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IDA18 Mid-Term Review

Transitioning out of IDA financing:

A review of graduation policy and transition process

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ACRONYMS AND ABBREVIATIONS

World Bank's Fiscal year (FY) = July 1 to June 30

AfDB	African Development Bank
AfDF	African Development Fund
ADB	Asian Development Bank
ADF	Asian Development Fund
CEMAC	Central African Economic and Monetary Community
COP21	Conference of the Parties
CPIA	Country Policy and Institutional Assessment
CPF	Country Partnership Framework
CRW	Crisis Response Window
DPF	Development Policy Financing
FSO	Fund for Special Operations
GAVI	Global Alliance for Vaccines and Immunization
GDI	Graduation Discussion Income
GDP	Gross Domestic Product
GNI	Gross National Income
HCI	Human Capital Index
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
LIC DSA	Low-Income Countries Debt Sustainability Analysis
MPA	Multi-Phased Approach
MTR	Mid-Term Review
NPV	Net Present Value
OCR	Ordinary Capital Resources
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OECS	Organization of Eastern Caribbean States
PBA	Performance-Based Allocation
PF	Petroleum Fund
PforR	Program-for-Results
PPP	Public-Private Partnership
PRGT	Poverty Reduction and Growth Trust
RDB	Regional Development Bank
RSW	Refugee Sub-Window
SCD	Systematic Country Diagnostic
SCI	Synthetic Creditworthiness Indicator
SDG	Sustainable Development Goal
SDR	Special Drawing Rights
SIEE	Small Island Economies Exception
SUF	Scale-Up Facility
WBG	World Bank Group

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EXECUTIVE SUMMARY

i. **During the IDA18 replenishment negotiations, Participants reviewed IDA's graduation process.** They agreed that the current process, which is both flexible and holistic, has helped countries make successful and lasting exits from IDA. They welcomed the addition of three new countries—Bolivia, Sri Lanka, and Vietnam—to the list of 35 countries that have successfully graduated from IDA. At the same time, they noted that these three countries were facing increasingly complex challenges and global headwinds and there were uncertainties in IBRD's financial capacity. They, therefore, agreed to provide transitional support in the amount of two-thirds of the resources that these countries received in IDA17 and temporarily suspend the IDA acceleration clause.

ii. **For the IDA18 mid-term review (MTR), Participants requested a holistic review of the transition from IDA to IBRD, taking into account IBRD's financial capacity.** The review would also include analysis on the role of the blend period to ensure graduation readiness, covering financing for blends, including the current cap on large blend borrowers and measures to prepare countries for graduation. They also asked for a review of the level of transitional support to Bolivia, Sri Lanka, and Vietnam, as well as of the contractual acceleration clause. This report responds to that request.

iii. **Since the IDA18 negotiations concluded, the IBRD/IFC capital package, endorsed by the Development Committee in the Spring of 2018, has substantially strengthened the ability of the World Bank Group (WBG) to support its clients as they move up the income spectrum.** As part of this capital package, IBRD will prioritize support to IDA graduates and new blend countries, aiming to make available resources to fully replace IDA financing for IDA graduates. The package also provides for IBRD to adopt IDA's long-standing practice of price differentiation based on country income and circumstances. This helps ensure a more gradual change in the terms of financing throughout IDA/IBRD's spectrum of client countries. Finally, the capital package made permanent the IDA18 formula for IBRD transfers to IDA, enabling larger transfers to IDA in the future along with higher retention to its own reserves.

iv. **This report undertakes a holistic review of the process of the countries' transition from IDA to IBRD.** The issues covered include the graduation process in the context of the IBRD capital package, the World Bank's support to blend countries through its country programs and opportunities for using the blend period effectively for preparing for successful graduation from IDA, and issues of financing countries' transition from IDA to IBRD, including the contractual acceleration clause, the cap on allocations to large blend countries, and the transitional support. The report also looks at the special case of the transition of Small States. Since it has been decided to combine the IDA18 Mid-Term Review (MTR) and the first IDA19 Replenishment Meeting, the report also provides an update on the graduation outlook and its financial implications.

v. **The report emphasizes how important it is for the transition process to be country-specific and gradual.** The process of transitioning from IDA to IBRD financing has three aspects: (a) the design of the country programs, (b) the rules for accessing financing, and (c) the terms of this financing. IDA pays close attention to all three aspects. Among outcomes, this has enabled a series of graduations—the seven countries that graduated over the last two replenishments alone accounted for 27 percent of IDA commitments since inception (in real terms)—while avoiding reverse graduations. The 2018 IBRD capital increase further strengthened the gradual nature of the transition path.

vi. **The report also emphasizes how critical the effective use of the World Bank's lending and advisory engagement is for helping countries prepare for their graduation from IDA.** Given the large variation in development challenges faced by individual blend countries, more generalized approaches are unlikely to work. While there are some general themes of support—economic transformation, debt

management, and institutional development—the specific priorities will vary across countries and will require the full range of the Bank lending and analytical tools to ensure early involvement on transition-related issues, including to coordinate with other development partners. There are in addition two main cross-cutting issues: assisting the blend countries in addressing risks of debt distress, and transfer of knowledge and tools related to this transition.

vii. **Looking at access to World Bank finance, the review finds that access is usually quite stable through the transition and proposes the following:**

(a) **To reduce the total transitional support available to the countries during IDA18 by about one-third, with reduction being in a range between US$900 million and US$1.3 billion.** Introduced in IDA17, transitional support helped smooth the transition to IBRD at a time of uncertainty regarding the availability of IBRD resources for recent graduates. With its capital increase, IBRD's commitment to aim at fully replacing the IDA financing for IDA graduates reduced this uncertainty. The current recipients—Bolivia, Sri Lanka, and Vietnam—can now benefit from additional IBRD resources. Therefore, the amount of transitional support can be reduced, but some flexibility in the timing and amounts of commitments is necessary to accommodate country-specific situations and avoid any discontinuities.

(b) **To explore during IDA19 replenishment negotiations providing to recent IDA graduates access to IDA's Crisis Response Window (CRW) and Regional Program, including the Refugee Sub-Window (RSW)**, for a limited period after the graduation—for example, during three subsequent replenishments. This would deal with the specific access issues that graduates might face in the aftermath of a large crisis and would maintain incentives and support for providing regional public goods, often with spillovers to IDA countries. This would be particularly relevant for small islands exposed to natural disasters which may need such support longer than others. Management also recommends exploring that any IBRD-only Small State be granted access to CRW in the aftermath of a severe natural disaster if (i) its pre-disaster per capita income did not exceed the high-income threshold and (ii) it has limited access to IBRD resources.

(c) **To maintain the 7 percent cap on the performance-based allocation (PBA) for blends with large populations and long access to IDA and IBRD.** Pakistan would remain the only current blend country whose allocation is capped in IDA18.

(d) **To revise the Small Island Economies Exception (SIEE) to allow entry to IBRD-only Small Island Economies that, in Management's assessment, meet the following four conditions:**

1) The country's per capita income is at or below IBRD's Graduation Discussion Income (GDI) (currently US$6,795).
2) The country has limited access to IBRD resources.
3) The country has limited creditworthiness for accessing commercial credit.
4) The country is highly vulnerable to natural disasters and climate change.

viii. **IDA's differentiated financial terms are supportive of the transition process; the report looks at two issues related to them.** Management recommends that the contractual acceleration clause should continue to be suspended through the end of IDA18 replenishment for the three countries that graduated from IDA at the end of IDA17. This recommendation is consistent with the objectives of the IBRD capital package commitment to aim at maintaining the volume of World Bank lending to IDA graduates at least constant and keep the financial terms lower compared to that for other IBRD countries. Simulations suggest that the aggregate impact of such suspension on IDA's finances is relatively modest. Management also recommends exploring in the IDA19 negotiations, changing the terms of lending for Small States once they reach a certain level of development (this would apply to both island and non-island Small States). Under

this proposal, a higher level of development and resilience to shocks could trigger IDA blend terms. Such an approach would recognize that the ability of a Small State to cope with shocks increases with development, while also recognizing that even at higher levels of development, some Small States may be more vulnerable compared to other economies. It would help smooth the transition in the terms of financing for this group of countries.

ix. **A review of the graduation readiness of the current blend countries indicates that all of them are facing significant headwinds.** The report summarizes country-specific findings of this review. Management will further review this matter to make a final recommendation at the June meeting of the IDA19 replenishment. The challenges notwithstanding, two blend countries with low poverty rates and relatively high incomes per capita—Moldova and Mongolia—deserve further consideration. These countries have a poverty headcount close to zero at the US$1.90 poverty rate. However, they do have macroeconomic and institutional vulnerabilities. Management will further review these cases to finalize a recommendation at the June meeting of IDA19 replenishment.

x. **Finally, the report reviews the outlook for graduation in the longer term.** While blend countries are currently facing headwinds, making it more difficult for them to graduate at the end of IDA18, a significant number of graduations is likely to take place during the next decade. Vulnerabilities created by elevated risks of debt distress are the principal challenge currently inhibiting graduation of most blend countries. Longer-term graduation prospects also deserve close attention. During the IDA18 replenishment negotiations, IDA for the first time performed analysis of the long-term graduation trends based on simple stylized facts about blend countries, such as the ratios between their incomes per capita and IDA operational cutoff and the time since they attained blend status. The methodology for such projections has been now refined to account for uncertainties surrounding the transition paths, including the recent rapid rise in risks of debt distress in IDA countries, large fluctuations in commodity prices and their impact on economic growth in these countries, and the uncertainty about the ability of Africa's labor markets to generate annually 11 million jobs needed to employ the new entrants. A considerable number of graduations is expected to happen in the 2020s, with countries representing over 20 percent of today's population expected to graduate by 2030. Nevertheless, the overall population of IDA countries is expected to remain nearly constant between the IDA18 and the IDA22 replenishments because population growth (a cumulative 25 percent) would outweigh reductions in population driven by expected graduations. This in fact is similar to the experience in IDA17, where the cumulative population growth of IDA countries was 5.4 percent, whereas the reduction in population from the graduation of Bolivia, Sri Lanka, and Vietnam was only 4.1 percent.

xi. **Staff would welcome the Participants' views on:**

- The approach on how to effectively use the blend period for preparing for successful graduation from IDA (paragraph 53);
- The future of the transitional support to graduating countries (paragraph 69);
- The proposal to reduce IDA18 transitional support by one-third (paragraph 70);
- The proposal on capping allocations to blend countries with large cumulative World Bank commitments (paragraph 72);
- The proposal to keep the contractual acceleration clause suspended for Bolivia, Sri Lanka, and Vietnam (paragraph 77);
- The proposals for revising the SIEE policy and exploring changing financing terms for IDA-eligible Small States once they reach a certain level of development (this would apply to both island and non-island Small States (paragraph 83); and
- The outlook for graduation (Section IV).

INTRODUCTION

1. **At the request of the Participants of the IDA18 replenishment negotiations, this report reviews the process of transitioning out of IDA financing.** The IDA graduation policy is a cornerstone of IDA, enabling it to target resources to countries that need it most in a context where the demand for IDA resources far outstrip the supply. A critical objective of this policy is to ensure that graduations are a sign of success: reverse graduations—making graduated countries eligible again to IDA—would be (a) adversely affecting reputations of the countries and their governments and (b) disruptive for planning purposes. The intention is also to avoid fiscal cliff-effects from the transition from concessional to non-concessional funding. Therefore, a smooth transition out of IDA financing has two features: (a) development of the policy and institutional features for countries in their transition before they graduate and (b) appropriate timing, to ensure that graduation does not happen prematurely while the objective of targeting resources to the countries that need it most requires avoiding unnecessarily delayed graduations.

2. **The purpose of this review is to assess IDA's experience with these issues and make recommendations for improvements in line with the guidance from the Participants.** For the IDA18 mid-term review (MTR), Participants requested a holistic review of the transition from IDA to IBRD, taking into account IBRD's financial capacity. The review would also include analysis on the role of the blend period to ensure graduation readiness, covering financing for blends, including the current cap on large blend borrowers and measures to prepare countries for graduation. The Participants also asked for a review of the level of transitional support to Bolivia, Sri Lanka, and Vietnam, as well as of the contractual acceleration clause. This report responds to that request. Since it has been decided to combine the MTR and the first IDA19 Replenishment Meeting, the report also provides an update on the graduation outlook and its financial implications and looks at the issues related to the transition of Small States.

3. **The IBRD capital package, endorsed by the Development Committee in Spring 2018, has enhanced the context of transitions out of IDA financing after the Participants' request was made.** As part of the policy package, IBRD will prioritize support to IDA graduates and new blends, aiming to make available resources to replace 100 percent of IDA financing for IDA graduates, helping ensure sustainable IDA graduations. The package also includes measures that help smooth the transition by making the change in the terms of financing more gradual throughout the IDA/IBRD spectrum of client countries at different levels of development.

4. **The capital package has reinforced a well-established transition process from IDA to IBRD**. The transition involves (a) a specific focus on issues related to transition and graduation in the Country Partnership Frameworks (CPFs) of the transitioning countries; (b) a shift in access from IDA only, to both IDA and IBRD, to IBRD only (with better access guaranteed by the capital package for recent graduates); and (c) a shift in the terms of financing, which are now differentiated by income levels of the client countries. IDA's decisions on the issues related to this transition take into account policies and practices of other development partners on allocating their financing to the country in question.

5. **The report builds on the findings of earlier analyses** discussed during previous IDA replenishments (World Bank 2012, 2016); on analytical work produced by other multilateral institutions and think tanks (for example, ADB 2016; Kharas Prizzon, and Rogerson 2014; and Rose, Collinson, and Kalow 2017); and on feedback received from various stakeholders during consultations.[1] World Bank (2012) looked at the factors associated with successful graduation outcomes, discussed the broad

[1] Including the session on graduation policy and transition support of the 14th Multilateral Development Banks-Multilateral Financial Institutions Technical Meeting on Performance-Based Allocation (PBA) Systems and a number of bilateral consultations.

parameters that could guide transitional support helping to smooth countries' transition from IDA-eligibility to IBRD-only status, and examined the feasibility of using alternative measures of relative poverty to complement the per capita income criterion, concluding that they were not feasible. World Bank (2016) concluded that IDA's flexible and holistic graduation process has helped countries make a successful and lasting exit from IDA, that IDA's operational gross national income (GNI) per capita cutoff is set at an appropriate level, and there was no pressing case for modifying it and recommended a more coordinated approach within and outside the World Bank to smooth transition to non-concessional finance for IDA graduates.

6. **The remainder of the report is organized as follows.** Section I describes IDA's graduation process and puts it into a context of the IBRD capital package and the approach other development partners take to graduation. Section II looks at the World Bank's support to blend countries and discusses opportunities for using the blend period effectively for preparing for successful graduation from IDA. Section III takes the recipients' perspective to look at the issue of financing countries' transition from IDA to IBRD, including the contractual acceleration clause, the cap on allocations to large blend countries, and the transitional support. Section IV provides outlook for IDA graduations. The final section suggests issues for discussion by the MTR Participants.

I. REVIEW OF IDA GRADUATION PROCESS

7. The process of transitioning from IDA to IBRD financing has three aspects: (a) the design of the country programs, (b) the rules for accessing financing, and (c) the terms of this financing. This section describes the World Bank's approach and summarizes similar processes of other development partners.

A. IDA GRADUATION PROCESS

8. **IDA has a flexible multistage graduation process which relies on careful case-by-case analysis of specific country situations.** IDA provides concessional financing (credits, grants, and guarantees) to the world's poorest countries to help reduce poverty and improve living standards. IDA's eligibility criteria are constructed around (a) absence of creditworthiness and (b) the concept of absolute poverty, as measured by GNI per capita below the IDA operational cutoff (US$1,145 for FY19). The IDA graduation process involves multiple stages, offering countries an opportunity to gradually adjust to tighter terms of financing (Figure 1) as they move from IDA-only non-gap to IDA-only gap, to IDA-blend, and then graduate to IBRD-only status, as well as different access to IDA and IBRD. Flexibility in graduation decisions is important because countries remain vulnerable even when they exceed the per capita income cutoff.

9. **A country's transition from IDA to IBRD usually proceeds the following way** (see Annex 1 for a list of countries in each stage):

- **IDA-only non-gap to IDA-only gap.** Countries that have been above the IDA operational cutoff[2] for more than two years but are not yet deemed creditworthy for IBRD financing are classified as IDA-only 'gap' countries.
- **IDA-only non-gap or IDA-only gap to blend.** A positive creditworthy assessment by IBRD leads to reclassification of a country from IDA-only non-gap or IDA-only gap status to blend status (IDA/IBRD). The assessment needs to be requested by the country.

[2] A country may graduate from IDA before its per capita income reaches the operational cutoff if it has been assessed as creditworthy and is able to meet its financing needs from IBRD and other commercial sources. Such countries would normally have strong export earnings and large international reserves, a good credit rating, and a demonstrated track record of borrowing in international capital markets.

