IDA16

IDA16 FINANCING FRAMEWORK

International Development Association
IDA Resource Mobilization Department (CFPIR)

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Selected Abbreviations and Acronyms

AfDF	African Development Fund
AsDF	Asian Development Fund
CRW	Crises Response Window
FY	Fiscal Year
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IoC	Instrument of Commitment
MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
SDR	Special Drawing Right
US$	United States Dollars

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EXECUTIVE SUMMARY

i. **The IDA16 replenishment comes at a time of a difficult and uncertain international financial environment.** This has created significant fiscal constraints in many donor countries and at the same time must be balanced against the need to support the fragile recovery in IDA countries and to redouble efforts towards the Millennium Development Goals (MDGs). In the companion paper for the second IDA16 meeting ("The Demand for IDA16 Resources and Strategy for their Effective Use") Management has presented five potential scenarios for the IDA 16 replenishment based on IDA countries' needs. The scenarios provide a broad range of options from keeping IDA16 flat in real terms relative to IDA15 (i.e., 5.72 percent increase in nominal terms) to incrementally higher scenarios of 10, 15, 20 and 25 percent which allow for progress to be made with regard to scaling up IDA to meet the MDGs as well as to address additional needs under IDA16. This paper presents financing options for these five scenarios. Given the current extraordinary circumstances, Management is seeking the guidance of IDA Deputies by presenting several potential scenarios rather than recommending a specific "ask" scenario (as was done for IDA15).

ii. **Financing the volume of the IDA16 replenishment** will partly depend on the volume of new financing commitments from donors and their compensatory contributions for IDA's debt relief and grant compensation, and the volume of internal resources including internal reflows and investment income, and transfers from IBRD's and IFC's net income. Other sources could be from changes in IDA's lending terms, as proposed in this paper, for blend, hardened and hard term credits.

iii. **The IDA16 replenishment would be enhanced by a strong World Bank Group internal resource mobilization effort** which would include IDA internal reflows (US$9.5 billion), IBRD transfers (US$2.0 billion), and proposed additional resources from adjustments to IDA's lending terms and accelerations of repayments on outstanding IDA credits (about US$2.8 billion), if endorsed by IDA Deputies. This is a larger internal effort to support IDA's replenishment when compared to other ongoing replenishment negotiations, and larger than under IDA15. Increases in IDA's internal resource mobilization effort would absorb 100 percent or more of the increase in resources needed to meet the indicated volumes under the first two scenarios, thereby maintaining or lowering the level of donor contributions needed. For the upper three scenarios, IDA's internal resource mobilization effort would account for between 64, 48, and 38 percent, respectively, of the increase needed.

iv. **Donor contributions in IDA16** presented under the five potential scenarios would equal between SDR19.6 billion to SDR24.9 billion (US$29.8-37.9 billion). This represents between a decrease in overall donor contributions of 5 percent to an increase of 21 percent. The variable portion represents the donor basic contributions. The range of scenarios include donor basic contributions of between SDR13.5-18.8 billion (US$20.5-28.6 billion), net of the structural financing gap. The remaining portion is the known portion for which donors 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 IDA16 totaling SDR6.1 billion (US$9.3 billion).

(in SDR million)	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Total Donor Resources	19,565	20,684	22,168	23,505	24,910
% change over IDA15	*-5%*	*0%*	*7%*	*14%*	*21%*
Total Financing Framework	28,911	30,030	31,514	32,851	34,257
% change over IDA15	*6%*	*10%*	*15%*	*20%*	*25%*

v. **The structural financing gap in IDA's cost of debt relief and grants creates a real financial risk as IDA will not receive full donor compensation for such cost.** It is proposed that donors scale up their HIPC, arrears clearance**,** grant financing and MDRI burden shares proportionally to close the gap.

vi. **During the first IDA16 meeting in Paris, IDA proposed adjusting the lending terms of IDA's more economically developed borrowers** by hardening the blend, hardened and hard credit terms to reflect their stronger financial capacity. Most participants supported this proposal. As a follow-up to Participant recommendations, IDA has further consulted with affected countries, analyzed the impact, and compared the terms with other IFIs. Based on this review, IDA reaffirms the proposal to: (i) adjust the lending terms of these credits to a final maturity of 25 years with a 5 year grace period along with instituting a 1.25 percent p.a. interest rate for blend and hardened credits; (ii) adjust the terms for the small island country exception from blend credit terms to regular credit terms; and (iii) expand access to 'hard term' credits to all blend countries.

vii. **In addition to the options proposed to adjust the lending terms of the more economically developed countries, management aims to accelerate the repayment of eligible, outstanding IDA credits of IDA graduates** under a contractual clause of its financing agreements. In addition, outreach to potential new donors and options available under the voice reform program for countries to maintain voting power in IBRD potentially could increase the number of new donors to IDA16.

viii. **Many innovative ideas for enhancing IDA's financial sustainability have been put forward by Deputies, Executive Directors and in internal discussions by IDA management**. Many of these ideas include changes to IDA's structure and will require time and consultation beyond the IDA16 discussions. Management suggests establishing a working group to evaluate additional options for potential funding mechanisms for future replenishment periods and will report back at the IDA16 Mid-term Review.

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

A. Do Deputies agree to implement changes to IDA's **lending terms** beginning in IDA16 including:

- consolidating IDA's blend and hardened terms into one instrument with the final credit maturity lowered to 25 years, the grace period lowered to 5 years, and implementing a 1.25 percent interest rate;
- changing the terms for the small island country exception from blend credit terms to regular credit terms; and

- lowering the maturity for "hard term" credits to 25 years with a 5 year grace period and expanding access to hard term credits to all blend countries?[1]

B. Do Deputies support the proposed approach of exercising the **acceleration clause** for eligible credits of IDA graduates, in which case Management would engage with these countries on the implementation modalities and seek approval from IDA's Executive Directors?

C. Do Deputies agree that the **financing scenarios** present a suitable range within which to discuss the financing framework for IDA16?

D. On the **structural financing gap,** for IDA's cost of debt relief and grants do Deputies agree to scale up proportionally their respective MDRI, HIPC, arrears clearance, and grant financing burden shares, so as to close the structural financing gap?

[1] Hard term credits would continue to have a fixed interest rate on the principal amount disbursed and outstanding which is set every fiscal year, based on the prevailing IBRD lending rate, converted into fixed-rate equivalents less 200 basis points.

IDA16 FINANCING FRAMEWORK

I. INTRODUCTION

1. The replenishment of IDA16 is taking place in a difficult and uncertain external environment. Many donor governments are facing significant fiscal challenges that will require adjustments in domestic and international programs, including in official development assistance (ODA). At the same time, IDA countries have been affected by multiple crises – ranging from the food and fuel crises to the recent global economic downturn – that have adversely impacted their progress toward meeting the Millennium Development Goals (MDGs).

2. Given these extraordinary circumstances, Management seeks guidance from Deputies on how to strike a balance between the fiscal constraints faced by many donors and the significant needs in IDA countries. In this context, the "ask" paper has presented a range of scenarios starting from a scenario that keeps IDA16 flat in real terms relative to IDA15 to incrementally higher scenarios rather than recommending a specific "ask" scenario (as was done for IDA15).[1] This paper provides the financing framework for IDA16 that would underpin these scenarios.

3. In parallel, Management proposes to increase the contribution of internal resources to the IDA16 replenishment. A key feature of IDA, unlike most other multilateral concessional funds, is that it generates substantial internal resources that form a significant part of the commitment authority. For IDA16, the level of credit reflows are expected to increase by SDR2.1 billion (US$3.2 billion) and, if endorsed by IDA Deputies by an additional SDR1.8 billion (US$2.8 billion) through a combination of measures to (i) harden the terms of IDA credits for blend countries and (ii) activate the acceleration clause for countries that have graduated from IDA and could be subject to the provision of this clause during IDA16.

4. The internal resource mobilization also assumes continued income transfers from IBRD that are kept constant in real terms in line with the IBRD's financial capacity and consistent with the decisions made at the Development Committee during the Spring Meetings in April 2010. Contributions from IFC are still under review in light of guidance received by the Development Committee during the Spring Meetings.

5. The paper lays out potential scenarios for donor contributions during IDA16. These contributions are broken down 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 estimated to amount to SDR6.1 billion (US$9.3 billion) during IDA16, roughly the same amount as under IDA15; and (ii) regular donor contributions which amounted to about SDR14.5 billion (US$22.2 billion) during IDA15.[2] Depending on the scenarios, a range of potential donor contributions for IDA16 are detailed, ranging from SDR19.6 billion (US$29.8 billion) to higher contributions compared to IDA15.

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[1] "The Demand for IDA16 Resources and Strategy for their Effective Use", May 2010.
[2] Original IDA15 Financing Framework as agreed at the start of IDA15.

6. Management is making a concerted effort to support the IDA replenishment through "fairer and wider burden-sharing" as the Development Committee has called for. In this context, it is in contact with potential new donors, including those that have made announcements during the Spring meetings as well as existing donors that are considering scaling-up their support.

7. The paper is organized as follows. Section II is the follow up to discussions held in Paris in March 2010 on changes in IDA's financing instruments that would help mobilize additional internal resources. Section III reviews additional considerations for increasing IDA's financing capacity. Section IV summarizes the original financing framework for IDA15 and describes subsequent changes to the framework, including the implementation of the pilot Crises Response Window and financing shortfall for the Multilateral Debt Relief Initiative (MDRI). Section V presents several potential financing scenarios for IDA16, including the volume of donor and internal resources under each scenario. Section VI then reviews the financing gap in donors' MDRI, HIPC, arrears clearance and forgone grant principal compensation in IDA replenishments and Section VII presents issues for discussion by donors.

8. The analysis in this paper is based on the core financial assumptions for IDA's long-term financial projections as discussed at the first IDA16 meeting in March 2010 in Paris.[3] Data on debt relief provided by IDA are as of June 30, 2009, as provided in the most recent annual update to donors,[4] and donor resources received for debt relief financing are as of March 31, 2010. These amounts will be updated based on the 2010 review prior to the conclusion of the IDA16 replenishment discussions. For ease of reference, IDA's SDR based financial data are also provided in US$ equivalent terms in this paper.[5]

II. FINANCING INSTRUMENTS

9. **IDA's lending terms are highly concessional, with an average level of concessionality of credits and grants to IDA-only and blend countries of 66 percent**.[6] IDA's overall concessionality has increased by 6 percent since the introduction of grants in IDA11. In addition, debt relief under the HIPC Initiative and the MDRI has further increased IDA's overall concessionality. For IDA15, an estimated 49 percent of commitments are expected to be provided on regular term credits, 18 percent on grant terms and 34 percent on blend and hard/hardened term credits (see Chart 1).[7] IDA currently has relatively undifferentiated financing terms between IDA-only and blend countries (61 and 57 percent concessionality, respectively) despite very different borrower circumstances in terms of income levels, economic prospects, and levels of external debt.

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[3] "A Review of IDA's Long Term Financial Capacity and Financial Instruments," IDA/SecM2010-0065, February 26, 2010

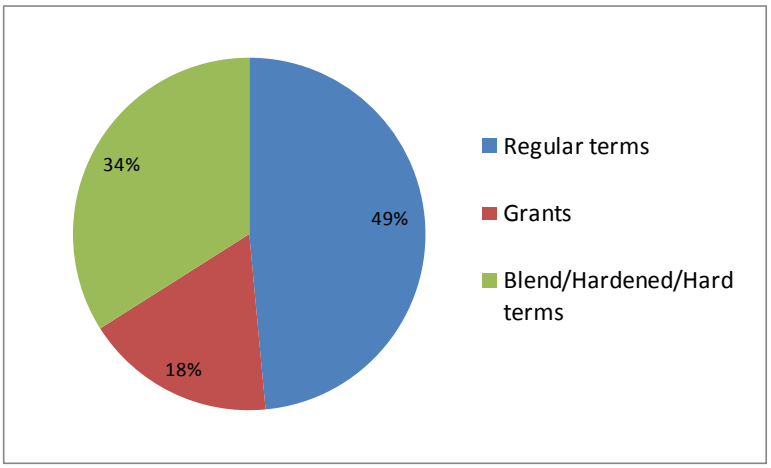
[4] "Debt Relief Provided by IDA under the MDRI and HIPC Initiative: Update on Costs and Donor Financing (as of June 30, 2009)," IDA/SecM2009-0548, October 6, 2009.

[5] Data for IDA15 are based on the IDA15 reference foreign exchange rate of US$/SDR1.52448. Data for IDA16 use the average foreign exchange rate for the period from February 1, 2010 to May 15, 2010 of US$/SDR1.52173. The applicable reference foreign exchange rates for IDA16 will be based on the average daily exchange rates over a six month period from April 1, 2010 to September 30, 2010 as agreed by IDA Deputies at the first IDA16 meeting in March 2010 in Paris.

[6] Based on a 6 percent discount rate.

[7] Based on FY10 country allocations for the full IDA15 period.

Chart 1: Estimated Terms of Commitments for IDA15



10. **During the first IDA16 meeting in Paris, participants discussed a proposal to adjust the terms of IDA's financial instruments offered to blend countries**.[8] Most participants provided strong support for the proposal. This included adjusting the terms of IDA's blend, hardened term and hard term credits. Based on the proposal, IDA's blend credits and hardened term credits would be harmonized into one instrument with a final credit maturity of 25 (or possibly 30-years) and a 5-year grace period, and instituting a 1.25 percent per annum interest rate (see Table 1). Hard term credits would also be harmonized with a similar maturity and grace period and continue to feature an interest rate based on the IBRD fixed rate equivalent minus 200 basis points. In addition, the terms for the small island country exception would be changed from blend credit terms to regular credit terms and access to 'hard term' credits would be expanded to all blend countries in proportion to their performance-based allocations.

[8] Management also indicated in the paper "A Review of IDA's Long Term Financial Capacity and Financial Instruments," IDA/SecM2010-0065, February 26, 2010, that it is currently exploring a possible future expansion of the spectrum of IDA guarantee instruments with a view to offering partial credit guarantees on sovereign debt, either through Partial Credit Guarantees for investment operations or Policy-Based Guarantees for general balance of payment support. Further discussion is provided in Annex 7.

