal option), Equatorial Guinea (selected principal option), Indonesia (selected principal option), FYR of Macedonia (selected interest option), and St. Kitts and Nevis (selected interest option).

Table 4: Outstanding IDA Credits of Acceleration Candidates

In SDR millions	Total IDA credits outstanding	Credits subject to acceleration	of which: Old clause	of which: New clause	Credits not subject to acceleration	Addition to IDA17 Commitment Authority 1/	Eligibility start date
Angola	282.5	265.4	132.0	133.3	17.2	10.1	July 1, 2014
Armenia	803.1	620.1	138.6	481.4	183.0	25.5	July 1, 2014
Azerbaijan	540.7	527.2	99.7	427.5	13.8	88.5	January 1, 2013
Bosnia-Herzegovina	778.0	526.6	101.9	424.7	251.4	21.7	July 1, 2014
Egypt	799.2	302.9	302.9	0.0 2/	293.8	10.8	July 1, 2015
Georgia	845.3	654.4	113.9	540.4	190.9	27.6	July 1, 2014
India	17,155.9	8,190.4	0.0 3/	8,190.4	4,894.0	382.7	July 1, 2014
Iraq	142.4	142.4	0.0	142.4	0.0	5.3	July 1, 2014
Philippines	99.0	69.4	69.4	0.0	29.6	1.2	July 1, 2016
	21,446.0	**11,298.8**	**958.5**	**10,340.2**	**5,873.6**	**573.4**	

1/ The increase in commitment authority is based on individual countries' confirmed election of either principal or interest option. Where countries have not yet made this election, the interest option is assumed.

2/ For Egypt, the Executive Directors have approved exercising of the accelerated repayment clause for credits subject to the new clause in June 2011. The amount of credit subject to the new clause is SDR 205.5 million.

3/ India does not meet the GNI per capita threshold for the old clause, therefore SDR 4,071.5 million of outstanding credits with an accelerated repayment clause are not currently eligible for acceleration.

25 The net present value of the interest option and principal option are the same and, therefore, in the long-term are financially equivalent. However, the principal option allows IDA to front-load the use of resources and is the preferred option.

26 Egypt and the Philippines will become eligible for contractual acceleration of the qualified IDA credits under the old clause in FY16 and FY17, respectively.

27 Reflows from accelerated repayment of qualified IDA credits available for IDA17 commitment authority will be those received in FY15-17. These are estimated based on individual countries confirmed election of either principal or interest option. Where countries have not yet made this election, the interest option is assumed.

E. Voluntary Prepayments

24. **IDA encourages its graduates to consider voluntary prepayments as part of the global efforts to provide resources to fund the development of countries most in need of concessional funding.** In December 2010, IDA's Board of Directors approved a new policy framework that allows IDA to offer graduate countries a discount to voluntarily prepay their outstanding IDA credits beyond their contractual obligations. The new policy framework is based on the core principles of equity of treatment among all IDA recipients and maintenance of IDA's financial sustainability.[28] The discount that IDA offers to graduates that voluntarily prepay their outstanding IDA credits beyond their contractual obligations depends on three broad factors: (a) an estimate of the investment income that IDA could generate holding the prepaid funds prior to disbursement for new credits and grants; (b) the amount the borrower elects to prepay; and (c) how the borrower elects to treat the discount. Graduates can elect to prepay all of their outstanding credits or provide a lump-sum to partially prepay their outstanding credits.[29] The borrower has the option to redirect the prepayment discount as a partner contribution to IDA, thereby allowing IDA to retain the funds for new commitments to IDA recipients in support of their development efforts.

25. **Internal resources available for IDA17 will be increased due to voluntary prepayments, which will allow IDA to redirect scarce resources to those countries most in need.** For IDA16 voluntary prepayments by two IDA graduates, China and Thailand, generated SDR0.6 billion (US$0.9 billion), which formed part of the global effort to mobilize funding for the world's poorest countries in IDA16. In addition, China elected to redirect its discount as a supplemental partner contribution increasing IDA16 resources by SDR74 million (US$111 million). For IDA17, the financing framework includes the additional resources resulting from Azerbaijan's decision to voluntarily prepay SDR181 million (US$272 million) of its outstanding IDA credits, over and above its contractually accelerated repayments, as part of its efforts to support IDA recipients as an emerging development partner following its own success and graduation from IDA. Management continues to encourage other graduates to consider voluntary prepayments to mobilize additional resources for IDA17.

F. Front-loading the Use of Reflows from Hardening of Terms

26. **The IDA17 financing framework reflects the potential resources from front-loading the use of credit reflows as a result of revising the lending terms for IDA-only credits.** The proposed option is to shorten the grace period and to adopt a straight line amortization of principal. As presented in the Paris meeting paper and summarized in Annex II, the option to revise the lending terms for IDA-only countries: (i) takes into account the improvements in the risk of debt distress of IDA countries and the impact of the hardened terms on their debt sustainability risk ratings, (ii) ensures that the IDA terms remain highly concessional relative to other MDBs, (iii) takes into account the impact of possible actions by other MDBs, and (iv) retains grant allocations for those countries assessed at high or moderate risk of debt distress.

27. **The financing scenarios aim to balance the trade-off between concessionality and increased lending volume for recipients**. At the Paris meeting, participants endorsed the review of

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[28] The discounts offered to IDA graduates must include consideration to i) IDA's ability to earn an investment return on funds held prior to their disbursement for new IDA credits and grants and to cover any discount offered plus loss of interest income on prepaid credits, where applicable; and ii) IDA's ability to earn sufficient service charge income to cover its annual administrative expenses.

[29] A partial prepayment is applied to the latest maturities of borrowers' outstanding IDA credits, as determined by IDA. A discount is not available for prepayments of individual IDA credits specified by borrowers.

lending terms for IDA-only countries in light of the improving economic and financial circumstances in many IDA borrowers. To reflect comments by participants at the Paris meeting, the hardening of terms in the financing scenarios has been refined, so that the degree by which the grace period is shortened is tied to the robustness of the scenario. Table 5 summarizes the concessionality of the resulting lending terms with the grace period from 5- to 10-years. It also illustrates the potential impact on the IDA17 commitment authority from front-loading the use of reflows assuming that the change in lending terms would be made to the IDA-only credits provided to green- and yellow-light countries starting in FY15 as proposed. The financing scenarios aim to balance this tradeoff by combining the least concessional alternative (5/37 SLA) with the highest total financing scenarios (scenario 4 and 5) so that recipients benefit not only from their contribution to increasing IDA's financial sustainability but also the synchronized effort from partner countries increasing their contributions to IDA. Conversely for scenario 1 and 2, recipients would receive more concessional terms (7/39 SLA) but would also receive a lower overall envelope. Scenario 3 is set between these alternatives (6/38 SLA). Therefore, the increase in internal resources due to hardening of lending terms ranges from SDR0.6 billion (US$0.9 billion) in scenario 1 to SDR1.1 billion (US$1.6 billion) in scenario 5.[30] This compares with the increase in internal resources available in IDA16 of SDR1.3 billion (US$2.0 billion) due to a shortening the grace period for blend-term credits to 5 years, shortening the maturity to 25 years (amortizing at 3.3 percent from year 6 to year 15, then 6.7 percent from year 16 to year 25), and adding at 1.25 percent interest charge.

