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## Concessional financing windows or the need to reform the magic triangle

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# Concessional financing windows or the need to reform the magic triangle

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## Abstract

This study is published in advance of the major negotiations which will take place during 2015 on reforming concessional financing, most notably the Third International Conference on Financing for Development in Addis Ababa, Ethiopia. While this conference aims to address the broader issues of financing, calculating concessionalism and what should be considered official development assistance (ODA), by including within it the various financial instruments which boost development finance in a form other than grants or loans, the multilateral development banks (MDBs) have launched a review focusing more narrowly on the future of their concessional financing windows.

The organisational framework for the concessional financing offered by MDBs is based on mobilizing donor contributions to generate resources which are allocated, in the form of grants or highly subsidized loans and based on performance, to recipient governments while meeting their debt sustainability level. This system was put in place around 15 years ago, and has since undergone a succession of only minor adjustments. Special waivers have also stacked up, producing an excessively complicated system. It is the structure of this system which now needs to be rethought. But reform must be comprehensive and based on the 'magic triangle' in which resource mobilization, allocation of resources and debt sustainability management are closely linked and achieve an overall balance.





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## Abbreviations

ADF	African Development Fund
AfDB	African Development Bank
AsDB	Asian Development Bank
AsDF	Asian Development Fund
CGD	Center for Global Development
CPA	Country Performance Assessment
CPIA	Country Policy and Institutional Assessment
DAC	Development Assistance Committee
DSA	Debt Sustainability Analysis
DSF	Debt sustainability framework
FDI	Foreign Direct Investment
FS	Fragile state
GAVI	Global Alliance for Vaccinations and Immunisation
GNI	Gross National Income
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
LIC	Low-Income Countries
MDB	Multilateral Development Bank
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MIC	Middle-Income Countries
NPV	Net Present Value
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PBA	Performance-Based Allocation
PPA	Portfolio Performance Assessment
RAD	Resources – Allocations – Debts (the ‘magic triangle’)
SDGs	Sustainable Development Goals
SDR	Special Drawing Rights
UA	Init of Account
WBG	World Bank Group

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[Globalization Demystified: an iPhone in Bamako] (Autrement, 2008); *Le tour de l'économie en dix étapes* [A Tour of the Economy in Ten Steps] (Dunod, 2010).

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## Summary

This study is published in advance of the major negotiations which will take place during 2015 on reforming concessional financing, most notably the Third International Conference on Financing for Development in Addis Ababa, Ethiopia. While this conference aims to address the broader issues of financing, calculating concessionality and what should be considered official development assistance (ODA), by including within it the various financial instruments which boost development finance in a form other than grants or loans, the multilateral development banks (MDBs) have launched a review focusing more narrowly on the future of their concessional financing windows.

The organisational framework for the concessional financing offered by MDBs is based on mobilizing donor contributions to generate resources which are allocated, in the form of grants or highly subsidized loans and based on performance, to recipient governments while meeting their debt sustainability level. This system was put in place around 15 years ago, and has since undergone a succession of only minor adjustments. Special waivers have also stacked up, producing an excessively complicated system. It is the structure of this system which now needs to be rethought. But reform must be comprehensive and based on the 'magic triangle' in which resource mobilization, allocation of resources and debt sustainability management are closely linked and achieve an overall balance.

Resources from traditional donors appear to have reached a climax. After the significant increase in ODA during the 2000s, reaching US\$ 135.2 billion in 2014, and a highly focused political agenda, political mobilisation became more diffuse and was made more difficult by the budgetary constraints experienced by the main donors. It can therefore be reasonably expected that the level of concessional financing will see weak growth during the next replenishment cycles, with the notable exception of multilateral organisations focusing on an issue which is an international political priority with leadership at the highest level. This was the case with the Green Climate Fund, which was able to get pledges up to US\$ 10 billion in Lima in December 2014 for its first fundraising initiative, thanks in particular to decisive commitment from the G20 Heads of State and Government.

In parallel, the allocation formula, the objective of which is to reward performing countries, has become increasingly complicated. Reality (health and food crises, climate disruption, support for endemically fragile and vulnerable regions) has introduced, over the course of various replenishment cycles, a number of a posteriori adjustments – whether to allocate funding based on exceptional circumstances (the Crisis Response Window provided by the World Bank (WB) and the Asian Development Bank (AsDB) and the Fragile States Facility operated by the African Development Bank (AfDB)) or to target priorities such as the AfDB's regional integration projects. Since then, the stacking up of waivers and set asides has only made the allocation framework more cumbersome, rendering the whole system opaque and complex. There is a large volume of literature on this subject, demonstrating the need to take greater account of countries' structural vulnerability in a bid to make the system intrinsically fairer and more effective. The resources allocated through the current performance-based system represent slightly more than 50% of total resources. And more than half of recipient countries – whether International Development Association (IDA) or African Development Fund (ADF) – are fragile countries. This trend will grow over the next ten years.