Table 1: Proposed Adjustments to IDA Financing Instruments

CURRENT		Proposed (March Meeting)
Blend Terms: 10-yr Grace 35-yr Maturity Standard Service/Commitment Charges *Grant Element: 57%* **Hardened Terms:** 10-yr Grace 20-yr Maturity Standard Service/Commitment Charges *Grant Element: 40%*	→	**Blend/Hardened Terms:** 5-yr Grace 25-yr Maturity (possibly 30-yr Maturity) Standard Service/Commitment Charges 1.25% Interest Rate *Grant Element: 35% (25 yr maturity)* *39% (30 yr maturity)*
Hard Terms 10-yr Grace 35-yr Maturity Standard Service/Commitment Charges IBRD Interest Rate less 200bps *Grant Element: 16%*	→	**Hard Terms** 5-yr Grace 25-yr Maturity (possibly 30 yr maturity) Standard Service/Commitment Charges IBRD Interest Rate less 200bps *Grant Element: 14% (25 yr maturity)* *15% (30 yr maturity)*

11. **The proposed adjustments to IDA's financing terms for blend countries reflects their stronger financial capacity and is one of the measures to strengthen IDA's long-term financial capacity to assist poor countries**. The debt sustainability of blend countries has shown important improvements over the years including sharp decreases in their debt service ratios, improved creditworthiness as evidenced by their credit rating upgrades and also their rising stock of foreign reserves.[9] IDA's graduation policies envisaged that the transition to IBRD-only status would be associated with progressive hardening of terms of financial assistance and a phasing out of IDA lending.

12. **Most of the participants at the first IDA16 replenishment meeting in Paris supported the principle of adjusting IDA's financing terms including better alignment of blend credit terms with those offered by the Asian Development Fund**. At the meeting, some participants requested additional analysis in two areas. First, further consultation with affected countries should be done before implementation along with additional analysis of the impact of the proposed changes on these countries. Also, the proposed terms should be compared with other international financial institutions in addition to the Asian Development Fund. Second, some participants requested additional analysis to support changing the terms of the small island country exception from blend credit terms to regular credit terms.

[9] "A Review of IDA's Long Term Financial Capacity and Financial Instruments," IDA/SecM2010-0065, February 26, 2010.

A. Adjusting IDA's Financing Terms for Blend and Gap Countries

Borrower Consultations and Impact Analysis

13. **While some blend and gap countries have suggested that the status quo would be optimal given IDA support for social sector programs, most view the proposed hardening of IDA terms as a transition from IDA to IBRD borrower status.** Alternative measures such as early graduation cause greater concern for several blends because IBRD borrower limits could restrict these countries' ability to increase their IBRD commitment volumes to replace their current IDA allocations. Some countries indicated that any changes in IDA lending terms or graduation policies should be looked at in the context of the terms and resources able to be provided by IBRD. India, for example, has limited availability under the IBRD lending cap under the Single Borrower Limit (SBL) and would have limited alternative resources available if it were graduated early or had its IDA allocation cut. Other countries also have limited resources allocated from IBRD based on their country credit limits. In contrast, some countries that already receive credits on hardened terms, including small countries such as Bhutan that receive small allocations from IDA, would not be significantly impacted by the proposed changes in financing terms.

14. **The impact analysis of the proposed changes to the terms of IDA's financial assistance to blend countries showed that the new terms would not present significant risks to the long-term economic prospects of the affected countries or increase their risk of debt distress.** Many blend countries continue to borrow from IBRD and other IFIs on significantly less concessional terms. With scarce resources available to lend to IDA eligible countries, the effective use of lending terms is important to improve the availability of future reflows. Changes in IDA's lending terms would benefit all borrowers through an increase in resources available for IDA16 commitment authority. This increase comes about through IDA's advance commitment scheme, whereby future credit reflows can be committed in advance because commitments disburse over a 9 to 11-year period. The shorter grace period of 5 years and shorter amortization period would allow for these credit reflows to be recommitted more quickly in IDA16 and future replenishments.

15. **Despite the increase in payments to IDA during the IDA16 disbursement period (FY12-22), the debt burden indicators of these countries would experience only a limited increase**. For Pakistan (the country with the largest increase in debt service payments), the largest estimated impact is an increase of 0.25 percent of the debt service-to-export ratio in 2020. During this period, the increase in the debt service-to-GDP ratio is below 0.03 percent for the two most affected countries, Pakistan and Papua New Guinea. After this period, all indicators show a declining path and gradually return to their original values. Countries receiving blend credit terms with the exception of India would continue to receive positive net transfers through the IDA16 disbursement period.

Comparison with Other IFIs

16. **IDA's regular credits are among the most concessional forms of financing available from development organizations and its current blend terms are substantially more concessional than equivalent instruments offered by many other International Financial**

Institutions (IFIs) that have shorter maturities and grace periods (see Annex 1). Asian blend countries, India, Pakistan and Vietnam, account for the bulk of IDA's total lending at blend terms (95 percent in IDA15) so a comparison to the Asian Development Fund (AsDF) is specifically relevant. The AsDF's lending terms include a maturity of 24 years for program loans and 32 years for loans to finance specific projects along with an 8 year grace period and a 1 percent interest charge during the grace period and a 1.5 percent interest charge during the amortization period. IDA's current blend terms which include a 35 year maturity with a 10 year grace period and a 75 basis point service charge offer a concessionality substantially higher (57 percent) than equivalent instruments offered by the AsDF (between 41 to 47 percent). The African Development Fund's (AfDF) lending terms (50 year maturity with 10 year grace and standard service and commitment charges) are currently more concessional than IDA's, however during the third AfDF-12 meeting in May 2010, a proposal was put forward to adjust the terms for blend/gap countries to 25 or 30 year maturities similar to that proposed by IDA. The AfDF has two blend countries (Nigeria and Zimbabwe) and one gap country (Angola) that would be affected by changes to the terms. **Based on the consultations with borrowers and a review of the lending terms of other IFIs, Management reiterates its proposal to lower the final credit maturity for IDA's blend and hardened terms to 25 years, with a 5 year grace period and a 1.25 percent interest rate beginning in IDA16. Hard term credits would also be harmonized with a similar maturity and grace period and continue to feature an interest rate based on the IBRD fixed rate equivalent minus 200 basis points.**

B. Small Island Exception

17. **Due to their continued vulnerability, at the March 2010 meeting in Paris it was proposed that the terms for the small island exception be changed to allow these countries to receive IDA credits on regular credit terms (40-year maturity, 10-year grace) instead of the proposed hardened blend credit terms.** At the meeting, some Deputies questioned the need to allow these countries, which have a relatively high per-capita GNI, to receive terms based on regular IDA credit terms. The four Caribbean blend countries[10] that currently receive this exception however continue to face serious debt challenges. In the last two years, the declining global activity and the slow growth in these countries have led to a worsening of their debt outlook. Very high public debt levels threaten fiscal stability in an economic environment characterized by tight liquidity.[11] Furthermore, the ongoing economic downturn points to further exacerbation of the debt problems if a solution to their debt situation is not quickly found.

18. **High debt levels have contributed to increasing the financing costs, creating pressure for further borrowing.** This makes the roll-over of maturing debt more difficult in the present economic environment. High debt levels also limit the capacity of the governments to use fiscal policies to mitigate the impact of the global financial crisis. In this context, the Governments' attempts to deal with the tight fiscal constraints could result in rising inequality and poverty levels, reversing the progress made in the past decades.

19. **In addition, the current levels of indebtedness limit these countries' capacity to address the impact of natural disasters.** These countries are in a region prone to such disasters

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[10] Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines.

[11] The average debt-to-GDP ratio for these countries was estimated at 84 percent at end-2009 and the 2009 debt service-to-revenue ratio is estimated to have reached 20 percent on average.

and their impact on their debt situation has been considerable.[12] In fact, these four countries rank among the countries in the world with the highest exposure to natural disasters. The average annual expected cost of hurricanes for these countries amounts to one percent of GDP.

20. **While replacing current blend terms by regular terms for these countries would not increase payments to IDA as a result of the proposed hardening of blend credit terms, it would also not lead to immediate reduction in payments to IDA**. As grace periods and service charges under the current blend terms and regular credit terms are the same, the change in terms for IDA16 allocations would only reduce payments to IDA starting in 2022 (after the end of the grace period). Even this difference would be limited, as the annual difference would only be 0.5 percent of the principal outstanding. These small island countries however are expected to continue to receive positive net transfers from IDA during the IDA16 disbursement period.

Impact on IDA16 Financing:

21. Adjustments to IDA's financing terms for blend and gap countries could increase IDA16 financial capacity by some US$2.0 billion (with a 25-year maturity). This would increase the level of internal resource mobilization for IDA16 and benefit IDA borrowers through an increase in resources available for commitment authority. This increase comes about through IDA's advanced commitment scheme, whereby future credit reflows of IDA are committed in advance over the disbursement period of the current replenishment. The shorter grace period of 5 years would allow faster repayment of credit reflows of committed funds to be used for future commitments. This additional level of internal resource mobilization is included in the financing scenarios presented in this paper.

III. ADDITIONAL CONSIDERATIONS FOR INCREASING IDA'S FINANCING CAPACITY

22. **A review of IDA's long term finances indicates that IDA continues to be highly dependent on donor funding for its long-term operations**. Incorporating the impact of graduations of IDA borrowers and increased volume of reflows over time will help reduce this dependency but does not significantly change the conclusion. Hence, IDA is continuing to look at financing options that could enhance its long term financial sustainability. Additional financing options to further expand the level of IDA resources fall into two main categories:

- **Additional resources from acceleration of IDA credits and graduations**. These options would build up IDA's long term financial capacity by releasing resources from IDA graduates and blend countries. For IDA16, IDA could accelerate repayments of IDA graduates' eligible outstanding credits. In addition, the projected graduation of Azerbaijan over the course of the IDA16 period will slightly reduce funding needs and release resources for allocation to the remaining IDA countries. The projections for country graduations are discussed in more detail in the companion paper on demand for IDA16 resources.[13]

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[12] In these countries, years where large shares of the growth in debt-to-GDP ratios could not be explained by fiscal policy factors have tended to coincide with natural disasters such as hurricanes (Grenada, St. Vincent and the Grenadines, and St. Lucia), and Dean in 2007 (Dominica).

[13] "The Demand for IDA16 Resources and the Strategy for their Effective Use", IDA Resource Mobilization Department, May 2010.

- **Additional resources from new donors.** Outreach to potential new donors and options available under the voice reform program for countries to maintain voting power in IBRD potentially could increase the number of new donors to IDA16.

23. The following section expands on some of the options presented above: acceleration of repayments of IDA graduates' eligible outstanding credits and outreach to potential new donors.

A. Credit Accelerations

24. **IDA has included a credit acceleration clause in the legal agreements of regular and blend credits approved since 1987 that allows it to double the principal repayments of the credit (i.e. shorten the maturity) or increase the interest rate if a borrower's GNI per capita exceeds a specific threshold and the borrower is IBRD creditworthy.** This clause provides that Executive Directors would consider the borrower's economic development before approving the exercise of the clause. The GNI per capita threshold was originally set as exceeding the historic cut-off (US$1,855 in FY10) for 5 consecutive years (the 'old clause'), but for agreements after 1996 it was lowered to exceed the operational cut-off (US$1,135 in FY10) for 3 consecutive years (the 'new clause'). If the borrower's economic condition deteriorates at any time after implementing the modified repayment schedules, IDA could, at the request of the borrower, revert back to the original repayment schedules. To date, IDA has never exercised the acceleration clause as historically only a few countries met the eligibility criteria and the potential benefit to IDA was relatively small.

25. **For the IDA16 period, there are seven countries that exceed or are expected to exceed the GNI per capita threshold and are creditworthy for IBRD borrowing**: Albania, China, Egypt, Equatorial Guinea, Indonesia, Macedonia and St. Kitts and Nevis. Table 2 shows that about 70 percent[14] of their outstanding credits contain an acceleration clause. If all of these credits were accelerated, IDA would benefit from an NPV gain of about US$1.2 billion.[15]

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[14] This ratio excludes US$511 million of Egypt's credits: although these are subject to the old acceleration clause, Egypt's per capita GNI has not exceeded the historical cut-off for 5 consecutive years, therefore these loans do not currently meet the conditions for acceleration.

[15] The present value gain is determined using a discount rate of 6 percent.

Table 2: Outstanding IDA Credits of Acceleration Candidates

In US$ millions	Total IDA credits outstanding (Mar 31, 2010)	of which: Credits subjection to acceleration	Old clause	New clause	Present value gain to IDA if acceleration starts in FY12 1/
Albania	826.3	656.7	243.1	413.6	85.9
China	9,147.2	6,903.4	5,819.8	1,083.6	761.1
Egypt	1,360.3	319.2	0.0 2/	319.2	36.8
Equatorial Guinea	44.6	10.0	10.0	0.0	1.3
Indonesia	2,223.5	1,528.0	0.0	1,528.0	252.0
Macedonia	367.7	344.0	145.5	198.5	40.1
St. Kitts & Nevis	1.3	1.3	1.3	0.0	0.2
	13,970.8	**9,762.5**	**6,219.7**	**3,542.8**	**1,177.3**

1/ Discount rate of 6 percent has been used to determine present value gain.

2/ Egypt does not meet the GNI per capita threshold for the old clause, therefore US$511 million of outstanding loans with the acceleration clause would not be subject to acceleration.