Table 5: Concessionality and Commitment Authority due to Hardening Lending Terms for IDA-only Credits

	IDA16	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Grace Period (years)	10	7	7	6	5	5
Maturity (years)	40	39	39	38	37	37
Amortization (per year)	2%/4%[31]	3.125%	3.125%	3.125%	3.125%	3.125%
Concessionality (%)	62%	55%	55%	53%	51%	51%
Potential internal resources available in IDA17						
(in SDR million)	0	601	605	824	1,055	1,095
(in eq. US$ million)	0	904	910	1,240	1,587	1,647

Notes:

- *Amounts are projected using the PBA allocations under each IDA17 financing scenario and based on scenario specific assumptions with respect to the allocation of resources between FCS and non-FCS countries.*

28. **The financing scenarios assume that IDA would receive bridge funding**– either through a 3-year draw down of a concessional loan or somewhat front-loaded partner encashment schedules - to cover the timing difference between making disbursements and receiving credit reflows under the new repayment terms.

G. IBRD Net Income Transfers

29. **For IDA17, transfers from IBRD net income are currently assumed to be constant at the IDA16 level in real terms.** At the Spring Meetings in March 2010, Development Committee members recognized the importance of IBRD's commitment to IDA by enhancing the value of IBRD transfers in line with IBRD's financial capacity.[32] Based on the annual average US$ inflation rate of 2.29 percent

[30] In each scenario the proportion of reflows that could be front-loaded are calculated based on projections about the proportion of commitment authority that would be allocated on IDA-only credit terms.

[31] 2 percent for year 11-20 and 4 percent from year 21-40.

[32] Development Committee Communiqué, Washington, D.C. April 25, 2010.

in calendar years 2010-2012, the level of IBRD transfers is expected to amount to US$1,950 million, while a three year encashment schedule would generate additional investment income for IDA bringing the total contribution from IBRD transfers to an estimated US$2,046 million.[33] IBRD's actual transfers in support of IDA17 will depend on various factors, including IBRD's capital and future net income situation, which is dependent on market interest rates and IBRD's need for loan loss provisions, among other factors. Any decisions about future IBRD net income transfers will be subject to annual approvals by IBRD's Executive Directors and Board of Governors.

H. IFC Grants

30. **In conjunction with its operations in IDA countries and as per the individual IDA/IFC grant agreements, IFC grants to IDA are used in furtherance of IFC's purposes, with emphasis on sectors such as finance, industry and trade, information and communication, energy and mining and transportation.** The financing framework currently assumes the same cash contribution of US$1 billion from the IFC net income in IDA17 as in IDA16 in nominal terms. IFC's actual transfers to IDA will depend on its annual results and financial capacities. IFC's Board approves annual net income allocations, which will lead to any decisions of contribution to the IDA17 replenishment.

I. Concessional Partner Loan Contributions

31. **The level of internal resources available for IDA17 could be between 20 to 25 percent lower than in IDA16**. For IDA16, the cumulative impact of three measures significantly increased the level of internal resources available for commitment authority. These were: (1) voluntary credit repayments; (2) the front-loading of credit reflows generated by applying differentiated blend lending terms; and (3) the implementation of the accelerated repayment clause for IDA graduates. This resulted in total internal resources of IDA of SDR9.7 billion (US$14.6 billion) for IDA16. While the IDA17 financing framework includes new measures that increase the total level of internal resources, the level of internal resources for IDA17 (between SDR7.2 to 7.7 billion, excluding WBG transfers) is some 20 to 25 percent lower than in IDA16.

32. **Concessional loans could provide additional funding that would allow IDA to maintain or even increase its total funding envelope and thus contribute to the collective effort by all partners.** Additional resources from partner loans could offset the decrease in internal resources allowing IDA to achieve IDA16, or potentially higher funding levels, without requiring large increases in grant funding from partners. In addition, if IDA mobilizes concessional loan funding drawn-down over the three years of IDA17, this additional liquidity would allow IDA to increase the level of internal resources available for IDA17 commitment authority (between SDR0.6 and 0.9 billion).[34] Therefore, the concessional loans would have an additional positive multiplier effect.

33. **The financing scenarios include concessional loans as a balancing amount that would be required to reach target replenishment sizes at a particular level of grant contributions.** The amounts are not based on actual indications of interest from partner countries, and the actual level of funding mobilized from concessional loans could be higher or lower than the balancing figure indicated to reach the targeted replenishment size. Scenario 1 is the only scenario that would be financed without concessional partner loans. The other four scenarios would require additional funding from partners in

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[33] The assumption about the encashment schedule is indicative pending the finalization of IDA17 financing and IBRD financial outlook at that time.

[34] The amount of this increase in internal resources would be dependent on the actual level of the debt funding mobilized.

the form of concessional loans or increased grant contributions for amounts ranging from SDR 0.7 to 4.1 billion (US$ 1.1 to 6.2 billion) including the grant element of concessional loans.

IV. THE FINANCING GAP IN COMPENSATORY ITEMS

34. **The volume of partner financing required for IDA17 is expressed net of the structural gap and financing gaps that currently exist in partners' IDA burden shares.** Over time, the partner financing shares used in prior replenishments have reflected changing partner circumstances. On a net basis, some partners have reduced their shares without a compensating increase by other partners. This has created a structural gap in the burden sharing scheme. The volume of partner financing required for IDA17 is expressed net of the structural gap that currently exists in partner burden shares. Since the structural gap of basic contributions is not included in IDA's commitment authority, it does not create operational or financial risk.

35. **However, the structural gap for basic contributions to an IDA replenishment is different from the financing gap for IDA's grants and debt relief costs (HIPC, MDRI as well as arrears clearance), which do create an operational and financial risk to IDA**. While a small residual structural gap is desirable for regular contributions,[35] contributions to finance IDA's debt relief costs (HIPC, MDRI as well as arrears clearance) and principal forgone on grants should fully cover any losses incurred by IDA, without any residual gap. Any financing gaps for debt relief costs and principal forgone on grants mean that partner compensation is insufficient to fully cover the costs to IDA and IDA's resources are being reduced. Namely, not covering these financing gaps during FY15-17 will lower the amount of resources available for IDA's commitment authority in IDA17 and in effect means that borrowing countries will be paying for their own debt relief by receiving lower financial assistance.

A. Gap in HIPC, Arrears Clearance, and Forgone Grant Principal Compensation

36. **The financing gap for forgone reflows due to the HIPC Initiative is 4.7 percent.** In IDA16, partners primarily continued to use their IDA13 scaled up burden shares to finance IDA's forgone reflows due to the HIPC Initiative. To help lower the gap for financing HIPC costs during IDA16, two partners "scaled up" their IDA15 burden shares.[36] For HIPC costs in IDA17, during FY15-17, partners are again requested to consider scaling up their IDA16 burden shares to reduce the financing gap.

37. **The financing gap for arrears clearance operations (4.7 percent) is similar to the HIPC financing gap due to partners applying similar burden shares.** There is a strong economic linkage between arrears clearance and the provision of debt relief under the HIPC Initiative, in view of the fact that successful arrears clearance is a prerequisite for reaching the HIPC decision point. Moreover, since arrears clearance operations are of a quick-disbursing nature, the respective partner contributions are encashed on an accelerated basis, in line with the three-year schedule that is being used for encashment of partners' HIPC-related contributions. Similar to the request for eliminating the HIPC financing gap, partners are requested to consider scaling up burden shares to fully finance arrears clearance costs.