Debt sustainability remains a constant concern. Concessional loan maturities mean that it will be particularly from 2020–2025 that the significant rise in loans granted between 2005 and 2015, as a result of the increased resources made available to concessional financing windows, will have an impact on the public finances of borrowing countries. This situation may leave countries vulnerable to external shocks, all the more so in the case of those countries which also borrowed from capital markets but on much more expensive terms – these loans will mature at the same time.

The acceleration of countries completing the debt cancellation processes (Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI)), combined with the acceleration of global economic changes, is generating a multitude of paradoxical situations where countries currently eligible for concessional financing windows can, at the same time, gain access to capital markets. The recent revision of credit policies allowing countries eligible for concessional financing to access non-concessional funds requires a comprehensive revision of classification and graduation procedures.

While the arguments in favour of maintaining concessional financing are strong – according to WB estimates, extreme poverty will still affect 504 million people in 2025, 58 percent of whom will be in Sub-Saharan Africa (80.7 percent if India, the major source of poverty outside Africa, is excluded) – it is the way in which it is mobilized and allocated that needs to be fundamentally rethought.

Concessional resources should not be only considered a liquidity tool but as well as an equity one. Four main avenues of reform could be explored (the detail of these proposals is given after the summary): (i) the mobilization of concessional financing should be based on high-level political consensus; (ii) the division of effort between development institutions should be rethought in order to identify obvious comparative advantages; (iii) the country classification needs to be improved and there should be an increased focus on financing sectorial priorities; (iv) the framework for allocation resources should be adjusted to take account of these changes.

The proposed reforms of the magic triangle take account of the profound economic changes countries are experiencing, and the constraints faced by development institutions. But no reform is possible without the political will to lead it. It is therefore first and foremost for capitals and for shareholders to demonstrate the courage to lead an ambitious and strategic reform agenda for the next decade.

## Overview of key recommendations

Resource mobilisation should be based on high-level political consensus	
1. Hold the last replenishment meeting for MDBs negotiating the volume of contributions during Annual General Meetings, at the Governor level	
The division of effort between development institutions should be rethought in order to identify obvious comparative advantages	
2. Refocus the activities of regional development banks on regional integration projects and fragile states 3. Adopt a much more selective approach to sectorial priorities or institutional themes 4. Disengage the WB and regional development banks from areas covered by specialist international organisations (the Global Fund, Global Alliance for Vaccinations and Immunisation (GAVI) and the Green Climate Fund), while remaining mindful of the need to establish rules for the strategy of creating vertical funds 5. Hold an annual joint meeting of authorised representatives from the IDA and ADF in the margins of WB and AfDB meetings since the main IDA countries will be ADF countries in ten years 6. Change replenishment cycles from three to four years for the IDA and the ADF and organise an appeal for contributions during the mid-term review for the first transition cycle	
Country classification needs to be improved and there should be an increased focus on financing sectorial priorities	
7. Create two operational thresholds for IDA- and ADF-only countries with separate concessional financing levels (ordinary and regular) 8. Create IDA+/ADF+ windows for countries with a GNI per capita above the operational threshold, with two categories (ordinary and advanced) 9. Create IDA++ and ADF++ windows and introduce a requirement relating to capital market access in addition to the creditworthiness requirement for a temporary period 10. Create a budget for sectorial priorities or adopt more concessional financing terms for each institutional sectorial priority	
The principles behind allocation should be rethought to take account of these changes	
11. Remove the Country Policy and Institutional Assessment (CPIA) rating from the allocation calculation and transform it into a tool for political dialogue only 12. Include a vulnerability index in the allocation formula	

## Introduction

This study is published in advance of the major negotiations which will take place during 2015 on reforming concessional financing, most notably the Third International Conference on Financing for Development in Addis Ababa, Ethiopia. While this conference aims to address the broader issues of financing, calculating concessionality and what should be considered ODA, by including within it the various financial instruments which boost development finance in a form other than grants or loans, such as those announced by the OECD's Development Assistance Committee (DAC), it will also have to take account of the parallel exercise being undertaken by the MDBs, which is more focused on reforming their own concessional financing windows. This paper is aimed particularly at all decision-makers who will be responsible for leading these negotiations.