26. A preliminary economic analysis of the seven acceleration candidates finds that these countries' current total public debt situations, including external debt, do not present significant risks and the impact of accelerated repayments to IDA would be limited but other factors will need to be looked at in light of recent market events:

i. **The current public and external debt situation of the seven acceleration candidates does not present significant risks**. [16] However, as described below, their debt outlook is not homogenous: [17]

- *China and Equatorial Guinea*: current and projected debt stocks and debt service are very small relative to GDP. [18]

- *Albania, Egypt, Indonesia and Macedonia*: public debt and external debt levels, while manageable, are higher than those for China and Equatorial Guinea; debt sustainability analyses project a decline in debt burden indicators in the coming years. Albania's debt is projected to decline from 24 percent of GDP in 2009 to 16 percent in 2015.[19] Egypt's debt indicators have experienced a significant decline in recent years (e.g., end-2009 external debt/exports ratio at 45 percent, compared to 163 percent at end-2003). Indonesia's debt has also declined steadily, from over 298 percent of export in 1998 to 97 percent in 2008. Macedonia's public debt has declined from 37 percent of GDP in 2004 to 22 percent in 2008. The global

[16] The analysis for these countries is based, unless otherwise indicated, on their public and publicly guaranteed external debt levels. It draws from Debt Sustainability Analysis (DSAs) performed by the IMF staff, under the IMF framework for Middle-Income Countries, except for Albania where the DSA was performed under the Debt Sustainability Framework for Low-Income Countries. The analyses for Equatorial Guinea and Macedonia have been performed prior to the global financial crisis.

[17] The figures presented below reflect the baseline scenario in the IMF debt sustainability analyses. Alternative scenarios and stress tests performed in such analysis lead to higher, but not unmanageable, debt levels.

[18] China's total PPG debt stock in 2009 amounts to 1.9 percent of GDP and 6.2 percent of exports; Equatorial Guinea's total PPG debt in 2009 amounts to 0.66 percent of GDP and 0.9 percent of exports.

[19] Part of this decline is due to the delaying of a planned Eurobond issuance, due to the financial crisis.

financial crisis has resulted in an increase of the debt ratios for Macedonia, the public debt-to-GDP ratio rising to 26 percent in 2010, with a rise of the share of external debt (around 80 percent of total public debt in 2008, around 95 percent in 2010) and stabilizing at about that level during 2011-2015.

- *St. Kitts and Nevis*: even if the debt situation still appears to be manageable, this country is in a more fragile situation. St. Kitts and Nevis has a declining external debt (projected to reach 41 percent of GDP in 2013) but is facing a very high level of total public debt (external and internal) that could be higher than 200 percent of GDP in 2013. The amount of eligible credits for acceleration is US$1.3 million and represents only 0.01 percent of the total eligible credits subject to acceleration from the seven countries. IDA would need to further consult with this country as well as the other countries prior to implementation.

ii. **The impact of accelerated repayments to IDA would be limited for all seven countries**. In terms of total debt stock, IDA's exposure in these countries is limited (see Table 3 below). In terms of flows, the share of potentially accelerated IDA loans in these countries' total debt service is below 8 percent, except for Equatorial Guinea, whose total debt service is negligible (less than 0.05 percent of GDP per year). These repayments represent only between 0.005 percent and 0.085 percent of GDP and between 0.01 percent and 0.26 percent of exports in 2009. The impact of acceleration would thus be limited to a maximum of 0.3 percent of exports (Albania), implying no measurable impact on these countries' debt outlook. For Macedonia, the country that appears to be in the most fragile external debt situation, the low share of IDA in total debt service (4 percent) implies that acceleration of repayments to IDA would only add 0.07 percent of GDP and 0.16 percent of exports to the total debt service burden in 2011.

Table 3: Estimated Public and Publicly Guaranteed Debt Stock of the Acceleration Candidates at end-2008 (US$ million)

	Albania	China	Egypt	Equatorial Guinea	Indonesia	Macedonia	St. Kitts and Nevis
Total PPG debt stock	2,222	89,283	28,518	221	76,904	1,538	257
Multilateral	1,295	30,655	6,999	98	19,962	1,015	112
o/w IBRD	17	12,464	1,255	0	6,968	230	13
o/w IDA	817	9,786	1,444	48	2,006	361	1
Others	927	58,627	21,519	123	56,942	522	145
Memorandum item							
IDA's share	*37%*	*11%*	*5%*	*22%*	*3%*	*23%*	*1%*

Source: DRS

27. **If the acceleration clause were exercised, the seven acceleration candidates would have an option to (a) accelerate their principal repayments (i.e. shorten the maturity of affected loans), (b) maintain the original loan maturity, but pay interest at a rate that would achieve the same NPV as the accelerated loan profile, or (c) a combination of these two.** Although the NPV gain over the life of the loans would be the same under any option, the impact on IDA's liquidity and projected IDA16 commitment authority would be different depending on the option the borrowers elected.

28. **Principal option assumptions:** Each credit agreement of the seven acceleration candidates was reviewed to determine which, if any, acceleration clause (old or new) would be applied. The analysis assumes that the acceleration clause would be exercised for all eligible repayments on or after July 1, 2011 (FY12) and only the loans that are subject to an acceleration clause are included in the analysis (i.e. loans that were approved before 1987 or loans issued on hardened terms are not accelerated). For loans subject to the new acceleration clause, acceleration begins immediately after July 2011, provided that a minimum of 5 years since the inception of the loan has elapsed. A total of US$9.8 billion of outstanding credits from the 7 countries met these requirements.

29. **Interest option assumptions:** Setting the interest rate to achieve the same level of concessionality as the accelerated loan repayment schedule, requires an assumption about the discount rate. For the purpose of this paper, a discount rate of 6 percent has been used and a weighted average interest rate of 1.82 percent, based on the total cashflows for each the seven acceleration candidates, was used to illustrate the cash flow effect for IDA. The discount rate used would warrant specific review prior to exercising the acceleration clause (a higher discount rate would yield a higher interest rate and vice-versa), and the interest rate would be determined on a loan by loan basis rather than on the weighted average used for this analysis. Possible options for the discount rate include:

i. the discount rate currently used to determine the concessionality of IDA credits (6 percent);
ii. the discount rate used to determine the concessionality of accelerated loans when the policy was first introduced in 1987 (10 percent);[20] or
iii. the discount rate prescribed in the Nonconcessional Borrowing Policy (ten-year average CIRR plus 1.25 percent).

Impact on IDA's cashflows:

30. **Principal option:** Accelerating the repayment of principal for the seven acceleration candidates would increase IDA's nominal credit reflows from FY11 to FY20, with an off-setting decrease from FY21 to FY42. In nominal terms, total cash flows would be partially offset by about US$337 million due to lower service charge income earned from these countries because the outstanding balance is repaid faster. 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 disbursements. In present value terms, IDA would benefit by about US$1.2 billion over the life of the credits.

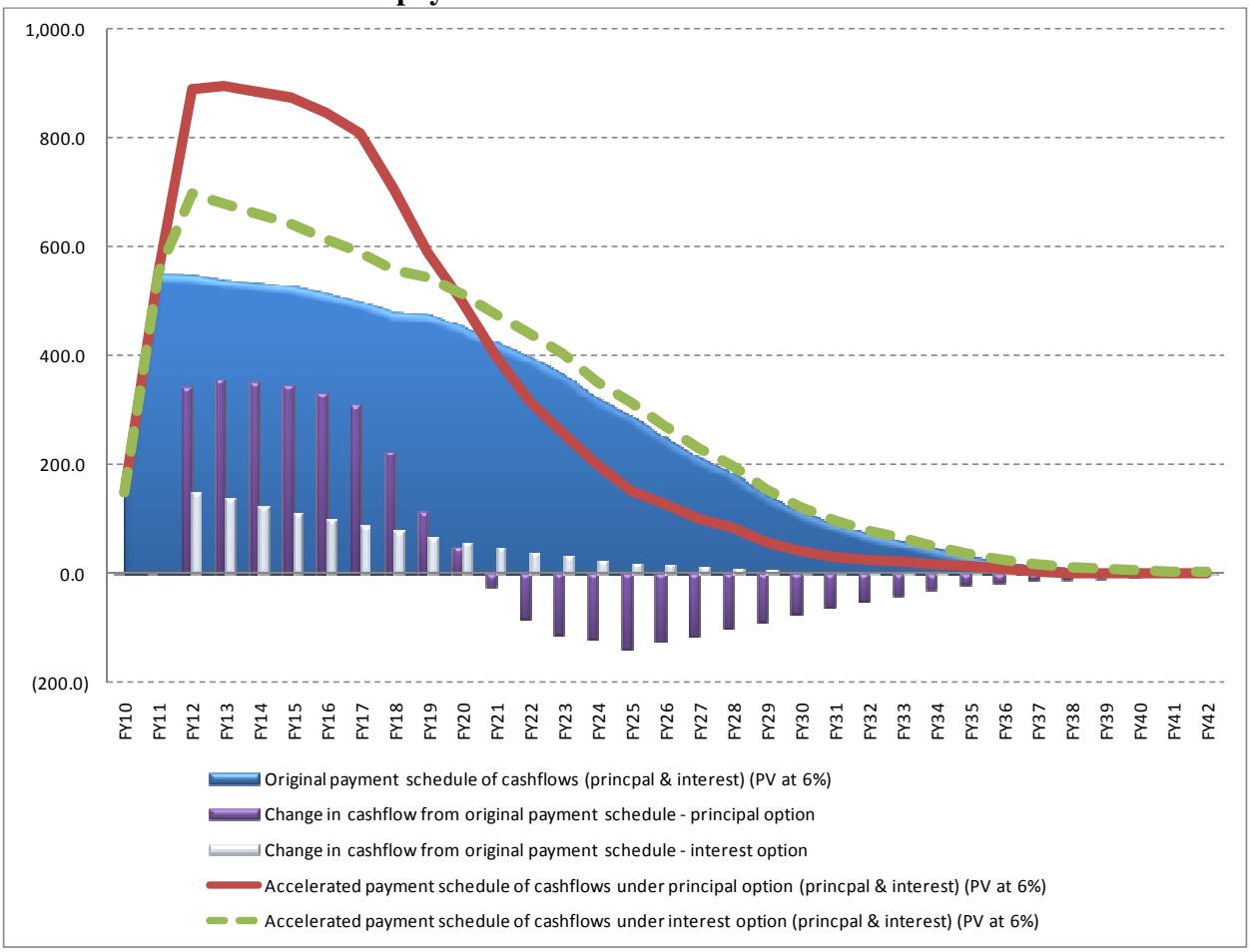
31. **Interest option:** Paying interest on eligible credits would result in additional interest income for IDA of US$1.9 billion up to FY42. In present value terms, IDA would benefit by the same US$ 1.2 billion over the life of the credits.

32. Chart 2 illustrates the cash flows under the original repayment schedule vs. the cash flows under the principal and interest options in present value terms**.** From this it can be seen that although equivalent in NPV terms, each option yields a different cash flow profile. Under the principal option, this would be frontloaded with high increases in the earlier years (FY12-20)

[20] "IDA Financial Policy Review," IDA/R87-26, March 12, 1987.

averaging US$362 million per annum, but followed by decreases in the outer years (FY21-42) averaging US$163 million per annum. Under the interest option, the NPV cash flows would always be positive starting at a maximum of US$167 million in FY12 with a steady decline until FY42 as the outstanding credit balance is repaid and the interest charge becomes smaller.

Chart 2: Repayment Profile for Acceleration Candidates



Impact on IDA16 Financing:

33. **The difference in the cash flow profile of the principal option vs. the interest option impacts the potential increase in internal resources included in the financing framework for IDA16.** IDA16 internal resources could be increased over the base case (without credit accelerations) by SDR0.5-1.3 billion (US$0.8-2.0 billion). IDA has used the low end of the estimated increase in internal resources as potential additional financing for the potential scenarios for IDA16 as it is unknown if borrowers would choose the principal option for acceleration of repayments. Based on guidance from IDA Deputies, Management's intention is to actively engage these affected countries on the implementation arrangements and seek Executive Directors approval with a view to come back to Deputies in the third meeting with a more detailed estimate of the level of internal resources available for IDA16. Early endorsement will be needed to provide affected countries time for consideration of the impact on their budget process to meet new financing needs.

B. Outreach to New Donors

34. **The total number of donor countries that have contributed to IDA has continued to increase.** Since IDA's first replenishment, IDA donors have increased from 18 countries to 45 countries during IDA15. There are currently 10 IBRD eligible borrowers that are IDA donors to IDA15.[21] During the first replenishment meeting of IDA16, representatives from Thailand and Romania attended the meeting. IDA management is continuing to reach out to these countries and other potential countries to become donors to IDA16 or future replenishments.

35. **Under the Voice Reform Program, Developing and Transition Countries (DTC) could receive recognition in IBRD shareholding if they become a new donor to IDA16 at their notional burden share.** Five countries have indicated interest in contributing to IDA16.[22] Contributions from these five countries based on their notional burden shares would be about US$150 million for IDA16. In addition, DTCs that are current IDA donors would receive recognition in IBRD shareholding if they increase their IDA16 contributions by at least 50 percent above IDA15. Three countries have indicated their willingness to increase their contributions by this level, collectively contributing about US$118 million more to IDA16, or about US$351 million in total.

C. Long-term Financial Sustainability

36. **Additional innovative ideas for IDA's financial sustainability have been put forward by Deputies during the first IDA16 replenishment meeting, brainstorming sessions with IDA's Executive Directors, as well as internal discussions by IDA management**. Some ideas include establishing an endowment fund, an IDA blended financing facility, and theme-based debt (such as funding for gender or climate change projects) offered through private placements with credit enhancements from donor guarantees and contributions to finance interest charges.[23] However, many of the ideas include fundamental changes to IDA's structure and will require time and consideration beyond the IDA16 discussions. It is suggested that subsequent to these discussions, a working group including representation of both IDA donors and IDA recipient countries be established to evaluate alternative options and report back at the IDA16 Mid-term review with specific recommendations for potential funding mechanisms to be introduced at the start of IDA17.

IV. IDA15 FINANCING FRAMEWORK

37. **The financing framework as originally agreed at the start of the IDA15 period which covers FY09-11 was to provide SDR27.3 billion (US$41.7 billion) of total resources**. This amount included SDR16.5 billion (US$25.2 billion) in new donor resources, SDR4.1 billion

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[21] IBRD eligible borrowers that are IDA donors to IDA15 include: Brazil, China, Egypt, Korea, Mexico, Poland, Russia, the Slovak Republic, South Africa, and Turkey.