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[35] A small structural gap, such as 5 percent, would allow partners' reported burden shares to remain constant irrespective of any subsequent changes in other partners' contributions or additional supplemental contributions.

[36] Luxembourg and the Russian Federation.

38. **With respect to grants, IDA16 was the first replenishment that asked for compensation of forgone principal reflows due to grants and all except one partner applied their HIPC burden shares, leaving a financing gap of 5.7 percent**. Partners are requested to consider scaling up their burden shares for this component, in line with scaled-up burden shares for HIPC and arrears clearance. The respective contributions are encashed on an accelerated basis, in line with the three-year schedule that is being used for encashment of partners' HIPC-related contributions.

B. Gap in MDRI Contributions

39. **Over the entire 40-year period of the MDRI, the financing gap is equivalent to SDR1.9 billion (US$2.8 billion) or 7.8 percent**.[37] Under the initial MDRI replenishment, partners agreed to apply their IDA13 burden shares to finance IDA's forgone reflows due to MDRI, and twenty-two partner countries have already scaled-up their burden shares beyond the IDA13 burden share level. However, until the end of the IDA16 disbursement period (FY22), even with all partners delivering on their financial pledges at the agreed MDRI burden shares, a financing gap of 7.6 percent remains, equivalent to SDR0.7 billion (US$1.1 billion), of which SDR0.2 billion (US$0.3 billion) relate to FY07-14 and SDR0.5 billion (US$0.8 billion) relate to FY15-22. Management is soliciting new contributions to reduce the financing gap up to the end of the IDA16 disbursement period (FY07-22) and encourages the remaining partners to scale-up their MDRI compensation.

V. NEW FINANCING OPTIONS

40. **During the first IDA17 meeting in Paris, participants discussed additional financing options that were proposed to further enhance IDA's resources and its long-term financial sustainability.** Most participants welcomed the proposal to introduce a limited amount of debt in IDA's financing framework through partner concessional loans. In addition, some participants agreed with the proposal for a pilot program for participations, while others noted concerns about risks such as earmarking. This section is meant to further the ongoing dialogue regarding these two options.

A. Concessional Loans

41. **The concessional loan option is a new initiative that could make the difference for mobilizing additional resources to achieve a highly successful IDA17 replenishment**. While IDA will depend on grant funding for the majority of its operations, a unique combination of circumstances[38] creates an opportunity to introduce some debt funding into the IDA17 financing framework. The concessional loan option also provides a new mechanism for partners – including middle income countries – to scale up their contributions to IDA beyond their core grant contributions. This initiative provides an opportunity to leverage IDA's grant contributions and would contribute to a successful IDA17 replenishment despite the challenging fiscal environment for many partners.

42. **At the first IDA17 replenishment meeting in Paris, most participants welcomed the proposal to introduce a limited amount of debt in IDA's financing framework through**

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[37] "Debt Relief Provided by IDA under the MDRI and HIPC Initiative: Update on Costs and Donor Financing (as of June 30, 2012),"IDA/SecM2012-0604, December 28, 2012. See Tables 8a and 8b, page 27.

[38] These include the increased price differentiation introduced in IDA16, the relatively large proportion of blends in IDA's overall lending which allows for a meaningful amount of debt funding, and the historically low interest rate environment which provides an opportunity for IDA to borrow on terms appropriate to its concessional lending operations.

concessional loans, and the possibility to attract additional resources through this mechanism. Several noted that the long-term implications for IDA need to be carefully considered, particularly given the substitution risk. Participants endorsed the broad principles of ensuring additionality and equitable access, and requested further elaboration on the implementation of these principles. Moreover, based on initial feedback from participants at the Paris meeting and Spring meetings consultations, it appears that the overall debt limit will not likely be triggered and therefore the prioritization component of the framework will not likely be applicable. Partners are encouraged to maintain ongoing communication with Management on their intentions regarding their use of the concessional loan option in order to facilitate its implementation.

43. **This section of the paper discusses four specific topics related to the implementation of concessional loans in IDA17 in order to further the on-going discussion:** (a) the discount rate to be used to calculate the grant element; (b) the suggested reference baseline to assess additionality; (c) the currency in which loans could be denominated; and (d) the term options for concessional loans. For background purposes, Annex III provides a summary of the concessional loan option, including additional details on the proposed terms of the concessional loan, the calculation of the grant element and other technical features.

(a) Discount rate used to calculate the grant element

44. **The discount rate used for calculating the grant element of the concessional loan needs to balance the incentives for providing grant funding versus concessional loans, as well as the benefits of the increased lending envelope that concessional loans could provide**. If the discount rate is set too high, then the recognition on the concessional loan in terms of the burden sharing and voting rights would be high and potentially exceed the benefits to IDA and IDA recipients. If the discount rate is set too low, partners may not consider the concessional loan and IDA may not mobilize the additional funding that concessional loans could provide for IDA countries.

45. **The discount rate is a key financial driver on which a consensus will ultimately need to be reached.** Many of the other financial variables of the proposed terms of the concessional loan (i.e., the maturity, the grace period, and even the coupon to a certain extent) are necessary in order for IDA to match its lending terms to recipient countries and to prevent cross-subsidization between grant funding and concessional loan funding. The discount, however, is a key financial driver because of the significant implications on the grant element on the concessional loan, and the direct and indirect burden sharing and voting rights implication to all IDA partners.

- **The grant element on the concessional loan –** The discount rate is the most important variable in determining the grant element of the concessional loan. It will determine the size of the grant element relative to the concessional loan, or vice versa the size of the concessional loan relative to the desired grant element, and therefore the leverage effect provided by the concessional loan: a higher discount rate results in a high grant element and vice versa.

- **The burden sharing and voting rights** – Because the grant element of the IDA concessional loan will be provided with burden sharing and voting rights recognition, the discount rate applied will either directly or indirectly affect all IDA partner countries. Therefore a consensus must be established around the discount rate, which represents a unique challenge for IDA. While a number of trust funds have combined grant funding with concessional or non-concessional loans to provide concessional financing for development purposes, these trust

funds do not attempt to provide recognition in terms of burden share and voting rights among the group of participants.

46. **While the IDA grant element recognition is important for all partners, a "market-driven" grant element must also be considered.** The economic substance of the proposed concessional loan could be viewed as a financing package with two components: a non-concessional loan and a grant ("market-driven" grant element). The non-concessional loan component could be evaluated as an investment and compared to the market yield on a similar investment. In that situation, the market yield would determine the required "market-driven" grant required for the concessional loan.[39] The greater the gap between the IDA discount rate and the market yield on the non-concessional loan, the greater the gap between the IDA grant element recognition and the required "market-driven" grant element and the lower the likelihood that concessional loans will be provided.