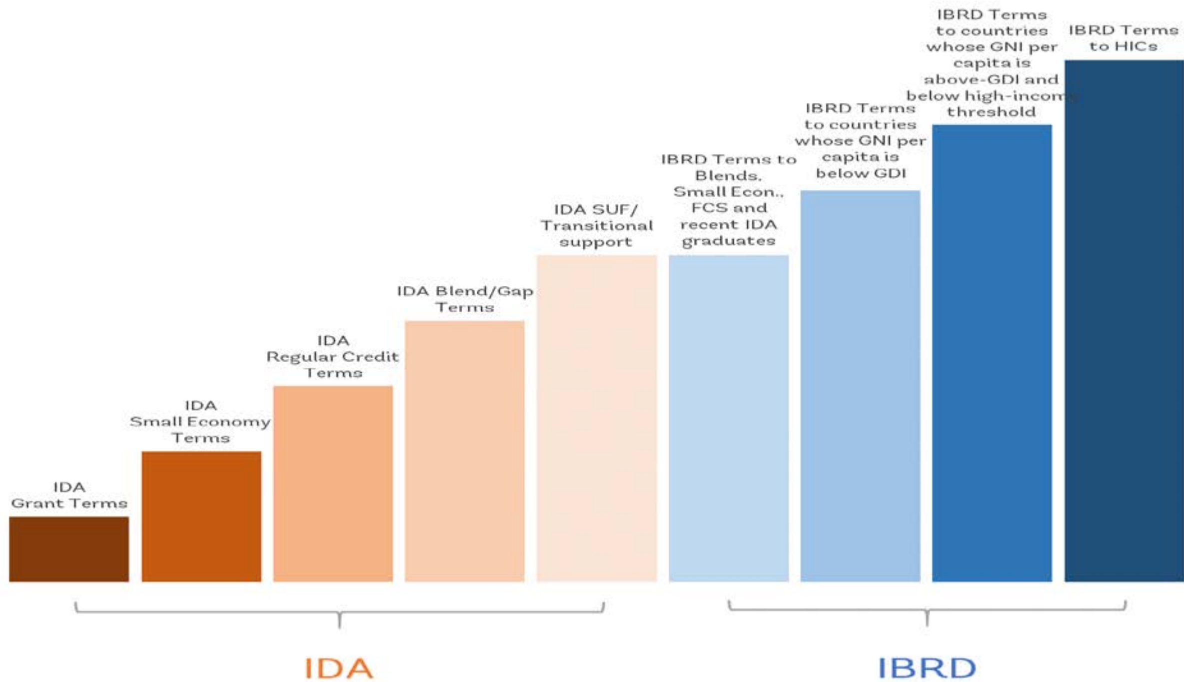
- **Blend to IBRD-only.** The IDA graduation process concludes with a reclassification from blend status to IBRD-only borrower. The IDA decision to graduate a country to IBRD-only status is based on an assessment of the country's macroeconomic prospects, risk of debt distress, vulnerability to shocks, institutional constraints, and levels of poverty and social indicators.
- During the IDA17 and IDA18 replenishments, four graduates (India, Bolivia, Sri Lanka, and Vietnam) have been receiving transitional support from IDA (credits on non-concessional IBRD terms) during the first three years after graduation. Past IDA commitments to all graduates continue to disburse as projects progress.

10. **Country programs.** The WBG supports the countries' transition from IDA to IBRD as a part of implementation of the respective country programs. The central tool of Management and the Board for reviewing and guiding the country programs and gauging their effectiveness is the CPF. When preparing a CPF, the WBG works with the government, in consultation with key stakeholders in the country, to draw on the findings of the Systematic Country Diagnostic (SCD) and knowledge of the WBG's comparative advantage, to determine the CPF objectives and flexible program of engagement.

11. **Access to World Bank financing.** As countries move along the continuum of this transition, their access to World Bank resources varies. IDA-only countries (whether gap or not) have access to IDA and all its windows—with the exception of countries with high risk of debt distress that do not have access to the Scale-Up Facility (SUF) and the blend countries that, for the most part, do not have access to the Private Sector Window. Blend countries have access to both IDA core envelopes and most other windows, as well as to IBRD. The 2018 IBRD capital package ensures prioritization of blend countries (and recent IDA graduates) in the allocation of IBRD resources. After graduation, countries only have access to IBRD resources. Since 2015, that is, in IDA17 and IDA18, recent graduates have had access to transitional support in IDA, as noted earlier (additional volumes at IBRD terms). Consistent with commitments under the 2018 IBRD capital package, in the future, IBRD will aim to make available resources sufficient to fully replace the IDA financing for IDA graduates.

12. **Financial terms.** Finally, the terms of World Bank financing are adjusting through the continuum of the transition (Figure 1 and Annex 2). IDA has a long-standing approach to such gradual price differentiation, with grants for countries at high risk of debt distress; regular, low fixed interest rate, long maturity credits for most clients; slightly higher fixed interest rate, slightly shorter maturity credits for gaps and blends; and non-concessional terms (IBRD terms) for countries accessing the SUF. With the 2018 IBRD capital package, this price differentiation is in part expanded to IBRD. Blend countries and IDA graduates will be exempted from the maturity premium increase approved as part of the capital package, with new graduates exempted for two replenishment cycles and recent IDA17–18 graduates exempted for six years starting from July 1, 2018. Further, a discount of 5–20 basis points will be introduced for countries below IBRD's Graduation Discussion Income (GDI) (currently, US$6,795) relative to the standard schedule of maturity premiums. These changes in IBRD terms of financing, combined with IDA's existing set of terms, create a continuum of World Bank financing terms for its client countries.

Figure 1. Continuum of World Bank's Terms of Financing



Source: World Bank.
Note: HIC = High-income country.

13. **Small States.** Small States have somewhat different arrangements, both in terms of access and financial terms. The Small Island Economies (SIEs) have received special treatment from IDA since 1985 pursuant to the Small Island Economies Exception (SIEE) Policy (see Annex 3). They receive IDA credits on the most concessional lending terms that IDA offers—the Small Economy Terms, at no interest, 40-year amortization, with a 10-year grace period. Starting from IDA18, other Small States[3] are also eligible to receive IDA financing on these terms. Once granted SIEE, a country continues to enjoy its benefits—regardless of the country's per capita income—until the country graduates to an IBRD-only status. So far, only St. Kitts and Nevis has graduated to an IBRD-only status (in 1994), consequently losing its eligibility for the SIEE. At present, four blend countries with per capita incomes significantly above the IDA operational cutoff continue to enjoy the benefits of the SIEE—Dominica, St. Vincent and the Grenadines, St. Lucia, and Grenada, which have per capita incomes ranging from US$6,990 to US$9,650. There is also the Maldives, a country that has been granted the 'IDA-only' status under the SIEE, with a per capita income of US$9,570. On the other hand, there are also IBRD-only SIEs like Fiji, which has a GNI per capita of US$4,970.

14. **The IDA graduation policy has been successful in achieving its objectives and, since IDA's inception, 35 countries have graduated from IDA to become IBRD-only borrowers, with reverse graduations a rare occurrence** (see Annex 4). A significant amount of scarce IDA resources has been released through recent graduations: the countries which graduated in the last two replenishments—Angola, Armenia, Georgia, India, Bolivia, Sri Lanka, and Vietnam—were recipients of more than 27 percent (or US$145 billion in 2017 prices) of cumulative real IDA commitments during IDA1–IDA17. At the same

[3] The World Bank defines a Small State as a country with a population of 1.5 million persons or less. This definition is different from the membership to the Small States Forum: three forum members have populations above this threshold.

time, during the past 20 years, reverse graduation occurred only twice (Indonesia, FY99 and Syria, FY17), in both cases following major economic and political crises. For the countries which graduated from IDA since 2000, the average annual growth in GNI per capita (Atlas method) since graduation is 5.8 percent.

15. **The history of IDA graduation provides useful insights on the factors associated with successful graduation outcomes.** A review of the countries that have graduated from IDA undertaken by the World Bank (2012) helped identify these factors. Outcomes were found to be closely linked to the following factors:

(a) **Country circumstance at the time of graduation.** Sound macroeconomic management, sustainability of public debt and strong debt management systems (also at subnational level if applicable), low poverty rates, and robust social indicators lead to sustained graduations.

(b) **The level of reliance on IDA funding.** No country that graduated since 2000 received IDA financing larger than 0.7 percent of its gross domestic product (GDP) on average during the last three years preceding graduation.

(c) **The track record of access to international capital markets.** Ability to access the market prudently, avoiding overborrowing, and retaining the access even during economic downturns are the key factors that help ensure successful graduations.

(d) **Economic structure and vulnerability to exogenous shocks.** More diversified economies with scale and scope sufficient for development of multiple export-oriented sectors are better prepared for graduation.

16. Section IV of the report looks at how these factors play out in the current blend countries. Section V provides the outlook for graduations in future replenishments.

B. IDA GRADUATIONS AND THE POLICIES OF OTHER DEVELOPMENT PARTNERS

17. **One recurrent question is the risk of compounding challenging transitions from IDA to IBRD with additional transitions from other multilateral and bilateral partners.** A review of the policies underpinning these transitions (Annex 5) suggests the following:

(a) **Criteria for graduation are often, like IDA, flexible and with room for country-specific issues.** Criteria for graduation from the Poverty Reduction and Growth Trust (PRGT) of the International Monetary Fund (IMF) include income per capita, access to markets, and absence of short-term vulnerabilities. Criteria for graduation from the concessional windows of the largest regional banks (African, Asian, and Inter-American) are related to the country’s income per capita and its ability to repay its debts. Eligibility for support from the Global Alliance for Vaccines and Immunization (GAVI) focusing on the world’s poorest countries is determined solely based on average national income for the last three years. The Global Fund’s Eligibility Policy is designed to ensure that grants are allocated to countries with the highest disease burden and lowest economic capacity, as well as to key and vulnerable populations disproportionately affected by the three global diseases it seeks to help end (AIDS, tuberculosis, and malaria), and its graduation decisions are based on a case-by-case analysis, with only high-income countries and Organization for Economic Co-operation and Development (OECD) members being automatically ineligible.

(b) **While regional development banks typically have a gradual transition in terms, others have much less gradualism.** All regional banks ensure gradual transitions to less concessional terms of financing in a way broadly similar to the transition between IDA and IBRD. Graduations from concessional support provided by bilateral donors, vertical funds, and private foundations often involve withdrawal of grant financing rather than change in lending terms.

18. **Overall, this brief review suggests the need for country-level and global coordination.** Taking a recipient country perspective, Section III suggests that there are differences across countries in terms of their access to financing during the transition, and the key is to coordinate country programs during this phase, a point reinforced in Section II. To further share lessons learned and good practices, Management intends to organize a consultative meeting in 2019 with other development partners to explore further opportunities for coordination.

II. WORLD BANK SUPPORT TO THE BLEND COUNTRIES

19. **This section looks in detail at the content of the country programs during the blend stage of the countries' transition from IDA to IBRD.** In response to the Participants' request to enhance effectiveness in using the blend period for preparing countries for successful graduation from IDA, it reviews basic characteristics of the blend countries, looks at the challenges that individual blend countries are facing in their transition and at the support offered by the World Bank in meeting these challenges, and develops policy options for enhancing this support.

A. BLEND COUNTRIES: BASIC CHARACTERISTICS AND WORLD BANK PROGRAMS

20. **Today's blend countries are a diverse group.** Fifteen active IDA countries are classified as 'blend' as of October 2018 (Table 1, Map 1). Their GNI per capita (Atlas method) ranges from US$1,360 (Cameroon, Republic of Congo) to US$9,650 (Grenada); their populations range from 0.1 million (Grenada, Dominica, and St. Vincent and the Grenadines) to 197 million (Pakistan); their poverty headcount rates at the US$ 1.90 poverty line range from 0 (Moldova) to 62.1 percent (Uzbekistan); the average annual World Bank lending to them over the last three years ranged from 0.04 percent of GDP (St. Lucia) to 1.2 percent of GDP (Moldova); and the time for which they have been classified as 'blend' ranges from one year (Kenya) to decades (Dominica, Grenada, Pakistan, St. Lucia, St. Vincent and the Grenadines, and Uzbekistan).

21. **In turn, development issues affecting these countries' readiness for graduation from IDA and, therefore, the World Bank's efforts to assist them in addressing these issues vary from country to country.** This section briefly summarizes the development issues in each country and the thrust of the World Bank's programs. Members of the Organization of Eastern Caribbean States (OECS) (Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines) are grouped for the purposes of the qualitative discussion because of the commonality of the issues.

22. **Cameroon** is a natural resource-rich country and a member of the Central African Economic and Monetary Community (CEMAC). It has been experiencing a serious macroeconomic crisis because of the commodities price shock and is at high risk of debt distress. Cameroon also has low social indicators with a human capital index (HCI) score of 0.39 and pockets of fragility in the North where Boko Haram is active. Because of its institutional vulnerabilities, the country has a Country Policy and Institutional Assessment (CPIA) rating of 3.3. The World Bank's CPF prioritizes addressing multiple poverty traps in rural areas, with a focus on northern regions, fostering infrastructure and private sector development, and improving governance. The World Bank is also currently engaged in the concerted effort to address the crisis in all CEMAC countries through a series of Development Policy Financing (DPF) for each country and an Investment Project Financing for the regional central bank. In Cameroon, the planned three-project US$400 million DPF series focusing on (a) fiscal consolidation, (b) economic diversification, and (c) human development and protection of the poor is expected to be a major component of the World Bank's assistance during the IDA18 period. Cameroon was the first country to access the RSW under IDA18. Infrastructure projects constitute a large portion of the World Bank's portfolio.

Table 1. Basic Characteristics of Blend Countries

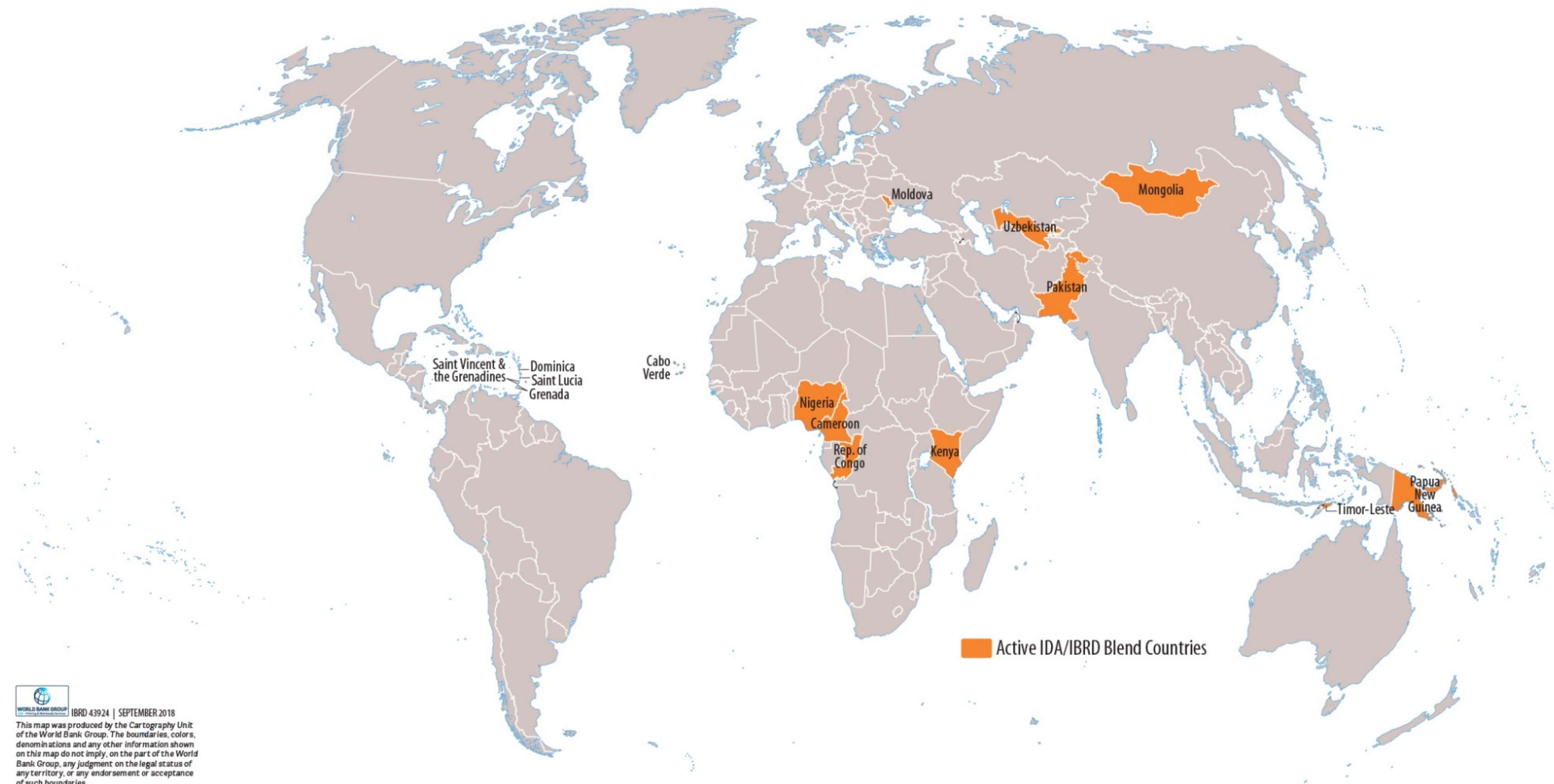
Country	Fiscal Year of Becoming Blend	Population (millions) 2017	GNI Per Capita (2017, Atlas current US$)	Latest Available Poverty Headcount Rate at US$ 1.90	Year of the Latest Available Poverty Headcount Rate at US$1.90	Average Annual World Bank Group Lending during IDA17 (percentage of GDP)	Average Annual IDA Lending during IDA17 (percentage of GDP)	Average Annual IDA Lending during IDA17 (US$, millions)	Average Annual IBRD Lending during IDA17 (percentage of GDP)	Average Annual IBRD Lending during IDA17 (US$, millions)	Total Natural Resources Rents (percentage of GDP, 2016)	Tax Revenue (percentage of GDP, latest available)	CPIA Rating, 2017	HCI Score, 2017
Cameroon	FY14	24.1	1,360	23.8	2014	1.0	0.44	141.1	0.53	172.3	6.3	12.6	3.3	0.39
Congo, Rep.	FY14	5.3	1,360	37.0	2011	0.9	0.43	33.3	0.53	41.7	24.9	9.4	2.7	0.42
Kenya	FY18	49.7	1,440	36.8	2016	1.0	0.95	671.0	0.00	—	2.9	15.4	3.7	0.52
Moldova	FY00 and FY14	3.5	2,180	0.2	2016	1.2	0.78	52.3	0.61	40.9	0.3	19.3	3.7	0.58
Mongolia	FY12	3.1	3,290	0.5	2016	0.3	0.30	33.0	0.00	—	23.2	11.3	3.3	0.63
Nigeria	FY14	190.9	2,080	53.5	2010	0.3	0.29	1,187.0	0.04	166.7	5.4	1.5	3.2	0.34
Pakistan	Before FY00	197.0	1,580	4.0	2016	0.5	0.42	1,182.3	0.09	263.3	1.2	9.2	3.2	0.39
Papua New Guinea	FY03	8.3	2,410	38.0	2010	0.2	0.21	42.7	0.00	—	16.3	13.5	3.0	0.38
Uzbekistan	FY02	32.4	1,980	62.1	2003	0.5	0.34	230.0	0.16	105.7	11.4	17.3	3.6	—
Small States														
Cabo Verde	FY09	0.5	2,990	8.1	2007	0.9	0.87	14	0.00	—	0.8	17.9	3.7	—
Dominica	Before FY00	0.1	6,990	—	—	—	—	—	—	—	0.1	22.1	3.6	—
Grenada	Before FY00	0.1	9,650	—	—	0.8	0.61	6.4	0.16	1.7	—	19.4	3.5	—
St. Lucia	Before FY00	0.2	8,780	35.8	1995	0.04	0.03	0.5	0.00	—	—	20.4	3.6	—
St. Vincent and the Grenadines	Before FY00	0.1	6,990	—	—	0.5	0.46	3.6	0.00	—	—	23.9	3.6	—
Timor-Leste	FY13	1.3	1,790	30.3	2014	0.4	0.66	11.7	0.00	—	20.2	9.8	2.9	0.43

