54240

IDA'S NON-CONCESSIONAL BORROWING POLICY: PROGRESS UPDATE

IDA Resource Mobilization Department (CFPIR)

April 2010

Abbreviations and Acronyms

AFD	Agence Française de Développement (French Development Agency)
AfDB	African Development Bank
AfDF	African Development Fund
AsDB	Asian Development Bank
AsDF	Asian Development Fund
CEMLA	Centro de Estudios Monetarios Latinoamericanos (Centre for Latin American Monetary Studies)
CFP	Concessional Finance and Global Partnerships
CPIA	Country Policy and Institutional Assessment
DEC	Development Economics
DeMPA	Debt Management Performance Assessment
DMF	Debt Management Facility
DRC	Democratic Republic of Congo
DRS	Debtor Reporting System
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework for Low Income Countries
EC	European Commission
ECA	Export Credit Agency
EIB	European Investment Bank
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Country
IaDB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IsDB	Islamic Development Bank
JVI	Joint Vienna Institute
LICs	Low Income Countries
MDB	Multilateral Development Bank
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MEFMI	Macroeconomic and Financial Management Institute for Eastern and Southern Africa
MTDS	Medium-Term Debt Management Strategy
NCBP	Non-Concessional Borrowing Policy
NPV	Net Present Value
OC	Operations Committee
OECD	Organization for Economic Co-operation and Development
OECS	Organization of Eastern Caribbean States
OPCS	Operations and Policy Services
PBA	Performance-Based Allocation
PEFA	Public Expenditure and Financial Accountability
Pôle Dette	Pôle Régional de Formation de La Dette en Afrique du Centre et de l'Ouest
PREM	Poverty Reduction and Economic Management
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Papers
TA	Technical assistance
UNCTAD	United Nations Conference on Trade and Development
WAIFEM	West African Institute for Financial and Economic Management

Table of Contents

EXECUTIVE SUMMARY

i. **Implementation of IDA's Non-Concessional Borrowing Policy (NCBP) has advanced well.** The Bank and the Fund have continued their creditor outreach efforts aimed at broadening the use of the Debt Sustainability Framework (DSF) for Low Income Countries (LICs), improving the understanding of the NCBP and the IMF debt limits policy and encouraging creditors to provide financing on terms consistent with these policies. A number of non-concessional borrowing cases have arisen and IDA's responses to such cases reflect the flexibility that exists in the framework. Complementing the above, the Bank has continued to provide support to LICs to help them implement sound borrowing policies and increase their public debt management capacity. Finally, adjustments to the NCBP implementation have been introduced aimed at enhancing its flexibility as well as strengthening country ownership.

ii. **The Bank, jointly with the Fund, has continued its creditor outreach efforts.** As a result, several Multilateral Development Banks (MDBs) incorporate elements of the DSF into their financing decisions. These include the African Development Fund (AfDF), the Asian Development Fund (AsDF), the Inter-American Development Bank (IaDB) and the International Fund for Agricultural Development (IFAD). Furthermore, the AfDF has adopted a non-concessional borrowing policy mirroring that of IDA and the Organization for Economic Co-Operation and Development (OECD) Working Group on Export Credit Agencies (ECAs) has adopted lending guidelines aligned with the NCBP and the IMF debt limits policy. Staff will continue to seek opportunities to reach out to other creditors. Efforts in that regard will include: (i) posting relevant information, publications and tools on the Bank web site, (ii) responding to specific questions which creditors require answers to in arriving at their lending decisions, (iii) providing training for staff from MDBs, and (iv) coordinating and consulting on relevant issues.

iii. **IDA responses to the cases assessed under the NCBP since the June 2008 update reflect the flexibility that already exists in the framework.** Exceptions to the policy were granted for loans to the Democratic Republic of Congo (DRC), Senegal, Republic of Congo, Cameroon and Rwanda. In these cases, the use of non-concessional financing was warranted by the development impact of the loans and the fact that the debt outlook was not at risk. In the case of the loan to DRC, the decision to grant such an exception also took into account the fact that the loan under consideration was part of a concessional integrated financing package, thus using one of the elements of added flexibility introduced in the policy at the time of the June 2008 update. Since June 2008, no new disincentive measures have been applied. However, IDA decided to continue providing its allocation to Ghana on blend terms during FY10 in response to continued significant levels of non-concessional borrowing with limited information on the expected returns of the financed projects.

iv. **The implementation of the NCBP has generated a number of lessons.** First, there remain limitations in the ability of the NCBP to affect non-concessional borrowing decisions. This issue is particularly relevant when IDA financing is small relative to other financing sources. Second, upstream dialogue on non-concessional borrowing cases is crucial as it may lead to better financing terms. Early discussion also helps reduce the time needed for assessing non-concessional borrowing cases. Third, the NCBP is already very flexible as illustrated by the range of IDA responses in the cases already considered. Finally, further outreach efforts are needed to enhance awareness of the rules and elements warranting the consideration of exceptions to the policy.

v. **Complementing the above, the Bank has continued helping LICs to implement sound borrowing policies and strengthen their debt management capacity.** Staff activities included building the LICs' capacity to use the DSF aiming at helping authorities conduct debt sustainability analyses (DSAs), and communicate with donors, lenders, and other stakeholders using the DSF. In addition, the Bank and the Fund have completed the development of a comprehensive set of tools that can help strengthen the public debt management framework in LICs. This architecture comprises: the Medium Term Debt Management Strategy (MTDS) toolkit; the Debt Management Performance Assessment (DeMPA) toolkit; the implementation of country-specific reform plans; and targeted capacity building as well as training and outreach events. The application of these tools highlights the need for continued support in strengthening the LICs' public debt management frameworks. To support these activities, the Bank launched a multi-donor trust fund –the Debt Management Facility (DMF) for LICs– in November 2008.

vi. **Adjustments to the implementation arrangements for the NCBP have been introduced with the aim of strengthening its flexibility, enhancing country ownership of debt management and streamlining the NCBP process.** These adjustments relate to three areas, namely:

- **Setting of debt limits.** A differentiated approach, based on the countries' macroeconomic and public financial management capacity and debt vulnerability, will be applied in setting such limits. The enhanced flexibility under this approach will be applied only at the authorities' request.

- **Streamlining the Bank's decision process.** The decision level, within IDA Management, for IDA's response to non-concessional borrowing cases will be determined following a risk-based approach.

- **Enhancing the communication of NCBP decisions to creditors and borrowers.**

vii. **These adjustments have been closely coordinated with the IMF, to preserve consistency between the NCBP and the IMF debt limits policy.**

I. INTRODUCTION

1. **This note provides an update on the application of the NCBP as well as on adjustments to its implementation aimed at strengthening country ownership of debt management.** The NCBP was discussed by IDA's Executive Directors in July 2006 and applies to countries eligible for IDA grants and to recipients of assistance under the Multilateral Debt Relief Initiative (MDRI).[1] Its primary objective is to address the risk that non-concessional loans may lead to a rapid re-accumulation of external debt thus undermining borrowers' debt outlook.

2. **Questions were raised by some borrowers and donors as to whether the concessionality requirements from the Bank and the Fund were unduly constraining financing to LICs**.[2] In 2009, the G-20 requested the Bank and the IMF to review the DSF –the common tool used by both institutions to evaluate risk of debt distress– to determine if some aspects could be made more flexible. In response to that request, some aspects of the DSF were reviewed in August 2009. In line with the call for increased flexibility, IDA also reviewed some implementation aspects of the NCBP and found the need for some adjustments to be made. Such adjustments are consistent with the increased flexibility provided in the context of Fund programs through the new IMF guidelines for debt limits in Fund-supported programs.[3]

3. **This paper unfolds as follows.** Section II of the paper presents the NCBP and provides details on its rationale. Section III updates on creditor outreach. Section IV provides an overview of IDA's response in the cases assessed under the NCBP since the last progress report. Section V provides an update on the Bank's debt management capacity building efforts in LICs. Section VI presents the recent adjustments in the implementation of the NCBP. Section VII concludes.