[22] Management has actively engaged three of these countries (Argentina, Chile, and Peru) in a meeting organized by the Peruvian government in Lima in May 2010.

[23] IDA has previously outlined the issues and risks related to the acceptance of donations from the private sector and an operational framework for handling them. See "Operational Framework for Accepting Unsolicited Private Donations to IDA", IDA/R2008-0071/1, May 12, 2008. To date IDA has received about US$1.8 million in total from Nikko Asset Management and Chiba Bank.

(US$6.3 billion) of donor compensation for MDRI, SDR2.6 billion (US$3.9 billion) from IBRD and IFC transfers and SDR4.1 billion (US$6.3 billion) from internal resources.[24]

38. **The IDA15 financing framework has subsequently been revised to SDR 28.5 billion (US$43.6 billion) to reflect additional donor contributions and the adjustments for hedging of national currencies, the use of additional internal resources from IDA16 for the Pilot Crises Response Window (CRW) and to cover the MDRI financing shortfall, and the carry-over of funds from IDA14.** Since the start of IDA15, IDA has received additional donor contributions including support for the pilot CRW and the Voice Trust Fund. In June 2008, the Executive Directors of IDA approved the use of internal resources equivalent to SDR4.1 billion (US$6.3 billion) for IDA15. Due to the subsequent need for financing of the pilot CRW in December 2009 and the MDRI shortfall in January 2010, IDA's Executive Directors approved the use of additional internal resources for IDA15 of SDR 0.3 billion (US$0.5 billion) for the pilot CRW and SDR 1.0 billion (US$1.5 billion) to maintain the IDA15 commitment level for the shortfall in MDRI financing commitments from donors. The additional internal resources provided to IDA15 will reduce the amount of resources available for IDA16. Also, SDR0.6 billion (US$0.9 billion) of resources was carried forward from prior replenishments for unused resources from IDA14 of SDR0.2 billion and SDR 0.4 billion in donor arrears and withholding from prior replenishments.[25] Annex 2 describes the IDA15 financing framework as originally agreed and updated to reflect the subsequent changes.

V. IDA16 POTENTIAL FINANCING SCENARIOS

39. **The IDA16 replenishment comes at a time of a difficult international financial environment.** This has created significant fiscal constraints on some donors. This must be balanced against the need to support the fragile recovery in IDA countries and to redouble efforts towards the Millennium Development Goals. In the companion paper for the second IDA16 meeting ("The Demand for IDA16 Resources and Strategy for their Effective Use") management has presented five potential scenarios for the IDA 16 replenishment based on IDA countries' needs and a realistic assessment of how these scenarios can be financed. The scenarios provide a broad range of options from keeping IDA16 flat in real terms relative to IDA15 (i.e., 5.72 percent increase in nominal terms) to incrementally higher scenarios which allow for progress to be made with regard to scaling up IDA to meet the MDGs as well as to address additional needs under IDA16 related to expected country arrears clearances and reactivations, extension of the post-conflict and re-engaging countries exceptional allocation phase-out, the proposed permanent Crisis Response Window, a scale up of regional projects and a special reconstruction allocation for Haiti following the recent earthquake. These are trade-offs to be considered under different replenishment levels that are presented in the above mentioned demand paper.

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[24] The total IDA15 commitment authority additionally included SDR434 million of carryover funds from IDA14 due to donor arrears and withholding from earlier replenishments.

[25] Donor arrears consists of unpaid contributions of the United States to IDA12, IDA13 and IDA14 (SDR 263 million), corresponding pro-rata contributions shares withheld by Austria, France and Germany (SDR 48 million), and pledged contributions from Italy to IDA14 (SDR 123 million) for which parliamentary approval was delayed due to a change in government.

40. **Financing the volume of the IDA16 replenishment will partly depend on the volume of new financing commitments from donors and their compensatory contributions for IDA's debt relief and grant compensation, and the volume of internal resources including internal reflows and investment income, and transfers from IBRD's and IFC's net income.**[26] Other sources could be from changes in IDA's lending terms as proposed for blend, hardened and hard term credits as discussed in Section II and from acceleration of repayments of IDA credits as discussed in Section III.

41. **This section presents financing options for the five scenarios**. The scenarios, presented in Table 4 (in SDR; see Annex 3 for financing scenarios in US$), include significant increases in internal resources, including the potential additional resources from changes in IDA's financing terms and accelerations. This is a larger internal effort to support IDA's replenishment when compared to other ongoing replenishment negotiations. Increases in IDA's internal resource mobilization effort would absorb 100 percent or more of the increase in resources needed to meet the indicated volumes under the first two scenarios, thereby maintaining or lowering the level of donor contributions needed. For the upper three scenarios, IDA's internal resource mobilization effort would account for between 64, 48, and 38 percent, respectively, of the increase needed.

Table 4: Financing of IDA16 Scenarios
(SDR billion)

Source of Funds	IDA15	IDA16 Financing Framework									
	Original [a/]	Scenario 1 Flat in Real terms [b/]		Scenario 2		Scenario 3		Scenario 4		Scenario 5	
I. TOTAL DONOR RESOURCES	**20,657**	**19,565**	*-5%*	**20,684**	*+0%*	**22,168**	*+7%*	**23,505**	*+14%*	**24,910**	*+21%*
Donor basic contributions	14,537	13,475	*-7%*	14,594	*+0%*	16,078	*+11%*	17,415	*+20%*	18,820	*+29%*
Supplemental contributions	91										
Donor compensation for HIPC (FY12-14)	1,138	1,715		1,715		1,715		1,715		1,715	
Donor financing of arrears clearance operations	742	770		770		770		770		770	
Donor compensation for grant principal forgone	-	60		60		60		60		60	
Total Donor Contributions	**16,509**	**16,020**	*-3%*	**17,139**	*+4%*	**18,623**	*+13%*	**19,960**	*+21%*	**21,366**	*+29%*
Donor compensation for MDRI (FY20-22)	2,182	2,589		2,589		2,589		2,589		2,589	
Donor compensation for MDRI carry forward (pre FY20)	1,966	956		956		956		956		956	
Total MDRI Compensation	**4,148**	**3,545**	*-15%*	**3,545**	*-15%*	**3,545**	*-15%*	**3,545**	*-15%*	**3,545**	*-15%*
II. TOTAL INTERNAL RESOURCES	**6,690**	**9,346**	*+40%*	**9,346**	*+40%*	**9,346**	*+40%*	**9,346**	*+40%*	**9,346**	*+40%*
Internal Reflows	4,132	6,214		6,214		6,214		6,214		6,214	
IBRD Transfers	1,279	1,292		1,292		1,292		1,292		1,292	
IFC Transfers	1,279	*[tbd]*		*[tbd]*		*[tbd]*		*[tbd]*		*[tbd]*	
Potential Additional Financing:											
Hardening of lending terms		1,314		1,314		1,314		1,314		1,314	
Acceleration		526		526		526		526		526	
Total Financing Framework	**27,347**	**28,911**	*+6%*	**30,030**	*+10%*	**31,514**	*+15%*	**32,851**	*+20%*	**34,257**	*+25%*

Notes:
Amounts may not add up due to rounding
a/ Original IDA15 Financing Framework as agreed at the start of IDA15.
b/ Based on the three year SDR inflation rate of 5.72%.

[26] Under the MDRI replenishment, donors agreed to a contribution baseline, representing the floor for their future financial support to regular IDA replenishments. Donors agreed to continue to increase their contribution by the SDR inflation rate for subsequent replenishments. See Annex 4 for further details.

A. Donor Contributions

42. **To satisfy the IDA16 financing needs, total donor resources excluding MDRI in IDA16 would need to equal between SDR16.0 billion to SDR21.4 billion (US$24.4-32.5 billion).** The variable portion represents the donor basic contributions. The range of scenarios include donor basic contributions of between SDR13.5–18.8 billion (US$20.5 - 28.6 billion), net of the structural financing gap.[27] This represents a range from a 7 percent decrease up to a 29 percent increase over the agreed basic donor contributions in IDA15. The remaining portion is the fixed portion for which donors 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 IDA16, including:

- **Donor compensation for HIPC costs**: IDA16 is the third replenishment during which donors will finance IDA's forgone credit reflows due to the HIPC Initiative. Under the current compensation arrangements, donor financing of HIPC costs occurs on a pay-as-you-go basis, over the 3-year commitment period of IDA replenishments. Over the IDA16 commitment period (FY12-14) donor contributions for HIPC costs are estimated at about SDR1,715 million (US$2,610 million), including a carry-forward amount of SDR109 million (US$166 million) reflecting the unfunded portion of HIPC costs incurred during earlier replenishments due to a financing gap in commitments.[28]
- **Donor financing of arrears clearance operations**: Starting in IDA15, arrears clearance operations formed part of IDA's overall financing commitments and were financed by donor contributions. Four countries have been in protracted arrears (Myanmar, Somalia, Sudan and Zimbabwe). Given the high uncertainty about their re-engagement, we assume that potentially only Sudan and Zimbabwe may become eligible for exceptional IDA support for arrears clearance during the IDA16 period (FY12-14) with a cost estimated at about SDR770 million (US$1.2 billion).
- **Donor compensation for principal forgone on grants**: Grant making began in earnest in IDA13. In IDA14, donors committed to replace forgone principal reflows due to the making of grants, on a pay-as-you-go basis.[29] Given the 10-year grace period on regular IDA credits, IDA16 would be the first replenishment for the financing of forgone principal reflows due to grants extended in IDA13. Donor contributions for grant principal repayments forgone are estimated at SDR60 million

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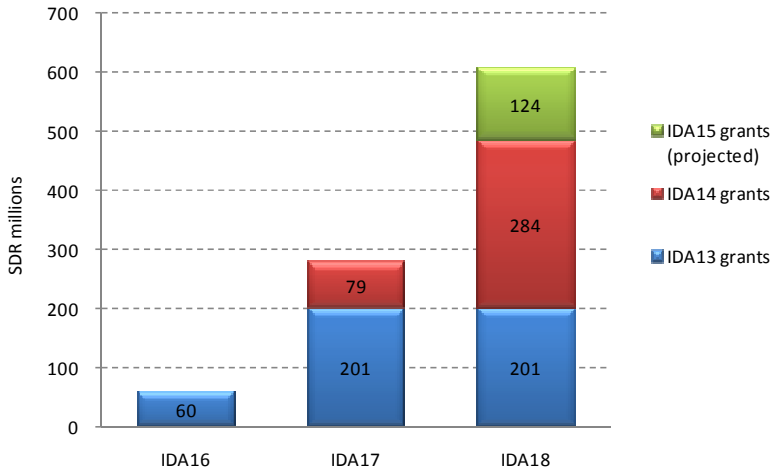
[27] Donor burden shares for IDA15 represented only 79.8 percent of the target amount, leaving a structural financing gap of 20.2 percent. For IDA16, if donors choose to apply the same regular burden shares as in IDA15, this target funding would need to be scaled up to account for this gap. Annex 3, Table B illustrates the scale up necessary in order to achieve full funding under each scenario. Management will provide a discussion note for the third IDA16 replenishment meeting and provide proposals to reduce this structural financing gap. For the African Development Fund, donors agreed to recalibrate (or normalize) burden shares so as to leave a structural gap of 5 percent for ADF-11. If this approach were adopted for IDA, the basic shares for IDA15, which totaled 79.8 percent of the targeted funding volume, would be recalibrated to 95 percent.

[28] HIPC costs are estimated based on the cost update as of June 30, 2009. Actual amounts will be based on the 2010 cost updates.

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

(US$91 million) during the IDA16 period. Chart 3 illustrates the forgone principal repayments on grants over the next 3 replenishments.

Chart 3: Forgone principal on grants for IDA16 – IDA18 (SDR million)



43. **Donor 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 donor contributions are drawn down by IDA on an "as-needed" basis. In past replenishments, donors have been given the option of providing their contributions in cash 'up-front', provided that the present value of the accelerated encashment schedule is at least equal to that of the standard schedule.[30] Many donors used the additional resources from accelerated encashments as a credit item, either to increase their own regular burden share, to cover a share of their costs under the MDRI replenishment, or to lower the overall structural financing gap in the replenishment. On select cases, IDA has allowed some donors to back load their encashments provided that the present value is maintained. This however has an impact on IDA's liquidity as funds are managed to ensure that future disbursements on credits and grants will be backed by sufficient liquid funds.

44. **The effect of foreign exchange rates will continue to impact the level donor contributions in national currencies**. At the first IDA16 meeting in Paris, Deputies agreed to use the daily average foreign exchange reference rates over the six-month period from April 1, 2010 – September 30, 2010 for purposes of converting national currency contributions to IDA16 into SDR equivalent amounts. Since IDA15 and in particular during recent months, the exchange rates of many currencies have significantly adjusted (see Table 5). This will translate into different country efforts over IDA15 levels based on the final exchange rate.

[30] The standard encashment schedule and discount rate for IDA16 will be provided to Deputies for the third IDA16 replenishment meeting.

Table 5: Foreign Exchange Rates

	IDA15 Actual	IDA16 Preliminary Estimate 1/	IDA16 Reference Period to date
	Apr 1, 2007 to Sep 30, 2007	Feb 1, 2010 to May 15, 2010	Apr 1, 2010 to May 26, 2010
US$ / SDR	1.52448	1.52173	1.50134
EUR / SDR	1.12141	1.13157	1.14971
GBP / SDR	0.76152	0.99759	0.99883
JPY / SDR	181.86553	139.57949	139.55289

1/ Preliminary estimate used for IDA16 tables.