Source: World Bank, IMF, and staff calculations.

Note: (1) Aggregate ratings for risk of debt distress exist only for the countries for which low-income country debt sustainability analysis is performed but not for the countries for which market access country debt sustainability analysis is performed.

(2) The HCI ranging between 0 and 1 measures the human capital of the next generation, defined as the amount of human capital that a child born today can expect to achieve in view of the risks of poor health and poor education currently prevailing in the country where that child lives. If a country's score is 0.5, then its GDP per worker would be twice as high if the country reached the benchmark of complete education and full health.

Map 1. Active IDA/IBRD Blend Countries



Source: World Bank.

23. **Cabo Verde** is a small country receiving IDA financing under the small economy exception. Located on an archipelago of 10 islands off the coast of West Africa, the country has few natural resources and suffers from serious water shortages exacerbated by cycles of long-term drought. Vulnerability to external shocks and lack of economies of scale and scope in production are among the key factors which led to a high risk of debt distress. Emigration levels are high, and it is believed that more Cabo Verdeans live abroad than inside the country. The World Bank's engagement with the country focuses on infrastructure and private sector development/tourism; the new SCD and CPF are under preparation. Cabo Verde is also a part of the regional fishery project series for West Africa.

24. **Republic of Congo** is a natural resource-rich country and a member of CEMAC. The country is in debt distress. Despite relatively high income per capita, the Republic of Congo has high poverty headcount rates and low social indicators (HCI score of 0.42), in a large part because of low quality of its governance, and, more broadly, of its institutions. The CPF for the Republic of Congo is currently under preparation. The Republic of Congo is also a subject to the World Bank's concerted effort to address severe macroeconomic crisis in CEMAC countries. Preparation of the DPF series is under way; like the World Bank's overall engagement with the country, it is complicated by the governance constraints. The DPF series are likely to focus on efficiency of public spending, governance reforms, and development of fiscal rules. Debt management support from both the World Bank and the IMF is also under consideration.

25. **Kenya** became a blend country on July 1, 2017, shortly after its GNI per capita crossed the operational cutoff. Compared to other countries at similar income per capita, the country has a dynamic private sector, relatively viable fiscal institutions, and good access to international financial markets. It is seen by many as the economic leader of East Africa. On the downside are significant institutional risks and pockets of fragility in the country's north and northeast. The country program and pipeline have two distinctive features: a number of projects supporting the mobilization of private financing for development through guarantees and public-private partnerships (PPPs) and a number of projects supporting regional integration. CPF priorities also include support to human resource development and decentralization.

26. **Moldova** is a relatively small landlocked country in the Europe and Central Asia Region, with considerable financing needs. Because of a 'frozen conflict', the government does not control parts of the country which constituted the industrial core of its economy during the soviet era. Many working-age individuals leave the country because of limited employment opportunities; remittances from emigrant workers constitute about a quarter of GDP. While the tax revenues have increased over the last three years and the country has relatively high CPIA score (3.7), Moldova has significant fiscal vulnerabilities which come primarily from two sources. One is demographic pressures resulting from population aging and large outmigration of workers, creating fiscal pressure on the country's pension system. Another source is implicit contingent liabilities of the state-owned enterprises, the assets of which account for one-third of GDP. There are also significant institutional vulnerabilities which may lead to high macroeconomic risks, as exemplified by banking fraud amounting to over 10 percent of 2016 GDP, which was uncovered several years ago. Financial stability has improved but risks remain. With the CPF focus areas, including support to skills development and enhancement of economic and service governance, supplemented by climate change as a cross-cutting theme, the World Bank's portfolio includes projects related to health, education, land management, tax administration, business regulations, energy, and climate change adaptation.

27. **Mongolia** is a resource-rich country, which experienced a macroeconomic crisis from the of end 2013 to 2016. This crisis was mainly triggered by the fall in commodity prices and the implementation of pro-cyclical fiscal policies that led to unsustainable debt levels. Over the course of about a decade, the economy experienced double-digit GDP growth as the country managed to develop its natural resource sector, but its institutions for macroeconomic stabilization have not been effective. Some relevant laws and regulations are in place, but they are not being followed, which reflects broader institutional problems (CPIA rating 3.3). A multiyear IMF-led stabilization package, totaling US$5.5 billion (over 40 percent of

Mongolia's annual GDP), is being put in place with the World Bank's participation. With the poverty headcount rate at the national poverty line increasing from 21.6 percent in 2014 to 29.6 percent in 2017, restoring macroeconomic stability and debt sustainability, strengthening social protection, and advancing structural reforms to enhance competitiveness are the primary foci of the World Bank's current DPF series which is part of the package that also includes the IMF program. The DPF series is likely to be the core of the World Bank's support to the country during the IDA18 period while the preparation of the new CPF is under way. Mongolia's IBRD creditworthiness is limited and the country has not yet borrowed from IBRD.

28. **Nigeria** is a resource-rich country with low quality of institutions (CPIA rating 3.2) and the largest number of the poor in Africa. Nigeria is an outlier on many human development indicators (HCI score of 0.34). The country suffered from a macroeconomic crisis in 2015 and 2016, falling into recession in 2016 because of large declines in oil prices and production. Recovery from the 2016 recession is slow and fragile. Nigeria is a large federal country where states enjoy significant fiscal autonomy—and are borrowing (through on-lending from the federal government) from the World Bank—while the country's intergovernmental fiscal framework leaves much to desire. Very high fertility rates in some of Nigerian states could further increase the already high inequality. While Nigeria is considered IBRD-creditworthy, most of its states would have difficulties borrowing on IBRD terms. The country's problems are compounded by the insecurity, conflict, and desertification, which drives northern Fulani cattle herders gradually southward, intensifying clashes with farmers in the middle belt, and exacerbates food insecurity. In addition to Boko Haram in the northeast, there is a simmering discontent in the southeast. A latent conflict lingering in the Niger Delta slashed Nigeria's crude output by as much as a third in 2016. At the same time, the country needs to take a leading role in regional integration given its weight in the region (both in economic and security terms). The World Bank's strategy focuses, in a large part, on overhaul of the power sector which could help fix systemic and persistent bottlenecks to economic growth and strengthen institutions for service delivery and on investments supporting institutional reforms with a focus on social sectors and fiscal institutions at both the federal and state levels. During IDA18, the country team plans to intensify performance-based approach to lending and introduce the Multi-phased Approach (MPA) in a series of operations with common objectives, which will help make the country program more sequential and results oriented.

29. **OECS countries (Dominica, Grenada, St. Lucia and St. Vincent)** are SIEs which receive IDA credits on the most concessional terms because of their exposure to exogeneous shocks, vulnerability to natural disasters, and limited creditworthiness. While these countries have relatively high CPIA scores (3.5 – 3.7), the magnitude of capital shocks they routinely experience because of natural disasters, including the 2017 hurricanes, is comparable to their annual GDPs, making it very difficult for their governments to both sufficiently invest in the post-disaster reconstruction and keep their public debts at sustainable levels. The World Bank's strategy in these countries focuses on crisis response/preparedness and development of innovative financial products for disaster insurance, some of which involve regional pooling of risks, and on other regional operations. Despite these efforts, bringing the public debts to a sustainable trajectory remains a challenge.

30. **Pakistan** is a large lower-middle-income economy with high inequality, pockets of fragility, volatile economic growth, lagging social indicators (HCI score of 0.39), and fiscal space limited by low domestic revenues and inflexible spending, resulting in structurally large fiscal deficits fluctuating around 5 percent of GDP and significant debt sustainability issues. Its CPIA rating of 3.2 is within the fragility range. The World Bank has a large and comprehensive work program in the country, covering all major sectors and development issues, and involving innovative approaches. The strategic priorities are energy, private sector development, inclusion, and service delivery. The country team is helping the government enhance domestic revenue mobilization capacity and employs policy-based guarantee and partial risk guarantee instruments to facilitate the country's access to commercial financing. Other efforts to ensure sustainability and sufficiency of public finances after eventual graduation from IDA include debt

management support at both the federal and subnational levels, both by means of DPF and technical assistance. Large-scale efforts in social sectors recently included the country's first subnational IBRD loan for education. Energy sector is another major priority and so are investments in the areas of conflict and fragility.

31. **Papua New Guinea** is a resource-rich country with low quality of institutions (CPIA rating 3.0). Mechanisms for macroeconomic stabilization have limited effectiveness and, despite relatively high income per capita, 87 percent of its population is engaged in subsistence activities, its poverty headcount is high (38 percent at the US$1.90 poverty line), and its social indicators are low (HCI score of 0.38). The relationship with the World Bank has been uneven, resulting in a somewhat opportunistic country work program which has been geared toward development of rural areas. The fall in commodity prices required significant fiscal adjustment and resulted in foreign exchange shortages that remain to be resolved. In FY18, IDA started to prepare a DPF series with policy focus on fiscal management and resource mobilization and planned amount of US$200 million for two operations in the series, to be complemented by US$300 million from the Asian Development Bank. Preparation of the new CPF is under way.

32. **Timor-Leste** is a young and small state. It became a sovereign state in 2002 and has a population of around 1.2 million. It is a resource-rich country that created a well-designed petroleum fund (PF) shortly after its independence—to manage its petroleum revenues. However, after 2014, excess withdrawals (above the estimated sustainable income) have been made and transferred to the state budget on a regular basis. The government is reluctant to borrow from IBRD as returns to the PF investments are around 4 percent (between IDA and IBRD interest rates). Apart from the PF's relative success, the country's institutions are very weak (CPIA rating 2.9) and its development needs are large (for example, stunting rate among children is around 46 percent and HCI score is 0.43). The World Bank's portfolio is focused on infrastructure (roads) and a DPF is also under consideration. Preparation of the CPF is under way.

33. **Uzbekistan** is a resource-rich (natural gas, gold, cotton), double-landlocked (separated from the sea by two countries) economy that is dominated by the state—about 40 percent of GDP is from public sector and state-owned enterprise activity. In 2017, the government announced a bold reform agenda to reorient the economic model toward a competitive market-based and private sector-led economy. It has taken a series of important first steps, such as the abolishment of forced labor in the cotton sector, the liberalization of the exchange rate, and reforms to the tax system. The government is now developing its priorities for the next phase of reforms and is expected to tackle more challenging issues such as improving agriculture sector performance, removing market distortions, and addressing factor market constraints. While Uzbekistan's fiscal and external position remain strong, these more difficult reforms could create fiscal challenges in the short to medium term. The country team is closely monitoring the situation, refocusing the CPF to support sustainable transformation toward a market economy, reforming state institutions and service delivery, and building the human capital and citizens' participation and stands ready to step up assistance as the authorities move ahead with the reform agenda.

B. TYPOLOGY OF COUNTRIES AND COUNTRY PROGRAMS

34. **Based on the previous section, blend countries can be grouped according to the challenges which they face as they prepare for their eventual graduations from IDA.** The following six groups of blend countries are considered (some countries might belong to several groups):

- Resource-rich countries;
- Resource-poor large and medium-size countries;
- Federal countries;

- Small countries;
- Countries with pockets of fragility;
- Countries in transition to a market economy.

35. **This section outlines the key challenges faced by each group and key elements of country programs for addressing these challenges.** Table 2 summarizes these challenges and potential opportunities for the World Bank support based on the experiences with individual country programs, while the remainder of this section explains and elaborates them.

Table 2. Country-specific Challenges Faced by the Countries in Transition and Emerging Priorities for World Bank's Support

Type of Countries	Key Challenges	Potential Opportunities for World Bank Assistance
Resource-rich countries	• Macroeconomic vulnerability because of lack of institutions for macroeconomic stabilization • Lower quality of institutions resulting in higher level of inequality, higher poverty headcount rates, and lower social indicators	• Emphasis on macroeconomic stabilization, diversification, and institution building in the country programs • Focus on DPF to alleviate the macroeconomic crises and to support fiscal and debt management reforms in the short term
Resource-poor large- and medium-size countries	• Fiscal vulnerabilities/low government revenues	• Strengthened assistance on revenue mobilization, addressing fiscal vulnerabilities, and debt management
Small countries	• Magnitude and frequency of external shocks • Lack of economies of scale and scope	• Expanding assistance in resilience building and regional integration (for example, use of catastrophe deferred draw-down option, regional pooling of natural disasters risks) • Recognizing that these countries will continue to require concessional financing in the foreseeable future
Federal countries	• Pockets of poverty • Lack of creditworthiness of the subnational governments in charge of delivering public services in these areas	• Technical assistance to the central governments on designing fiscal support to their subnational governments for their borrowing from IBRD
Countries with pockets of fragility	• Fragility	• Focus on the fragile areas in the country programs
Countries in transition to a market economy	• Transition to a market economy	• Focus on assistance with institutions building • Possibly stepped-up financing

Resource-rich Countries

Cameroon, the Republic of Congo, Mongolia, Nigeria, Papua New Guinea, Timor-Leste, and Uzbekistan

36. **It is no coincidence that almost half of the blend countries are resource rich.** Resource-rich countries have an opportunity to request IBRD creditworthiness assessments during the periods when commodity prices are high and natural resources are seen as a 'collateral'. Such 'collateral' makes it easier for these countries than for others to be assessed as IBRD-creditworthy. To the contrary, graduation of resource-rich countries from IDA is hindered (put differently, the risk of reverse graduation is increased) by two primary constraints which are less likely to affect graduation of other countries.

37. **The most immediate constraint is macroeconomic vulnerability.** While these countries do not lack fiscal resources generally, they often lack effective institutions for macroeconomic stabilization and fail to build fiscal buffers in good times. Because the commodity prices are highly volatile, this means that at any point in time these countries are either at risk of a macroeconomic crisis (when commodity prices are high but can fall at any time) or in a crisis (as after the major fall in commodity prices in 2014). In the longer term, macroeconomic instability also leads to economic structure characterized by lack of diversification of economic activity, which further increases these countries' vulnerabilities to economic shocks.

38. **A more profound constraint is the quality of these countries' public institutions.** The quality tends to be significantly lower than that of other countries with similar incomes per capita, resulting in higher levels of inequality, higher poverty headcount rates, and lower social indicators and being an underlying reason for the lack of institutions for macroeconomic stabilization. Even a simple correlation between the World Bank's CPIA rating on governance and public sector management and the share of resource rents in GDP is negative (–0.24) and statistically significant at 5 percent level. The magnitude of correlation increases if the income per capita and other relevant variables are controlled for. Such institutional constraints tend to lead to higher poverty rates.