47. **Some options for setting the discount rate are listed below, including their respective advantages and trade-offs.**

a. **Discount rate at 1.25 percent**. The paper from the Paris meeting utilized a discount rate of 1.25 percent. This reflects the interest charge on blend credits and the grant element would therefore represent the direct financial benefit to IDA by effectively providing recognition for the positive spread of interest earned from blend credits versus the borrowing cost of the loan. A number of participants have, however, noted that this level of recognition would be insufficient to incentivize partners to provide concessional loans to IDA. They noted that a discount at this level would create a significant gap between the IDA grant element recognition and the "market-driven" grant element and therefore would not likely generate concessional loans for IDA. While a discount rate at this level would measure the direct financial benefit to IDA, it would not recognize the benefits to IDA recipients of the additional resource mobilization that concessional loans could provide.

b. **Discount rate between 1.4 – 2.0 percent.** At the lower limit of the range, the approach is conceptually the same as that considered in Paris but would also take into consideration the potential to earn higher interest income on transitional support credits. The trade-offs and benefits would be the same as the 1.25 percent option. At the upper limit of the range, the discount would include recognition on the 0.75 percent service charge when setting the discount rate to reflect the total revenue for IDA generated by the concessional loan. On an NPV basis this would generate a positive return for IDA but part of the grant would effectively be utilized to buy-down the concessionality of the loan. While the grant element recognition would exceed the net direct financial gain to IDA, a discount at this level would recognize the benefit to IDA recipients of the larger lending envelope, given the increased likelihood of receiving some concessional loans. This is because at the upper level of the range, the gap between the IDA grant element recognition and the "market-driven" grant element has been substantially reduced, due to the fact that the equivalent rate in US dollars of the upper range is close to the current yield on US Treasuries with the same duration. In either case, IDA's total interest income (excluding service charges used to cover administrative expenses) would still exceed its total borrowing costs because the percentage of commitment authority allocated to blends and, if applicable, transitional support exceeds the maximum debt limit as a percentage of commitment authority.

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[39] All partners face the same market investment yields, and while this might not be the approach used by all partners to evaluate concessional loans (given different approaches to financing concessional loans and the different borrowing costs each partner faces), this approach does provide a uniform benchmark to evaluate the appropriate discount rate and recognition among all participants.

c. **Discount rate above 2.0 percent**. Above a discount rate of 2 percent, there would be increasing incentives for partners to consider the concessional loan option but the grant element recognition provided by IDA would exceed the required "market-driven" grant element for US dollars. Furthermore, the total borrowing costs would exceed IDA's total interest income and would require the use of some principal reflows to cover the cost of borrowing.

Given these considerations, Management recommends that the SDR discount rate used to calculate the grant element of the concessional loan be set between of 1.4 – 2.0 percent.

(b) Suggested reference baseline to assess additionality

48. **The Paris meeting paper provided guidance for the setting of the *minimum* level of grant and concessional loan contributions to achieve a reference baseline and ensure a common framework acceptable to all participants**. It suggested that partners would aim to provide at least 80 percent of their IDA16 basic burden share in the form of a core grant contribution, and target at least their IDA16 basic burden share on a grant equivalent basis. This approach encourages partners to use the concessional loan as an additional scale-up to their grant contributions, with no maximum target for the concessional loan size.

49. **The concessional loan option provides the most benefit to IDA when loan funding is provided in addition to IDA's grant funding**. Since partners endorse the principle of additionality, establishing a baseline provides a mechanism by which this can be evaluated. Based on feedback received, in Management's view using the IDA16 replenishment and the basic contribution amount in SDR (rather than the basic burden share) as the reference baseline to assess additionality would provide greater planning certainty for partners evaluating the loan option, while using the most recent decisions of partners as a point of reference. This suggested baseline could not provide a binding obligation on partners, and the level of contribution would continue to be discretionary. However, in the unlikely event that loan offers would exceed the maximum prudential debt limit of IDA, concessional loan offers would be accepted first from those that had maintained or increased their contribution relative to the suggested baseline.

(c) Currency in which loans could be denominated

50. **Managing the currency risk from receiving concessional loans that are not denominated in SDRs presents a significant challenge for IDA**. The challenge for IDA stems from three issues:

- **No market instruments available to hedge to SDRs** – The SDR is not a tradable currency. It is based on a basket of currencies (currently EUR, GBP, JPY and US$) and this basket is rebalanced by the IMF every five years. There are no market instruments to convert a single currency amounts to SDRs. In the case of grant contributions from partners, the contributions are hedged based on the existing SDR basket and then rebalanced for changes in the SDR basket composition, where IDA bears the risk of rebalancing. Given the comparatively short period (between 3 - 9 years), this limits the impact and cost of rebalancing the hedge transactions.
- **Usage of credit lines with market counterparts** – Using market transactions to attempt to mitigate the currency exposure on the concessional loan transactions would absorb a high share of IDA's limited credit lines and could constrain IDA's ability to hedge non-SDR contributions from partners in future.

- **Potential requirement to post collateral as a result of changing regulations** - proposed changes in the regulation of derivative markets would result in a larger number of transactions being centrally cleared with the requirement for counterparties to post collateral. However, since collateral would be posted on adverse movements in the mark-to-market value of the derivative without offsetting cash inflows from beneficial changes in the mark-to-market value of the loan, IDA would need sufficient liquidity to meet its obligations to post collateral. This could constrain IDA's lending capacity.

51. **Partners are therefore encouraged to seek arrangements to denominate concessional loans to IDA in SDRs.** The Paris paper suggested either denominating concessional loans in SDRs or having IDA enter into bilateral back-to-back hedging arrangements with Central Banks.[40] Alternatively, a grant plus a non-concessional loan arrangement might make it more feasible for partners to arrange the loan component in SDRs, given that the provision of concessional loans will likely require coordination among various agencies or entities within a partner country. Many partner countries have used this arrangement with other organizations to provide concessional financing, some of which have been in SDRs.[41] While partner countries continue to seek SDR arrangements, the IDA team will also continue to seek internal solutions to single-currency concessional loans. These include adapting the existing IDA Single-Currency Lending Pilot Program for IDA recipient countries, or potentially setting the transitional support allocations in a single currency. However, the volume of single-currency lending and transitional support could be lower than the total volume of debt, therefore, this could provide only a partial solution to the challenge of single-currency concessional loans.

(d) Borrowing term options for concessional loans

52. **The borrowing terms of a concessional loan will be a critical factor in determining their impact on IDA's financing framework and long-term financial sustainability**. In order for debt funding to be sustainably incorporated into IDA's financing framework to a significant extent, the borrowing terms should have concessional features such as a grace period, long maturity, amortizing principal and low coupon rate.

53. **To ensure equity of treatment and transparency, partners would collectively agree on a few concessional loan options.** IDA Deputies would agree on a few loan options from which partners providing loan contributions could select. While this would limit IDA's flexibility to negotiate different terms with individual partners, it would ensure equity and transparency of the process. In order for the agreed loan options to reflect the preferences of partners considering this option, it is important that IDA receive feedback on the proposed terms so that these can be modified to incorporate partner views. Preliminary feedback suggests interest in both the 25 and 40 years options and preference for a higher coupon range (the Paris paper suggested 0.5 percent and Table 6 has been updated to 1.0 percent based on this feedback).

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[40] IDA does maintain an SDR account at the IMF or could take receipt of the underlying SDR basket currencies.

[41] Partner contemplating single-currency concessional loans would also need to consider the single-currency equivalent of the proposed SDR coupon rates (see Annex III). In addition, SDR denominated loans provide a more stable foreign currency investment for partners, than one denominated in a single-currency, and would significantly reduce the risk and uncertainty for IDA.