B. Donor Compensation for MDRI Costs

45. **To replace IDA's forgone credit reflows due to the MDRI, donors established a separate MDRI replenishment, spanning four decades (FY07-44)**. Starting from IDA14, IDA's commitment authority is *de jure* and *de facto* backed by two simultaneous replenishments: the funding that becomes available under the latest regular IDA replenishment, and additional donor commitments provided under the ongoing MDRI replenishment. MDRI costs and related donor 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 and HIPC costs for financing occurred as of September 30, 2007 during the IDA15 replenishment discussions. For donors' financing pledges to IDA16, the debt relief costs of IDA will be updated once again, as of September 30, 2010. This cost update will be provided to donors prior to the third IDA16 meeting.

46. **To preserve IDA's financial capacity following implementation of the MDRI, donors acknowledged the need to provide unqualified, firm financing commitments over a rolling decade, thereby matching the disbursement period of each future IDA replenishment.** Specifically, in the context of the MDRI replenishment, donors recognized that: *"It will be critical to provide an Unqualified Commitment for subscriptions and contributions in FY07 and 08"*. For the remainder of the first decade of MDRI implementation (FY09-16), donors recognized that: *"Firm, Unqualified Commitments are also needed over this period. Participants recognized that some donors would require periodic approval of their contributions over this period, resulting in the provision of some portion of Qualified Commitments. ... Participants encouraged IDA's donors to take all necessary steps in successive replenishments to provide firm financing on a rolling basis."*[31] Although Executive Directors now have the ability to count 85 percent of qualified donor commitments to the MDRI for commitment authority as approved by IDA's Board of Governors, donors are still expected to provide unqualified, firm financing commitments to cover the costs over the disbursement horizon of IDA16 (FY12-22).

[31] "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.

47. **For the IDA16 replenishment, additional, firm donor financing commitments for MDRI are required for an estimated SDR3.5 billion (US$5.4 billion)**.[32] This is broken down into two amounts, as follows: (i) SDR2.6 billion (US$3.9 billion) of forgone MDRI reflows during FY20-22 relating to IDA16 disbursements, which would be covered through new, firm financing commitments from most donors;[33] and (ii) SDR1.0 billion (US$1.5 billion) of forgone MDRI reflows carried forward from IDA15, which remain uncovered by firm financing commitments from a few donors.[34] The carry forward amount would not trigger additional contributions from the majority of donors who have already provided firm financing commitments for the IDA15 period.

C. Internal Reflows

48. **The future level of IDA's liquidity becomes the binding constraint when determining the volume of internal reflows that are available for IDA16**. Internal reflows consist primarily of IDA's future credit reflows after factoring in debt relief and the projected investment income on IDA's liquid assets. If the internal reflows committed for a given replenishment exceed these two sources of funds, then IDA's liquid assets will fall over time in order to satisfy IDA's disbursement needs under a given replenishment. Annex 5 provides detailed background information on IDA's cash flows, the structure of liquid assets, the historical evolution of accelerated encashment by donors, and the projected future level of IDA's liquidity.

49. **For IDA16, the maximum amount of internal resources available under IDA's current lending policies would be about SDR6.2 billion (US$9.5 billion)** after deducting SDR1.3 billion (US$2.0 billion) that was brought forward into IDA15 to cover the MDRI financing shortfall of SDR1.0 billion (US$1.5 million) and additional financing for the pilot CRW of SDR0.3 billion (US$0.5 million) (see para. 38). This compares with internal resources in the original IDA15 financing framework of SDR4.1 billion (US$6.3 billion) which was subsequently revised to SDR5.4 billion (US$8.3 billion) after the additional internal resources allocated to IDA15 for the MDRI financing shortfall and pilot CRW.

50. **Using additional internal resources for IDA16 would either reduce liquidity below the prudential minimum, or would require a reduction of available resources for IDA17.** Lowering further the projected internal resources and thereby total commitment capacity for IDA17 would compromise the objective of providing a predicable stream of new IDA resources to recipient countries over time. Under the Advance Commitment Scheme, credit reflows that will be received over the IDA16 disbursement period are allocated to the replenishment in advance so as to match the cash flows needed for disbursement in that year. As the 11-year disbursement period overlaps with multiple future replenishments, a portion of the reflows during the IDA16 disbursement period (FY12-22) will be allocated to future replenishments.

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[32] MDRI costs are estimated based on the cost update as of June 30, 2009. Actual amounts will be based on the 2010 cost updates to be provided during the third IDA16 meeting.

[33] A few donors have already provided up-front, unqualified financing commitments over the entire four decades of the MDRI; these donors would not need to provide additional MDRI financing commitments during IDA16.

[34] This amount includes remaining 15 percent of US$3,427 million in qualified commitments received up to the end of the IDA15 financing period (FY19) and US$942 million related to the structural financing gap and outstanding donor financing commitments. Firm, unqualified commitments would be required to replace the full amount of qualified commitments already received.

Therefore, any increase in internal resources allocated to IDA16 would require a reduction in internal resources available for IDA17 and potentially impact the liquidity needed to meet disbursements during that replenishment.

D. IBRD Net Income Transfers

51. **For IDA16, transfers from IBRD net income are currently assumed to increase from the IDA15 level (US$583 million per year) in real terms.** At the Spring Meetings in March 2010, Development Committee members recognized the importance of IBRD's commitment to IDA by enhancing the value of IBRD transfers in line with IBRD's financial capacity.[35] Based on the annual average US$ inflation rate of 2.11 percent in calendar years 2007-2009, the level of IBRD transfers is expected to increase by this level to US$595 million in year one, US$608 million in year two and US$621 million in year three. This continues to represent an up-front draw-down with each annual payment being paid when approved by the Governors similar to IDA15. Including investment income of about US$0.17 billion based on accelerated transfers over three year period, this would provide about US$2.0 billion (SDR1.3 billion) of IDA16 commitment authority. IBRD's actual transfers in support of IDA16 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. Bank management will review this topic after the net income allocation decisions for FY10 have been taken by the IBRD Board of Governors, in the autumn of 2010. Any decisions about future IBRD net income transfers will be subject to annual approvals by IBRD's Executive Directors and Board of Governors.

E. IFC Net Income Transfers

52. **IFC and IDA.** IFC stands committed to continue its rapid growth in the IDA countries. Unlike for IBRD which has a long history of financial support to IDA replenishments, the IFC contribution to IDA15 of US$1.75 billion was authorized in support to IDA15 during a more favorable period for IFC's financial capacity. IFC's net income has displayed higher year-to-year volatility than that of IBRD, given IFC's private sector mandate and its resulting risk exposure, including to equity assets. IFC's Board approves annual net income allocations, which will lead to any decisions of contribution to the IDA16 replenishment. This topic is scheduled for Board discussion in August 2010.

VI. THE FINANCING GAP IN DONORS' MDRI, HIPC, ARREARS CLEARANCE AND FORGONE GRANT PRINCIPAL COMPENSATION

53. **The volume of donor financing required for IDA16 is expressed net of the structural financing gap that currently exists in donors' IDA burden shares.** This is the amount of financing that needs to actually be paid by the donors so as to enable IDA to approve new credits and grants in the desired overall volume and to disburse fully on these credits and grants. Since the financing gap of basic contributions is not included in IDA's commitment authority, it does not create operational or financial risk. However, the financing gap for basic contributions to an IDA replenishment is different from the financing gap for the financing of IDA's debt relief

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

costs (HIPC, MDRI as well as arrears clearance) which does create an operational and financial risk to IDA.

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

54. While a small residual financing gap is desirable for donors' regular contributions, contributions to finance IDA's debt relief costs (HIPC, MDRI as well as arrears clearance), and principal forgone on grants should be fully financed, without any residual gap, so as to achieve the objective of full donor compensation of such costs. Donor contributions for these initiatives compensate IDA for losses incurred during the three years from FY12-14. Increased donor contributions from new or existing donors or recalibration of donors' burden shares would be required to eliminate or reduce any real financing gap resulting from the structural gap.

55. **In IDA15, donors primarily continued to use their IDA14 burden shares to finance IDA's forgone reflows due to the HIPC Initiative, leaving a structural financing gap of 5.2 percent**. Not covering this gap when financing IDA's lost HIPC reflows during IDA16 would lower the amount of resources available for IDA's commitment authority. To help lower the structural gap for financing HIPC costs during IDA15, seventeen donors "scaled up" their IDA14 burden shares. For HIPC costs in IDA16, during FY12-14 donors are again requested to consider scaling up their IDA15 burden shares proportionally to eliminate the structural financing gap.

56. **Arrears clearance operations were part of IDA's overall new financing commitments during IDA15.** Donors applied their HIPC burden shares for the financing of the arrears clearance operations, leaving a similar structural financing gap. 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 donor contributions should be encashed on an accelerated basis, in line with the three-year schedule that is being used for encashment of donors' HIPC-related contributions. Therefore, similar to the request for eliminating the HIPC structural financing gap, donors are requested to consider using their scaled-up HIPC burden shares to finance arrears clearance costs.

57. **IDA16 would be the first replenishment that donor compensation is requested to finance forgone principal reflows due to grants extended in IDA13**. Over the 3-year commitment period of IDA16, donor contributions for grant principal repayments forgone are estimated at SDR60 million (US$91 million). The respective donor contributions should be encashed on an accelerated basis, in line with the three-year schedule that is being used for encashment of donors' HIPC-related contributions. Donors are also requested to consider using their scaled-up HIPC burden shares to finance the grant principal forgone.

B. Gap in Donors' MDRI Contributions

58. **Under the initial MDRI replenishment, donors also agreed to apply their IDA13 burden shares to finance IDA's forgone reflows due to the HIPC Initiative.** Over the first

two years of MDRI financing (FY07-08), a number of donors used customized burden shares. For the IDA15 and IDA16 disbursement period (FY09-22), even with all donors delivering on their financial pledges at the agreed MDRI burden shares, a structural financing gap of 7.6 percent remains, equivalent to SDR764 million (US$1,164 million). Over the entire 40-year financing period of the MDRI, the structural financing gap is equivalent to SDR1.9 billion (US$3.0 billion).[36] As proposed for HIPC-related costs, donors are requested to consider scaling up their MDRI burden shares proportionally to eliminate the structural financing gap over the IDA16 disbursement period (FY12-22).

VII. Issues for Discussion

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

A. Do Deputies agree to implement changes to IDA's **lending terms** beginning in IDA16 including:

- consolidating IDA's blend and hardened terms into one instrument with the final credit maturity lowered to 25 years, the grace period lowered to 5 years, and implementing a 1.25 percent interest rate;
- changing the terms for the small island country exception from blend credit terms to regular credit terms; and
- lowering the maturity for "hard term" credits to 25 years with a 5 year grace period and expanding access to hard term credits to all blend countries?[37]

B. Do Deputies support the proposed approach of exercising the **acceleration clause** for eligible credits of IDA graduates, in which case Management would engage with these countries on the implementation modalities and seek approval from IDA's Executive Directors?

C. Do Deputies agree that the **financing scenarios** present a suitable range within which to discuss the financing framework for IDA16?

D. On the **structural financing gap,** for IDA's cost of debt relief and grants do Deputies agree to scale up proportionally their respective MDRI, HIPC, arrears clearance, and grant financing burden shares, so as to close the structural financing gap?

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[36] "Debt Relief Provided by IDA under the MDRI and HIPC Initiative: Update on Costs and Donor Financing (as of June 30, 2009)," IDA/SecM2009-0548, October 6, 2009. See Table 8b, page 25.

[37] Hard term credits would continue to have a fixed interest rate on the principal amount disbursed and outstanding which is set every fiscal year, based on the prevailing IBRD lending rate, converted into fixed-rate equivalents less 200 basis points.

ANNEX 1

CONCESSIONALITY OF LOANS BY SELECTED CREDITORS

Table A: Concessionality of Loans by Selected Creditors

Creditor	Loan Type		Grace Period (yrs)	Maturity (yrs)	Interest Rate	Fees	Service Charge	Commitment Charge	Estimated Concessionality (6% discount rate)	Repayment assumption
IDA	Grant	a/	na	na	na	na	na	na	100%	IDA standard
	Regular IDA credit	b/	10	40	0%	0%	0.75%	0-0.5%	61%	IDA standard
	Blend credit	c/	10	35	0%	0%	0.75%	0-0.5%	57%	IDA standard
	Hardened term credit	d/	10	20	0%	0%	0.75%	0-0.5%	40%	IDA standard
	Hard term credit	e/	10	35	3.52%	0%	0.75%	0-0.5%	20%	IDA standard
IDA16 proposed changes	New Blend credit	cd/	5	30	1.25%	0%	0.75%	0-0.5%	39%	
	New Hard Term credit	e/	5	30	3.52%	0%	0.75%	0-0.5%	15%	
African Dev Fund (AfDF)	Project Loan		10	50	0%	0%	0.75%	0.50%	62%	annually equal
	Lines of credit		5	20	0%	0%	0.75%	0.50%	38%	annually equal
Asian Dev Fund (ADF)	Loans to finance specific projects		8	32	1% & 1.5%	0%	0%	0%	47%	annually equal
	Program loans to support sector development		8	24	1% & 1.5%	0%	0%	0%	41%	annually equal
	Emergency Assistance Loans		10	40	1%	0%	0%	0%	59%	2% first 10 yr, 4% after
Arab Bank for Econ Dev in Afr (BADEA)	Concessional Loan		4-10	20-30	1-3%	0%	0%	0%	21% - 49%	annually equal
	Weighted average		8.46	27.4	1.50%	0%	0%	0%		
Carribean Dev Bank	Group 1 (Bahamas, Barbados, Cayman, Trinidad & Tobago)		≤5	≤10	5%	0%	0%	0%	≤3.8%	annually equal
	Group 2 (Anguilla, Antigua & Barbuda, British Virgin Is.)		≤5	≤25	4%	0%	0%	0%	≤16%	annually equal
	Group 3 (Belize, Dominica, Grenada, Jamaica, St Kitts, Lucia and St V&G)		≤10	≤30	2.50%	0%	0%	0%	≤34%	annually equal
	Group 4 (Guyana, Haiti)		≤10	≤30	2%	0%	0%	0%	≤39%	annually equal
	Loan to regional project		≤7	≤25	2.50%	0%	0%	0%	≤30%	annually equal
European Investment Bank (EIB)			10	50	1%-4%	0%	0%	0%	23%-61%	annually equal
IMF	Extended Credit Facility		5.5	10	0% - 0.5%	0%	0%	0%	25% - 27%	annually equal
Inter-American Development Bank (IADB)	General loan		10	40	1% & 2%	0%	0%	0%	48%	annually equal
	FSO Loan		10	40	0.25%	0%	0%	0%	65%	annually equal
International Fund for Agricultural Developmenet (IFAD)	Special Loans on highly concessional terms		10	40	0%	0%	0.75%	0%	59%	annually equal
Islamic Dev Bank	Regular concessional loan		3-7	15-25	0%	0	up to 2.5%	0%	20% - 52%	annually equal
	Softer loan		10	30	0%	0.75%	0%	0%	52%	annually equal
OPEC	The OPEC Fund for International Development		3-5	12-20	0-3.5%	0%	0%	0%	12% - 44%	annually equal

a/ Grant eligibility is determined on the basis of a country's risk of debt distress.
b/ Regular IDA credits to IDA borrowers with per capita GNI below the operational cut-off (FY10: $1,135), with some exceptions (countries that are not IBRD credit worthy and are undertaking major adjustment efforts and small island economies).
c/ Blend credits to IDA borrowers that have limited IBRD creditworthiness and a 2008 GNI per capita between US$910 and US$5,730, with some exceptions.
d/ Hardened terms for borrowers with a per capita income above the operational cut-off for more than two consecutive years.
e/ Hard-term lending window for blend countries with per capita incomes below the operational cut-off and active IBRD lending programs.