39. **Emphasis on macroeconomic stabilization, diversification, and institution building in the country programs helps prepare these countries for graduation.** While the specifics will vary across countries, some examples of the ongoing efforts include the following. The current focus on DPF to alleviate the macroeconomic crises and support fiscal and debt management reforms is appropriate in the short term. Greater focus on performance-based lending to support institutional development allows increasing focus on the results and recognizing the need to support, whenever possible, not only adoption but also genuine implementation of structural and institutional reforms. Further, because savings and debt are closely related to each other, implementation of the new World Bank/IMF low-income country debt sustainability framework, which became effective at the beginning of FY19, could help enhance policy dialogue on macroeconomic stabilization (see the paper on Debt Vulnerabilities in IDA Countries, IDA 2018b).

Resource-poor Large and Medium-size Countries

Kenya, Moldova, and Pakistan

40. **These countries still experience significant fiscal vulnerabilities and benefit from concessional financing which helps address their development challenges.** In Pakistan, government revenues, excluding grants, are at 12.6 percent of GDP and in Kenya at 15.4 percent of GDP. Pakistan is also facing serious fiscal issues in the short to medium run, and Moldova's demographic and institutional vulnerabilities may pose significant fiscal risks.

41. **This group of countries often benefits from the World Bank's assistance on revenue mobilization and debt management.** This helps ensure that the phase-out of concessional financing does not create fiscal sustainability risks. The ongoing operations supporting enhancement of tax revenue in Pakistan and mobilization of private financing through guarantees and PPPs in Kenya are examples of such support. If successful, they can offer lessons that other blend countries, current and future, could benefit from.

Federal Countries

Nigeria and Pakistan

42. **Many public services in this category of countries are provided by the subnational governments which can, in principle, borrow from the World Bank.** The problem is that the poorest of

them find it difficult to repay IBRD loans for a long time after the federal government becomes IBRD-creditworthy, especially those financing the projects in social sectors (for example, health and education) where returns take longer to generate. In practice, many subnational governments can borrow for social sector projects only from IDA.

43. **Federal countries tend to be larger than unitary ones, and in practice, graduation of large countries tends to happen somewhat earlier than others.** Among the countries which graduated since 2000, GNI per capita in the year of graduation for the three countries with population over 90 million (India, Indonesia, and Vietnam) exceeded IDA's operational cutoff for that year by factor of 1.42 on average, meaning that a significant portion of their subnational jurisdictions which are often eligible for the World Bank's subnational lending 'graduated' at the income levels much below the operational cutoff. GNI per capita in the year of graduation for the 11 other countries which graduated from IDA since 2000 exceeded the operational cutoff by factor of 3.04 on average.

44. **Hence, an important part of the World Bank's engagement in preparing these large countries for graduation is technical assistance to the central governments in designing fiscal support to the subnational governments for their borrowing from IBRD.** This is especially important for the subnational governments which are responsible for the poorest parts of the country. These governments and populations they serve can benefit much from transfer of knowledge and resources which comes with the World Bank lending, but many of them may face difficulties with repaying their debts without the central government's support. Blend countries can learn from Colombia, Mexico, and South Africa where strong central arrangements for subnational debt management are already in place.

***Small Countries*[4]**

Cabo Verde, Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines

45. **The magnitude and frequency of external shocks combined with economic structure characterized by the lack of economies of scale and scope represent major challenges to these countries' development.** It is nearly certain that these countries will continue to require concessional financing in the foreseeable future—possibly even more than they receive now, depending on the magnitude of shocks they experience. Serious and systemic debt sustainability issues are among the consequences of the external shocks which make it difficult for these countries to graduate from IDA. Many of these shocks are climate related (hurricanes in OECS and droughts in Cabo Verde) and are expected to intensify in the future (see also the Climate Change Special Theme Progress Report, IDA 2018a).

46. **The World Bank is expanding efforts in assisting these countries in resilience building and regional integration.** Supporting regional pooling of natural disasters risks for OECS countries is one of the promising initiatives. Use of DPFs with catastrophe deferred draw-down option for these purposes could help.

47. **It is important to ensure horizontal equity of the access of small countries to IDA resources and smooth their transition in terms of financing under SIEE.** In particular, it is worth exploring access to IDA for IBRD-only small states which are no less vulnerable than the current blend countries. Management recommends exploring in the IDA19 negotiations changing the terms of lending for Small States once they reach a certain level of development (this would apply to both island and non-island Small States). Section III.F reviews these issues.

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[4] See also Section III.F.

Countries with Pockets of Fragility

Cameroon, Kenya, Nigeria, and Pakistan

48. **Provision of public services in fragile areas is a major challenge which IDA is helping address.** It requires concessional financing for a number of reasons, including its highly uncertain returns. Investments which help reduce fragility of institutions in such areas have elements of a global public good because such fragilities often have regional and global implications (see also Fragility, Conflict, and Violence Special Theme Progress Report). Focus on the fragile areas is present in IDA's country programs of all four countries and will help prepare these countries for graduation. While IDA should be carefully selective in choosing the projects to finance in these areas given the high risks involved, it is generally at least no more difficult to address fragilities which are localized in some parts of a country than to address countrywide fragilities.

Countries in Transition to Market Economy

Uzbekistan

49. **Transition to a market economy is a complex process which involves short- and medium-term risks.** If the experience of all other, even the most successful, post-communist transitions in Europe and Central Asia is of any guidance, the risks are significant, including a risk of a transitional recession (although not a certainty if experiences of countries from other regions are considered).

50. **A focus on assistance with institutions building is important.** If the transition to a market economy largely completed elsewhere finally takes hold in Uzbekistan, the World Bank will need to focus in the short and medium run on primarily supporting this transition, more than the country's transition from IDA to IBRD financing in a usual sense.

Common Issue: Crises Response and Debt Sustainability

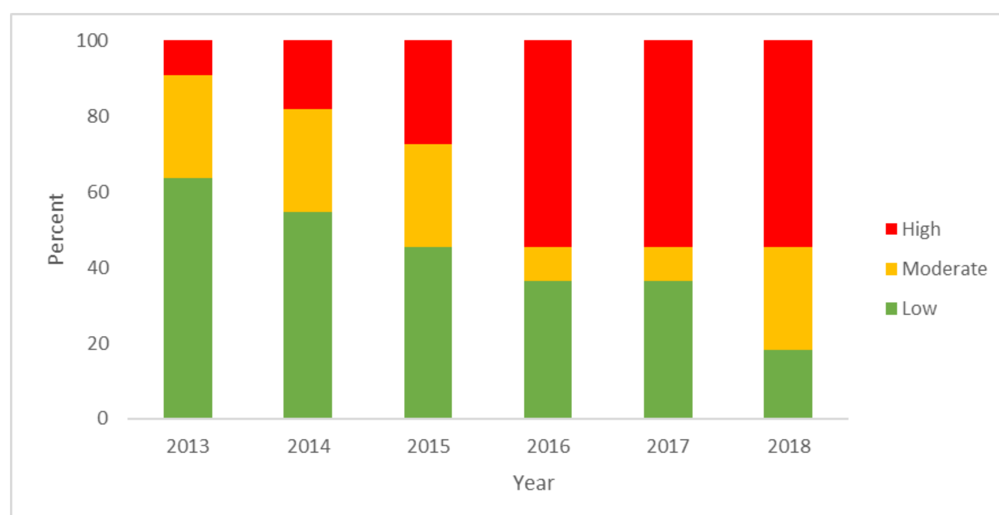
51. **All the current blend countries are vulnerable to crises and economic shocks, albeit to varying degrees.** Seven of them are resource rich (vulnerable to macroeconomic shocks); five are SIEs (vulnerable to natural disasters and other external shocks); and the remaining three (Kenya, Moldova, and Pakistan) have various institutional fragilities which may potentially generate significant economic and fiscal shocks. Kenya, in addition, is facing natural disasters and drought risks which can potentially trigger economic and social crises of significant magnitude. While all these risks could be mitigated to a certain extent, as described earlier, they are likely to remain substantial in the short and medium term, increasing the countries' risks of debt distress and making it more difficult for them to graduate from IDA. One possibility would be to redefine graduation as a point when the country stops having a core country envelope but keep access to the Crisis Response Window (CRW) open to recent graduates as a means of transitional support (see next section).

52. **The blend countries are also exposed to debt risk and, hence, to shifts in international financial markets, including rising interest rates, lower risk tolerance, and potential contagion effects from emerging markets.** Among the 11 blend countries subject to the LIC DSA, 6 are rated as high risk or in debt distress, up from 1 in 2013 (Figure 2). Among the other four blend countries,[5] three have high risk credit ratings from the international rating agencies and one country has no ratings at all. Put differently, even the blend countries which have access to international capital markets have not yet established a satisfactory track record in dealing with these markets. While IDA countries overall have seen an increase in public debt levels in recent years, the largest increase has occurred among blend countries, from 48

[5] These countries are subject to the Market Access Country Debt Sustainability Analysis which does not produce a single rating for a risk of debt distress.

percent of GDP, on average, in 2007 to 64 percent of GDP in 2016 (see the paper on Debt Vulnerabilities in IDA Countries, IDA 2018b). While the share of external public and publicly guaranteed debt owed to commercial creditors has increased on average across IDA countries, the shift is more pronounced in blend and gap countries where it has increased by about 10 percentage points of GDP on average since 2007. In parallel, blend countries experienced a larger increase in the share of variable rate debt in external public and publicly guaranteed debt, reaching an average of 46 percent in 2016, compared to 21 percent for IDA-only non-gap countries and 25 percent for IDA gap countries. The increased role of private creditors has brought benefits but entails new risks as well. Of note is the growing number of Eurobond issues, often with bullet maturities. While this opening of market access represents a key opportunity for scaling up development outcomes, it also poses new challenges for country authorities, including the need to maintain a credit rating, manage liquidity pressures and refinancing risks inherent in market finance, and pay market interest rates. For blend countries, these developments are to some extent a logical consequence of their stage of development, but they do point to the need for enhanced risk mitigation and debt management by country authorities, together with policy reform to promote growth and external competitiveness, and for continued support from IDA and other official creditors.

Figure 2. Evolution of Risk of Debt Distress Ratings for 11 Blend Countries under LIC DSF
(percentage of countries)



Source: World Bank/IMF.
Note: Based on the data for 11 countries (see also paragraph 51).

53. **The foregoing review emphasizes how critical the effective use of the World Bank's lending and advisory engagement is for helping countries prepare for their graduation from IDA.** Given the large variation in development challenges faced by individual blend countries, more generalized approaches are unlikely to work. While there are some general themes of support—economic transformation, debt management, and institutional development—the specific priorities will vary across countries and will require the full range of the Bank lending and analytical tools to ensure early involvement on transition-related issues, including to coordinate with other development partners. There are in addition two main cross-cutting issues:

(a) **Assisting blend countries in addressing risks of debt distress.** In addition to the country-specific support, the IDA/IMF joint debt sustainability framework for low-income countries has been approved by the Board in FY18 (IDA and IMF 2017) and the IBRD/IMF framework for market

access countries is expected to be approved before the end of IDA18 replenishment.[6] Maximizing Finance for Development (World Bank 2017), the World Bank Group's approach to systematically leverage all sources of finance, expertise, and solutions to support developing countries' sustainable growth, will help the countries leverage private sector finance, which would partially substitute for the public sector borrowing. At the country program level, most of the emerging priorities for the World Bank's support to the blend countries (Table 2) may contribute to alleviating the risks of debt distress.

(b) **Strengthening knowledge and tools available to country teams in that process.** IDA's graduation task force will bring the knowledge, tools, and experience to enhance the effectiveness of the World Bank's support to blend countries. It will also systematically assess the consistency of approach across blend countries.

III. FINANCING COUNTRIES' TRANSITIONS BETWEEN IDA AND IBRD

54. **This section reviews the financing of the countries' transition from IDA to IBRD, both from a public finance point of view and from the point of view of the World Bank's financial support.** It looks at public finances and access to external financing through graduation transitions and amounts of the World Bank lending to these countries. Analysis of these issues informs the responses to IDA deputies' requests to review the transitional support, implementation of the contractual acceleration clause, and the policy on caps for allocations to large blend countries.

A. PUBLIC FINANCES AND ACCESS TO EXTERNAL FINANCING THROUGH GRADUATION TRANSITIONS

55. **The first question is whether graduation from IDA tends to result in undue macro-fiscal constraints.** For instance, do these countries experience a major drop in official development assistance (ODA) or external financial flows upon graduation? Are countries graduating at a time of low or stagnating domestic revenues or high debt levels?

56. **The countries in transition from IDA to IBRD are typically experiencing an increase in the tax revenues as a share of GDP and a smaller decline in ODA.** Table 3 summarizes basic information on IDA graduations since 2000 on a country-by-country basis. As of 2014, the latest year for which the data on tax revenues are available in the IMF World Revenues Longitudinal Dataset, the average tax revenue-to-GDP ratio for 15 countries currently classified as blend was 16.7 percent and for the 14 countries which graduated from IDA since 2000 it was 21.1 percent. The same year, ODA constituted 2.5 percent and 1.2 percent of GDP for these two groups, respectively. Increase in tax revenues as a percentage of GDP outweighs the decline in ODA also if the median countries in these two groups are compared (Figure 3). This effect is in part because of the close attention paid to the fiscal variables when the decisions on graduation of countries from IDA are being made and in part because at the stage of development when graduation typically takes place, the successful transitioning countries often experience expansion of their tax bases as increasing shares of their populations are shifting from the subsistence agriculture to the more formal economic activities.

[6] Which of these two frameworks applies to an individual blend country depends on whether that country has access to IMF's PRGT.

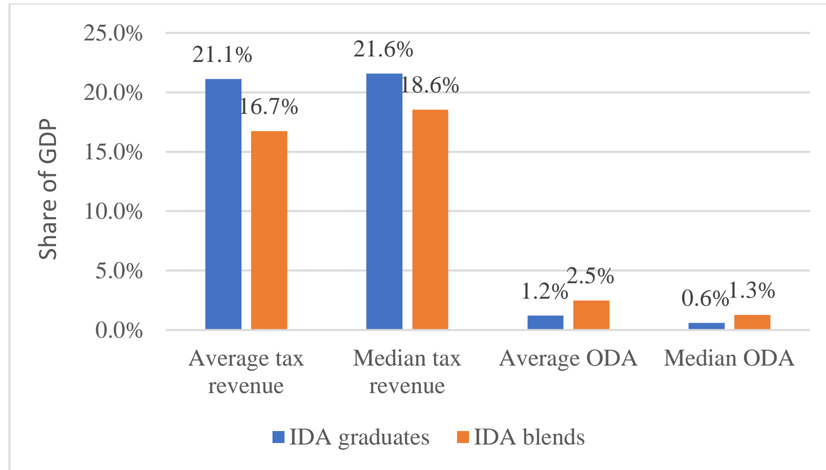
Table 3. Basic Characteristics of the Countries Which Graduated from IDA since 2000

Country	IDA Graduation Year	GNI Per Capita at Graduation	Ratio of GNI Per Capita to IDA's Operational Cutoff in the Year of Graduation	Population, Millions (2017)	Latest Available Poverty Headcount Rate at US$1.90	Average IDA Commitments for Three Years Preceding Graduation (percentage of GDP)	Average IBRD Commitments for Three Years Preceding Graduation (share of GDP)	Average IBRD Commitments for Three Years Following Graduation (percentage of GDP)	Average Net ODA Received for Three Years Preceding Graduation (percentage of GNI)	Average Net ODA Received for Three Years Following Graduation (percentage of GNI)
Albania	FY08	2,970	2.8	2.9	1.10	0.49	0.14	0.29	3.04	3.02
Angola	FY14	4,580	3.8	29.8	30.10	0.04	0.00	0.32	0.23	—
Armenia	FY14	3,720	3.1	2.9	1.80	0.45	0.84	2.10	2.34	—
Azerbaijan	FY11	4,850	4.2	9.9	0.50	0.18	0.97	0.17	0.45	0.21
Bolivia	FY17	3,080	2.6	11.1	7.10	0.31	0.26	—	—	—
Bosnia and Herzegovina	FY14	2,220	1.8	3.5	0.07	0.16	0.23	0.15	3.16	—
Georgia	FY14	3,280	2.7	3.7	4.20	0.70	0.43	1.81	3.91	—
India	FY14	1,530	1.3	1,339.2	21.20	0.10	0.08	0.11	0.13	—
Indonesia	FY08	1,410	1.3	264.0	5.70	0.08	0.18	0.48	0.21	0.15
Macedonia, FYR	FY02	1,710	1.9	2.1	5.20	0.67	0.63	0.46	6.80	4.61
Montenegro	FY08	3,710	3.5	0.6	0.36	0.43	0.00	0.43	2.02	2.19
Serbia	FY08	4,030	3.8	7.0	0.35	0.23	0.14	0.91	1.75	2.08
Sri Lanka	FY17	3,800	3.2	21.4	0.70	0.44	0.04	—	—	—
Vietnam	FY17	1,980	1.7	95.5	2.00	0.65	0.25	—	—	—

Source: World Bank and OECD databases and staff calculations.