Table 6: Proposed SDR Borrowing Term Options for the IDA17 Replenishment

	Maturity	Grace Period	Amortization	SDR Coupon range
Option 1	25 year	5 years	5% per annum (Yr 6 – 25)	0 – 1.0%
Option 2	40 years	10 years	3.3% per annum (Yr 11 – 40)	0 – 1.0%

B. Partner Participation

54. **The IDA participation option would help reduce aid fragmentation and promote the Paris Declaration on Aid Effectiveness, by allowing partners to finance existing IDA projects that meet their specific interest with comparatively low costs and risks.** Allowing participations in IDA financings would strengthen IDA's financial capacity by expanding the currently available funding sources. This option could allow IDA to access bilateral ODA funding, without eroding the un-earmarked, country-driven nature of its operations. Participations are already in use for development finance and IBRD had a similar program that ran from 1953 to 1980 and another pilot program in the 1980s. Partners would effectively replace IDA as financier for a portion of IDA projects already under implementation. This process would involve identifying projects that meet partners' specific sectoral, thematic or regional priorities from IDA's existing portfolio. Partners would either provide their funding as an outright grant or as a loan, repaid as the underlying IDA credit is repaid by the borrower. The proceeds from the participations would form part of IDA's commitment authority and be allocated to IDA recipients through the PBA system. Partner participations would be intra-replenishment supplementary contributions but would not be considered for burden sharing or voting rights purposes.

55. **IDA participation would be an efficient development aid option for partners** since: (i) IDA would have initially provided the funding, supported project preparation, and assumed much of the initial project risk; and (ii) IDA's preferred creditor status in the participated projects would be still maintained. In this sense, participations would provide partners with an opportunity to quickly support projects already showing development results. IDA would maintain full and sole responsibility for implementation, supervision, and administration of the underlying projects and would retain at least some interest in the underlying projects.

56. **There would be no risk that participation would lead to earmarking of IDA resources or that projects would be steered ex ante towards the priorities of participating partners.** First, the participation option would apply to projects already under implementation and participation proceeds would be allocated to all IDA countries on a pro rata basis through the PBA system. Second, IDA's country-based model would ensure that projects would continue to be selected and designed on the basis of IDA clients' needs and priorities as defined in the Country Assistance Strategies, and not individual partners' preferences. Since partner participations would not change the selection and design of individual projects, would not affect the recipient's repayment obligations, and would not directly increase the resources for the specific country, there would not be an incentive for either the country or country teams to steer projects ex ante towards sectors or themes based on perceived interests of partners to provide ex post financing. Therefore, the un-earmarked, country driven nature of IDA's programs would not be compromised under partner participation.

57. **Funds received from participation would not be treated as contributions for voting rights and burden sharing purposes in IDA replenishments.** To mitigate the potential substitution risk and to account for the fact that it provides funding to specific projects, participations would be separate and distinct from a country's regular partner contribution to IDA. In this sense, participation agreements

would be negotiated outside of the replenishment process as one option for partners to provide supplemental contributions to an on-going replenishment. Furthermore, participations would not be considered for burden sharing or voting rights purposes.

58. **Given the initial feedback and concerns received in the Paris meeting, it is proposed that this financing option be introduced on a pilot basis after the start of IDA17 to test it and refine its policy framework.** A pilot participation program would allow IDA to understand the benefits of participations most valued by partners and clients and evaluate its cost implications.

VI. ISSUES FOR DISCUSSION

59. **Guidance is sought from IDA Deputies on the following questions:**

- Do Deputies agree that the **financing scenarios** present a suitable range within which to discuss the financing framework for IDA17?

- What guidance can Deputies provide with respect to the need for additional funding to reduce the **MDRI financing gap**?

- Do Deputies support the **revision of lending terms** for IDA-only countries as illustrated in the financing scenarios?

- What are the Deputies' views on the options presented in this paper for **implementing concessional loans in IDA17?**

- Do Deputies support allowing partners to participate in **financing existing IDA projects** based on an initial pilot program to be introduced after the start of IDA17?

ANNEX I

IDA17 FINANCING FRAMEWORK TABLES

Table A: IDA17 Financing Framework (SDR million)

IDA17 FINANCING FRAMEWORK (SDR million)		IDA17 Financing Framework									
Source of Funds	IDA16 Agreed a/	Scenario 1	% change	Scenario 2	% change	Scenario 3	% change	Scenario 4	% change	Scenario 5	% change
I. TOTAL PARTNER RESOURCES	**21,073**	**19,990**	***-5.1%***	**20,420**	***-3.1%***	**20,851**	***-1.1%***	**21,188**	***+0.5%***	**21,569**	***+2.4%***
Basic grant contributions	15,574	14,691	***-5.7%***	15,121	***-2.9%***	15,552	***-0.1%***	15,889	***+2.0%***	16,270	***+4.5%***
Supplemental contributions	230										
Compensation for HIPC (FY15-17)	1,320	1,585		1,585		1,585		1,585		1,585	
Financing of arrears clearance operations	381	423		423		423		423		423	
Compensation for grant principal forgone	56	281		281		281		281		281	
Total Partner New Contributions	**17,561**	**16,980**	***-3.3%***	**17,411**	***-0.9%***	**17,841**	***+1.6%***	**18,178**	***+3.5%***	**18,560**	***+5.7%***
Compensation for MDRI (FY23-25)	**3,512**	**3,010**		**3,010**		**3,010**		**3,010**		**3,010**	
II. TOTAL INTERNAL RESOURCES	**11,725**	**9,292**	***-20.8%***	**9,296**	***-20.7%***	**9,515**	***-18.9%***	**9,746**	***-16.9%***	**9,785**	***-16.5%***
Internal reflows	6,575	5,879		5,879		5,879		5,879		5,879	
Contractual acceleration of credit repayments	1,217	573		573		573		573		573	
Voluntary prepayments b/	592	181		181		181		181		181	
Frontloading use of reflows from hardening terms	1,314	601		605		824		1,055		1,095	
Internal Resources of IDA	**9,698**	**7,233**	***-25.4%***	**7,238**	***-25.4%***	**7,457**	***-23.1%***	**7,688**	***-20.7%***	**7,727**	***-20.3%***
IBRD transfers	1,310	1,360		1,360		1,360		1,360		1,360	
IFC transfers	717	698		698		698		698		698	
Total Transfers c/	**2,027**	**2,058**	***+1.5%***	**2,058**	***+1.5%***	**2,058**	***+1.5%***	**2,058**	***+1.5%***	**2,058**	***+1.5%***
FINANCING FRAMEWORK (without loans and carry forwards)	**32,799**	**29,281**	***-10.7%***	**29,716**	***-9.4%***	**30,366**	***-7.4%***	**30,934**	***-5.7%***	**31,355**	***-4.4%***
Concessional Partner Loans (net of grant element)		0		575		1,880		2,586		3,517	
Concessional partner loans (gross)			0		679		2,218		3,051		4,149
Internal Reflows - increase due to loans		0		575		900		900		900	
Carry Forward of Unused IDA16 Arrears Clearance Funding		383		383		383		383		383	
TOTAL FINANCING FRAMEWORK	**32,799**	**29,664**	***-9.6%***	**31,249**	***-4.7%***	**33,529**	***+2.2%***	**34,803**	***+6.1%***	**36,155**	***+10.2%***
Debt limit (25/5, 1.0%)		*4,582*	13.5%	*5,334*	15.0%	*6,071*	16.4%	*6,080*	16.2%	*6,139*	16.3%
Financing gap in MDRI compensation FY23-25		*262*		*262*		*262*		*262*		*262*	

Notes:

a/ Original IDA16 financing framework as agreed in the IDA16 Deputy's Report.

b/ For scenario 1 through 5, this represents the actual amount prepaid by Azerbaijan.

c/ The figures for IBRD and IFC transfers in IDA16 and assumed for IDA17 include investment income generated by a three year encashment schedule.