II. RATIONALE AND FEATURES OF THE NCBP

4. **IDA's NCBP was introduced in July 2006 in response to donor concerns about debt sustainability risks posed by external non-concessional borrowing by grant-eligible and MDRI recipient countries.** Both debt relief and IDA grants have increased these countries' borrowing space.[4] While this development is in itself positive, donors were concerned about potential mismanagement of this new borrowing space, resulting in rapid re-accumulation of external debt. Thus, the NCBP was designed to support debt policies preserving long-term external debt sustainability. The NCBP is a two-pronged policy involving creditor outreach as well as measures aimed at ensuring

---

[1] "IDA Countries and Non-Concessional Debt: Dealing with the "Free Rider" Problem in IDA14 Grant-Recipient and Post-MDRI Countries," IDA/R2006-0137/1, June 2006.

[2] See for instance the "Nouakchott Declaration on the Financing for Development in Africa: The role of nontraditional donors", August 1, 2008, Nouakchott, Mauritania.

[3] The new Fund guidelines ("Debt Limits in Fund-Supported Programs: Proposed New Guidelines," SM/09/215, August 5, 2009) were approved by the Fund's Executive Board on August 31, 2009.

[4] The IDA grant allocation system, first introduced in IDA14, is based on external debt distress risk ratings emerging from DSAs performed under the DSF.

borrowers to reduce the risk of over-borrowing. The first prong of the policy aims at encouraging other creditors to incorporate debt sustainability considerations and the information provided by the DSF into their lending decisions. The second prong of the policy involves IDA responses (reductions in volumes or hardening of IDA lending terms) to cases of non-concessional-borrowing as well as capacity building in IDA countries.

5. **The NCBP is complementary to other policies and tools developed in recent years by the Bank and the IMF to foster debt sustainability in LICs**. In particular, the DSF is a tool designed to assess the LICs' risk of debt distress and inform both borrowers and creditors in their financing decisions (see Annex 1). DSAs undertaken under the DSF are key inputs in the NCBP, as they are used by IDA to determine annually which countries are grant-eligible, and thus subject to the NCBP (see Box 1). Capacity building in debt management supported by the World Bank and the IMF, notably through new tools such as DeMPA and MTDS, is also key for country ownership of long-term strategies to maintain debt sustainability.

6. **The NCBP is based on the premise that concessional financing remains the most appropriate form of financing for most LICs, and in particular for grant-eligible and MDRI recipient countries.** Non-concessional lending increases external debt service ratios more rapidly than concessional lending for a given borrowing amount. The financing of long-term investment projects with non-concessional lending, that typically need to be repaid quicker than concessional loans and often before sufficient economic and financial returns from the project materialize, can also lead to debt sustainability problems.

7. **A key building block of the NCBP is the establishment of debt limits for countries subject to the policy.** Such debt limits are generally established in terms of a minimum concessionality requirement, which is measured in terms of the grant element of a loan.[5] For countries subject to the NCBP with a Fund-supported program, the minimum grant element is the one established under such program. For countries subject to the NCBP that do not have a Fund-supported program, a grant element of at least 35 percent is required. As described in Section IV of this document, this approach for setting debt limits has been expanded to a differentiated approach based on the county's debt vulnerabilities and capacity.

8. **While the NCPB sets debt limits, it is not a blanket ban on non-concessional borrowing.** The policy acknowledges that under certain circumstances non-concessional loans can appropriately form part of a financing mix that helps promote economic growth. The policy contains a set of specific criteria for assessing potential exceptions to the policy. These criteria are both country-specific and loan-specific (see Annex 4). So far, most of the non-concessional borrowing episodes considered under the NCBP have

---

[5] The grant element is the difference between the face value of a loan and its Net Present Value (NPV), expressed as a percentage of the face value of the loan. The NPV is the discounted value of the future debt service payments using a currency-specific discount rate. For details on the parameters and methodology used for calculating the grant element under http://go.worldbank.org/ZJBDV52RD0.

been reviewed following a loan-by-loan approach.[6] Further, since 2008, the NCBP also allows for reviewing non-concessional loans as part of integrated financing packages whose concessionality is evaluated as a whole.[7] The review of non-concessional borrowing episodes determines whether an exception or an adjustment to the terms or volume of IDA's assistance is warranted.

Box 1: IDA's Grant Allocation Framework

The objective of the grant allocation framework introduced during IDA14 is to proactively mitigate the risks of external debt distress revealed by the DSF. The framework comprises two elements: grant eligibility and grant allocation.

Grant eligibility

Grant eligibility is determined by the assessment of the country-specific risk of external debt distress emerging from DSAs performed under the DSF. For countries assessed at low risk of external debt distress, IDA provides its financing on standard IDA credit terms (40 year maturity including a 10 year grace period, leading to a grant element of over 60 percent). For countries assessed at moderate risk of external debt distress, IDA provides its financing 50 percent on standard IDA credit terms and 50 percent on grant terms. Countries assessed at high risk of external debt distress or countries assessed to be in external debt distress receive all of their assistance on grant terms.

Furthermore, IBRD/IDA blend countries and IDA hardened-term (or "gap") countries are a priori excluded from access to grants, irrespective of their external debt situation.

Grant allocation

Once grant eligibility is determined, the grant allocation system (which is part of the Performance-Based Allocation (PBA) system) determines the amount of grant financing that a grant-eligible country will receive. Starting from the PBA based country allocation and the share of the PBA allocation that is to be provided on grant terms, this is done through a Modified Volume Approach:

- A 20 percent upfront volume discount on the overall grant allocation. This is divided into two components: (i) an "incentive-related" discount, currently at 13 percent, which aims to preserve the integrity of the incentive system embedded in the PBA; and (ii) a "charges-related" discount, currently at 7 percent, which aims to recoup forgone charge income on grants.
- An incentive to subsets of IDA countries, in two forms: (i) resources generated by the "incentive-related" discount are allocated to all IDA-only countries (excluding post-conflict and "gap" countries) according to the PBA system; and (ii) resources generated by the "charges-related" discount are earmarked for a "hard-term" window that can be accessed by creditworthy blend countries with a GNI per-capita below the IDA operational cutoff.

---

6 The loan-by-loan approach, as opposed to an aggregate approach (e.g. overall NPV limit or overall concessionality requirement), was originally utilized for a number of conceptual and practical issues (see IDA/R2006-0137/1 Op.Cit.). Key among the practical considerations was that, at the time, the limited availability of DSAs performed under the DSF would not have allowed implementing an aggregate approach for a critical mass of countries.

7 See "IDA's Non-concessional Borrowing Policy: Review and Update," June 2008, IDA/SecM2008-0473, for details on the treatment of integrated packages. This document also presents how other special cases (e.g. Islamic financing or loans to SOEs) are treated under the NCBP.

9. **As of December 1st, 2009, IDA has granted seven exceptions to the NCBP.** These exceptions relate to loans to Cameroon, Republic of Congo, DRC, Mali, Rwanda (twice) and Senegal. These seven exceptions compare to two cases of hardening of IDA lending terms, for Angola and Ghana.[8]

III. CREDITOR OUTREACH

10. **The LICs' financing landscape has experienced significant changes in recent years.**[9] This includes increased availability of non-traditional sources of financing which frequently are non-concessional. IDA's softening the terms of its assistance (through the grant allocation mechanism) has little impact on the LICs' debt outlook if other creditors do not adjust the terms of their assistance based on debt sustainability considerations. To encourage other creditors to take debt sustainability considerations into account, the Bank and the Fund have continued their efforts to disseminate the DSF and to improve understanding of the NCBP and the IMF policy on debt limits. **Staff efforts have resulted in an increasing number of creditors using the DSF as the basis for their financing decisions.** As of now, several MDBs incorporate elements of the DSF into their own financing decisions. The AfDF, the AsDF and IFAD have adopted grant allocation frameworks similar to that of IDA. The IaDB takes DSF risk ratings into account to adjust the composition (concessional vs. non-concessional resources) of its lending. Regarding bilateral creditors, DSAs performed under the DSF are taken into account in the context of Paris Club negotiations.