Note: During the first three years following its graduation from IDA, India received transitional support from IDA on IBRD lending terms amounting to 0.03 percent of its GDP during this period. Bolivia, Sri Lanka, and Vietnam are expected to receive similar support amounting to estimated 0.18 percent, 0.25 percent, and 0.36 percent of their respective GDPs.

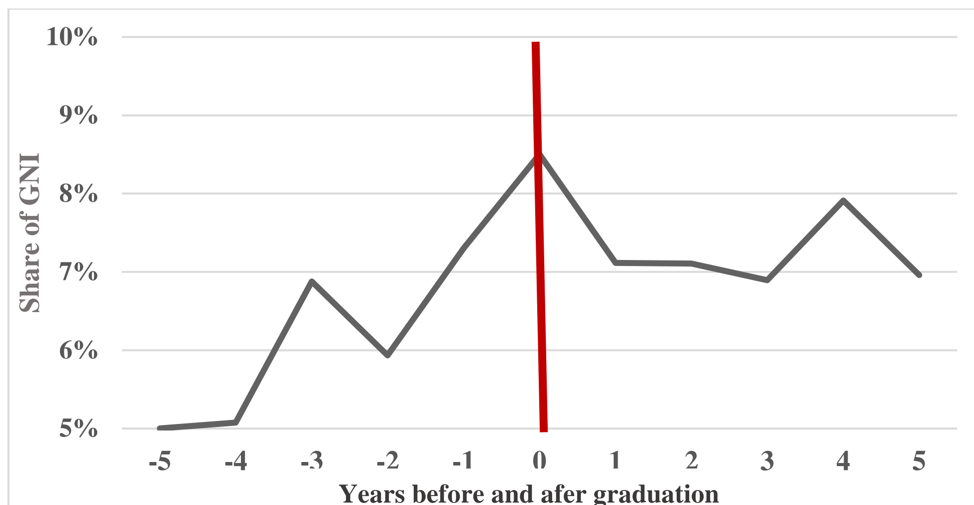
Figure 3. Tax Revenues and ODA Received by the Current Blend Countries and Recent Graduates in 2014



Sources: IMF, OECD.

57. **Graduation is usually not followed by a decline in availability of external financing.** Figure 4 shows the average flows as a percentage of GNI for the years preceding and following IDA graduation for eight countries for which the data are available on all sources of external financing, including official flows (ODA grants and debt) and private flows (portfolio investment, debt, foreign direct investment, and remittances). It demonstrates that while, on average, for these countries the flows as a share of GNI peak during the graduation year, they do not decline during the post-graduation period compared to the pre-graduation one. There are, however, some exceptions to this average. In some cases, they occur for country-specific reasons—for example, in Armenia and Bosnia and Herzegovina, where the inflows did peak several years before graduation. However, the availability of private external financing also depends on global financial markets conditions which sometimes change quickly and abruptly. Such change during the financial crisis in the second half of the 1990s was among the reasons for Indonesia's reverse graduation. This is a reminder that the external environment should be part of the assessment for graduation decisions.

Figure 4. IDA Graduated Countries: Total Net Financial Flows, Percentage of GNI

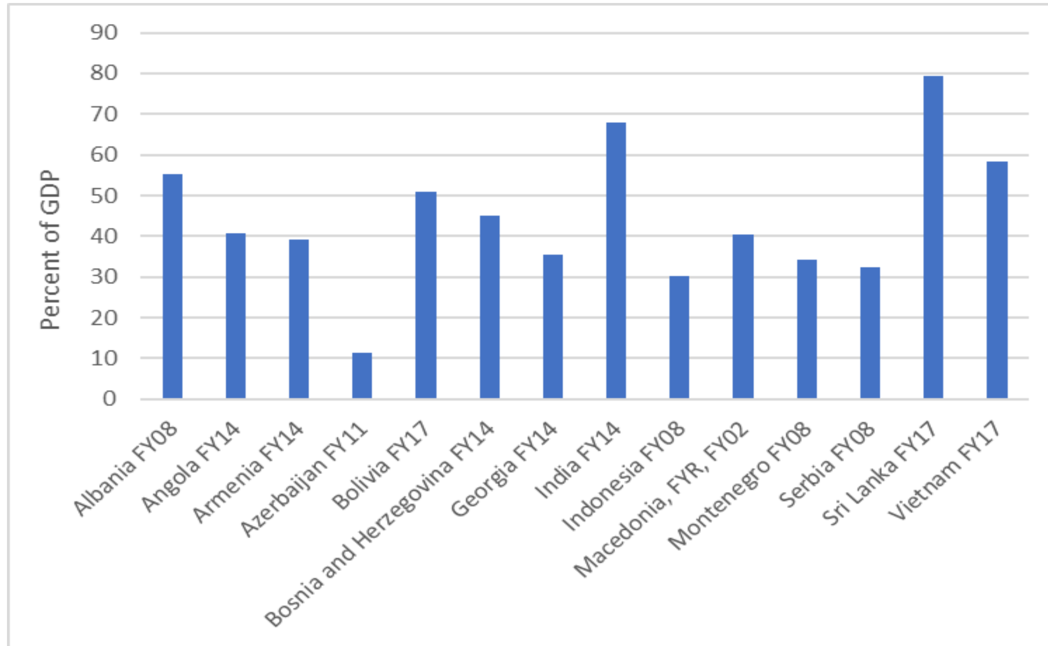


Sources: World Bank, IMF, and OECD.

Note: Countries covered in the graph: Albania, Azerbaijan, Egypt, Indonesia, Macedonia, FYR, Montenegro, the Philippines, and Serbia.

58. **Graduating countries typically have low to moderate public debts.** The average gross public debt-to-GDP ratio of the countries which graduated since 2000 (Figure 5) is 44.3 percent. Only two countries had this ratio in excess of 60 percent in the year of graduation: India (which has greater debt service capacity because of the sheer size of its economy) and Sri Lanka (a medium-size country which graduated when its GNI per capita exceeded IDA's operational cutoff by more than three times).

Figure 5. Gross Public Debt of IDA Graduates in the Year of Graduation



Source: World Economic Outlook database and staff calculations.

59. **While graduation from IDA does not tend to result in undue macro-fiscal constraints, public finances of the graduating countries could be still affected by several issues which deserve close attention.** These include varying graduation policies of other development partners, potential missed opportunities in financing high-return public investments and public services, global financial markets conditions, and debt-related risks.

60. **Multiple transitions away from concessional financing could make it more difficult to finance some public services.** As discussed earlier, graduation from concessional support from other donors is based on different criteria and has different fiscal implications, but most graduation policies are flexible and leave sufficient room for consideration of country-specific issues (Section II). Attention to the interplay of the issues arising from such transitions in the context of each IDA graduation decision is critically important to ensure that they do not result in undesirable shifts in public expenditures. The questions to be considered include, for example, whether the reduced concessionality leads to under-provision of public services to vulnerable populations, and whether the countries' contributions to regional and global public goods may require concessional financing for longer periods compared to other public investments.

61. **Greater access to global financial markets by the countries transitioning from IDA to IBRD may help them finance their development needs—but may also cause problems down the road by increasing risks of debt distress.** Over the last several years, this access has expanded considerably, leading to greater overall availability of external financing and increased share of non-concessional borrowing in their debts and to the rising risks of debt distress (see the paper on Debt Vulnerabilities in IDA Countries, IDA 2018b). Developing countries' access to global financial markets could be subject to

a sudden stop, making it impossible to refinance their debts. It is important for IDA to walk a fine line between providing the countries with access to IDA financing as long as it is necessary to mitigate such risks and ensuring that such access does not create incentives to over-borrow on commercial terms. The design of IDA's CRW, for example, aims to balance these two objectives by allowing the countries to access CRW resources in the event of a severe economic crisis only if this crisis affects multiple countries in the region, thus making the country ineligible for such financing in case of idiosyncratic debt crisis resulting from unsustainable borrowing policies (see Crisis Response Window: Review of Implementation, IDA2018d).

62. **Small states face special challenges.** Average gross public debt to GDP ratio of five blend small states (excluding resource-rich Timor-Leste) was 87.7 percent in 2016, compared to the average of 53.4 percent for larger blend countries. These countries require greater and longer access to concessional finance as (a) many of them have limited access to concessional resources from major multilateral lenders because their per capita incomes are much above (indicative) thresholds for receiving concessional resources; (b) despite high per capita incomes, many of them are highly vulnerable to macroeconomic shocks, natural disasters, and long-term impacts of climate change; and (c) these countries' ability to adequately respond to these challenges is often constrained by insufficient domestic resources—for example, a narrow tax base and insufficient levels of domestic credit—due to very limited economies of scale and scope. Hence, many of these countries have been forced to assume significant external debt to mitigate consequences of various macroeconomic and climate-related shocks (World Bank 2018).

B. WORLD BANK LENDING THROUGH GRADUATION TRANSITIONS

63. **Within this broader public finance framework, how does World Bank lending look like during transitions?** This section reviews the pattern of IDA and IBRD allocations during these transitions.

64. **IDA's current case-by-case graduation approach implies that the countries that are strongly fiscally dependent on IDA are typically not considered for graduation.** For the sample of countries which graduated since 2000, the average annual IDA commitments for the years of their last replenishment before graduation constitutes 0.35 percent of GDP (ranging from 0.1 percent in India to 0.7 percent in Georgia among the countries which graduated since 2000). In terms of disbursements, this lending is being phased out over at least at least a five-year period because of the time it takes to disburse credits approved before graduation and has been at least partially substituted for by IBRD financing. On average, the World Bank commitments during the first three years following graduation from IDA remained nearly constant as a share of GDP compared to the country's last IDA replenishment, at 0.66 percent versus 0.65 respectively, and average World Bank disbursements are higher during the three years following graduation (0.56 percent of GDP) than for the three years preceding it (0.45 percent of GDP). Graduation of the countries which are more fiscally reliant on IDA is usually delayed.

65. **However, the variation among countries was large, and some countries are 'outliers'.** For example, in Armenia, the World Bank commitments increased from 1.29 percent of GDP to 2.10 percent of GDP during the three years following graduation from IDA and, in Azerbaijan, it declined from 1.15 percent of GDP to 0.17 percent of GDP.

66. **The 2018 IBRD capital increase commitments help address the problem of 'outliers' among the graduates.** Ensuring that no graduate sees a reduction in lending volume upon graduation while also making the transition in terms of financing smoother, these commitments are expected to reduce the remaining uncertainties related to the countries' IDA graduation experience.

C. TRANSITIONAL SUPPORT TO RECENT IDA GRADUATES

67. **Transitional support has been provided to the recent IDA graduates during the IDA17 and IDA18 replenishments.** Its objective was to ensure that these countries do not experience fiscal cliff effect, a shortage of fiscal resources upon their graduation, and enable continuous World Bank support for implementation of their poverty reduction strategies, particularly in their poorest areas, which is especially important to large countries. This was especially relevant at a time of uncertainty in IBRD's capital outlook. The current recipients of IDA's transitional support—Bolivia, Sri Lanka, and Vietnam—are expected to receive support in the amounts of SDR 99 million, SDR 303 million, and SDR 1.593 billion, respectively, over the IDA18 replenishment period. IDA deputies' request to review the levels of transitional support at the MTR emphasized the need to take into account the outcome of the IBRD capital discussion and consider a holistic and longer-term approach to transition.

68. **Management's assessment is that the need for transitional support in its present form is reduced.** The IBRD capital package commitment to aim for fully replacing IDA financing to recent IDA graduates reduces the uncertainty regarding availability of the World Bank financing to recent graduates.

69. **Nevertheless, Management recommends exploring in the IDA19 negotiations providing recent IDA graduates with access to IDA's CRW and Regional Program, including the RSW.** Such financing could be made available on IDA blend terms for a limited period after the graduation—for example, during three subsequent replenishments.

- Access to the CRW would mean that the countries will be graduating with insurance which will reduce a risk of their reverse graduations, with the latter typically resulting from an economic or social crisis. As discussed in the previous section, all current blend countries are, to varying but significant degrees, crisis prone. This would reduce the risk of delaying graduation to maintain access to the CRW as insurance. It would also mitigate the risk of a country using all its exposure to IBRD in the event of a disaster beyond its control.
    - This would be particularly relevant for small islands exposed to natural disasters which may need such support longer than others. Therefore, Management also recommends exploring that any IBRD-only Small States be granted access to the CRW under certain limited conditions, including:
        (i) The severity of a natural disaster would be assessed based on the same CRW eligibility criteria applicable to IDA-eligible clients in the aftermath of a natural disaster; and
        (ii) Adequacy of a country's access to IBRD resources would be assessed based on a rigorous analysis of the magnitude of IBRD resources accessible to a country relative to its development challenges.
- Access to the Regional Program would support projects involving the provision of regional public goods. As mentioned in the previous section, many of the current blend countries are participating in projects financed from the program. This access could be limited to the projects with significant benefits to the countries which have not yet graduated from IDA, or to the nationals of such countries in case of the RSW. The size of this access could also be capped to avoid reducing access for IDA countries (see also Review of the IDA Regional Program, IDA 2018c).

70. **Management also proposes to reduce the overall amount of IDA18 transitional support by about one-third for the current recipients of IDA's transitional support—Bolivia, Sri Lanka, and Vietnam.** These countries can now benefit from additional IBRD resources. Therefore, the amount of transitional support can be reduced, but some flexibility in the timing and amounts of commitments during the implementation period is necessary to accommodate country-specific situations and avoid any

discontinuities. Given the current demand and programming, as discussed in the IDA18 MTR Implementation and Results Progress Report, Management proposes that the transitional support resources in the amount between US$900 million and US$1.3 billion are reallocated. IDA18 commitments to each country will not exceed the country's initial transitional support allocation agreed upon by IDA deputies.

D. POLICY ON CAPPING ALLOCATIONS TO LARGE BLEND COUNTRIES

71. **IDA's policy on caps for allocations to large blend countries was established with the purpose of limiting the share of IDA resources allocated to countries with large populations and existing access to IBRD.** During the first year of IDA operations, allocations for India and Pakistan were well over 60 percent of total IDA lending. Later in the 1960s, as more IDA-eligible countries joined the WBG, it was recognized that if large countries, especially those with access to IBRD, were to continue to receive IDA allocations of a size suggested by the allocation criteria, there would not be sufficient IDA resources remaining for the smaller countries. IDA Deputies also intended to ensure African countries would receive a sufficient share of IDA resources. In FY68, the shares of India and Pakistan in IDA financing were limited to 45 percent and 16 percent, respectively and were subsequently further reduced to 40 percent and 12.5 percent, respectively. China after its re-engagement with the World Bank in the beginning of 1980s, and Indonesia (IDA12–IDA14) were also covered by the cap policy. The policy applied to all these countries until their graduations from IDA. In IDA18, the policy applies to one country—Pakistan, the IDA18 allocation of which is capped at 7 percent of IDA's total country-allocable envelope.

72. **Management proposes to maintain at 7 percent the cap on the country-allocable envelope for countries with significant access to IDA and IBRD in cumulative terms**. The rationale for the cap – ensuring a fair distribution of resources, not excessively biased toward large countries and to countries that have long-standing access to both IDA and IBRD – remains relevant. As noted in Table 4, the countries subject to the cap so far (India, Pakistan, Indonesia and China) are at the top of past and present IDA recipients in terms of their cumulative access to World Bank (IDA and IBRD) resources. In addition, the cap now applies only to the country-allocable envelope (the performance-based allocation): since IDA18, the share of windows has grown to one third of the replenishment, opening additional access to IDA resources for countries subject to the cap, such as Pakistan.

Table 4. Top 10 Cumulative IDA/IBRD Commitments to Past and Current IDA Clients*
(US$ billion, FY17 prices)

Country	Status	IBRD	IDA	IBRD/IDA
India	Graduated FY14	104	102	207
Indonesia	Graduated FY08	95	7	102
China	Graduated FY99	74	19	92
Pakistan	IDA blend	22	36	58
Bangladesh	IDA only	0	43	43
Philippines	Graduated FY93	40	1	41
Nigeria	IDA blend	18	20	38
Egypt	Graduated FY99	27	5	32
Vietnam	Graduated FY17	4	24	28
Ethiopia	IDA only	1	26	27
Sub-total		384	283	667
Overall total		**1,284**	**555**	**1,839**

*The table includes countries that are currently IDA recipients or graduated between 1990 and 2017. Data includes FY45-18.
Source: World Bank.

E. CONTRACTUAL ACCELERATION CLAUSE

73. **Since 1987, IDA can accelerate credit repayments from blend and graduate countries to redirect its resources toward the poorest countries.** Under the presumption that country's ability to repay debt improves as they develop—and as they become blend and, even more so, graduate from IDA—the clause enables credits to be repaid faster to finance new IDA credits to poorer countries. In other words, the acceleration clause embeds a principle of solidarity from better-off IDA members toward the poorest IDA members. Financing Agreements for credits approved since 1987 include a clause that allows IDA to accelerate credit repayments once a borrower meets the specified GNI per capita and creditworthiness thresholds (IDA 1987, 1996).[7] The accelerated repayment clause can be implemented flexibly based on eligible countries' debt servicing preferences through either the principal option (the default option) or the interest option. Under the existing loan agreements of qualifying credits, once a country reaches the eligibility thresholds, IDA can modify the repayment terms requiring the country to double its principal repayments ('principal option')—that is, the maturity of eligible loans would be shortened. Alternatively, the country can request that the original amortization schedule be retained and pay an interest charge based on the outstanding balance at a rate that would result in the same net present value as accelerating the repayments ('interest option'). Although the present value over the life of the loans would be the same under either option, the impact on IDA's liquidity and projected IDA18 commitment authority would be different. Contractual accelerated repayments were implemented for the first time as part of the IDA16 replenishment and then as part of the IDA17 replenishment. The clause has never been implemented in a country which has not yet graduated from IDA.