Several studies have sought to feed into and shed light on the debate, including on drawing up the post-2015 agenda and the review of the Millennium Development Goals (MDGs), which have now become the Sustainable Development Goals (SDGs). They have been able to highlight the challenges of development finance (Kharas, Prizzon and Rogerson, 2014) and the costs and resources of the SDGs, while also addressing country classification by group and the need to review the eligibility criteria for concessional financing (Reisen and Garroway, 2014). Other studies have sought to illustrate the limits of the current debt sustainability framework (Panizza, 2015), while looking for ways to promote innovative financing for development (Guarnaschelli, 2014).

However, the recent abundance of economic literature has paid only marginal attention to the overall operation of MDB concessional financing windows: the IDA for the WB, the ADF and the Asian Development Fund (AsDF). To these institutions, which have a generalist approach, should also be added specialist funds (the Global Fund, GAVI and the International Fund for Agricultural Development (IFAD)), which operate in a very similar fashion. Thus, of the total US\$ 134 billion in ODA in 2014, US\$ 41 billion was made up of multilateral net direct flows. Concessional financing issued by MDB windows accounts for 25 percent of this financing. Reform in this area is therefore of limited scope in terms of volume, but it is crucial in the overall structure of aid.

The decision taken during the AsDB's 2014 Annual General Meetings to merge its concessional and non-concessional windows illustrates the need for an in-depth review of the current system. However, the adjustments which have been made to date have essentially been peripheral. IDA and ADF informal working groups of Deputies and Delegates set up in 2014 show that there is an urgent need to profoundly rethink the system. The appointment during the meeting of MDB leaders in January 2015 of a WB emissary to focus on this issue bears witness to the rapid changes faced by the development sector, a reflection of the acceleration of economic change.

That said, the main risk would be to focus on just one aspect: either the allocation formula, or revising the debt sustainability framework, or looking at country classification, at the expense of taking a comprehensive view, which is necessarily more ambitious and more difficult. This view is based on the magic triangle, in which resource mobilisation, allocation of resources and debt sustainability management (resources – allocation – debt, or RAD) are closely linked and achieve an overall balance. Concessional resources should not be only considered a liquidity tool but as well as an equity one. Consequently, it is advisable to understand reform from the point of view of these three elements simultaneously, where changing any one of them – however relevant it may be –

could destabilise or render ineffective the other two. This study seeks to offer some insight and proposals in this direction, with all the limitations that this may entail. The scope of this study excludes climate change funding and takes only a marginal look at innovative financing.

## **Section I: The current system for managing concessional resources has run its course**

The organisational framework for the concessional financing offered by MDBs is based on mobilizing donor contributions to generate funds which are allocated, in the form of grants or highly subsidized loans, to recipient governments while meeting their debt sustainability level. This system was put in place around 15 years ago, and has since undergone a succession of only minor adjustments. Special waivers have also stacked up, producing an excessively complicated system. It is therefore the structure of this system which now needs to be rethought and radically reformed.

### **1.1 History**

Looking back, the 1990s was a difficult decade for ODA. The concept came under scrutiny, accused of being inefficient, useless and disconnected from reality (Wappenhans, 1993). It was attacked from all sides. Some sought to promote trade instead of aid, considering that public money was not being used effectively; others believed that aid was not reaching the poorest and was influenced more by the commercial interests of donors. For their part, civil society and non-governmental organisations (NGOs) criticised the harmful effects on the environment caused by major infrastructure projects. The multiple crises and conflicts, particularly in Sub-Saharan Africa, reinforced this belief, while the fall of the Berlin Wall shifted the focus of Western countries' efforts eastwards. Africa was at that time considered – to quote the front page of the 13 May 2000 edition of *The Economist* – ‘the hopeless continent’, a description embodied by the image of child soldiers. The financial impact was indisputable: ODA fell from US\$ 61 billion in 1990 to less than US\$ 50 billion in 1996 before just about returning to US\$ 60 billion at the very beginning of the 2000s. It was the lost decade.

A new agenda became essential in order to define concrete and measurable objectives and identify the funding to achieve them (Monterrey, 2002). It was in this spirit that the G8 Summit held under the UK Presidency at Gleneagles committed to providing an additional US\$ 50 billion by 2010 and to devote half of that amount to Sub-Saharan Africa.