11. **As a result of staff efforts, an increased number of creditors are committed to adhering to the NCBP and the IMF policy on debt limits.** The AfDF has adopted a policy on non-concessional debt accumulation mirroring that of IDA.[10] In addition, the OECD Working Group on ECAs has adopted a set of guidelines in line with the NCBP and the IMF debt limits policy.[11] The guidelines were adopted after a series of meetings and workshops where active participation of non-OECD creditors was also encouraged.

12. **Staff continues to seek a broader use of the DSF and an increased understanding of the NCBP through several means.** These include:

- **Posting relevant information, publications and tools on the Bank and Fund external websites.** Web pages in the Bank and Fund external websites provide access to various DSF, NCBP and debt limits policy documents, guidance notes

8 For a detailed discussion on the case of Angola see IDA/R2006-0137/1, Op. Cit. For a detailed discussion on the case of Ghana see IDA/SecM2008-0473 Op. Cit. and IDA/SecM2010-0007.

9 See IMF, "The Implications of the Global Financial Crisis for Low-Income Countries—An Update" September 2009.

10 See African Development Bank, "Bank Group Policy on Non-Concessional Debt Accumulation," ADF/BD/WP/2008/09/Rev.1, 28 March 2008.

11 See OECD Trade and Agriculture Directorate, Working Party on Export Credits and Credit Guarantees ("the working group"), "Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low-Income Countries", TAD/ECG(2008)1, January, 2008.

and templates as well as access to public DSAs.[12] In addition, the list of countries subject to the NCBP is posted on the Bank's website and updated whenever changes occur.[13] The Fund also updates the list of countries under IMF-supported arrangements regularly on its website.[14] A consolidated version of both tables is updated and sent each month to the OECD Working Group of ECAs. Finally, with the aim of providing a common understanding on the requirements, a grant element calculator is available at both the Bank and Fund websites.[15]

- **Responding to individual queries for guidance/clarification.** The Bank and the Fund have established email accounts to respond to creditors who may have transaction-specific queries.[16] Creditors seek clarifications on the DSF, the NCBP, the IMF debt limits policy, and the application of these tools/policies in countries where creditors may be contemplating doing business. Over the last few months, staff has responded to a steady stream of inquiries, stemming primarily from members of the OECD Working Group of ECAs. With 43 queries responded to by IDA's Lending to LICs team in 2009, the use of this service shows a slight increase compared to 2008 (see Table 1). Most of the 2009 queries referred to specific lending projects in countries subject to the NCBP, while the majority of questions in 2008 concerned the general NCBP framework. The shift in the nature of the requests could reflect an increased understanding by ECAs of the general aspects of the policy and the systematic application of the OECD guidelines. Anecdotally, it would appear that several queries have led ECAs to modify the terms of loans to LICs, in line with NCBP requirements. Nineteen countries have been discussed in this dialogue between IDA staff and ECAs, the same number as in last year.

- **Providing training.** The Bank and the Fund have organized training workshops on the DSF for staff from several MDBs. This includes workshops for staff from the IaDB (December 2008 and December 2009) and the AsDB(March 2009) in the last twelve months, as well as a training event in Vienna in March 2009 with participation of staff from IFAD, the European Investment Bank (EIB), the European Commission (EC), the Islamic Development Bank (IsDB) and the Saudi Fund for Development.

---

[12] See http://go.worldbank.org/SOM6UQ9ZX1 and http://www.imf.org/external/pubs/ft/dsa/lic.aspx, http://www.imf.org/concessionality.

[13] Only IDA-only countries eligible for IDA grants and/or MDRI recipients are subject to the NCBP. The latest list of countries subject to the NCBP can be found at http://go.worldbank.org/FYMWR5Y892

[14] See http://www.imf.org/external/np/exr/facts/prgf.htm.

[15] The grant element calculator, as well as details on the definition of grant element and the formulas and parameters used for its calculation, can be found at http://go.worldbank.org/G5N6RYIHU0 and http://www.imf.org/external/np/pdr/conc/calculator/default.aspx.

[16] LendingToLICS@worldbank.org and LendingToLICS@imf.org.

Table 1: Statistics on IDA's "Lending to LICs" Mailbox

	2008	2009
Total number of requests	40	43
o/w policy requests	10	3
o/w project-related requests	30	40
Average projected loan amount (US$ million)	69.6	56.3
Number of countries discussed	19	19

- **Coordination and consultation.** The DSF, the IMF debt limits policy and the NCBP implementation arrangements have been revised to increase their flexibility. Consultations with creditors and donors took place prior to the introduction of these changes. In 2008, the consultation process included meetings in Bern, Brussels, Geneva, London, Paris and Washington and included discussions with the Paris Club, the MDBs (in the context of bilateral discussions and the 2009 meeting of MDBs hosted by the World Bank) and the United Nations Conference on Trade and Development (UNCTAD).[17]

13. **Staff will continue to seek opportunities to reach out to other creditors.** A collective response by creditors is needed if the financing needs of LICs are to be satisfied without creating future debt problems. In that regard, staff will continue their outreach efforts. This will include coordination with other creditors that have outreach programs similar to the Bank and the IMF (e.g. the AfDB).

IV. IDA'S RESPONSE IN THE CASES ASSESSED UNDER THE NCBP SINCE THE LAST PROGRESS REPORT

14. **Since the June 2008 update, IDA has continued to analyze non-concessional borrowing episodes in countries subject to the NCBP.** Exceptions to the policy were provided in cases where the use of non-concessional financing was assessed to be appropriate. Following the June 2008 NCBP update, the following exceptions were agreed:

- **Democratic Republic of Congo (March 2009).** The country borrowed €55 million (less than 1 percent of GDP) from the EIB with a grant element of 28 percent. This loan was part of an integrated financing package for two projects for which IDA was a co-financier. In this case, the DRC was granted an exception from the NCBP requirements on the basis of three factors: (i) the package

[17] See "Meeting of Multilateral Development Banks on Debt Issues, Washington D.C., July 8-9, 2009, Chairman's Summing Up."

satisfied the Bank and Fund criteria to be considered "integrated" in terms of purpose, disbursement schedules and other parameters; and (ii) the grant element of the overall financing package exceeded 35 percent.

- **Senegal (May 2009).** Senegal borrowed about US$160 million (1.4 percent of GDP) on commercial terms from the Government of France to finance the clearing of outstanding arrears with domestic suppliers. Senegal was granted an exception on the basis of a simultaneous occurrence of the following: (i) the significant macroeconomic benefits associated with restoring the credibility of the State and strengthening private sector balance sheets; (ii) the Fund Executive Board's, and other donors' endorsement of the government arrears clearance program and its financing; (iii) the limited scope for alternative financing in the deteriorating global context; (iv) the modest impact of the non concessional loan on the country's debt outlook; and (v) the strength of policies and institutions in Senegal and Senegal's commitment to sound debt management.

- **Republic of Congo (October 2009).** The Republic of Congo borrowed €29 million from the French Development Agency (Agence française de développement, AFD) with an estimated 12 percent grant element. The loan was taken to finance the rehabilitation of port facilities. An exception was granted based on the following combination of factors: (i) the projected positive economic returns of the project co-financed through the loan; (ii) the generally sound macroeconomic environment and prudent fiscal and borrowing policies followed in recent years; (iii) the very limited impact of the loan on the country's debt outlook; and (iv) the commitment of the authorities to seeking external financing on highly concessional terms.

- **Cameroon (October 2009).** Cameroon contracted a €60 million loan from the AFD, with a 28 percent grant element. The purpose of the loan is to finance the construction of water treatment facilities and the rehabilitation of the water distribution network. An exception to the NCBP was granted due to the following combination of factors: (i) the viability of the project demonstrated by the project's economic rate of return (estimated at 12 to 13 percent); (ii) the consistency of this project with other donors' projects supporting Cameroon's water sector, including IDA's; (iii) the modest impact of the loan on the country's solid debt outlook; and (iv) the proximity of the loan's grant element to the 35 percent NCBP threshold.

- **Rwanda (October 2009).** Rwanda contracted a US$33 million loan from the Exim Bank of China, with a 34 percent grant element, to finance a road improvement project. The exception to the policy was granted based on the following combination of factors: (i) the economic viability of the project as assessed by the Bank country team; (ii) the non-availability of more concessional financing, including from IDA; (iii) the negligible impact of the loan on Rwanda's debt outlook; and (iv) the development partners' assessment that contracting the loan does not limit Rwanda's access to concessional financing.