74. **The review of accelerated repayments of IDA credits by graduate countries has been undertaken in the broader context of the IDA18 replenishment discussions.** During the IDA18 Replenishment Meetings Participants agreed to postpone the final decision on contractual acceleration for the three graduating countries—Bolivia, Sri Lanka, and Vietnam—until the IDA18 MTR.

75. **The simulations suggest that the aggregate impact of suspension on IDA finances is relatively modest.** If IDA decides to postpone contractual acceleration for three IDA18 graduates through the end of IDA18, the impact for IDA during FY20 will amount to US$91.46 million.

76. The clause would still be maintained in IDA contracts and decisions pertaining to contractual acceleration in the past replenishments would not be revisited.

77. **Management proposes that contractual acceleration clause should continue to be suspended through the end of IDA18 for the three IDA18 graduates.** This reflects the following three considerations:

(a) From a client point of view, triggering the clause would be inconsistent with the objectives of the IBRD capital increase commitment to maintain the volume of World Bank lending to IDA graduates at least constant. In fact, simulations suggest that, on average, for the 10 blend countries (excluding SIEs) and three IDA18 graduates, the average fiscal effects in present value terms of lifting the suspension starting from FY20 in present value terms would have been comparable to the average annual IDA lending to the countries during their last replenishment before graduation (0.31 percent of GNI versus 0.35 percent of GNI).

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7 Note: credits approved before 1987 and credits on hardened terms (which were made available from IDA13 to IDA15 for gap countries with a 20-year maturity) do not include an accelerated repayment clause.

(b) Triggering the clause would also be inconsistent with broader concerns about debt sustainability. The countries are still facing the headwinds which led to a decision to provide them with transitional support during IDA18.

(c) From IDA's point of view, with the introduction of the hybrid financing framework that allows access to capital markets, IDA can mobilize additional resources and have quick access to liquidity. Hence the benefits of the acceleration clause—enabling more resources today rather than waiting for their repayment tomorrow—are more limited, at least while IDA's ability to expand borrowing in not constrained.

F. THE CASE OF SMALL STATES

78. **Under the existing IDA architecture, countries are eligible for IDA resources based on relative poverty and lack of creditworthiness.** In 1985, the Board approved an exception to these IDA eligibility criteria (the 'Exception') under which SIEs are granted access to concessional IDA financing even if a county's per capita income exceeds the IDA operational cutoff.[8] This Exception was introduced in recognition of small islands' special characteristics, including exposure to exogenous economic shocks, export vulnerability, high cost of basic infrastructure, higher unit costs of investment in the industrial sector, limited size of domestic markets, and distance from major markets—affecting their creditworthiness—despite having GNI per capita levels higher than the IDA operational cutoff. Currently, 15 SIEs with GNI per capita above the IDA operational cutoff are eligible for the most concessional Small Economy Terms pursuant to this Exception. Depending on their risk of debt distress ratings, 10 of them are also eligible for IDA Grants. Once a country is granted SIEE, it continues to enjoy Small Economy Terms until it graduates to 'IBRD-only' status.

79. **Three main issues have come up in implementing the SIEE Policy:** (a) the need for clear entry/reentry criteria for considering requests from IBRD-only clients, (b) the need for exit criteria for countries already under SIEE, and (c) the need to explicitly recognize vulnerability to natural disasters and climate change as part of the rationale for granting SIEE (see Annex 3 for details). In the context of this review of the IDA Graduation Policy, Management considered various options to address the abovementioned limitations of the SIEE Policy. The following proposals are presented for the Participants' consideration.

80. **Entry/reentry to IDA.** Management proposes that an IBRD-only SIE may enter/reenter IDA if, in Management's assessment, all of the following four conditions are satisfied:

(a) The country's per capita income is at or below the GDI.

(b) The country has limited access to IBRD resources.

(c) The country has limited creditworthiness for accessing commercial credit.

(d) The country is assessed as highly vulnerable to natural disasters and climate change.

where

(i) Adequacy of a country's access to IBRD resources would be assessed based on a rigorous analysis of the magnitude of IBRD resources accessible to a country relative to its development challenges.

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[8] See Board paper "Terms of Lending to Small Island Economies Graduating from IDA," November 18, 1985 (IDA/R85-134).

(ii) A country's access to commercial credit would be assessed based on sovereign credit ratings published by major credit rating agencies. If a country has an 'above investment grade' credit rating, it would not be eligible to enter/reenter IDA under SIEE.

(iii) A country's vulnerability to natural disasters and climate change would be assessed based on commonly used vulnerability indices (such as the Global Climate Risk Index and World Risk Index) supplemented, as necessary, by other information on a country's vulnerability to natural disasters and climate change.

81. Of the eight IBRD-only SIEs, only Fiji has a per capita income (US$4,970 in 2017) below the GDI (US$6,795 in 2017) and may meet three other criteria, which would imply that Fiji would become eligible for IDA.

82. **Access to the CRW.** In addition, Management proposes to explore in IDA19 that an IBRD-only Small States be granted temporary access to the CRW under certain limited conditions, as described in paragraph 69.

83. **Smoothing transition in the terms of financing.** To support IDA-eligible Small States' transition to IBRD-only status, Management recommends exploring in the IDA19 negotiations, changing the terms of lending for Small States once they reach a certain level of development (this would apply to both island and non-island Small States). Under this proposal, a higher level of development and resilience to shocks could trigger IDA blend terms. Such an approach would recognize that the ability of a Small State to cope with shocks increases with development, while also recognizing that even at higher levels of development, some Small States may be more vulnerable compared to other economies. It would help smooth the transition in the terms of financing for this group of countries.

IV. GRADUATION OUTLOOK

84. **A review of the graduation readiness of the current blend countries indicates that all of them are facing significant headwinds.** Building description of the blend countries and the World Bank country programs in Section II.A, and complementing the issues identified for various groups of blend countries, Table 5 summarizes country-specific findings of this review.

85. **These challenges notwithstanding, two blend countries with low poverty rates and relatively high incomes per capita compared to others not classified as Small States—Moldova and Mongolia—deserve additional consideration.** These countries have a poverty headcount close to zero at the US$1.90 poverty rate. Moldova is currently implementing its association agreement with the European Union which serves as an anchor for institutional changes and helps to secure concessional financing from a major source other than IDA. Mongolia used its national resource revenues for poverty reduction purposes relatively well. However, these countries also have macroeconomic and institutional vulnerabilities. Management will further review these cases to finalize a recommendation at the June meeting of IDA19 replenishment.

86. **Longer-term graduation prospects also deserve attention.** During the IDA18 replenishment negotiations, IDA for the first time performed analysis of the long-term graduation trends based on simple stylized facts about blend countries, such as the ratios between their incomes per capita and IDA operational cutoff and the time since they attained blend status. The methodology for such analysis has been now refined to account for uncertainties surrounding the transition paths, including the recent rapid rise in risks of debt distress in IDA countries, large fluctuations in commodity prices and their impact on economic growth in these countries, and the uncertainty about the ability of Africa's labor markets to generate annually 11 million jobs needed to employ the new entrants. A new methodology for probabilistic graduations

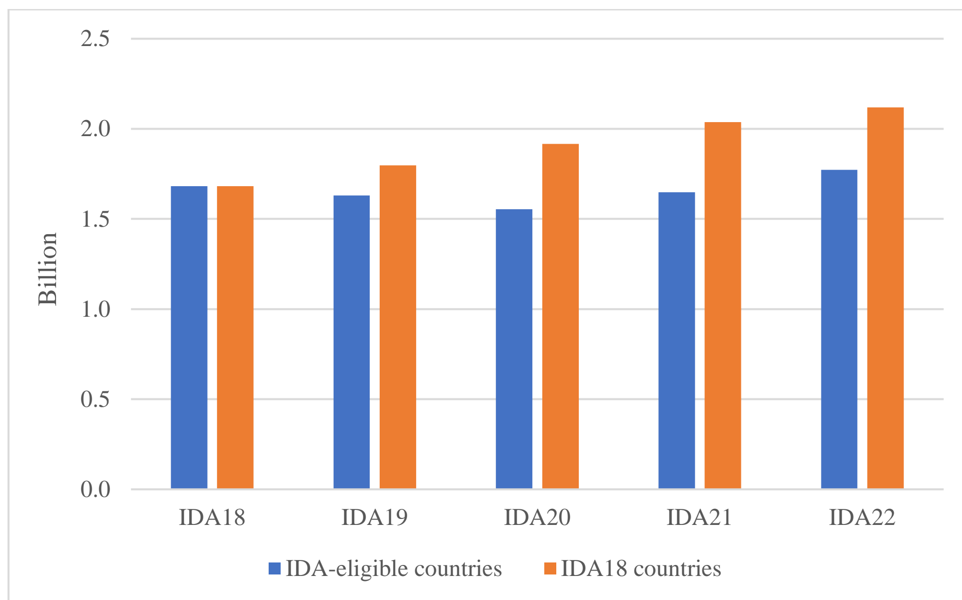
projections helps to assess the likelihoods of the countries remaining IDA borrowers and being IDA graduates, based on a statistical model accounting for a wide range of factors (e.g. GNI per capita, time the country's GNI per capita has been over IDA's operational cutoff, creditworthiness, poverty headcount, population, exports/GDP, life expectancy, urbanization, fragility, institutional development, and resource rents).

Table 5. Summary of the Review of Blend Countries' Readiness for Graduation from IDA

IDA Blend Country	Country-specific Challenges Affecting Readiness to Graduate from IDA
Cameroon	The country has high risk of debt distress; is currently undergoing fiscal consolidation; is highly vulnerable to commodity price risks; has relatively low GNI per capita (US$1,360), a poverty headcount rate of 24 percent at US$1.90 poverty line, and low HCI score of 0.39; has pockets of fragility and other institutional vulnerabilities.
Cabo Verde	The country has high risk of debt distress, is highly vulnerable to external shocks, and lacks economies of scale and scope needed to develop resilience to such shocks.
Republic of Congo	The country is classified as a fragile situation by the World Bank Group, has high risk of debt distress, is currently undergoing fiscal consolidation, is highly vulnerable to commodity price risks, and has a poverty headcount rate of 37 percent at US$1.90 poverty line in addition to a relatively low GNI per capita (US$1,360) and low HCI score of 0.42.
Kenya	Having become a blend country only in 2017, Kenya has a much lower income per capita compared to the average income per capita of medium-size countries, when they graduate from IDA, and a poverty headcount rate of 36.8 percent at US$1.9 poverty line.
Moldova	The country has significant demographic and institutional vulnerabilities which may result in serious fiscal risks; its current GNI per capita is 1.9 time higher than IDA's operational cutoff; whereas Armenia and Georgia, also small post-communist economies and two most closely comparable countries among recent IDA graduates, graduated when their GNI per capita were 3.1 and 2.7 times higher than IDA's operational cutoff, and after their CPI scores exceeded 4, compared to Moldova's current score of 3.7.
Mongolia	The country is undergoing fiscal consolidation in the aftermath of a major macroeconomic crisis which led to a significant increase in poverty. It is highly vulnerable to commodity price risks and has CPIA rating in a fragile range.
Nigeria	The country still needs to continue fiscal consolidation in the aftermath of a major macroeconomic crisis, remains vulnerable to oil price shocks, has a poverty headcount rate of 53.5 percent at the US$1.9 poverty line, has low HCI score of 0.34, has pockets of fragility, has tax revenue-to-GDP ratio in a single-digit range, and has an overall CPIA rating just above the fragile range. Nigeria's 36 state governments, which oversee provision of a wide range of public services, have much weaker fiscal positions post crisis and would find it difficult to borrow from IBRD, especially for the social sectors' projects.
OECS countries	The countries face high risks of debt distress, high vulnerability to external shocks, and lack of economies of scale and scope needed to develop resilience to such shocks.
Pakistan	The country has a relatively low GNI per capita (US$1,580) and low HCI score of 0.39. It faces significant institutional and fiscal vulnerabilities and territorial pockets of fragility. Its subnational government, which oversees provision of a wide range of public services, may find it difficult to borrow from IBRD, especially for the social sectors' projects.
Papua New Guinea	The country faces significant institutional and fiscal vulnerabilities, a poverty headcount rate of 38 percent at the US$1.90 poverty line, low HCI score of 0.38, vulnerability to commodity price risks, and the need for fiscal consolidation in the aftermath of commodity prices fall.
Timor-Leste	The country faces major institutional vulnerabilities and has a poverty headcount rate of 30.3 percent at the US$1.90 poverty line.
Uzbekistan	The country faces major institutional vulnerabilities, the latest available poverty headcount rate of 62.1 percent at the US$1.90 poverty line, and large concessional financing needs to support the recent transition towards the market economy.

87. **Beyond IDA19, projections confirm the likelihood of a significant number of graduations.** Considering probabilities of the countries remaining IDA borrowers, Figure 6 presents a projection of the expected total population of IDA-eligible countries for IDA18 and the subsequent four replenishment periods. While countries representing over 20 percent of today's IDA population are likely to graduate by 2030, the expected population growth of over 25 percent in the remaining IDA countries will more than offset this. In other words, the total population in IDA countries is expected to remain nearly constant between IDA18 and IDA22 replenishment because population growth outweighs reductions in total population because of graduations. This in fact is similar to the experience in IDA17, where the cumulative population growth of IDA countries during IDA17 replenishment was 5.4 percent, whereas the reduction in total population because of graduating Bolivia, Sri Lanka, and Vietnam was only 4.1 percent.

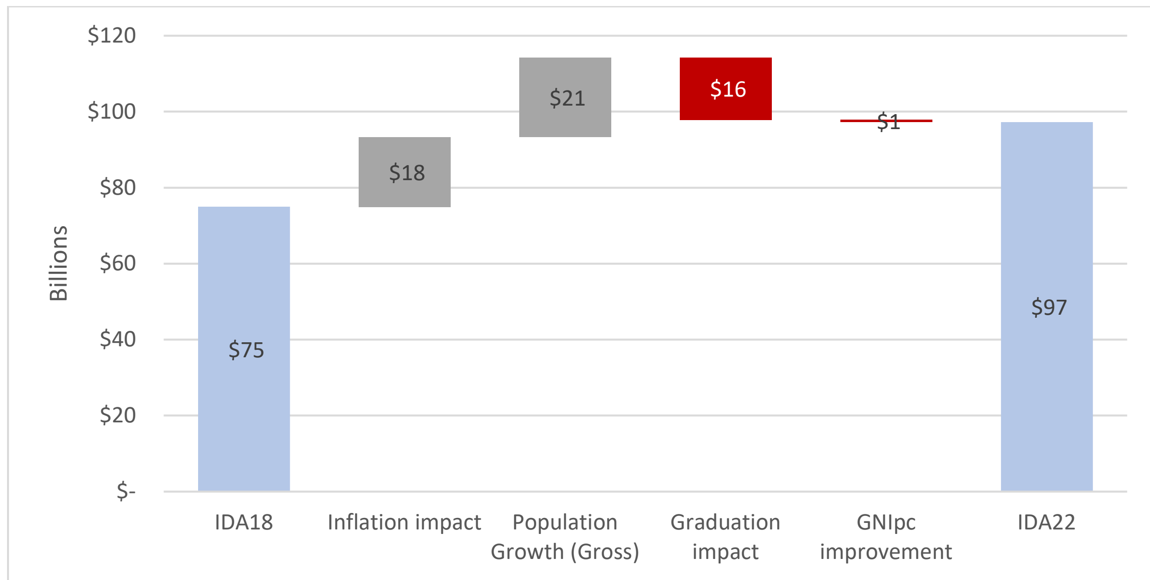
Figure 6. Total Projected Population of IDA18 Countries and IDA-eligible Countries for the IDA18–IDA22 Replenishment Periods
(period average)



Source: World Bank Populations Projections and staff estimates.

88. **As a result, the overall needs for IDA financing are likely to be on an upward trend in nominal terms through 2030 despite the probable graduations, but mostly because of inflation adjustments.** Assuming that the per capita allocations for countries remaining eligible to IDA are maintained in real terms (at about US$45 in 2018 prices per 3-year replenishment), Figure 7 presents the projections for IDA's financing needs showing a net increment of US$24 billion driven by (a) inflation adjustments also leading to an increase (US$18 billion) (b) population growth driving an increase (US$21 billion), (c) expected graduations leading to a reduction in the envelope (US$16 billion), and (d) expected GNI per capita growth reducing the envelope (US$1 billion).

Figure 7. Projected Demand for IDA Resources under an Assumption of Constant, Per Capita Demand - IDA18–IDA22
(US$, billions)



Source: Staff estimates.