Table B: Total Target Volume of Partner Basic Contributions for IDA17* (SDR millions)

	IDA17 Financing Framework				
	Scenario 1	**Scenario 2**	**Scenario 3**	**Scenario 4**	**Scenario 5**
Basic partner contributions:					
A. Actual amount of resource required (i.e. net of the IDA16 structural gap of 25.27%)	14,691	15,121	15,552	15,889	16,270
B. Scaled-up amount for the burden sharing purposes (i.e. gross of the IDA16 structural gap of 25.27%)	19,657	20,234	20,810	21,261	21,771

* The volume of partner financing required for IDA17 is expressed net of the structural gap that currently exists in partners' basic IDA burden shares (Line A in the above table). This means that this is the amount of financing that needs to actually be paid by partners, so as to enable IDA to reach the level of partner contributions included in the scenario. In IDA16, the burden shares of partners' basic contributions summed to only 74.73 percent. For IDA17, if partners choose to apply the same basic burden shares as in IDA16, the target funding would need to be scaled up to account for this gap (Line B in the table). For example, under the third scenario, if a partner's IDA16 basic burden share was 2 percent and the partner decides not to change it in IDA17, its basic contribution for IDA17 would be SDR 416.2 million (SDR 20,810 million*0.02).

ANNEX I

IDA17 FINANCING FRAMEWORK TABLES

Table C: IDA17 Financing Framework
(US$ million)

IDA17 FINANCING FRAMEWORK (US$ equiv. million)		IDA17 Financing Framework									
USD/SDR reference exchange rate	1.50233	1.50434									
Source of Funds	IDA16 Agreed [a/]	Scenario 1	% change	Scenario 2	% change	Scenario 3	% change	Scenario 4	% change	Scenario 5	% change
I. TOTAL PARTNER RESOURCES	**31,659**	**30,071**	***-5.0%***	**30,719**	***-3.0%***	**31,367**	***-0.9%***	**31,874**	***+0.7%***	**32,448**	***+2.5%***
Basic grant contributions	23,398	22,100	***-5.5%***	22,748	***-2.8%***	23,396	***-0.0%***	23,902	***+2.2%***	24,476	***+4.6%***
Supplemental contributions	345										
Compensation for HIPC (FY15-17)	1,983	2,385		2,385		2,385		2,385		2,385	
Financing of arrears clearance operations	572	637		637		637		637		637	
Compensation for grant principal forgone	85	422		422		422		422		422	
Total Partner New Contributions	**26,383**	**25,543**	***-3.2%***	**26,191**	***-0.7%***	**26,839**	***+1.7%***	**27,346**	***+3.7%***	**27,920**	***+5.8%***
Compensation for MDRI (FY23-25)	**5,277**	**4,528**		**4,528**		**4,528**		**4,528**		**4,528**	
II. TOTAL INTERNAL RESOURCES	**17,615**	**13,978**	***-20.6%***	**13,984**	***-20.6%***	**14,314**	***-18.7%***	**14,661**	***-16.8%***	**14,721**	***-16.4%***
Internal reflows	9,877	8,844		8,844		8,844		8,844		8,844	
Contractual acceleration of credit repayments	1,829	862		862		862		862		862	
Voluntary prepayments [b/]	889	272		272		272		272		272	
Frontloading use of reflows from hardening terms	1,974	904		910		1,240		1,587		1,647	
Internal Resources of IDA	**14,570**	**10,882**	***-25.3%***	**10,888**	***-25.3%***	**11,218**	***-23.0%***	**11,565**	***-20.6%***	**11,624**	***-20.2%***
IBRD transfers	1,969	2,046		2,046		2,046		2,046		2,046	
IFC transfers	1,077	1,050		1,050		1,050		1,050		1,050	
Total Transfers [c/]	**3,046**	**3,096**	***+1.7%***	**3,096**	***+1.7%***	**3,096**	***+1.7%***	**3,096**	***+1.7%***	**3,096**	***+1.7%***
FINANCING FRAMEWORK (without loans and carry forwards)	**49,274**	**44,049**	***-10.6%***	**44,703**	***-9.3%***	**45,681**	***-7.3%***	**46,535**	***-5.6%***	**47,168**	***-4.3%***
Concessional Partner Loans (net of grant element)		0		865		2,829		3,891		5,291	
Concessional partner loans (gross)			0		1,021		3,337		4,590		6,242
Internal Reflows - increase due to loans		0		865		1,354		1,354		1,354	
Carry Forward of Unused IDA16 Arrears Clearance Funding		575		575		575		575		575	
TOTAL FINANCING FRAMEWORK	**49,274**	**44,625**	***-9.4%***	**47,009**	***-4.6%***	**50,439**	***+2.4%***	**52,355**	***+6.3%***	**54,389**	***+10.4%***
Debt limit (25/5, 1.0%)		*6,894*	13.5%	*7,899*	15.0%	*8,967*	16.4%	*9,019*	16.2%	*9,157*	16.3%
Financing gap in MDRI compensation FY23-25		*394*		*394*		*394*		*394*		*394*	

Notes:

a/ Original IDA16 financing framework as agreed in the IDA16 Deputy's Report.

b/ For scenario 1 through 5, this represents the actual amount prepaid by Azerbaijan.

c/ The figures for IBRD and IFC transfers in IDA16 and assumed for IDA17 include investment income generated by a three year encashment schedule.

ANNEX II

SUMMARY OF REVISION OF FUTURE LENDING TERMS

1. **In light of evolving conditions, a revision of future lending terms for IDA-only countries would be timely and could contribute to strengthen IDA's financial capacity**. The terms on which IDA provides financial assistance is one of the most important factors for IDA's financial sustainability. The decision to review IDA lending terms was driven by two items: first, since the inception of the Debt Sustainability Framework (DSF), significant improvements have taken place in the risk of debt distress ratings; second, regular IDA-only credits remain among the most concessional forms of finance available from development organizations with a grant element of 62 percent.

2. **Shortening the grace period and moving to a straight line amortization of principal (SLA) is the recommended option for revising the lending terms of future IDA-only credits**. The two changes recommended - shorter grace period and straight line amortization of principal - increase the rate at which IDA receives reflows that can be recycled for new lending, while maintaining a high degree of concessionality for recipients. The proposed change would strengthen IDA's financial sustainability in the long-term. In addition, the volume of IDA17 commitment authority could be immediately increased by front-loading the use of a portion of the increased credit reflows resulting from the changes. The ability to front-load the use of these reflows would depend on the availability of liquidity to cover the timing differences between making disbursements on commitments and physically receiving the reflows after the grace period ends. This required bridge financing could come from drawing down a concessional loan over 3-years (i.e., faster than the projected disbursements) or somewhat front-loading the standard encashment schedule for partners' grant contributions.