15. **No new disincentive measures have been applied to countries subject to the NCBP since the last update.** IDA, however, has continued providing its allocation to Ghana on blend terms, as decided in 2008.[18] In 2008, the Government of Ghana contracted around US$617 million equivalent in new non-concessional credits.[19] Keeping Ghana's allocation on blend terms recognizes that: (i) market conditions have changed fundamentally; (ii) additional external financing sought by the Ghanaian authorities aimed at supporting ongoing development projects are needed to sustain economic growth and assist in meeting the MDGs; (iii) a graduated response permits time to assess developments as they unfold, including projected oil exports beginning in 2011; and (iv) there are benefits associated with IDA's continued full engagement with this country as it makes sectoral policy choices and builds up its own capacity to evaluate the expected returns on its public investments. IDA's response will be reassessed by end of FY10, in light of: (i) further information on the volume and use of the additional non-concessional financing contracted since 2009, (ii) a thorough assessment on the extent to which the government's project selection and appraisal systems have been enhanced, and (iii) a better understanding of the use of the proceeds of the non-concessional loans contracted in 2007 and 2008. This reassessment will also consider how Ghana has implemented the non-zero limit on non-concessional lending included in its Poverty Reduction Growth Facility (PRGF).

16. **The implementation of the NCBP has generated a number of lessons, including**:

- **There remain limitations to the ability of the NCBP to affect borrowing and lending decisions.** This issue is particularly relevant when financing from IDA is small relative to other external financing sources. In that context, staff will persist in its efforts for reaching out to other creditors (particularly private creditors and non-OECD bilateral creditors) and borrowers.

- **Upstream dialogue on non-concessional borrowing episodes is crucial.** First, it may lead to better financing terms as early reporting gives the Bank a chance to work with the borrower to assess the benefits and risks of the envisioned borrowing. [20, 21] Second, early discussions help reduce the time needed for assessing cases of non-concessional borrowing. With the objective of reinforcing the precautionary role of the NCBP, staff remains ready to provide a preliminary assessment (at the request of borrowers) on the basis of a draft loan agreement.

[18] For a detailed discussion of the 2008 decision on Ghana see Section IV of the document "IDA's Non-Concessional Borrowing Policy: Review and Update."

[19] As recorded in the World Bank debt reporting system. These figures exclude around US$95 million of integrated financing arrangements, which combine credits from commercial banks with grants from development agencies to achieve the benchmarked 35 percent grant element. It also excludes borrowing by State-Owned Enterprises.

[20] The advanced reporting requirement introduced by the NCBP stipulates that countries report to the Bank their plans for non-concessional borrowing ahead of contracting the loans.

[21] For example, in 2009 IDA and IMF staff analyzed the structure of a projected large external borrowing by the Democratic Republic of Congo. The ex-ante analysis led to substantial modifications of the financing agreement, consistent both with the NCBP and development objectives.

Third, building on the recent experience, ex-ante guidance to creditors will continue as it has proved particularly effective in providing IDA management with the information needed to review instances of non-concessional borrowing.

- **The NCBP provides for significant flexibility.** As illustrated by the range of responses from IDA in the previous country cases, the NCBP has been applied with flexibility. The modifications to the NCBP implementation introduced recently (discussed in the next section of this document) further enhanced this flexibility by reflecting better the debt sustainability situation and debt management capacity of countries subject to the policy.

- **Further outreach efforts are needed.** Despite the flexibility already existing in the framework, the perception that the NCBP unduly constrains financing to LICs persists. This is linked to the lack of awareness among borrowers and creditors on the built-in flexibility in the policy as well as perceptions regarding the apparent complexity of the framework. To enhance awareness of the rules and elements warranting the consideration of exceptions to the policy, staff will continue its outreach efforts at all levels. In addition, staff has introduced modifications to the implementation of the NCBP that should help mitigate concerns regarding the apparent complexity and pace of the decision process.

V. Update on Capacity Building in LICs

17. **The Bank continued helping LICs to implement sound borrowing policies and strengthen their capacity in public debt management.** Staff activities include efforts to build the capacity in LICs to use the DSF. The Bank and the Fund have also substantially scaled up their efforts to enhance public debt management in LICs and developed a comprehensive set of tools that can help strengthen the public debt management framework in LICs.[22] This architecture comprises several components: the MTDS toolkit, the DeMPA toolkit, the implementation of country-specific reform plans and targeted capacity building as well as outreach events.[23] These components complement each other and complement the analyses performed under the DSF as well as other capacity building and technical assistance provided by the Bank and the Fund.

18. **DSF capacity building activities in LICs are a core element of the Bank's outreach program.** Since the adoption of the DSF, the Bank –in partnership with the Fund and regional capacity building institutions– has organized a number of DSF training workshops. The objective of these workshops is to help government officials in LICs to understand and conduct analyses of the medium- and long-term debt implications of various policies and alternative financing strategies and to communicate those to donors,

---

[22] The tools were developed building on the *Guidelines for Public Debt Management* (IDA Report No. 35950) and the significant experience of Bank and Fund staff on debt issues, and in providing public debt management capacity building and technical assistance in client countries.

[23] A full discussion on these components can be found in the joint Bank/IMF paper "Managing Public Debt: Formulating Strategies and Strengthening Institutional Capacity," IDASecM2009-0100, February 24, 2009.

lenders, and other stakeholders. Capacity building activities over the last twelve months included events organized in collaboration with: the Asian Development Bank (AsDB), the Center for Latin American Monetary Studies (CEMLA), Pôle Régional de Formation de La Dette en Afrique du Centre et de l'Ouest (Pôle Dette), the Macroeconomic and Financial Management Institute for Eastern and Southern Africa (MEFMI) and the West African Institute for Financial and Economic Management (WAIFEM).

19. **The Bank has also participated in the Asian Regional Public Debt Management Summit, which was organized as part of the AsDB's regional technical assistance program.** The summit organized by Bank Negara Malaysia and the AsDB represented an opportunity to inform senior government officials about the principles and objectives of the DSF and DeMPA activities.

20. **Developed jointly with the Fund, the MTDS toolkit provides guidance to country authorities for the formulation of a medium-term plan to achieve the desired composition of the debt portfolio.** The toolkit, which has been posted on the Bank and Fund external websites, provides a framework for formulating and implementing a debt management strategy.[24] It is useful for illustrating government's cost and risk tradeoffs associated with different debt management strategies and for managing the risk exposure embedded in a debt portfolio. Such guidance is provided taking into account the macroeconomic and market environment and the related vulnerabilities. The toolkit comprises: a guidance note, a cost-risk analytical tool and a template for a public debt management strategy document.

21. **Application of the MTDS toolkit confirms its usefulness in providing a coherent framework and the needed analytical support for debt management strategy formulation.** The toolkit has proved to be flexible in dealing with unique debt structures and adjusting for various indirect costs and constraints. The staffs' goal is to apply the toolkit in four to six new countries per year. Delivery of this work will remain driven by country demand, thus ensuring ownership and securing a clear commitment to follow-up.

22. **So far, several MTDS workshops have taken place.** This includes a training event for Eastern European Government Officials and one training event for government officials in Eastern and Southern Africa which was organized in collaboration with MEFMI. In addition, one outreach activity took place in New Zealand, for country officials from Vietnam. Further training activities are planned to take place during 2010.

23. **The DeMPA aims at assessing the strengths and weaknesses in the institutional arrangements and processes supporting a country's public debt management operations.** A DeMPA toolkit was developed jointly by the Bank's Poverty Reduction and Economic Management (PREM) and Treasury departments and has been posted on the Bank's external website.[25] DeMPA reports provide a detailed

---

[24] See http://go.worldbank.org/7NX8I18ZS0 and http://www.imf.org/external/np/pp/eng/2009/030309.pdf.

[25] See http://go.worldbank.org/PPPEJIKAW0.

qualitative description of a country's public debt management situation, which could be used as the basis for the development of prioritized reform programs.[26] Furthermore, DeMPA assessments performed at different points in time can also help monitor a country's progress in strengthening debt management operations.[27] After piloting of the DeMPA toolkit in five countries, thirty four country assessments have been undertaken as at end-November 2009. The DeMPA is a demand driven work program.