Note: Concessionality is estimated for all creditors based on standardized disbursement assumptions determined with reference to the grace period. In addition, where information is not currently available for the repayment terms of each product, it is assumed that the loan would amortize equally over the repayment portion of the loan. Actual concessionality levels would take into account each creditors average disbursement profile and the actual repayment terms of its products, therefore actual concessionality levels may differ from the estimates shown.

Table A: IDA15 Financing Framework
(SDR billion and US$ billion)

	SDR billions		US$ eq. billions	
	IDA15 as agreed 1/	IDA15 updated 2/	IDA15 as agreed 1/	IDA15 updated 2/
I. TOTAL DONOR RESOURCES	**20.7**	**20.0**	**31.5**	**30.5**
Donor basic contributions	14.2	14.2	21.7	21.7
Supplemental contributions	0.1	0.4	0.1	0.6
Acceleration of donor encashment schedules 3/	0.3	0.3	0.5	0.5
Donor financing of arrears clearance operations	0.7	0.8	1.1	1.2
Donor compensation for HIPC (FY09-11)	1.1	1.2	1.7	1.8
Total Donor Contributions	**16.5**	**16.8**	**25.2**	**25.7**
Donor compensation for MDRI (FY17-19)	2.2	1.8	3.3	2.7
Donor compensation for MDRI carry forward (pre FY17)	2.0	1.4	3.0	2.1
Total MDRI Compensation	**4.1**	**3.2**	**6.3**	**4.9**
II. TOTAL INTERNAL RESOURCES	**6.7**	**7.8**	**10.2**	**12.2**
Internal Reflows	4.1	5.4	6.3	8.3
IBRD Transfers	1.3	1.2	1.9	1.9
IBRD Transfers	1.3	1.2	1.9	1.9
III. TOTAL FINANCING FRAMEWORK	**27.3**	**27.9**	**41.7**	**42.7**
Carry Forward	0.4	0.6	0.7	0.9
Total IDA15 Commitment Authority	**27.8**	**28.5**	**42.4**	**43.6**

Notes:

Amounts may not add up due to rounding

US$ amounts are for information only. Actual commitment authority is based on SDR amounts determined using IDA's hedged exchange rate for IDA15. USD equiavlents are based on the IDA15 reference exchange rate US$/SDR 1.52448, except for IBRD and IFC transfes, which are based on actual USD commitments plus additional investment income of US$400 million.

1/ Original IDA15 Financing Framework as agreed at start of IDA15.

2/ IDA15 Financing Framework updated to reflect: additional donor contributions; additional internal resources for the CRW; MDRI donor financing shortfall and off-setting increase in internal resources; and the increase in carry forward due to recommitments from IDA14 .

3/ Represents the additional investment income generated on funds received from acceleration of donors encashments schedules.

Table A: IDA16 Financing Framework
(SDR million)

Source of Funds	IDA15	IDA16 Financing Framework									
	Original [a/]	Scenario 1 Flat in Real terms [b/]		Scenario 2		Scenario 3		Scenario 4		Scenario 5	
I. TOTAL DONOR RESOURCES	**20,657**	**19,565**	*-5%*	**20,684**	*+0%*	**22,168**	*+7%*	**23,505**	*+14%*	**24,910**	*+21%*
Donor basic contributions	14,537	13,475	*-7%*	14,594	*+0%*	16,078	*+11%*	17,415	*+20%*	18,820	*+29%*
Supplemental contributions	91										
Donor compensation for HIPC (FY12-14)	1,138	1,715		1,715		1,715		1,715		1,715	
Donor financing of arrears clearance operations	742	770		770		770		770		770	
Donor compensation for grant principal forgone	-	60		60		60		60		60	
Total Donor Contributions	**16,509**	**16,020**	*-3%*	**17,139**	*+4%*	**18,623**	*+13%*	**19,960**	*+21%*	**21,366**	*+29%*
Donor compensation for MDRI (FY20-22)	2,182	2,589		2,589		2,589		2,589		2,589	
Donor compensation for MDRI carry forward (pre FY20)	1,966	956		956		956		956		956	
Total MDRI Compensation	**4,148**	**3,545**	*-15%*	**3,545**	*-15%*	**3,545**	*-15%*	**3,545**	*-15%*	**3,545**	*-15%*
II. TOTAL INTERNAL RESOURCES	**6,690**	**9,346**	*+40%*	**9,346**	*+40%*	**9,346**	*+40%*	**9,346**	*+40%*	**9,346**	*+40%*
Internal Reflows	4,132	6,214		6,214		6,214		6,214		6,214	
IBRD Transfers	1,279	1,292		1,292		1,292		1,292		1,292	
IFC Transfers	1,279	*[tbd]*		*[tbd]*		*[tbd]*		*[tbd]*		*[tbd]*	
Potential Additional Financing:											
Hardening of lending terms		1,314		1,314		1,314		1,314		1,314	
Acceleration		526		526		526		526		526	
Total Financing Framework	**27,347**	**28,911**	*+6%*	**30,030**	*+10%*	**31,514**	*+15%*	**32,851**	*+20%*	**34,257**	*+25%*

Notes:
Amounts may not add up due to rounding
a/ Original IDA15 Financing Framework as agreed at the start of IDA15.
b/ Based on the three year SDR inflation rate of 5.72%.

Table B: Total Target Volume of Donor Basic Contributions for IDA16 [a/]
(SDR million)

Based on IDA15 regular burden shares	IDA16 Financing Framework				
	Scenario 1 Flat in Real terms	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Regular donor contributions					
Net amount of resources required i.e. 79.8% after the structural financing gap.	13,475	14,594	16,078	17,415	18,820
In order to achieve "full" (100%) basic contribution funding, IDA15 burden shares would need to be compared to a target volume (i.e. basic contribution required / 79.8%)	16,886	18,288	20,148	21,823	23,585

a/ The volume of donor financing required for IDA16 is expressed net of the structural financing gap that currently exists in donors' IDA burden shares. This means that this is the amount of financing that needs to actually be paid by the donors so as to enable IDA to reach the level of donor contributions included in the scenario. For IDA15, the burden shares of donors' regular contributions sum to only 79.8 percent. For IDA16, if donors choose to apply the same regular burden shares as in IDA15, this target funding would need to be scaled up to account for this gap. As an example, under Scenario 1, if a donor's IDA15 burden share was 2 percent, the basic contribution for IDA16 would be SDR337.62 million (SDR16,881 million*0.02).

Table C: IDA16 Financing Framework
(US$ billion)

Source of Funds	IDA15	IDA16 Financing Framework									
	Original [a/]	Scenario 1 Flat in Real terms [b/]		Scenario 2		Scenario 3		Scenario 4		Scenario 5	
I. TOTAL DONOR RESOURCES	**31.5**	**29.8**	*-5%*	**31.5**	*-0%*	**33.7**	*+7%*	**35.8**	*+14%*	**37.9**	*+20%*
Donor basic contributions	22.2	20.5	*-7%*	22.2	*+0%*	24.5	*+10%*	26.5	*+20%*	28.6	*+29%*
Supplemental contributions	0.1	-		-		-		-		-	
Donor compensation for HIPC (FY12-14)	1.7	2.6		2.6		2.6		2.6		2.6	
Donor financing of arrears clearance operations	1.1	1.2		1.2		1.2		1.2		1.2	
Donor compensation for grant principal forgone	-	0.1		0.1		0.1		0.1		0.1	
Total Donor Contributions	**25.2**	**24.4**	*-3%*	**26.1**	*+4%*	**28.3**	*+13%*	**30.4**	*+21%*	**32.5**	*+29%*
Donor compensation for MDRI (FY20-22)	3.3	3.9		3.9		3.9		3.9		3.9	
Donor compensation for MDRI carry forward (pre FY20)	3.0	1.5		1.5		1.5		1.5		1.5	
Total MDRI Compensation	**6.3**	**5.4**	*-15%*	**5.4**	*-15%*	**5.4**	*-15%*	**5.4**	*-15%*	**5.4**	*-15%*
II. TOTAL INTERNAL RESOURCES	**10.2**	**14.2**	*+40%*	**14.2**	*+40%*	**14.2**	*+40%*	**14.2**	*+40%*	**14.2**	*+40%*
Internal Reflows	6.3	9.5		9.5		9.5		9.5		9.5	
IBRD Transfers	1.9	2.0		2.0		2.0		2.0		2.0	
IFC Transfers	1.9	*[tbd]*		*[tbd]*		*[tbd]*		*[tbd]*		*[tbd]*	
Potential Additional Financing:											
Hardening of lending terms		2.0		2.0		2.0		2.0		2.0	
Acceleration		0.8		0.8		0.8		0.8		0.8	
Total Financing Framework	**41.7**	**44.0**	*+6%*	**45.7**	*+10%*	**48.0**	*+15%*	**50.0**	*+20%*	**52.1**	*+25%*

Notes:

Amounts may not add up due to rounding

IDA16 scenario US$ amounts based on the 3.5 month average exchange rate (1-Feb-10 to 15-May-10) of US$/SDR 1.52173

a/ Original IDA15 Financing Framework as agreed at the start of IDA15. US$ amounts based on IDA15 reference exchange rate of US$/SDR 1.52448.

b/ Based on the three year SDR inflation rate of 5.72%.

BASELINE DONOR CONTRIBUTIONS FOR IDA16

1. **Under the MDRI replenishment, donors agreed to a contribution baseline, representing the floor for their future financial support to regular IDA replenishments**. The contribution baseline serves to establish the actual additionality of donor financing of forgone credit reflows due to debt relief provided by IDA. In the context of the MDRI replenishment,[39] donors agreed that the baseline amount *"would continue to increase by the SDR inflation rate for subsequent replenishments. The actual SDR inflation rate over the preceding three years would be used to determine the baseline volume of regular contributions in each future replenishment."*[40] The actual average inflation rate based on the SDR basket of currencies was 1.87 percent per year, in calendar years 2007-2009.[41] Compounded over three years, regular contributions in IDA16 would therefore increase by 5.72 percent over each donor's regular contributions to IDA15, in SDR.

2. **In addition to basic contributions, donors would cover debt relief costs under the HIPC Initiative and MDRI, financing of arrears clearance operations, and forgone principal reflows due to grants.** Donors have agreed to cover 100 percent of HIPC and MDRI costs (both principal and forgone charges) and forgone principal reflows due to grants through contributions in future replenishments, on a pay-as-you-go basis, without leaving a financing gap. In addition, donors agreed to provide during IDA15 the costs of arrears clearance operations for select countries. Donors have also agreed that contributions to these programs would be additional to donors' regular contributions to a given replenishment.

3. **The total baseline resources from donors for IDA16 are SDR 17.9 billion (US$27.3 billion) including basic contributions set to maintain the IDA15 level in real SDR terms, compensation for arrears clearance, HIPC costs, and principal forgone due to grants**. This represents a 8 percent increase over the agreed donor contributions in IDA15 (SDR 16.5 billion), excluding the potential impact of any decision by donors to accelerate the encashment of IDA16 contributions.

4. **Basic donor contributions**: Based on the inflation rate over the three years from 2007 to 2009 (5.72 percent), a baseline amount equivalent to SDR 15.4 billion (US$23.4 billion) in regular donor contributions would be needed to maintain the level of IDA16 basic contributions in real SDR terms (excluding supplemental contributions and the impact of the acceleration of donors encashment schedules in IDA16). In IDA15, regular donor contributions net of accelerated, supplemental and incentive contributions – amounted to SDR 14.5 billion.

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[39] To finance IDA's forgone credit reflows under the MDRI, donors established a separate MDRI replenishment, spanning four decades (FY07-44).

[40] "Additions to Resources: Financing the Multilateral Debt Relief Initiative," Resolution No. 211 adopted on April 21, 2006. See para 37, page 10.

[41] The SDR-based inflation rate was 2.25 percent in 2007; 3.36 percent in 2008; and 0.04 percent in 2009 respectively. Annual CPI data for the four component currencies of the SDR basket are based on historic consumer prices indices published by Bloomberg.

IDA's Liquid Assets

A. IDA's Financial Dynamics and Risks

1. IDA commitments under a given replenishment are limited to funds from donors and contributions from Bank Group income, complemented by credit reflows and other internal resources of IDA. Within these constraints, IDA's ability to disburse committed funds on schedule is essential for developing countries relying on IDA's cash inflows. IDA's liquidity needs to be managed to ensure that future disbursements on credits and grants will be backed by sufficient liquid funds. To achieve this, donor funds are encashed to match the disbursement profile of credits and grants, and future credit reflows are committed in advance so that resulting disbursements will match the time profile of reflows. Comprehensive liquidity projections are used to validate the availability of resources in the future.