3. **Revising the lending terms of IDA-only credits (also taking into account proposed changes by AfDF and possible future changes by other MDBs) is unlikely to have a material impact on the countries' debt sustainability risk ratings**. To test the impact of revising regular IDA-only lending terms, simulations were undertaken on IDA-only countries that are currently rated at either low or moderate risk of debt distress.[42] The external public and publicly guaranteed debt burden trajectories were simulated for each country first assuming that IDA and, if applicable, AfDF, lending terms would be revised as proposed, and second assuming that in addition to IDA and AfDF, other MDBs could also decrease the grace period to 5 years and reduce maturity correspondingly.[43] Revising IDA and AfDF financing terms alone would not result in worsening risk ratings among the IDA-only countries that receive regular IDA-only credits. Simulated external public and publicly guaranteed debt burden trajectories demonstrate that a revision in both IDA and AfDF financing terms is unlikely to have a material impact on the countries' risk ratings as defined by the joint WB-IMF Debt Sustainability

[42] The analysis was performed using WB-IMF joint Debt Sustainability Analyses (DSAs) available as of end of January 2013.

[43] Conservative scenarios of hardened terms were simulated for 27 IDA-only countries, utilizing individually tailored WB-IMF joint DSAs. In the first round of simulations, the conservative scenario included hardening terms on all IDA and AfDF loans as opposed to new loans only starting in FY14. In the second round of simulations, it was assumed that all multilateral creditors harden terms resulting in a 5-year grace period with a corresponding shortening of the loan maturity. Specifically, the simulations modeled earlier principal payments due to a shorter grace period, and shorter loan maturities. Both resulted in earlier and larger rollover and, thus, in upward shifts of the baseline and shock trajectories of the respective five debt burden indicators present in the external DSA template. However, these shifts were marginal with respect to the corresponding thresholds. This is not surprising as the hardening terms had a modest impact on the concessionality of loans and therefore on the present value of different external debt burden indicators over the projection horizon.

Framework. Therefore, no reversals in gains achieved over the past eight years would be expected as a result of the changes in IDA's financing terms. Even if other multilateral institutions follow with a restructuring of terms, the analysis found that the risk ratings would be unlikely to deteriorate significantly.

4. **The proposed changes would be implemented in a way to preserve IDA's focus and commitment on improving countries' debt sustainability.** First, countries assessed at a high or moderate risk of debt distress ("red" and "yellow" light countries) would continue to receive all or some of their financial assistance in the form of grants. Second, the DSAs that are regularly conducted for IDA countries would provide a regular mechanism to recalibrate the lending terms for countries in the event of a deterioration of their debt sustainability. Third, the lending terms for small island economies would not be changed because of their particular vulnerabilities (such as export concentration, high infrastructure and transportation costs and fewer opportunities to pursue economies of scale), limited institutional capacity and severe human resource constraints, lack of natural resources, and high vulnerability to natural disasters.

5. **The proposed option from the Paris meeting has been further refined to reflect the tradeoff between concessionality and overall commitment authority by linking the grace period to the overall robustness of the financing scenario.** At the first IDA17 replenishment meeting in Paris, there was a broad consensus among Participants that revising the lending terms would benefit IDA by increasing IDA's internal resources available for new commitments, while maintaining a high degree of concessionality. In Paris, many Participants noted the trade-off between concessionaility and the volume by which IDA17 commitment authority could be increased. They also stressed that harder lending terms should be accompanied by higher volumes and not used to offset declines in partner funding. At the same time, some participants, including Borrower Representatives, asked management to consider a somewhat longer grace period. Therefore, the proposed option from Paris has been further refined to reflect the tradeoff between concessionality and commitment authority volume by synchronizing the effort of partners and recipients such that the less concessional lending terms option (5-year grace period) is applied in the higher financing scenarios, the more concessional option (7-year grace period) is applied to the lower financing scenarios, and the mid-point (6-year grace period) is applied in scenario 3.

ANNEX III

SUMMARY OF CONCESSIONAL LOAN OPTION

1. **Under the concessional loan option, a contributing partner country would provide a loan to IDA with concessional terms** (described in section (A) below). The partner would receive burden sharing recognition and allocation of voting rights based on the 'grant element' of the loan (described in section (B) below). Loan funding would not be earmarked for any purpose and would be used as part of IDA's overall pool of funding – including 'core' grant contributions from partners, IDA's internal resources (predominantly from credit reflows resulting from recipients repayments on outstanding credits), and any transfers from IDA's sister institutions (IBRD and IFC). IDA would establish a prudential debt limit setting the maximum volume of debt that could be sustainably incorporated into its financing framework to ensure that IDA would meet its debt servicing obligations without disrupting operations or needing to use grant contributions from partners (i.e., ensuring that debt would be fully repaid through reflows from the additional lending made possible with the debt).

A. Proposed terms of the concessional loan:

2. **The borrowing terms of a concessional loan will be a critical factor in determining its impact on IDA's financing framework and long-term financial sustainability**. In order for debt funding to be sustainably incorporated into IDA's financing framework to a significant extent, the borrowing terms should have concessional features so that IDA can continue to provide concessional financial assistance to its recipients "on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans" as mandated in its Articles of Agreement.[44] The following summarizes the key features to consider for a concessional loan to IDA:

- **Maturity**: For debt funding to be a meaningful proportion of IDA's financing framework, maturities between 25 or 40 years would match IDA's blend and regular credits, respectively.
- **Grace period**: Debt issued by IDA with a 5 or 10-year grace period would allow principal reflows from credits issued in the new replenishment to be used for debt servicing as IDA's regular and blend credits have grace periods of 10 and 5 years respectively.
- **Principal repayment**: Debt repayments based on an amortizing repayment schedule starting after the initial grace period would allow closer matching between IDA's borrowing and lending terms. A repayment schedule structured on a straight-line basis would minimize the debt serving costs to IDA while providing for close matching to IDA's regular and blend lending terms.
- **Coupon/Interest**: Concessional loans with a fixed coupon rate would provide IDA with greater planning certainty and reduce interest rate risk by matching the borrowing term structure to IDA's current lending terms. A coupon rate on the concessional loan below the interest rate of IDA's blend term credit would ensure that the coupon payments are below the blend term credit rate and allow IDA to pass on the borrowing cost to recipients without using any grant funding (such as partner grant contribution) to cover debt serving cost and, at the same time, ensure the concessional nature of IDA's financial assistance.

[44] See IDA's Articles of Agreement, Article I.

- **Currency**: Concessional loans denominated in SDRs would mitigate the currency risk considerations for IDA by matching the borrowing currency to IDA's functional currency. A mismatch between the borrowing currency and SDRs in which IDA operates would expose IDA to foreign currency risk.
- **Minimum size**: a minimum size of debt contribution, for example SDR70 million (equiv. US$100 million), could be considered in order to simplify the financial management of debt funding in IDA's operational and risk management framework.

3. **In order for the agreed loan options to reflect the preferences of partners considering this option, it is important that IDA receive feedback on the proposed terms so that these can be modified to incorporate partner views.** Table A shows the two options proposed in this paper.