24. **Results from assessments already performed are helping to identify priority areas for debt management reform across countries.** Across the 6 core public debt management functions (see Figure 1A), areas emerging as key weaknesses are operational risk management (related mainly to the absence of business continuity plans, strong operational controls and well articulated responsibilities for staff) and cash flow forecasting and management (impeded by weak forecasting of aggregate cash balances in government bank accounts). The results also show that very few of these countries have sound debt management strategies underpinned by thorough cost-risk analysis.

25. **Beyond the above areas, a source of concern is the weakness in the area of external borrowing.** This is particularly relevant considering that a number of countries have expressed their intention to borrow in the capital markets once the financial crisis subsides. The DeMPA indicator on external borrowing shows that there is: (i) a low degree of assessment of the most beneficial/cost-effective borrowing terms and conditions; and (ii) a general absence of documented procedures for borrowing in foreign markets.

26. **Several DeMPA training events have already taken place since the launch of the toolkit (November 2007).** The strategy has been two-fold: (i) to provide training to the trainers, and (ii) to provide training to client countries officials in collaboration with regional technical assistance (TA) providers. Three training for trainers events were held in Washington DC.[28] Seven regional training events have been held so far, six of which in collaboration with regional TA providers.[29]

---

[26] Public DeMPA reports disclosed by the authorities are posted in http://go.worldbank.org/1J1NBP7BA0.

[27] The toolkit was developed under the auspices of the Bank's Debt Management Technical Group, which comprises members from PRMED, BDM, DECDG, GCMSM, AFR, EAP, ECA, LCR, MNA and SAR as well as members from the IMF (MCM, FAD and SPR). A broad collaborative approach was adopted that involved consultation with international/regional technical assistance partners involved in debt management capacity building, as well as government authorities during the pilot phase.

[28] November 2007, April 2008, and May 2009.

[29] These providers are implementing partners in the World Bank's Debt Management Facility and include CEMLA, the Commonwealth Secretariat, the Debt Management Programme of the United Nations Conference on Trade and Development (DMFAS), Debt Relief International (DRI), MEFMI, Pole-Dette and WAIFEM.

Figure 1A. DeMPA Assessments' Results

Figure 1A: Percentage of Countries Meeting the Minimum Requirement
(by debt management function)

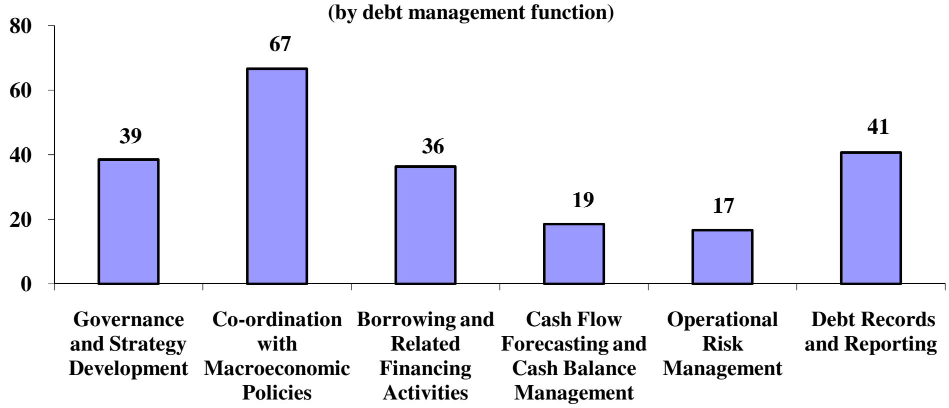
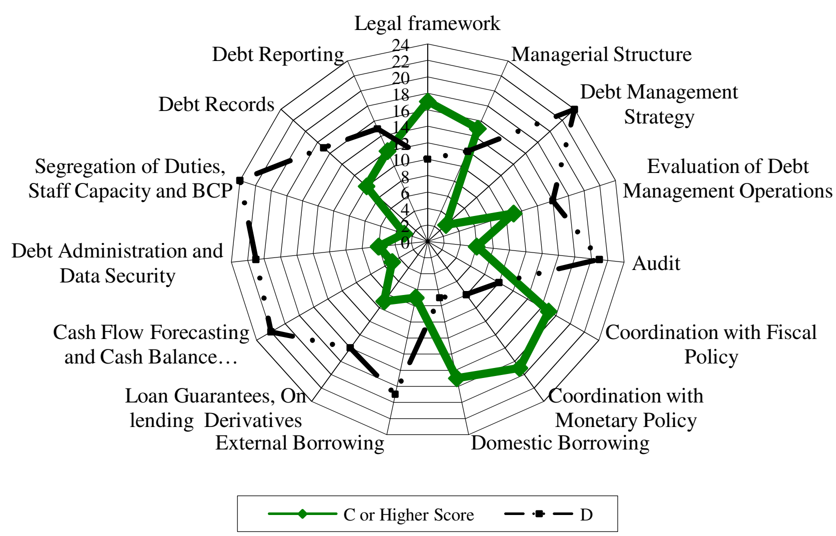


Figure 1B: DeMPA Score
(by debt management indicator)



Reflects the results for the 31 countries for which DeMPA assessments have been finalized.

27. **In addition, the Bank assists countries in developing country-specific reform plans.** Based on a comprehensive analysis of public debt management institutions and operations, a reform plan lays out a detailed and sequenced country-owned capacity building project plan. This will aim to alleviate the weaknesses identified and analyzed by the DeMPA or through other assessments. It details expected outputs and outcomes, actions, sequencing and milestones. It also provides an estimate of budget and resources required to implement the plan. Reform plan missions are implemented on country demand.

28. **To support the above activities, the Bank launched a multi-donor trust fund –the Debt Management Facility (DMF) for LICs– in November 2008.**[30] The DMF is a grant facility financed by a multi-donor trust fund to support the scaling up and accelerated implementation of the Bank's debt management work program in LICs. The objective of the DMF is to strengthen debt management capacity and institutions in developing countries through: (i) systematic application of the DeMPA tool in LICs; (ii) country-led application of a toolkit for formulating and implementing a MTDS; (iii) design of debt management reform programs; and (iv) promotion of learning and knowledge generation via an extensive program of training and outreach, including a Debt Management Practitioners' Program. The implementation of DMF financed missions is driven by country demand and is generally done jointly with one of the DMF's Implementing Partners.

VI. ADJUSTMENTS TO NCBP IMPLEMENTATION ARRANGEMENTS

29. **This section presents the adjustments introduced to the NCBP with the objective of strengthening country ownership and streamlining the NCBP process.**[31] The adjustments pertain to three areas of NCBP implementation, namely: (i) the approach to setting debt limits for countries subject to the NCBP, (ii) the internal Bank decision-making process for responding to non-compliance with the policy, and (iii) the communication of NCBP decisions.

A. The New Approach for Setting Debt Limits

30. **The approach for setting debt limits in countries subject to the NCBP has been adjusted with the objective of enhancing the flexibility of the policy and increasing country ownership in the area of debt management.** The new approach, which better reflects the diversity of countries subject to the NCBP, consists of a differentiated methodology for setting debt limits based on countries' macroeconomic and public financial management capacity (hereafter referred to as "capacity") and the extent of their debt vulnerabilities.[32] With regard to the extent of debt vulnerabilities, countries will be classified in two groups based on assessments performed under the DSF. Lower vulnerability countries will be those assessed at a low or moderate risk of debt distress. Higher vulnerability countries will be those assessed at a high risk of debt distress or those in debt distress. With regard to capacity, countries will be assessed as having lower or higher capacity (Annex 5 provides details of the capacity assessment process).

[30] For details on the DMF, including its governance structure, the partners and the calendar of activities, see http://go.worldbank.org/Y7XKCRZ1L0.

[31] Strengthened country ownership is consistent with the thrust of commitments made in the Accra Agenda of Action, as it provides countries with greater scope and responsibility to align the management of their debt with their development priorities.