2. IDA's key financial risks include foreign exchange and interest rate exposure. Donor funds are provided in a variety of national currencies whereas IDA's credits and grants are provided in SDRs. The long-term nature of IDA's disbursements creates the potential for substantial interest rate exposure, which is managed through IDA's liquid asset investment policy.

B. IDA's Cash Flows

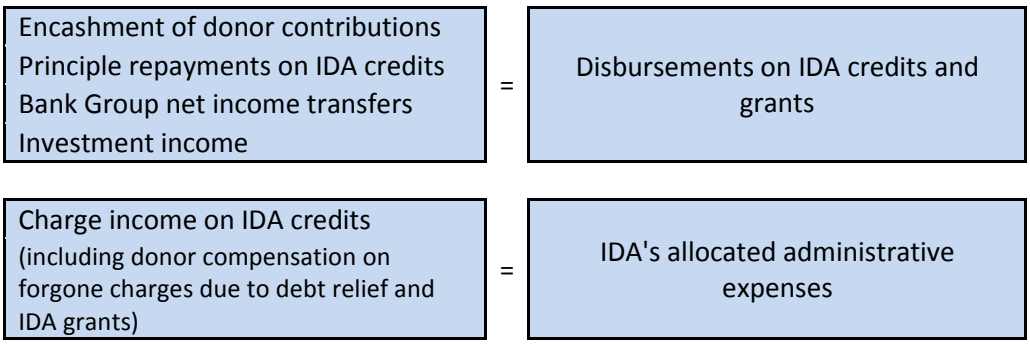
3. *Cash Flow Components*. IDA's cash inflows consist of four primary components (see Chart A): (i) encashment of contributions provided by IDA's donor countries; (ii) credit reflows, including principal repayments and charge income; (iii) Bank Group transfers; and (iv) investment income on IDA's liquid assets. IDA's cash outflows have two primary components: (i) disbursements on approved IDA credits and grants; and (ii) payments to IBRD for IDA's allocated annual share of Bank administrative expenses.

4. *Mismatches in Cash Flows*. In a dynamic equilibrium, cash inflows and outflows would match in any given year, leaving the balance of IDA's liquid assets unchanged. In practice, however, IDA faces timing mismatches between cash receipts from donors and borrowers and disbursements on new credits and grants, leading to changes in the volume of IDA's liquid assets. To manage such mismatches and ensure an optimal use of development resources, IDA employs a number of financial practices:

- *Encashment of donor funds*: Donor funds and IBRD transfers are generally encashed over time to match the average disbursement profile of credits and grants;[42]
- *Advance commitment of credit reflows*: Future repayments on existing IDA credits are committed in advance for new credits and grants so that resulting disbursements match the time profile of credit reflows;
- *Advance commitment of expected investment income:* Projected future investment income is committed at the beginning of each replenishment period; and
- *Annual adjustments of the IDA commitment charge*: Through annual adjustments of the level of commitment charge on IDA credits, total charge income – including donor compensation for forgone charge income due to debt relief – is projected to equal IDA's administrative expenses in a given year.

[42] Donor contributions are encashed on a *pro rata* basis among donors, in accordance with the encashment schedule agreed during the replenishment discussions or as agreed between a donor and IDA. IBRD transfers prior to IDA14 were encashed over 6-9 years. For IDA14 and IDA15, IBRD and IFC transfers were encashed over the 3-year replenishment period upon approval by their respective Board of Governors.

Chart A: IDA's Primary Cash Inflows and Outflows



5. *Minimum Liquidity*. Beyond these practices, IDA needs to be able to address any unexpected demands on its liquidity.[43] This is achieved primarily through a minimum prudent liquidity level for IDA, which is set at one third of annual gross disbursements on credits and grants over a rolling 3-year period. Given IDA's current level of liquidity, maintaining a minimum prudential level of liquidity is of no immediate concern. However, it is an important consideration for IDA's financial planning, including when determining the volume of internal resources to made available in IDA16 and subsequent replenishments.

C. Historical Liquidity Levels of IDA

6. *Relative Liquidity Levels*. Since the mid-1990s, IDA's liquid assets have grown from US$5.7 billion at end-FY95 to US$21.4 billion as of end-FY09. Much of this growth is the result of IDA's increasing assistance levels over time. In relative terms, IDA's total liquidity has been rather stable over the past decade.

7. The most direct measure of IDA's increasing assistance levels over time is the volume of IDA's annual disbursements. In relative terms, while IDA's liquid assets have increased from FY95 to FY99, they remained stable from FY00 through FY09, at about twice the volume of annual disbursements of IDA. IDA's liquidity levels vs. annual disbursements have been comparable to or below those of the African Development Fund and the Asian Development Fund (see Chart B &C).

8. A second measure for IDA's increasing assistance levels over time is the volume of undisbursed credits and grants. A main reason for holding liquidity is to disburse against approved, but undisbursed IDA credits and grants. On this account, IDA's liquidity levels have fluctuated around 60 percent of undisbursed balances since FY00, with a slight increase to 65 percent in FY06, reflecting primarily successful efforts over the past years to further raise disbursement ratios on approved credits and grants.

9. A third measure of the size of IDA's operations is the volume of its total reported assets. Compared against total assets, IDA's liquidity accounted for about 12 percent of total assets between FY00 and FY05. In FY06 and FY07 this increased up to 16 percent, but as of end-FY08, this ratio had again decreased to 13 percent. The increase in FY06 was due to the reduction of IDA's assets from US$130.4 billion at end-FY05 to US$102.9 billion at end-FY06, following loss provisions recorded in FY06 representing debt relief to be delivered by IDA under the MDRI.

[43] While IDA is allowed under its Articles to borrow, it does not do so as a matter of practice.

Chart B: Relative Levels of Liquidity of Soft-Loan Windows (IDA, AfDF and AsDF)

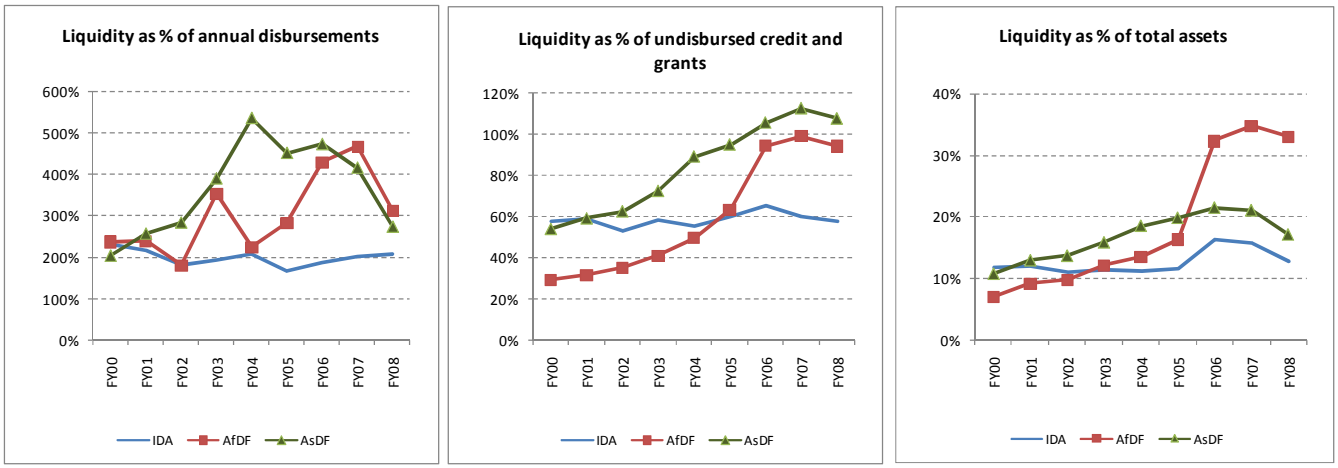
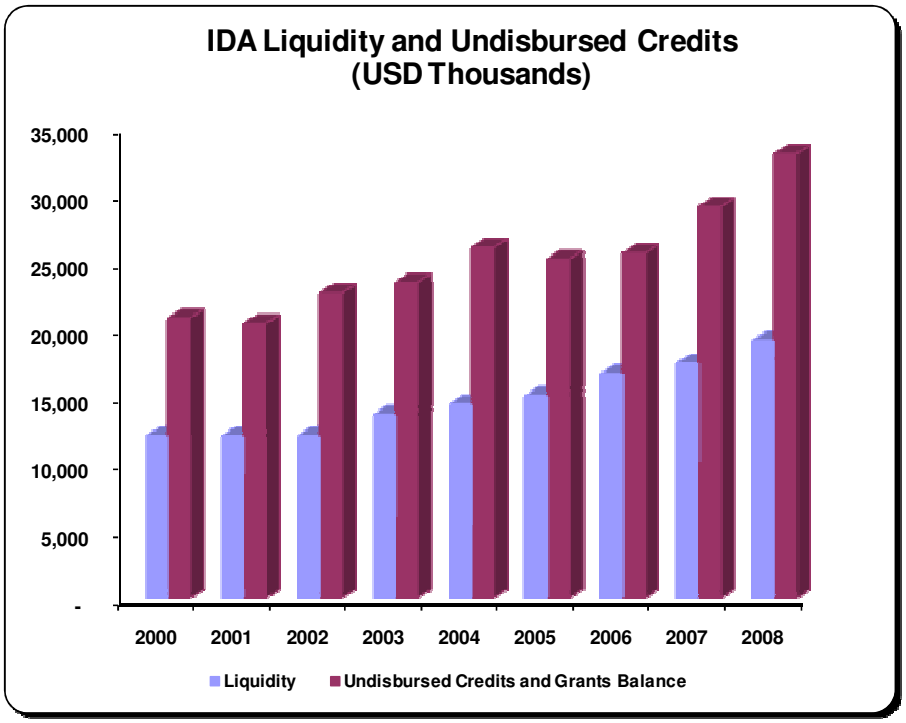


Chart C: IDA Liquidity and Undisbursed Credits and Grants (US$ Thousands)



10. *Acceleration of Donor Encashments*. Beyond the overall growth of IDA's financing activities, the primary driver for the increase in IDA's liquid assets has been the substantial increase in the number of donors accelerating their IDA encashments. Donors accelerate their IDA encashments either to receive payment discounts or as a way of providing additional resources to IDA. IDA needs to earn the discount rate when investing the accelerated portion of donor funds to generate the target volume of donor contributions for the replenishment.[44]

[44] The discount rate varies with market conditions. The rate reflects IDA's expected future return on liquid assets over the 9-year encashment period of donor contributions. For IDA15, the agreed discount rate is 4 percent per year.

11. Over the past nine years, accelerated encashment by donors has increased heavily, more than doubling IDA's total liquidity in the process. The incremental cash balance held by IDA due to accelerated donor encashments has increased from less than US$100 million in FY00 to an estimated US$12.7 billion at the end of FY09. For IDA15, all donors agreed to accelerate their contributions to a 9-year encashment schedule from the 11-year disbursement profile in order to help reduce the structural financing gap. In addition, IBRD and IFC contributions in IDA15 are encashed over 3 years, rather than over the standard 9-year profile, adding additional liquidity.

12. As of April 30, 2010, total liquidity from accelerated encashment was US$11.9 billion, representing 55 percent of total IDA liquidity of US$21.7 billion. These liquid funds need to be invested to generate sufficient income to cover donors' acceleration discounts and both the principal and interest amounts will be drawn down for disbursements for credit and grant commitments over the respective replenishment disbursement periods up to FY19.

D. Using Market-based Instruments for Hedging Currency Risk of IDA

13. IDA is exposed to foreign exchange risk due to currency mismatches between cash receivables from IDA's donors which are generally pledged in national currencies[45], and SDR-based disbursements under IDA's credit and grant commitments. Since, 2000, IDA was using a liquidity-based currency risk management framework which took a broad, portfolio-based view of IDA's finances. The framework maintained the combination of IDA's net assets – comprised of liquid asset investments plus the present value of future cash receivables and payables of IDA – in an SDR composition, thereby matching the currency of IDA's disbursements. For IDA15, IDA's currency exposure exceeded the limits of the currency risk management framework, as IDA's liquidity balance was not sufficient to balance the off-SDR currency exposure from donors' expected combined inflows under IDA15 and prior replenishments. Management therefore considered it necessary to add foreign exchange derivatives to IDA's currency hedging tools to cover the currency exposure of IDA starting from FY09, including the exposure resulting from expected donor inflows under IDA15. Under the new framework, IDA enters into foreign exchange swaps to convert donors' encashments provided in national currency into the four currencies of the SDR basket (i.e., U.S. dollar, Euro, Pound Sterling and Japanese Yen).[46] Currently, in order to access the derivative market, IBRD intermediates IDA's access to the foreign exchange market. IBRD enters into currency swaps with market counterparties and enters into back-to-back transactions with IDA.

14. Since the implementation of the hedging framework in May 2008, IDA's hedges have generated realized gains, offsetting weaknesses in currencies of donor contributions during the global financial crisis. If IDA had left its portfolio unhedged over this period, it would have suffered significant losses thereby reducing its commitment authority. In the coming year, the composition of the SDR basket will be revised, and IDA's hedging program will need to be adjusted to accommodate this change. In addition, new donor contributions under IDA16 will need to be incorporated in the hedging program starting in June 2011.

E. Investment Policy and Liquidity Tranching

15. *Investment Policy Objectives.* The primary objective in the management of the liquid assets of IDA is to provide a ready source of liquidity when needed by IDA to meet projected net cash requirements. Consistent

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[45] For IDA15, there are 45 donors providing contributions in 25 different currencies.

[46] Exposure from donors' encashments are combined with exposure resulting from other non-SDR cash flows of IDA, including inflows from IBRD and IFC (in U.S. dollars); inflows from credit repayments on U.S. dollar-denominated IDA credits; and outflows for IDA's annual administrative expenses (in U.S. dollars).

with the primary objective, IDA also seeks to maximize returns subject to loss constraints to generate investment income which can be added to IDA's resources.[47] In line with the above, IDA's assets are invested so that their duration closely matches the duration of net liabilities, defined as projected net cash outflows.