Table A: Proposed SDR Borrowing Term Options for the IDA17 Replenishment

	Maturity	Grace Period	Amortization	Coupon range
Option 1	25 year	5 years	5% per annum (Yr 6 – 25)	0 – 1.0%
Option 2	40 years	10 years	3.3% per annum (Yr 11 – 40)	0 – 1.0%

B. Calculation of the grant element:

4. **While the full nominal amount of the concessional loan represents a valuable resource in IDA17, allocation of voting rights for the concessional loan would be based on its grant element**. The full amount of a loan contribution is available for commitment authority to increase the amount of financial assistance that IDA can provide to its clients. However, unlike a grant contribution that receives recognition for burden sharing and voting rights purposes on a dollar-for-dollar basis, a loan contribution does not represent a permanent benefit to IDA because the loan would be repaid over time and, therefore, does not receive similar recognition.

5. Table B illustrates the grant element (i.e., the portion of the loan that would be considered a grant for burden sharing and voting right purposes) as a percentage of the concessional loan for hypothetical partner loans with varying coupon rates using a discount rate of 1.25 percent and 2 percent. The grant equivalent contribution will be calculated as the sum of partners' 'core' grant contribution and the grant element of concessional loan.

Table B: Illustrative Grant Element of Concessional Loans Denominated in SDR with Various Borrowing Terms (adjusting only maturity and coupon rates)

As a percentage of total concessional loan

Maturity[1/]	WAM[2/]	Discount rate	Coupon rate on concessional partner loan				
			0.00%	0.25%	0.40%	0.50%	1.00%
5-25	15	1.25%	15.2%	12.2%	10.3%	9.1%	3.0%
		1.4%	16.9%	13.8%	12.0%	10.8%	4.7%
		2.0%	23.0%	20.1%	18.3%	17.2%	11.4%
10-40	26	1.25%	24.9%	19.9%	16.9%	14.9%	4.9%
		1.4%	27.4%	22.4%	19.5%	17.5%	7.7%
		2.0%	36.3%	31.7%	29.0%	27.1%	18.0%

Notes:

1/ Assumes a 5-year or 10-year grace period respectively, and that debt is drawn down over 3 years, and no commitment fee is charged on the undisbursed portion.

2/ Weighted average maturity assuming grace period and straight-line amortization of principal thereafter.

C. Evaluating the return on the proposed SDR concessional loans as an investment relative to a market benchmark:

6. **Partners considering the SDR concessional loan option could evaluate the attractiveness of the discount rate relative to alternative investment options**. This requires using the appropriate currency and term structure.

a) **Currency.** In order to evaluate the SDR concessional loan to IDA, it is necessary to make adjustments for currency (i.e., the IDA SDR concessional loan option would be measured against equivalent single-currency rates). Table C provides a summary of the single-currency equivalent of various SDR rates. For example, a discount rate of 1.25 percent in SDR is equivalent to a US$ yield of 1.7 percent and a discount rate of 2.0 percent in SDR is equivalent to a US$ yield of 2.5 percent.

b) **Term structure.** The weighted average maturity of a 25/5 year IDA loan is 15 years, while its duration is 13.5 years.[45]

Table C: Summary of Single Currency Equivalents of Various SDR Rates

Rate in SDR:	0.00%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%
Equivalent rate in single currency:							
USD	0.41%	0.93%	1.19%	1.45%	1.71%	1.97%	2.49%
JPY	-1.00%	-0.55%	-0.32%	-0.10%	0.13%	0.35%	0.80%
GBP	0.16%	0.66%	0.92%	1.17%	1.42%	1.68%	2.18%
EUR	-0.28%	0.21%	0.45%	0.70%	0.94%	1.18%	1.67%

Notes:

Based on market rates as of May 14, 2013

[45] The Macaulay duration ('duration') is calculated as the weighted average maturity of cash flows discounted using zero rates derived from a computed SDR yield curve as of May 14, 2013.

D. Evaluating the required coupon on single-currency concessional loans relative to the proposed SDR terms:

7. **Partners considering a single-currency concessional loan option will also need to evaluate the concessional loan using the appropriate market rates.** The Table C above shows the equivalent rate in single currencies for various SDR rates.

E. Other features of the proposed implementation framework:

8. **The proposed framework aims to ensure additionality and a common understanding of the guidelines for implementing the concessional loan**. These include suggesting a reference baseline for contributions where a minimum portion of the contribution would be in the form of core grants and partners would target their contribution from the previous replenishment on a grant equivalent basis.

9. **Reference baseline.** The Paris meeting paper provided guidance for the setting of the *minimum* level of grant and concessional loan contributions to achieve a reference baseline and ensure a common framework acceptable to all participants. It suggested that partners would aim to provide at least 80 percent of their IDA16 basic burden share in the form of a core grant contribution, and target at least their IDA16 basic burden share on a grant equivalent basis. This approach encourages partners to use the concessional loan as an additional scale-up to their grant contributions, with no maximum target for the concessional loan size.

10. The concessional loan option provides the most benefit to IDA when loan funding is provided in addition to IDA's grant funding. Since partners endorse the principle of additionality, establishing a baseline provides a mechanism by which this can be evaluated. Based on feedback received, in Management's view using the IDA16 replenishment and the basic contribution amount in SDR (rather than the basic burden share) as the reference baseline to assess additionality would provide greater planning certainty for partners evaluating the loan option, while using the most recent decisions of partners as a point of reference. This suggested baseline could not provide a binding obligation on partners, and the level of contribution would continue to be discretionary. However, in the unlikely event that loan offers would exceed the maximum prudential debt limit of IDA, concessional loan offers would be accepted first from those that had maintained or increased their contribution relative to the suggested baseline.

11. **Prioritization**. IDA will set a prudential debt limit as a percentage of total grant funding mobilized for a replenishment based on: (1) the overall concessionality of IDA as a result of the projected mix of lending terms on which IDA provides financial assistance to its clients (in particular, the proportion of lending on blend terms and, if applicable, transitional support); and (2) the terms on which IDA would borrow.[46] Consequently, the debt limit is scenario specific and the debt limit for each scenario is illustrated in the IDA17 financing framework (see Table 2 and annex 1).

[46] The debt limits would take into account estimates for possible non-accruals on the underlying loan portfolio of IDA, possible timing differences between receiving reflows from recipients and making payments on debt obligations, and the possibility of assumptions used in modeling the debt limits being different from the actual parameters (for example,

12. **Based on initial feedback from partners at the Paris meeting and consultations during the Spring meetings, it appears that the overall debt limit will not be triggered and therefore the prioritization component of the framework will not be applicable**. However, it is advisable to consider an allocation methodology in the event that partners would provide loan offers in excess of the prudential debt limit. This could be based on prioritization in two stages: (1) loan offers for up to each partner's IDA17 core burden share of 50 percent of the overall debt limit; (2) additional loan offers would be prioritized based on the amount of additionality (as defined by the highest percentage increase in core burden share in IDA17 compared to IDA16). Partners are encouraged to maintain ongoing communication with Management on their intentions regarding their use of the concessional loan option in order to facilitate its implementation.

the actual mix of lending terms based on commitments, or the speed of disbursements). In addition, IDA would establish cumulative debt limits to ensure that IDA's aggregate debt levels would remain within prudential limits when assessed at a total balance sheet level taking into consideration the use of debt over successive replenishments.