[32] The new approach is consistent with the increased flexibility provided in the context of IMF programs. See: "Debt Limits in Fund-Supported Programs – Proposed New Guidelines," SM/09/215, August 7, 2009) and "Staff Guidance Note on Debt Limits in Fund-Supported Programs," SM/09/294, December 18, 2009.

31. **The capacity and debt vulnerability assessments will be used to determine the concessionality requirements under the NCBP.** Based on the above taxonomy, the new approach is as follows**:**

- For countries with lower capacity and higher debt vulnerabilities: the original approach under the NCBP will remain largely unchanged, with a case by case review of instances of non-concessional borrowing.

- For countries with lower capacity and lower debt vulnerabilities: there will be increased flexibility in setting non-zero limits on non-concessional external debt if this is consistent with maintaining low debt vulnerability.

- For countries with higher capacity and higher debt vulnerabilities: an overall limit on the present value of external or total public debt could be applied.

- For countries with higher capacity and lower debt vulnerabilities: a minimum average concessionality requirement to external or total public borrowing could be applied.

The increased flexibility envisaged under the last three options will be applied at the authorities' request. In the absence of such request, the original NCBP approach will continue to be applied.

32. **The new approach for setting debt limits reflects various developments related to debt management.** Key among them are:

- **The large diversity of situations in countries subject to the NCBP.** In particular, a number of NCBP countries have established a strong track record of macroeconomic performance and have a favorable debt outlook despite the crisis.[33]

- **The financing needs for the implementation of Poverty Reduction Strategy Papers (PRSPs).** For many countries such needs significantly exceed available concessional resources. If non-concessional borrowing is used to finance suitable projects, it can potentially play an important role in allowing these countries to make progress towards the Millennium Development Goals (MDGs). In the past, there has also been a significant increase in the engagement of non-traditional donors. The terms of the financing from most of these donors often do not meet the NCBP standard concessionality requirement but they do provide an additional source of financing for potentially high-return investments. Additional financing for suitable projects seems particularly important at a time when LICs are coping

[33] See Section V of "Heavily indebted poor countries (HIPC) initiative and multilateral debt relief initiative (MDRI) - status of implementation" IDA/SecM2009-0508.

with the impact of the global financial crisis.[34] In response to the crisis, most LICs are running countercyclical policies to preserve, and in some cases expand, social spending. It may not be possible to always cover the financing needs of these countries with concessional financing.

- **The increased availability of DSAs performed under the DSF.** This allows the use of an aggregate approach for evaluating the appropriateness of non-concessional borrowing systematically.

33. **Introducing greater flexibility, as presented above, requires changes to the way the NCBP is implemented in countries benefiting from the more flexible options.** For these countries, an annual waiver (based on non-zero debt limits, average concessionality requirements or an overall present value limit) will be provided as opposed to the current practice **o**f issuing loan-specific waivers. Moreover, waiver compliance will be monitored through a periodic annual review of the overall debt portfolio (instead of the loan-by-loan approach currently undertaken).[35] Waiver violations will be subject to the NCBP disincentive mechanism and the current set of criteria will be used to assess whether or not an exception to the policy should be granted.

34. **The first capacity assessment has taken place between September and November 2009.** All countries subject to the NCBP have been classified as "low capacity". This assessment was endorsed by representatives from the Bank regions, as well as regular members of the NCBP Committee during a roundtable that took place on November 5, 2009.[36] A parallel capacity assessment was performed by the IMF and reached the same conclusion regarding all NCBP countries. A representative from the IMF was an observer at the World Bank roundtable, while Bank staff participated as observers in the IMF roundtable. Table 2 presents the result of the process. More than half of the countries subject to the NCBP (those with low capacity and low debt vulnerability) will have the option for increased flexibility in setting non-zero limits on non-concessional external debt, if this is consistent with maintaining low debt vulnerability. The increased flexibility will apply, in particular, to critical infrastructure projects. Some of these countries could, however, also benefit from non-zero limits on non-concessional borrowing that are not tied to specific projects. For countries that are subject to IDA's NCBP and have an IMF program, determination of non-zero limits will take place in the context of IMF program discussions and – continuing current practice – non-zero limits will also be adopted by IDA. For countries that are subject to IDA's NCBP but do not have an IMF program, non-zero limits would be considered through the ex-ante review mechanisms introduced in the 2008 NCBP Review and update.

---

[34] For a discussion on the impact of the global financial crisis on LICs see "The implications of the Global Financial Crisis for Low Income Countries" (IMF, September 2009). The joint Bank/Fund paper IMF "Preserving Debt sustainability in the wake of the global crisis" (*forthcoming*) analyses the extent to which debt vulnerabilities have risen as a result of the global financial crisis.

[35] The monitoring will be based, among others, on information provided by debtor countries to the Bank through the Debtor Reporting System. OP14.10 requires that borrowing countries disclose loan-level details on their new borrowing to the World Bank with one month lag.

[36] The NCBP is composed of representatives from the Bank Regions, CFP, PREM, DEC and OPCS.

35. **Staff will prepare an NCBP Guidance Note.** This note, to be prepared in coordination with the IMF, will present the key operational aspects of the NCBP implementation. This will include: (i) the capacity assessment exercise (process, periodicity and timing coordination with the IMF, dispute resolution); (ii) the setting of more flexible options for debt limits in countries with low capacity and low debt vulnerabilities; (iii) the setting of average concessionality requirements or present value limits for eligible countries; (iv) the monitoring of such requirements; and (v) the Bank process involved in the NCBP decision making for IDA responses to cases of non-concessional borrowing. The NCBP guidance note is expected to be finalized in April 2010.

36. **Staff will post Table 2 of this paper on the external Bank website and update it, in case a country's classification changes**. Publishing the table will contribute to a better understanding by donors, creditors and debtors of the modifications to the implementation of the NCBP. In addition, these modifications will be disseminated among all relevant parties.

B. The Bank Decision-Making Process for Responding to Breaches of the Policy

37. **At present, all decisions on IDA's response to non-concessional borrowing episodes are taken by the Bank's Operations Committee (OC).** The OC is chaired by the relevant Managing Director and consists of the Bank's operational Vice Presidents. The NCBP Committee - consisting of representatives from the regions, Concessional Finance and Global Partnerships (CFP), PREM, Operations and Policy Services (OPCS) and Development Economics (DEC) - discusses cases reported by country teams and makes recommendations to management. The OC decides on IDA Management's response. The Board is informed of IDA's response before the next operation in that country is presented to the Executive Directors.

38. **Going forward, a risk based approach will be followed in determining the level within management at which decisions on IDA's response to non-concessional borrowing episodes are made.** The current practice of having all non-concessional borrowing cases reviewed by the OC entails significant transaction costs and has contributed to a lengthy decision-making process. Both creditors and borrowers have requested faster decisions from IDA in order to be able to proceed with projects under consideration. All waiver requests will now be reviewed by the NCBP Committee. The MD responsible for the Region concerned could vet the NCBP Committee's decision. If the MD or any member of the NCBP Committee considers a case to be controversial or creating high country or reputational risks, the MD would convene a meeting at vice-president level (CFPVP, OPCVP, DECVP, PRMVP, and Regional VP) including other networks when appropriate. The Board would continue to be informed in due course as per current practice.

Table 2. NCBP Countries: Eligibility to the Different Options

Capacity	Debt Vulnerability: Lower	Debt Vulnerability: Higher
Lower	**Minimum concessionality requirement based on loan-by-loan approach, but with added flexibility on nonconcessional external debt (e.g., higher and untied nonzero limits, if consistent with maintenance of low debt vulnerabilities)** Benin, Cambodia, Cameroon, CAR, Chad, Ethiopia, Ghana, Kyrgyz Republic, Kosovo, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nepal, Nicaragua, Niger, Rwanda, Senegal, Sierra Leone, Solomon Islands, Tanzania, Timor Leste, Uganda, Zambia	**Minimum concessionality requirement based on loan-by-loan approach, likely higher than 35 percent, with limited or no room for nonconcessional borrowing** Afghanistan, Burkina Faso, Burundi, Comoros, Côte d'Ivoire, Djibouti, DRC, Eritrea, Gambia, Guinea, Guinea-Bissau, Haiti, Lao, PDR, Liberia, Sao Tomé and Principe, Tajikistan, Togo, Tonga, Yemen
Higher	**Minimum average concessionality requirement applied to external or total public borrowing; for most advanced LICs, no concessionality requirements and overall nominal debt limit if needed**	**Overall limit on the PV of external or total public debt; for most advanced LICs, ceilings on nominal external or total public debt**

C. Enhanced Communication of NCBP Decisions

39. **Communication of IDA decisions to creditors and borrowers needs to be systematic and official.** Decisions by IDA management on cases of non-concessional borrowing, whether to grant a waiver or to apply a disincentive, are currently

communicated to borrowers and creditors either by CFP or country teams, depending on the origin of the request. Often, only the party at the origin of the request (in most cases, the creditor) is informed directly and is then in charge of communicating the decision to other parties involved. Going forward, a more systemic approach will be applied to guarantee that both borrowers and creditors have the same level of information at the same time. For every NCBP case, the decision will be communicated directly to the creditor and the borrower.