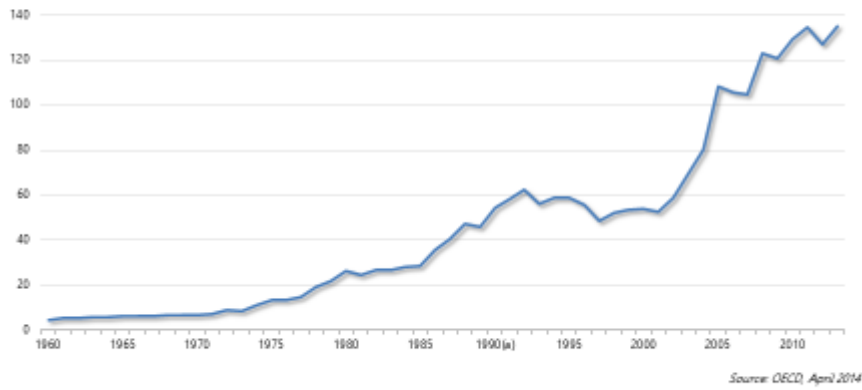
The economic literature demonstrated that the impact of aid on growth depends on the quality of the economic policies put in place (Isham and Kaufmann, 1999); and that the amount of aid has little influence on the quality of these policies (Collier, 1997), even where there are conditionalities (Alesina and Dollar, 2000). The political consequence of this for MDBs was to link the increase in these resources to an allocation framework based on performance. In other words, the level of resources would not primarily be dictated by needs, but rather by the policies and reforms implemented by governments and measured by CPIAs.

On this basis, the performance-based allocation (PBA) system was introduced at the end of the 1990s to determine the national allocation which would be granted and revised annually.

Rich countries – who essentially led this agenda – played their part to a certain extent and significantly increased their contributions from US\$ 60 billion in 2000 to US\$ 135 billion in 2014.

Figure 1: Total net ODA from DAC, 1960-2013 (US\$ billion)

**Evolution (from 1960 to 2013) of Total Net ODA from DAC (USD billion)**



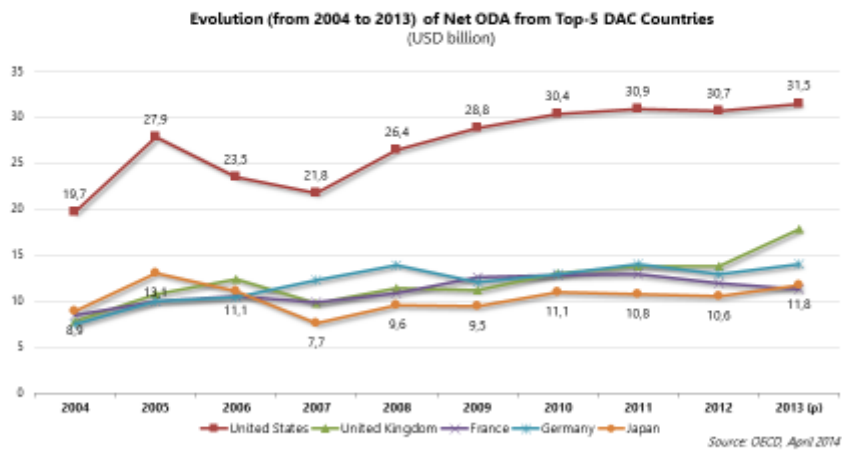
But there was a flip side to this trend: the new, emerging economies would remain largely outside this development agenda and the contributions that they would allocate to concessional financing would continue to be limited (Annex 1).

**1.2 The mobilization of traditional resources has probably reached its upper limit**

In terms of resources, 92 percent of the funding for the last two ADF cycles came from rich countries (Europe, North America, Japan) – the traditional donors.

Figure 2: ODA from top five donors, 2004-2013

**The weight of traditional donors remains crucial**



The same applies to the most recent major replenishments: IDA17 and GF4 (Manning, 2014). Emerging economies participate financially in these replenishments, but to varying degrees (Russia, for example, does not contribute to the ADF, while China grants more concessional resources to the ADF than to the AsDF, though the total amounts concerned remain modest).

There are two options for generating more resources. The first is to seek new donors: the WB reached 40 donors during its last cycle (IDA17), while the ADF reached 29 during ADF13. This solution involves reviewing the governance rules by allocating more space in terms of voting and capital rights to future contributing member states. In the short to medium term, however, this kind of development seems unlikely for reasons which are both historical and linked to the governance of these institutions (Chervelier, 2015). The second option is to turn to innovative forms of financing to generate leverage effects and, ultimately, to maximise impact on development through use of the limited concessional resources available (Guarnaschelli, 2014). This is the route that the majority of development finance institutions are taking, going beyond simple MDBs and following the example of specialist UN agencies such as IFAD. The main risk is that these resources will become a substitute for existing resources rather than add to them, and that they will be extremely complex, resulting in them being little used. The risk of substitution was the main concern put forward by some countries when, for example, the ability of donors to offer concessional loans was introduced under IDA17.