V. ISSUES FOR DISCUSSION

89. **Staff would welcome the Participants' views on**

- The approach on how to effectively use the blend period for preparing for successful graduation from IDA (paragraph 53);
- The future of the transitional support to graduating countries (paragraph 69);
- The proposal to reduce IDA18 transitional support by one-third (paragraph 70);
- The proposal on capping allocations to blend countries with large cumulative World Bank commitments (paragraph 72);
- The proposal to keep the contractual acceleration clause suspended for Bolivia, Sri Lanka, and Vietnam (paragraph 77);
- The proposals for revising the SIEE policy and exploring changing financing terms for IDA-eligible Small States with GNI per capita above GDI (paragraphs 80-83); and
- The outlook for graduation (Section IV).

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Annex 1: Eligibility to IDA Financing

	Country	FY19 Eligibility
1	Cameroon	Blend
2	Congo, Rep.	Blend
3	Kenya	Blend
4	Moldova	Blend
5	Mongolia	Blend
6	Nigeria	Blend
7	Pakistan	Blend
8	Papua New Guinea	Blend
9	Uzbekistan	Blend
11	Timor-Leste	Blend/small state
12	St. Lucia	Blend/small island
13	St. Vincent and the Grenadines	Blend/small island
14	Cape Verde	Blend/small island
15	Dominica	Blend/small island
16	Grenada	Blend/small island
17	Zimbabwe	Blend/inactive
18	Myanmar	Gap
19	Nicaragua	Gap
20	Zambia	Gap
21	Bangladesh	Gap
22	Djibouti	Gap/small state
23	Bhutan	Gap/small state
24	Guyana	Gap/small state
25	Eritrea	IDA only/inactive
26	Somalia	IDA only/inactive
27	Sudan	IDA only/inactive
28	Syrian Arab Republic	IDA only/inactive
29	Afghanistan	IDA-only
30	Benin	IDA-only
31	Burkina Faso	IDA-only
32	Burundi	IDA-only
33	Cambodia	IDA-only
34	Central African Republic	IDA-only
35	Chad	IDA-only
36	Comoros	IDA-only
37	Congo, Dem. Rep.	IDA-only
38	Ethiopia	IDA-only
39	Gambia, The	IDA-only
40	Guinea	IDA-only
41	Guinea-Bissau	IDA-only
42	Haiti	IDA-only
43	Kyrgyz Republic	IDA-only
44	Liberia	IDA-only
45	Madagascar	IDA-only
46	Malawi	IDA-only
47	Mali	IDA-only
48	Mauritania	IDA-only
49	Mozambique	IDA-only
50	Nepal	IDA-only
51	Niger	IDA-only
52	Rwanda	IDA-only

	Country	FY19 Eligibility
53	Senegal	IDA-only
54	Sierra Leone	IDA-only
55	South Sudan	IDA-only
56	Tajikistan	IDA-only
57	Tanzania	IDA-only
58	Togo	IDA-only
59	Uganda	IDA-only
60	Yemen, Rep.	IDA-only
61	Kiribati	Small island
62	Maldives	Small island
63	Marshall Islands	Small island
64	Micronesia, Fed. Sts.	Small island
65	Samoa	Small island
66	Sao Tome and Principe	Small island
67	Solomon Islands	Small island
68	Tonga	Small island
69	Tuvalu	Small island
70	Vanuatu	Small island
76	Bolivia	IBRD/transitional support
77	Sri Lanka	IBRD/transitional support
78	Vietnam	IBRD/transitional support

Annex 2: IBRD and IDA Terms of Financing

	Type	Maturity		Repayment		New Maturity Premium		Charges/Fees	
		Maturity (years)	Grace Period (years)	Principal Repayments	Acceleration Clause	Discount/Surcharge	Final Maturity	Service Charge for Credits (SDR)	Interest Rate (SDR)
IDA	**IDA Grant Terms**	NA	NA	NA	NA	-		NA	NA
	IDA Small Economy Terms	40	10	2% for yrs. 11-20	Yes	-		0.75%	NA
				4% for yrs. 21-40		-			
	IDA Regular Credit Terms	38	6	3.125% for yrs. 7-38	Yes	-		0.75%	NA
	IDA Blend/Gap Terms	30	5	3.3% for yrs. 6-25	Yes	-		0.75%	1.25%
				6.8% for yrs. 26-30		-			
	IDA Non-Concessional Credits (IDA SUF/Transitional Support)	Up to 35 yrs. maximum; up to 20 yrs. average maturity		the same as IBRD Group A terms	NA	the same as IBRD Group A terms	the same as IBRD Group A terms	the same as IBRD Group A terms	the same as IBRD Group A terms

	Type	Average Maturity (years)	Maturity Premium	Acceleration Clause	Discount/Surcharge	Final Maturity	Commitment Fee	Front-end Fee	Contractual Spread	Default Interest Rate
IBRD	**Group A** (Blends, small states, FCS and recent IDA graduates*: Exempted from proposed changes)	**<=8**	0.0%	NA	-	-	0.25%	0.25%	0.50%	0.50%
		8 -10	0.1%	NA	-	0.10%				
		10-12	0.2%	NA	-	0.20%				
		12 - 15	0.3%	NA	-	0.30%				
		15 - 18	0.4%	NA	-	0.40%				
		18 - 20	0.5%	NA	-	0.50%				
	Group B (IBRD Terms to countries whose GNI per capita is Below-GDI: Applied increased maturity premium but eligible for discount)	**<=8**	0.0%	NA	-	-	0.25%	0.25%	0.50%	0.50%
		8 -10	0.1%	NA	-	0.10%				
		10-12	0.3%	NA	-0.05%	0.25%				
		12 - 15	0.5%	NA	-0.10%	0.40%				
		15 - 18	0.7%	NA	-0.15%	0.55%				
		18 - 20	0.9%	NA	-0.20%	0.70%				
	Group C (IBRD Terms to countries whose GNI per capita is Above-GDI and Below HIC: Applied increased maturity premium)	**<=8**	0.0%	NA	-	-	0.25%	0.25%	0.50%	0.50%
		8 -10	0.1%	NA	-	0.10%				
		10-12	0.3%	NA	-	0.30%				
		12 - 15	0.5%	NA	-	0.50%				
		15 - 18	0.7%	NA	-	0.70%				
		18 - 20	0.9%	NA	-	0.90%				
	Group D (IBRD Terms to HICs: Applied increased maturity premium and subject to surcharge)	**<=8**	0.0%	NA	+0.05%	0.05%	0.25%	0.25%	0.50%	0.50%
		8 -10	0.1%	NA	+0.05%	0.15%				
		10-12	0.3%	NA	+0.1%	0.40%				
		12 - 15	0.5%	NA	+0.15%	0.65%				
		15 - 18	0.7%	NA	+0.2%	0.90%				
		18 - 20	0.9%	NA	+0.25%	1.15%				

*- new IDA graduates: exempted for 2 replenishment cycles

- IDA17/IDA18 graduates: exempted for 6 years starting from July 1, 2018

**1. IBRD lending rates include a standard lending spread comprising a contractual spread of 0.50% and, where applicable, an annual maturity premium. The lending rate also includes a charge to cover the bank's cost to fund the loans relative to the base lending rate and a market risk premium (for fixed spreads). DDO disbursements are priced at the prevailing spread over 6-Month LIBOR at the time of drawdown.

Annex 3: The Small Island Economies Exception

1. Under the existing IDA architecture, countries are eligible for IDA resources based on relative poverty and lack of creditworthiness. In 1985, the Board approved an exception to this IDA eligibility criteria (the 'Exception') under which SIEs are granted access to concessional IDA financing even if a county's per capita income exceeds the IDA operational cutoff.[9] This Exception was introduced in recognition of small islands' special characteristics, including exposure to exogenous economic shocks, export vulnerability, high cost of basic infrastructure, higher unit costs of investment in the industrial sector, limited size of domestic markets, and distance from major markets—affecting their creditworthiness—despite having GNI per capita levels higher than the IDA operational cutoff.

A. Countries Benefitting from the SIE Exception

2. Currently, 15 SIEs with GNI per capita above the IDA operational cutoff are eligible for the most concessional Small Economy Terms pursuant to this Exception. Of these, five are blend countries as they have access to both IDA and IBRD resources. The other 10 would in principle fall under the definition of a 'gap country' but have been granted the status of an 'IDA-only country' under SIEE. Throughout the rest of this annex, 'IDA-only country' includes the 10 (otherwise gap) countries that have been granted the status of an 'IDA-only country' under SIEE.

3. **Financing terms.** Countries that have been granted SIEE are eligible for IDA Concessional Credits on Small Economy Terms. Once a country is granted SIEE, it continues to enjoy Small Economy Terms on IDA Concessional Credits until it graduates to IBRD-only status;[10] this means that once granted, even blend countries continue to receive the Small Economy Terms until they graduate to IBRD-only status.

4. **Grant eligibility.** An SIE classified as 'IDA-only' is eligible to receive IDA Grants depending on its risk of debt distress rating, provided that it has not lost eligibility for grants because of the application of a disincentive under IDA's Non-Concessional Borrowing Policy:

- An SIE in debt distress or at a high risk of debt distress is eligible to receive 100 percent of its concessional core financing in the form of grants.
- An SIE at moderate risk of debt distress is eligible to receive 50 percent of its concessional core financing in the form of grants and the remaining 50 percent as credits.
- If an SIE is eligible for both IBRD and IDA resources (that is, a blend country), it is not eligible for IDA Grants.[11]

B. Implementation of the SIEE Policy

5. SIEE was first granted to six countries but with the understanding that it would be extended to other small island countries when they reach the IDA eligibility limit if they were to face similar circumstances. It was also agreed that each exception would have to be evaluated on a case-by-case basis. The initial set of countries to receive SIEE was Dominica, Grenada, St. Kitts and Nevis (St. Christopher and Nevis at the

[9] See Board paper "Terms of Lending to Small Island Economies Graduating from IDA", November 18, 1985 (IDA/R85-134).

[10] During IDA16, it was agreed that blend countries that have been granted the Exception will continue to receive IDA Concessional Credits on the same terms as those extended to IDA-only recipients, regardless of their GNI per capita levels.

[11] The only exception to this general provision is the IDA RSW. All IDA-eligible countries, including blend and gap countries, may receive grants from the RSW provided the country meets the eligibility criteria for accessing the RSW.

time), St. Lucia, St. Vincent and the Grenadines, and Tonga.[12] Their per capita incomes were above or almost approaching the IDA operational cutoff at the time when SIEE was granted (table 3.1). Most of them were considered not creditworthy to access IBRD. Of these,

- All six except Tonga reached blend country status in the late 1980s and St. Kitts and Nevis eventually graduated from IDA in 1994. Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines continue to receive IDA Concessional Credits on Small Economy Terms but are not eligible for IDA Grants (except through the RSW) because of their blend country status; and
- Tonga now falls under the definition of a gap country in principle but continues to be eligible for Small Economy Terms because it has been granted the status of an IDA-only country under SIEE. Tonga is also eligible for IDA Grants depending on its risk of debt distress rating; in FY19, Tonga receives 100 percent of its IDA concessional financing as grants.

6. **Post-1985 exceptions.** Ten additional countries have been granted SIEE since 1985—Samoa, Vanuatu, Cabo Verde, the Maldives, the Marshall Islands, the Federated States of Micronesia, Kiribati, Tuvalu, Sao Tome and Principe, and the Solomon Islands (Table A3.1).

- The Marshall Islands and the Federated States of Micronesia were reclassified from 'IBRD-only' to 'IDA-only' under SIEE effective from July 1, 2011, because they were assessed as 'not creditworthy' for IBRD.[13] They have continued to be eligible only for IDA resources since then. Both countries now fall under the definition of a gap country in principle, but because they have been granted SIEE, they continue to receive IDA Concessional Credits at Small Economy Terms. Both are eligible for IDA Grants depending on their risk of debt distress ratings; in FY19, both receive 100 percent of their IDA financing as grants.
- Cabo Verde was reclassified as a blend country effective July 1, 2009, based on a formal creditworthiness assessment. However, because it has been granted SIEE in 1997, it continues to be eligible for IDA Concessional Credits on Small Economy terms. However, Cabo Verde is not eligible for IDA Grants because of its blend country status.
- Samoa, Vanuatu, the Maldives, Kiribati, Tuvalu, Sao Tome and Principe, and the Solomon Islands were granted SIEE when their per capita incomes rose above the IDA cutoff. All seven now fall under the definition of a 'gap country' but continue to receive IDA Concessional Credits at Small Economy Terms because they have been granted the IDA-only country status under SIEE. All are eligible for IDA Grants depending on the risk of debt distress rating; in FY19, Samoa, Kiribati, Tuvalu, and Sao Tome and Principe receive 100 percent of their IDA concessional financing as grants whereas Vanuatu, Maldives, and the Solomon Islands receive 50 percent of their IDA concessional financing as grants and 50 percent as credits.

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[12] The World Bank had not yet reviewed the per capita income or creditworthiness of Tonga (a new member country) at the time, but its per capita income was estimated to be in the range of US$700–US$900. The Board decided that Tonga will also be granted the Exception, if a review of its income and creditworthiness confirmed similar circumstances to the other five islands.

[13] The Marshall Islands and the Federated States of Micronesia were initially classified as 'IBRD-only' when they joined the World Bank, respectively, in May 1992 and June 1993 and remained in that status until they were granted the Exception, effective FY12.

Table A3.1. Historical Application of the Small Island Economies Exception

Country	Effective Date of Exception	Per Capita GNI when Granting Exception (US$)	Operational Cutoff when Granting Exception (US$)	Prior IBRD Classification	Classification Granted
Tonga	July 1, 1987[a]	780	790	No	IDA-only
Grenada		880			
Dominica		1,080			
St. Lucia		1,130			
St. Vincent and the Grenadines		900			
Samoa (Based on 1991 GNP)	July 1, 1992	930	765	No	IDA-only
Vanuatu (Based on 1991 GNP)	July 1, 1992	1,120	765	No	IDA-only
Cabo Verde (Based on 1997 GNP)	July 1, 1997	1,090	925	No	IDA-only[b]
Maldives (Based on 1997 GNP)	July 1, 1998	1,150	925	No	IDA-only
Kiribati (Based on 1999 GNP)	July 1, 2000	910	885	No	IDA-only
Marshall Islands (Based on 2009 GNI)	July 1, 2011	3,060	1,165	Yes	Reclassified from IBRD to IDA-only
Micronesia, Fed. Sts (Based on 2009 GNI)	July 1, 2011	2,220	1,165	Yes	Reclassified from IBRD to IDA-only
Tuvalu (Based on 2010 GNI)	July 1, 2011	4,670	1,175	No	IDA-only
Sao Tome and Principe (Based on 2012 GNI)	July 1, 2013	1,320	1,205	No	IDA-only
Solomon Islands (Based on 2015 GNI)	July 1, 2016	1,940	1,185	No	IDA-only

Source: World Bank

Note: (a) Based on 1984 GNP per capita; SIEE was also granted to projects already in the pipeline for Board presentation in FY86 and FY87.

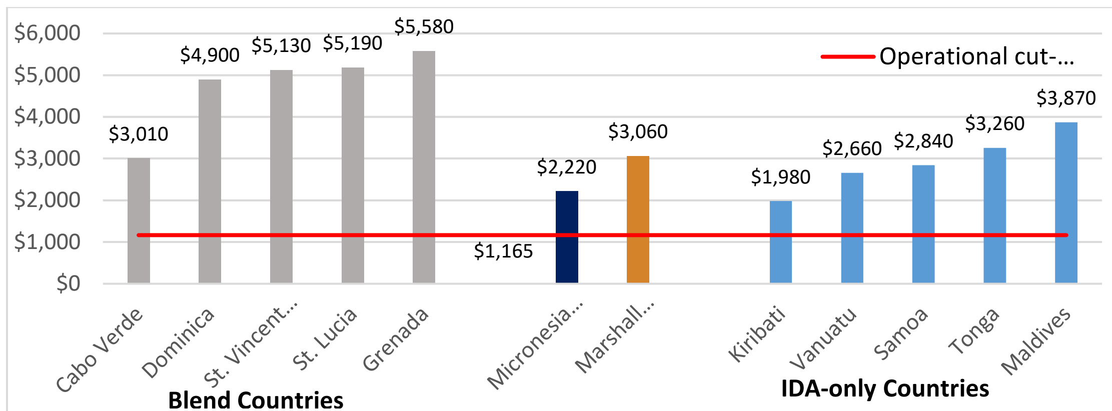
(b) However, Cabo Verde was declared creditworthy in FY08 based on a formal assessment and was reclassified as a blend country effective July 1, 2009.

7. **Two reclassifications.** The Marshall Islands and the Federated States of Micronesia were the only countries to be reclassified from IBRD-only to IDA through SIEE. It should be noted, however, that neither country had ever borrowed from the IBRD. Figure A3.1 compares their per capita incomes at the time they were considered for SIEE with those of 10 countries that were already under SIEE:

- Per capita income of the Federated States of Micronesia (US$2,220) was much lower than that of all countries benefitting from SIEE other than Kiribati.
- Per capita income of Marshall Islands (US$3,060) was much lower than that of all blend countries other than Cabo Verde and comparable to that of several IDA-only countries.

8. The IDA operational cutoff at the time was US$1,165. The related Board papers demonstrated that both countries displayed several SIE characteristics that underpinned the 1985 Board decision establishing SIEE. Both were not considered creditworthy for IBRD lending, based on formal creditworthiness assessments conducted by the World Bank's Credit Risk Department in 2009.