VII. CONCLUSION

40. **Since the introduction of the NCBP in 2006, its implementation has been continuously evolving.** Adjustments have been made to the implementation arrangements of the policy to ensure that its objective of supporting sustainable borrowing by countries that benefit from IDA grants or MDRI debt relief can be achieved in a rapidly changing external environment. However, the policy itself has not changed.

41. **The global financial crisis has created new challenges for many LICs with increased financing needs that cannot always be fully covered from concessional sources.** The implementation adjustments discussed in this note recognize countries' progress in strengthening their capacity to manage external debt and use the borrowing space created by debt relief responsibly. In addition, the adjustments also seek to enhance country ownership of external debt management consistent with IDA's commitment to the Accra Agenda for Action. The new implementation arrangements will give NCBP countries' greater scope and responsibility for choices regarding external finance in pursuit of their poverty reduction objectives, in line with their level of debt vulnerability and demonstrated capacity to manage external debt. Finally, these adjustments have been closely coordinated with the IMF, so as to preserve the essential consistency between the NCBP and the IMF policy on debt limits.

Annex 1: The Debt Sustainability Framework for Low-Income Countries

1. **The DSF is a standardized framework for analyzing debt-related vulnerabilities.**[1] It was introduced in 2005 and reviewed in 2006 and 2009. The main objectives of the DSF are to:

i) monitor the evolution of a country's debt burden indicators, help detect potential crises early, and allow preventive actions to be taken; and
ii) provide guidance to ensure that borrower's and creditors' decisions are consistent with progress towards the borrower's development goals and long-term debt sustainability.

2. **The DSF consists of a set of indicative policy-dependent thresholds** against which baseline scenario projections of external debt burden indicators over the next 20 years are compared in order to assess the risk of debt distress.[2] Vulnerability to external and policy shocks are explored in alternative scenarios and standardized stress tests. The indicative threshold for each debt burden indicator is determined based on each country's policy and institutional capacity measured by the three year moving average Country Policy and Institutional Assessment (CPIA) score. The specific thresholds are presented in the table below.

Debt Sustainability Framework Indicative Policy-Dependent Thresholds

	PV of debt in percent of			Debt service in percent of	
	Exports	GDP	Revenue	Exports	Revenue
Weak Policy (CPIA ≤ 3.25)	100	30	200	15	25
Medium Policy (3.25 < CPIA < 3.75)	150	40	250	20	30
Strong Policy (CPIA ≥ 3.75)	200	50	300	25	35

3. **Based on the analysis, one of four possible risk of debt distress ratings are assigned**.

- *Low risk*: When all the debt burden indicators are well below the thresholds.
- *Moderate risk*: When debt burden indicators are below the thresholds in the baseline scenario but stress tests indicate that the thresholds could be breached if there are external shocks or abrupt changes in macroeconomic policies.
- *High risk*: When one or more debt burden indicators breach the thresholds on a protracted basis under the baseline scenario.
- *Debt distress*: When the country is already experiencing difficulties in servicing its debt, as indicated perhaps by the existence of arrears (irrespective of capacity to repay based on a forward looking DSA).

4. **The assessment of the risk of debt distress needs to strike a balance between a mechanistic use of this classification and a judgmental approach.** There may be cases where staff judges that a mechanistic approach would imply an unreasonable rating. In those cases, judgment should be applied and explained in the DSA write-up.

---

1 For more details on the DSF please refer to http://go.worldbank.org/BFCKN04PH0

2 In the DSF context, debt distress episodes are defined as periods in which countries resort to any of three forms of exceptional finance: (i) substantial arrears on their external debt, (ii) debt relief from the Paris Club, and (iii) non-concessional balance of payments support from the International Monetary Fund.

Annex 2: Grant Eligible and Post-MDRI Countries to Which the NCBP Applies in FY10

"Red Light" Countries		"Yellow Light" Countries	MDRI Recipient and "Green Light" Countries
Afghanistan	Guinea-Bissau	Benin	Cameroon
Burkina Faso	Haiti	Cambodia	Ghana
Burundi	Lao People's Democratic Republic	Chad	Madagascar
Central African Republic	Liberia	Ethiopia	Mali
Comoros	Sao Tome and Principe	Kosovo	Mozambique
Congo, Democratic Republic of	Solomon Islands	Kyrgyz Republic	Senegal
Côte d'Ivoire	Tajikistan	Lesotho	Tanzania
Djibouti	Togo	Malawi	Uganda
Eritrea	Tonga	Mauritania	Zambia
Gambia, The	Yemen, Republic of	Nepal	
Guinea		Nicaragua	
		Niger	
		Rwanda	
		Sierra Leone	

1. This list is updated annually and subject to change should other IDA-only countries qualify for IDA grants and/or MDRI. It includes all IDA-only countries which are currently eligible for IDA grants on debt-sustainability grounds, as well as post-MDRI "green light" countries. It excludes "gap" and "blend" countries which receive hardened or blend terms from IDA and are not eligible for IDA grants. Should a country's IDA-only status change mid-year, the list would be updated at that time to reflect the change.
2. Timor-Leste is also subject to the policy given its eligibility for exceptional grants.
3. Inactive countries are excluded from the list. Their grant eligibility would be assessed upon becoming active.

Annex 3: List of Low-Income Countries Subject to the Non-concessional Borrowing Policy of the IMF and/or IDA (As of March 2010)

IMF and IDA	Minimum Grant Element 1/	IMF-only	Minimum Grant Element 1/	IDA-only	Minimum Grant Element 1/
Afghanistan	60	Angola	35	Benin	35
Burkina Faso	35	Armenia	35	Cambodia	35
Burundi	50	Cape Verde	35	Cameroon	35
Central African Republic	35	Congo, Republic of 3/	50	Chad	35
Comoros	50	Georgia	35	Eritrea	35
Congo, Democratic Republic of	35	Grenada	35	Kosovo 4/	35
Cote d'Ivoire	35	Maldives	35	Lao People's Democratic Republic	35
Djibouti	35	Moldova 3/	35	Lesotho	35
Ethiopia	35	Mongolia	35	Madagascar	35
Gambia, The	45	Pakistan	35	Mauritania	35
Ghana	35	Sri Lanka	35	Myanmar 5/	35
Guinea	35			Nepal	35
Guinea Bissau	50			Rwanda	35
Haiti	35			Somalia 5/	35
Kyrgyz Republic	35			Solomon Islands	35
Liberia 2/	100			Sudan 5/	35
Malawi 6/	35			Timor-Leste	35
Mali	35			Tonga	35
Mozambique	35			Yemen, Republic of	35
Nicaragua	35				
Niger	35				
Sao Tome and Principe	50				
Senegal	35				
Sierra Leone	35				
Tajikistan	35				
Tanzania	35				
Togo	35				
Uganda	35				
Zambia	35				
Number of countries	29	Number of countries	11	Number of countries	19

1/ Currently all countries have a minimum concessionality requirement on a loan-by-loan basis. Following the adoption of the new guidelines on debt limits (see http://www.imf.org/concessionality), the use of an average minimum grant element or present value target will be highlighted where relevant.
2/ The program does not envisage any external borrowing, with one specific exception mentioned in Country Report No. 332, paragraph 13 f the TMU.
3/ Reclassified as IDA-only/Gap countries for IDA Fiscal Year 2010, starting from July 2009.
4/ Joined the World Bank on June 29, 2009 and eligible for IDA grants for FY10.
5/ Inactive countries, which would be subject to the non-concessional borrowing policy upon becoming active.
6/ ECF approved 2/19/10.