16. It has been the practice for Management to review IDA's investment strategy on a regular basis, in conjunction with each new IDA replenishment. The IDA15 review benefited from the investment experience over the past years. During this time, IDA has seen a marked increase in accelerated donor and World Bank Group encashment balances and turbulent market conditions that have had both positive and negative impacts on IDA's portfolio and on expectations for future returns. Previously, Tranche 1 of IDA's liquid assets consolidated accelerated donor contributions with the projected volume of liquidity needed to fund prior and current financing commitments. While accelerated donor balances are increasing rapidly, the liquidity balances held to fund prior and current replenishments are decreasing. To enhance transparency and better reflect the strong dominance of donor accelerations within IDA's total liquidity, the portfolio of accelerations became separately managed as Tranche 1. In addition, for the remaining, core liquidity of IDA, it was beneficial for IDA to establish two separate tranches according to the applicable investment horizon for these liquid assets: one for IDA's medium-term investments in Tranche 2 and another for short-term working capital investments in Tranche 3. This separation has helped improve transparency and allow for better tailoring of investment objectives to the purpose for holding liquidity.

17. *Liquidity Tranching*. Based on the above considerations, the structure of IDA's liquidity is divided into three tranches starting from FY09:

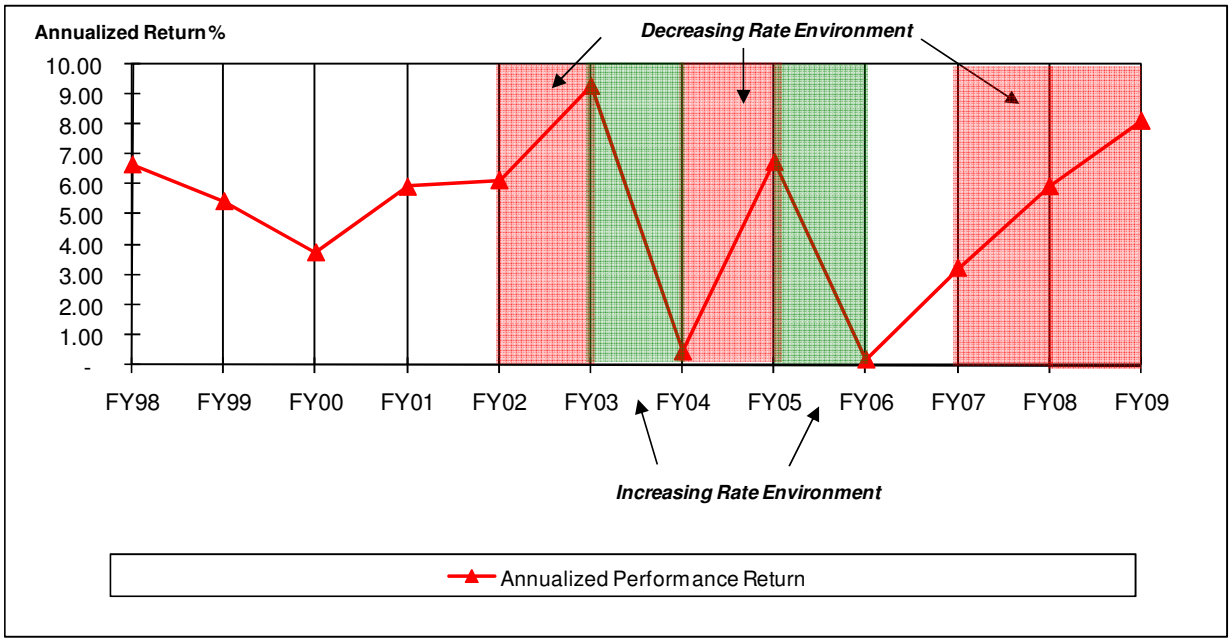
- Tranche 1 ('the Donor Acceleration Tranche') immunizes IDA from interest risks relating to accelerated encashments from donors and transfers from the World Bank Group. To enhance transparency, Tranche 1 has three components, to separate accelerated balances by replenishment:
    - IDA13 accelerated donor balances;
    - IDA14 accelerated donor balances; and
    - IDA15 accelerated donor balances.
- Tranche 2 ('the Medium-term Investment Tranche') includes core liquidity of IDA which is expected to be available over at least a 3-year investment horizon. The investment objective of Tranche 2 is to maximize investment returns, subject to risk constraints in the form of a maximum probability of negative return over a 3-year time horizon. Tranche 2 has three components:
    - The projected volume of liquidity reduction of IDA due to prior and current assistance commitments;
    - Liquidity available for future commitments, to be provided as internal resources in support of future IDA replenishments; and
    - 40 percent of minimum liquidity, required for unexpected liquidity needs of IDA's operations.
- Tranche 3 ('the Short-term Investment Tranche') includes liquidity needed for IDA's ongoing financial operations. The paramount investment objective of Tranche 3 is to ensure liquidity and timely availability of the investment balances when needed, with investment returns being a secondary consideration, subject to a maximum acceptable probability of negative return over a 1-year time horizon. Tranche 3 has two components:
    - Working capital required for ongoing cash flow needs; and

[47] "IDA Liquid Assets Investment Guidelines", November 6, 2003.

- 60 percent of minimum liquidity, required to manage expected cash flow volatility.

18. *Performance of Liquidity Portfolio*. Table A shows the historical investment returns on IDA's liquid assets. IDA's liquidity features a relatively long duration (i.e., interest sensitivity). This leads to lower (higher) portfolio returns in years when market interest are rising (declining), in view of the inverse relationship between fixed income asset prices and market interest rates. Actual reported investment returns are financially inconsequential in so far as the increase (decrease) of the marked-to-market value of the bond portfolio will be off-set by a decrease (increase) of the present value of the contracted net cash outflows of IDA. IDA's investment returns for FY09 were 8.11 percent reflecting primarily mark-to-market gains on IDA's long duration bond portfolio due to downward shifts in the US$, EUR and GBP market yield curves. Lower incremental returns are expected for FY10 due to the low interest rate environment and the possible upward shift in yield curves. Management closely monitors the investment portfolio of IDA, so as to maintain compliance with applicable risk parameters and investment guidelines.

Table A: Investment Portfolio Return of IDA (since FY98)



MDRI Financing Summary – IoCs Received as of March 31, 2010
(in US$ million equivalent)

Financing Received from IDA Donors	FY07-08 USDm	FY07-08 in%	IDA15 Period FY09-19 USDm	IDA15 Period FY09-19 in%	FY20-44 USDm	FY20-44 in%	FY07-44 (Total MDRI Costs) USDm	FY07-44 (Total MDRI Costs) in%
Unqualified Financing	740.27	98.6%	5,462.94	55.6%	708.85	2.6%	**6,912.06**	**18.4%**
Qualified Financing	-	0.0%	3,424.63	34.9%	22,476.55	83.3%	**25,901.18**	**68.9%**
Sub-Total IOCs Received	**740.27**	**98.6%**	**8,887.57**	**90.5%**	**23,185.40**	**85.9%**	**32,813.24**	**87.3%**
IOCs Not Received	1.05	0.1%	16.73	0.2%	45.96	0.2%	**63.74**	**0.2%**
IOC Shortfall	-	0.0%	133.50	1.4%	1,603.22	5.9%	**1,736.72**	**4.6%**
Structural Gap	9.70	1.3%	782.75	8.0%	2,162.15	8.0%	**2,954.60**	**7.9%**
Sub-Total To Be Committe	**10.75**	**1.4%**	**932.98**	**9.5%**	**3,811.33**	**14.1%**	**4,755.06**	**12.7%**
Total	**751.02**	**100.0%**	**9,820.55**	**100.0%**	**26,996.73**	**100.0%**	**37,568.30**	**100.0%**

Note: Amounts exclude surplus resulting from financing received higher than donor's target contributions under the current cost structure.

a/ Based on IDA15 MDRI cost estimates as of September 30, 2007

Donor Financing of IDA's Forgone Reflows due to the MDRI:
Firm Financing Required through IDA15 Disbursement Period (up to FY19)
As of March 31, 2010
(US$ equivalent millions)

Donors	A Firm Financing Commitments Received (Unqualified)	B Total Firm Financing required through FY19	B-A **Firm Financing required through FY19**
Australia	170.21	170.21	-
Austria	82.46	82.46	-
Belgium	40.02	163.87	**123.85**
Canada	872.82	411.34	-
Cyprus	-	1.98	**1.98**
Czech Republic	5.29	5.29	-
Denmark	183.95	183.95	-
Finland	67.77	67.77	-
France	517.48	648.50	**131.02**
Germany	1,036.20	1,036.20	-
Greece	13.73	13.73	-
Hungary	4.96	6.35	**1.39**
Iceland	3.17	4.24	**1.07**
Ireland	79.57	21.15	-
Italy	51.89	416.05	**364.16**
Japan	331.50	1,391.91	**1,060.41**
Korea, Republic of	96.87	96.87	-
Kuwait	57.66	15.86	-
Latvia	-	0.99	**0.99**
Luxembourg	40.05	10.54	-
Netherlands	303.39	303.39	-
New Zealand	13.73	13.73	-
Norway	200.21	177.59	-
Poland	2.18	3.16	**0.98**
Portugal	82.69	23.28	-
Russian Federation	33.39	9.53	-
Saudi Arabia	16.31	41.23	**24.92**
Singapore	-	14.81	**14.81**
Slovak Republic	0.98	1.06	**0.08**
Slovenia	0.57	3.16	**2.59**
South Africa	29.47	9.53	-
Spain	210.38	210.38	-
Sweden	305.51	305.51	-
Switzerland	152.71	258.75	**106.04**
United Kingdom	1,463.17	1,463.17	-
United States	449.96	2,191.58	**1,741.62**
TOTAL	6,920.25	9,779.12	**3,575.91**

a/ Based on IDA15 MDRI cost estimates as of September 30, 2007.

ANNEX 7

IDA CREDIT GUARANTEES

1. Guarantees are an effective catalyst for raising private financing and for leveraging resources. As noted in the Review of the IDA Guarantee Program[48] completed in 2009, IDA guarantees have contributed successfully to mobilizing private capital, enabling IDA client countries to leverage their limited IDA resources and marshal project financing of approximately ten times the IDA commitment. IDA guarantees have contributed successfully towards development objectives of IDA countries. No IDA guarantee has been called to date, and while specific project challenges remain, host governments have honored their contractual commitments as agreed.

2. As part of the review of IDA guarantees, management highlighted that it would explore a possible future expansion of IDA guarantee instruments, beyond the existing private sector Partial Risk Guarantees, to include guarantees on sovereign debt, either through Partial Credit Guarantees (PCGs) for investment operations or Policy-Based Guarantees (PBGs) for fiscal support, or both as in the case of IBRD.[49] This was in part a response to the various reports and Bank working groups that recommended that credit guarantees be made available to IDA countries. The most comprehensive report was the IEG report on WBG guarantees,[50] which recommended that Bank management maintain and promote credit guarantees as a countercyclical tool to leverage government access to commercial funds and extend such access to IDA countries. In particular, it noted that "given the growing number of IDA countries that fit the profile of well-performing countries with restricted access to markets, the option of a PCG instrument should be expanded to IDA countries. Current incentives in the Bank promote direct Bank lending rather than leveraging of private commercial finance, yet PCGs can have significant development impact and additionality in the right circumstances."

3. Key issues to consider when introducing credit guarantees are the effects on country debt sustainability, and how to adopt these instruments in a prudent manner in the context of IDA. Moreover, the notable unique issues for IDA credit guarantees are the lack of an IDA credit rating (versus the triple-A rating for IBRD) and the concessionality embedded in IDA's fully funded instruments. Introduction of these instruments would also require that the risk to IDA be adequately mitigated, to safeguard IDA's long-term financial capacity, and require equitable treatment for IDA client countries.

4. A number of positive trends bear consideration, which now make credit guarantees more feasible. First, IDA client countries and Bank managers and staff are seeking more sophisticated options and greater flexibility in structuring of IDA programs and have requested PCGs and PBGs. Credit guarantees could be particularly beneficial to IDA countries, given their high financing costs and lack of credit ratings in general, to improve market access, extend the tenor of available financing, and potentially reduce borrowing costs. These guarantees could provide an additional tool on, for example, high-return projects, endorsed by the Bank, where external financing is available. The Bank also now only effectively applies 25 percent against country allocation for guarantees, as compared to 100 percent prior to 2004, therefore substantially reducing the opportunity cost of using IDA allocation for guarantees.

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48 "Review of the IDA Guarantees Pilot Program"; IDA/R2009-0137 dated March 20, 2009

49 Partial Risk Guarantees (PRGs) cover commercial lenders to a ***private sector*** investment project against default on a loan arising from a government-owned entity failing to perform its obligations with respect to the private investment project. Partial Credit Guarantees (PCGs) primarily support ***public sector*** borrowing (through loans and bonds) from commercial creditors to finance public investment projects. They provide commercial lenders with partial coverage, as to a specific portion of debt service payments for an investment project. Policy Based Guarantees (PBGs) are a type of PCG that cover a portion of debt service on government borrowing (through loans or bonds) from commercial creditors to support an agreed policy and institution reform program.

50 "World Bank Group Guarantee Instruments 1990-2007: An Independent Evaluation"; CODE2008-0037 dated 2009.

ANNEX 7

IDA CREDIT GUARANTEES

5. It is anticipated that IDA credit guarantees would likely remain a niche instrument, demand driven and selectively utilized, and could be approved within the existing risk limits for IDA guarantees. Implementation could be consistent with and complement IDA's efforts on debt sustainability. Given the existing authorization to provide guarantees, management will finalize its assessment and will likely seek approval from Executive Directors to expand the application of IDA guarantees. The instrument would be prudently applied, within appropriate program parameters, established in order to reduce the risk to IDA and to ensure equitability among IDA client countries.