Figure A3.1. GNI Per Capita of the Federated States of Micronesia and the Marshall Islands: Comparison with Countries under SIEE (2009, US$)



Source: WDI; OP 3.10 Annex D, July 2010.

9. **Process for granting SIEE.** The first round of exceptions was approved by the Board when the SIE Policy was first adopted. All subsequent decisions to grant SIEE were taken by Management. In most cases, SIEE was granted when an IDA-only country was about to reach the gap country status. A formal creditworthiness assessment by the Credit Risk Department was required only in the case of a new member country or if a creditworthiness assessment has never been performed. The decision to classify Tuvalu and reclassify the Federated States of Micronesia and the Marshall Islands in 2011 as IDA-only countries were based on formal creditworthiness assessments, and the Executive Directors were informed through Board papers.[14]

C. Limitations of the SIEE Policy

10. Three main issues have risen regarding implementation of the SIEE Policy: (a) the need for clear entry/reentry criteria for considering requests from IBRD-only clients, (b) the need for exit criteria for countries already under SIEE, and (c) the need to explicitly recognize vulnerability to natural disasters and climate change as part of the rationale for granting SIEE.

[14] See IDA/SecM2011-0062, February 8, 2011 (on the Marshall Islands); IDA/SecM2011-0063, February 8, 2011 (on the Federated States of Micronesia); and IDA/SecM2011-0685, November 10, 2011 (on Tuvalu).

Absence of Entry Criteria for Considering Requests from IBRD-only Clients

11. In the 1985 Board paper, SIEE was proposed as a measure to support IDA-eligible SIEs in their transition to IBRD. It did not address whether IBRD-only SIEs could gain (or regain) access to IDA pursuant to SIEE. For instance, the Board paper did not mention Fiji or Mauritius, two SIEs that were already classified as 'IBRD-only.' Per capita incomes of Fiji and Mauritius in 1985 (respectively US$1,580 and US$1,060) were much below the per capita income of St. Kitts and Nevis (US$2,420) that was granted SIEE. Because the SIEE Policy is silent on this aspect, more recent decisions to decline access to Nauru and Palau, despite their lack of creditworthiness to borrow from the IBRD, were based primarily on their high per capita GNI—exceeding US$10,000 in 2016. Consistent with the overall IDA philosophy, the underlying rationale was the necessity to direct limited development resources to the poorest and the most vulnerable countries.

Absence of Exit Criteria

12. The SIEE Policy does not contain an exit provision. Once SIEE is granted, a country continues to enjoy the benefits of SIEE—regardless of its per capita income—until the country graduates to IBRD-only status. So far, only St. Kitts and Nevis has exited SIEE, consequent to its graduation from IDA in 1994. Currently, four blend countries - Dominica, St. Vincent and the Grenadines, St. Lucia, and Grenada—continue to be eligible for IDA Small Economy Terms despite having per capita incomes well above the IDA operational cutoff, ranging from US$6,990 to US$9,650. In fact, their per capita incomes even exceed the level that typically initiates discussions on graduating from the IBRD (currently US$6,795). The Maldives has a per capita income of US$9,570 but because it has been granted the IDA-only country status (under SIEE) it receives 50 percent of its IDA concessional financing as IDA Grants and pays Small Economy Terms on the remaining 50 percent of IDA concessional financing. Given IDA's overall philosophy to support the poorest and the most vulnerable countries, it is important to assess whether the existing SIEE Policy Framework provides adequate incentives for high-income small states to graduate from IDA by seeking an IBRD creditworthiness assessment. Such assessment and ensuing recommendation to revise the countries' status under the SIEE Policy, if any, should also recognize that the IDA graduation process provides for a gradual transition out of IDA to ensure a successful and lasting exit.

Need for Explicit Recognition of Vulnerability to Natural Disasters and Climate Change

13. The 1985 Board paper did not explicitly discuss small islands' vulnerability to natural disasters or climate change. Yet, all recent decisions to grant SIEE to new IDA members (Tuvalu) and IBRD-only members (the Marshall Islands and the Federated States of Micronesia) have all considered these countries' vulnerability to natural disasters and climate change as part of the rationale—in addition to their vulnerability to economic shocks—underscoring the need to formally recognize this aspect as part of the SIEE Policy. As such, vulnerability to natural disasters is possibly the most important factor cited in recent calls for multilateral development organizations to do more for small states.

D. Strengthening the SIEE Policy

14. In the context of a review of the IDA Graduation Policy, Management considered various options to address the abovementioned limitations of the SIEE Policy. The following proposals are presented for the deputies' consideration.

15. **Entry/reentry to IDA.** Management proposes that an IBRD-only SIE may enter/reenter IDA if, in Management's assessment, all of the following four conditions are satisfied:

(e) The country's per capita income is at or below the GDI.

(f) The country has limited access to IBRD resources.

(g) The country has limited creditworthiness for accessing commercial credit.

(h) The country is assessed as highly vulnerable to natural disasters and climate change.

where

- Adequacy of a country's access to IBRD resources would be assessed based on a rigorous analysis of the magnitude of IBRD resources accessible to a country relative to its development challenges.
- A country's access to commercial credit would be assessed based on sovereign credit ratings published by major credit rating agencies. If a country has an 'above investment grade' credit rating, it would not be eligible to enter/reenter IDA under SIEE.
- A country's vulnerability to natural disasters and climate change would be assessed based on commonly used vulnerability indices (such as the Global Climate Risk Index and World Risk Index) supplemented, as necessary, by other information on a country's vulnerability to natural disasters and climate change.

16. Of the eight IBRD-only SIEs, only Fiji has a per capita income (US$4,970 in 2017) below the GDI (US$6,795 in 2017) and may meet three other criteria, which would imply that Fiji would become eligible for IDA.

17. **Access to the CRW.** In addition, Management proposes to explore in IDA19 that an IBRD-only Small States be granted temporary access to the CRW under certain limited conditions, as described in paragraph 69.

18. **Smoothing transition in the terms of financing.** To support IDA-eligible Small States' transition to IBRD-only status, Management recommends exploring in the IDA19 negotiations, changing the terms of lending for Small States once they reach a certain level of development (this would apply to both island and non-island Small States). Under this proposal, a higher level of development and resilience to shocks could trigger IDA blend terms. Such an approach would recognize that the ability of a Small State to cope with shocks increases with development, while also recognizing that even at higher levels of development, some Small States may be more vulnerable compared to other economies. It would help smooth the transition in the terms of financing for this group of countries

Table A3.2. Eight IBRD-only Small Island Economies

Country	Population 2017	GNI Per Capita 2017[(a)]
Antigua and Barbuda	102,012	14,170
Fiji	905,502	4,970
Mauritius	1,264,613	10,140
Nauru	13,649	10,220
Palau	21,729	12,530
Seychelles	95,843	14,180
St. Kitts and Nevis	55,345	16,030
Trinidad and Tobago	1,369,125	15,350

Source: World Bank.

19. **Vulnerability to natural disasters and climate change.** This aspect is explicitly recognized in the entry/reentry criterion proposed above. If the IDA deputies were to endorse this proposal, the revised SIEE

Policy will articulate the need to consider vulnerability to natural disasters and climate change as part of the rationale for granting SIEE.

20. **IDA-eligible Small states that are not Islands.** Under IDA18, four non-island Small States (Bhutan, Djibouti, Guyana, Timor-Leste) were also granted the same Small Economy Terms as granted to the SIEs under SIEE. If IDA were to move to a pricing structure where SIEs with per capita incomes above the GDI will be subject to more expensive IDA financing terms, a similar pricing structure would be warranted for the non-Island Small States, as a matter of policy. Currently, the per capita incomes of Bhutan (US$2,720), Djibouti (US$1,880), Guyana (US$4,460), and Timor-Leste (US$1,770) are below the GDI; therefore, they would be able to continue with Small Economy Terms for now on all of their IDA Concessional Credits.

Annex 4: IDA Graduations

Country	Fiscal Year of Last IDA Credit on Initial Graduation	'Reverse Graduates'—Fiscal Year Reentered	Remarks
Chile	FY61		
Colombia	FY62		
Costa Rica	FY62		
Nigeria	FY65	FY89	
Côte d'Ivoire	FY73	FY92	
Dominican Republic	FY73		
Korea	FY73		
Turkey	FY73		
Botswana	FY74		
Ecuador	FY74		
Syria	FY74	FY17	
Mauritius	FY75		
Morocco	FY75		
Swaziland	FY75		
El Salvador	FY77		
Paraguay	FY77		
Jordan	FY78		
Thailand	FY79		
Tunisia	FY79		
Honduras	FY80	FY91	
Cameroon	FY81	FY94	
Nicaragua	FY81	FY91	
Congo, Rep.	FY82	FY94	
Papua New Guinea	FY83	FY03	Became blend in FY03.
Zimbabwe	FY83	FY92	
Equatorial Guinea	FY93[d]		Graduated from IDA in FY99.
Philippines	FY79; FY93	FY91[a]	Graduated again in FY93.
St. Kitts	FY94		
China	FY99		
Egypt	FY81; FY99	FY91[c]	
Macedonia, FYR	FY02		Graduated from IDA as of June 30, 2001. The last IDA credit was in FY02 (delay from FY01).
Albania	FY08		
Indonesia	FY80; FY08	FY99[c]	Reentered on 11/03/98.
Montenegro	FY08		Graduated from IDA as of July 6, 2007 (date of approval of the last IDA credit - delay from FY07).
Serbia	FY08		
Azerbaijan	FY11		
Angola	FY14		
Armenia	FY14		
Bosnia and Herzegovina	FY14		
Georgia	FY14		
India	FY14		
Bolivia	FY17		
Sri Lanka	FY17		

Country	Fiscal Year of Last IDA Credit on Initial Graduation	'Reverse Graduates'—Fiscal Year Reentered	Remarks
Vietnam	FY17		

Note: a. Graduated again in FY93; b. Reentered in November 1998; c. Graduated again in FY99; d. Remained IDA eligible until FY99.

Annex 5: Graduation Policies of Other Development Partners

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

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

International Monetary Fund

3. The IMF provides concessional lending to member countries under PRGT and the PRGT eligibility has been historically closely aligned with that of IDA. The framework for PRGT eligibility was established in 2010, and the framework together with the associated list of PRGT-eligible countries are reviewed by the IMF Board on a two-year cycle. The most recent review took place in May 2017. The review reconfirmed its broad alignment with IDA practices while "allowing scope for some differences in graduation criteria between the Fund and the World Bank given the different mandates of the two institutions."[15] As of end-August 2018, IDA and PRGT eligibility were aligned in all except seven cases.[16]

4. Similar to IDA, the concessional financing under PRGT is reserved for members that have low per capita income levels and do not have durable and substantial access to international financial markets. In broad terms, countries are expected to graduate (a) if they have either a persistently high level of income or (b) capacity to access international financial markets on a durable and substantial basis, and they do not face serious short-term risks. Small countries and microstates are given special consideration on account of their particular vulnerabilities. See box 5.1 for specific criteria.

5. The 2017 review did not introduce any changes to the PRGT eligibility framework and did not result in a graduation of any of the PRGT-eligible countries. While 13 countries met either the income or market access graduation criterion and were not assessed to be at high risk of debt distress or in debt distress, they were not proposed for graduation because of facing other serious short-term vulnerabilities.

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[15] IMF (International Monetary Fund). 2017. "IMF Executive Board Reviews Eligibility to Use the Fund's Facilities for Concessional Financing for 2017." IMF Press Release No. 17/188, May 23.

[16] Specifically, there are seven countries that were not PRGT eligible yet had some access to IDA resources. Mongolia, Nigeria, and Pakistan have blended access to IDA and IBRD resources, while Kosovo has access to IDA-only resources. Bolivia, Sri Lanka, and Vietnam are recipients of IDA transitional support during the IDA18 period.

Box A5.1. Criteria for Graduation from PRGT Eligibility

Income criterion. If the country's annual per capita GNI (a) has been above the IDA operational cutoff for at least the last five years, (b) has not been on a declining trend in the same period, and (c) is currently (i) at least twice the operational IDA cutoff, (ii) at least three times the IDA operational cutoff for small countries, or (iii) at least six times the IDA operational cutoff for microstates.

Market Access Criterion. If the country has the capacity to access international financial markets on a durable and substantial basis, as measured by one of the following two alternative tests:

(a) The existence of such capacity would normally be evidenced by public sector issuance or guaranteeing of external bonds or by disbursements under public and publicly guaranteed external commercial loans in international markets during at least three of the last five years (for which qualifying data are available), in a cumulative amount over that period equivalent to at least 100 percent of the country's quota at the fund at the time of the assessment. External bonds and commercial loans issued or contracted in markets that are not integrated with broader international markets do not qualify.

(b) The country could also be deemed to meet the market access criterion if there was convincing evidence that the sovereign could have tapped international markets on a durable and substantial basis, even though the scale or duration of actual public sector borrowing fell short of the specified thresholds. This would be a case-specific assessment, considering such relevant factors as the volume and terms of recent actual borrowing in international markets and the sovereign credit rating.

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

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

African Development Fund

6. The setup of African Development Bank (AfDB) and its concessional financing window, the AfDF, is the same as IBRD and IDA. Similar to IDA, AfDF eligibility is based on two criteria: (a) per capita income (GNI) below the operational cutoff and (b) the absence of creditworthiness that prevents borrowing from the AfDB's non-concessional window.

7. There are currently 38 countries that are AfDF eligible, covering the same IDA countries in Africa except for the Republic of Congo and Cabo Verde. Similarly, within the AfDF eligible countries, it has different groupings with differentiated financing terms. Its groupings are slightly different from IDA — AfDF has four groups, AfDF-only, AfDF-gap, blend, and graduating to AfDB. As of August 2018, Nigeria is under the 'Graduating to ADB' group.

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

Asian Development Bank

9. Concessional lending at ADB is composed of Asian Development Fund (AsDF) grant resources and concessional ordinary capital resources (OCR). The criteria that govern graduation from the AsDF mirror those of IDA and include income as measured by per capita GNP and debt repayment capacity. The income criterion is comparable to the one used for graduation from access to IDA resources and the process of determining creditworthiness for access to ADB's OCR follows much the same process as that of the World Bank. A three-way classification is developed: Group A countries may access both AsDF grants and concessional OCR, Group B countries may access both concessional and regular OCR, while Group C countries may only access regular OCR loans. As with IDA, the policies governing AsDF eligibility are reviewed periodically during replenishment rounds. Currently, 28 countries have access to concessional assistance.

Inter-American Development Bank

10. The IDB delivers its concessional financing through blending highly concessional resources from the Fund for Special Operations (FSO) and non-concessional resources from the Ordinary Capital account. FSO resources are directed at the poorest and least developed countries in the region that are also IDA-eligible countries: Bolivia, Guyana, Haiti, Honduras, and Nicaragua. In the case of Haiti, all financial support is provided in the form of grants, through the IDB Grant Facility.

11. Country eligibility for concessional resources is determined by two criteria: (a) a GNI per capita lower than the threshold of US$2,834 in 2015 prices or (b) insufficient creditworthiness for borrowing 100 percent on regular Ordinary Capital terms, as indicated by a country's score on a synthetic creditworthiness indicator (SCI). The SCI is the sum of (a) the percentage of concessional resources applicable to a country in the IDB's latest allocation of concessional resources period and (b) a numerical equivalent of the average of the long-term, foreign currency sovereign credit ratings available from S&P, Moody's, and Fitch.

Global Alliance for Vaccines and Immunization

12. The focus of GAVI is on the world's poorest countries, and eligibility for support from GAVI is determined in a large part on the basis of national income. Under the Eligibility and Transition Policy approved by the Board in June 2018, countries whose average GNI per capita over the past three years falls below the threshold (currently, US$1,580) are classified as either initial self-financing (GNI per capita under the IDA's operational cutoff) or in preparatory transition (above the IDA's operational cutoff). These countries are eligible to apply for vaccine or health system and immunization strengthening support from GAVI. When a country's average GNI per capita over the past three years exceeds the threshold, it will enter accelerated transition.

13. Countries are eligible to apply for new vaccine support during the five years of accelerated transition, provided that vaccine introductions during this phase effectively contribute to strengthening routine immunization and increasing coverage and equity. After five years in the accelerated transition phase, a country becomes fully self-financing. Fully self-financing countries can no longer access new financial support from GAVI.

The Global Fund

14. The Global Fund is designed to accelerate the end of AIDS, tuberculosis, and malaria as epidemics. Eligibility for Global Fund support considers the health and economic landscape of countries and regions to optimize the investment of financial resources. The Fund's Eligibility Policy establishes criteria to identify countries and disease programs that are eligible to receive an allocation. The policy is designed to

ensure available resources are allocated to countries with the highest disease burden and lowest economic capacity, as well as to key and vulnerable populations disproportionately affected by the three diseases.

15. Countries with GNI per capita below IDA's operational cutoff are eligible to receive an allocation and apply for funding regardless of disease burden. Lower-middle-income countries and upper-middle-income countries according to the World Bank classification are eligible to receive an allocation and apply for funding if they meet the disease burden requirements which are tighter for the latter group. The eligibility list is published on an annual basis. The 2018 Eligibility List will affect allocations for 2020–2022.