Annex 4: Principles that Would Guide Loan-by-Loan Exceptions to Non-Concessional Borrowing Ceilings

1. A number of country-specific and loan-specific factors would be taken into account in the NCBP to assess whether an exception to the zero-ceiling using the proposed benchmark is warranted. Although many proposed loans may have merit on specific economic or financial terms, the country environment in which they occur will strongly influence actual outcomes. There should be a favorable assessment at both the country-specific level and the loan-specific level to warrant an exception.

2. **Country-specific**:

- **Overall borrowing plans of the country**. A modest level of overall borrowing by the country on the basis of the DSA to accommodate a particular investment may warrant consideration. For such a consideration, clear reporting of overall borrowing plans is needed, and enhanced creditor coordination through the DSF would facilitate this possibility.
- **Impact of borrowing on the macroeconomic framework**. Whether or not the borrowing would have a deleterious effect on the macroeconomic framework would influence the consideration of an exception.
- **Impact on the risk of debt distress**. The current risk classification and whether or not the loan is likely to lead to a higher risk of debt distress will be a key consideration. Given their lower-risk of debt distress, and generally better performance, more flexibility is envisaged for “green light” countries. In addition, “yellow light” countries could benefit from somewhat greater (although still exceptional) flexibility than “red light” ones.
- **Strength of policies and institutions**, especially public expenditure management and debt management. As the fiscal space Board paper makes clear, policies and institutions, in particular those governing the efficiency of public investment, are critical. Without these, even high return projects may fail to meet objectives.

3. **Loan-specific**:

- **Development content and potential impact of the loan**, i.e., investment will unlock a proven bottleneck to development as determined by analytical work such as a PER.
- **Estimated economic, financial and social returns to investment of the project**, weighted by the probability that the project will succeed.
- **Lender equity stake in the project.**
- **No additional costs associated with the loan**, i.e., collateralization, hidden costs.
- **No other sources of more concessional financing are available.**
- **Concessionality of the overall financing package for a particular investment.**

Annex 5: The Macroeconomic and Public Financial Management Capacity Assessment Process

1. **The objective of the assessment is to identify those countries with enough capacity to handle more flexible options (described in paragraph 31)**. The more flexible options provide authorities greater latitude in determining which projects should be implemented with lower restrictions on modalities for financing. In that regard, sufficient capacity in the country will be crucial to ensure the adequate use of resources.

2. **The capacity classification exercise is being coordinated with the IMF and both institutions use the same method for carrying it out.** The IMF needs to perform its own capacity assessment in the context of its debt limits policy. The assessments of both institutions are being closely coordinated, with regular exchange of information and views at all levels. The coordination covers countries to which the policy of both or only one institution applies.[1] Details spelling out the coordination among both institutions, including the resolution of disputes, will be spelled out in the forthcoming NCBP guidance note (see paragraph 35).

3. **The capacity assessment is performed in two stages.** First, a preliminary classification is performed based on quantitative indicators. The second stage focuses primarily on countries where the indicators used in step one do not yield an unequivocal classification and on countries where staff's country knowledge suggests a different classification than that suggested by the indicator based approach. The process for performing the capacity assessment on the Bank side is presented in detail below.

First Stage

4. **Two quantitative indicators are used as guideposts to perform the preliminary classification.** These indicators are:

- A “sub-CPIA” index.[2] This index is the unweighted average of five CPIA components: (i) fiscal policy, (ii) debt policy, (iii) quality of budgetary and financial management, (iv) quality of public administration, and (v) transparency.
- A numerical PEFA index. This index is a numerical aggregation of PEFA ratings. The aggregation is performed in two steps. First, the four ordinal PEFA ratings (A, B, C and D) are converted into numerical values (4, 3, 2 and 1, respectively) with a “+” rating given an additional ½ point. Then the PEFA index of each country is calculated as the unweighted average of all its numerical PEFA ratings. PEFA indicators that have not been scored are excluded from the calculation of the average.

5. **Countries’ capacities are assessed using thresholds for the 2 indicators above.** For each indicator, the threshold is defined as the average index for IDA “blend” countries (i.e. countries eligible to borrow from IDA but creditworthy enough to borrow from IBRD).[3] The Annex Table below presents the thresholds obtained for the indicators based on the latest CPIA and PEFA assessments.

---

[1] At present 18 NCBP countries (that do not have a Fund-supported program) and 7 Fund program countries (that are not subject to the NCBP) fall in this category.

[2] A “sub-CPIA” index, as opposed to the full CPIA-index, is retained because the latter covers dimensions beyond the most relevant ones for assessing a country’s capacity to manage adequately its public resources.

[3] The IDA “blend” countries used to calculate the thresholds are: Armenia, Azerbaijan, Bolivia, Dominica, Georgia, Grenada, India, Pakistan, Papua New Guinea, St. Lucia, St. Vincent and the Grenadines and Uzbekistan. These are the blend countries as of March 2009, excluding Bosnia Herzegovina which is not PRGF-eligible. All of them have CPIA assessments but only 9 of them have PEFA assessments.

Annex Table: Average "sub-CPIA" and PEFA indexes

	Blend countries	NCBP countries
Average "sub-CPIA" index	3.67	3.03
Average PEFA index 1/	2.64	2.04

Sources: CPIA scores - OPCS; PEFA reports - PEFA Secretariat; and staff estimates

1/ For the purpose of calculating these averages, PEFA indicators that have not been scored are valued at 0.

6. **The preliminary capacity assessment is performed depending on the availability of both indexes (see Annex Figure).** For countries for which both the "sub-CPIA" and Public Expenditure Financial Accountability (PEFA) indexes are available:[4]

- "high capacity" countries are those with both indexes above their relevant thresholds.
- "low capacity" countries are those with both indexes below their relevant thresholds.
- "gray zone" countries are those for which one index is above the relevant threshold and the other below the other relevant threshold.

For countries for which only one index is available, "gray zone" countries are those for which the available indicator is higher than a lower bound (defined as the relevant threshold in Annex Table minus one standard deviation for the index of IDA "blend" countries). [5] All other countries will be classified as "low capacity" countries.

Annex Figure: Preliminary Classification of NCBP Countries According to their Capacity

Countries where both indexes are available

PEFA Index

Sub-CPIA Index	Above threshold	Below threshold
Above threshold	High Capacity Countries	Gray Zone
Below threshold	Gray Zone	Low Capacity Countries

Countries where only one index is available

	Above Lower Bound	Below Lower Bound
Available Index	Gray Zone	Low Capacity Countries

Note: lower bound is defined as the relevant threshold minus one standard deviation of the index for IDA "blend" countries.

Second Stage

7. **In the second stage, all other relevant information will be used to finalize the preliminary classification under the first stage.** The objective of the second stage is to have all NCBP countries classified either as a "high capacity" or "low capacity" country. The final classification will be informed by alternative sources of information regarding the country's macroeconomic, financial and debt management capacity. These include: the country's track-record in managing non-concessional borrowing; the quality of data provided to the Bank's Debtor Reporting System (DRS); other formal assessments like the Bank's DeMPA when publicly available; medium term debt strategies published by

---

4 At present, 40 active NCBP countries fall in this category.

5 At present, 5 active NCBP countries fall in this category.

country authorities; and country's self assessment of debt management capacity made in the context of DRI's Heavily Indebted Poor Country (HIPC) Capacity Building Program or follow up activities performed by regional organizations.[6] In addition, other factors (e.g. the countries' track record in accessing market financing, selecting high-return public investment projects, and managing non-concessional borrowing; the authorities' donor coordination efforts and the timely provision of debt data and proven ability of the authorities to do their own DSA) can also be factored into the second stage of the capacity assessment.

6 Assessments from DRI's Capacity Building Program can be found at the following link: http://www.hipc-cbp.org/index.php?option=com_content&task=view&id=182&Itemid=38.