Resources from traditional donors appear to have reached a climax. After the significant increase in ODA during the 2000s and a highly focused political agenda, political mobilization declined and was made more difficult by the budgetary constraints experienced by the main donors. Moreover, in the near future, significant demands will be made of traditional donors with respect to their commitments on debt relief through the MDRI: the cost to them is set to increase significantly over the coming years, reaching a peak between 2025 and 2030. It can therefore be reasonably expected that the level of concessional financing will see weak growth during the next replenishment cycles.

The notable exception which may result in additional concessional financing contributions is the thematic element, where an international political priority with leadership at the highest level is concerned. This is the case with the Green Climate Fund (Müller, 2014), which was able to raise more than US\$ 10 billion pledges in Lima in December 2014 for its first fundraising initiative, thanks in particular to decisive commitment from the G20 heads of state and government, encouraged by preparations for the COP21 Summit in Paris in November 2015. The Global Fund and GAVI are part of this trend, although it is not sufficient in itself. The Global Fund saw a 30% increase during the most recent replenishment in December 2013, reaching US\$ 12 billion, while GAVI saw a 74% increase, reaching US\$ 7.5 billion during its second replenishment which concluded in January 2015 under the patronage of German Chancellor Angela Merkel. By way of comparison, at the end of 2013, during its most recent replenishment (IDA17), the WB saw direct contributions increase by 1%, for a total of US\$ 26.1 billion and the ADF (ADF13) saw an increase of 0.5% for a total of US\$ 6 billion.

Consequently, the generalist windows, and especially those of the WB and the AfDB, find themselves confronting strategic and operational choices which cannot be understood solely from the point of view of resource mobilization and optimisation.

### 1.3 The allocation framework has become obsolete

The PBA system is the bedrock of the concessional financing allocation system used by the MDBs. Firmly in place since the end of the 1990s, it has often found itself constrained by ideological considerations, particularly where national parliaments are concerned. In order to justify expenditure on aid to taxpayers, and therefore to their representatives, aid must be seen to ‘be deserved’ and can only be considered effective if it is based on performance indicators. From that point, any refocusing of the formula was likely to undermine this principle, which became sacred. However, it has many weaknesses.

The formula is extraordinarily complicated for the uninitiated – paradoxical for a system that is supposed to value simplicity.

Box 1: Allocation formula used in ADF13 and IDA17

$$A_i = (CPA)_i^{4.125} \times (GNI/p)_i^{-0.125} \times Pop_i^1 \times AIDI_i^{-0.25}$$

Performance component

Needs component

$$CPA_i = \begin{cases} 0.20 \times CPIA_{(ABC)_i} + 0.58 \times CPIA_{D_i} + 0.06 \times CPIA_{E_i} + 0.16 \times PPA_i \\ 0.36 \times CPIA_{(ABC)_i} + 0.58 \times CPIA_{D_i} + 0.06 \times CPIA_{E_i} \text{ if no portfolio} \end{cases}$$

- $A_i$  is the distribution key for calculating the PBA for country  $i$
- $AIDI_i$  is the Africa Infrastructure Development Index score for country  $i$
- $CPA_i$  is the country performance assessment for country  $i$
- $CPIA_{(ABC)_i}$  is the average score for clusters A, B and C of the CPIA for country  $i$
- $CPIA_{D_i}$  is the score for CPIA cluster D (governance) for country  $i$
- $CPIA_{E_i}$  is the score for CPIA cluster E for country  $i$
- $(GNI/p)_i$  is the gross national income per capita for country  $i$
- $PPA_i$  is the portfolio performance assessment for country  $i$
- $Pop_i$  is the population of country  $i$

IDA17 formula

Country Allocation Formula =  $f(CPA)^4 \times Population^1 \times GNI \text{ per capita}^{-0.125}$

Country Performance Rating =  $(0.24 * CPIA_{A-C} + 0.68 * CPIA_D + 0.08 * PPR)$

An increase in GNI per capita translates into a reduction in the allocation per capita, while an improvement in the CPA, attributable to the positive impact of the  $CPIA_{ABC}$ ,  $CPIA_D$ ,  $CPIA_E$  and/or the PPA, leads to an increase in the allocation per capita. The population parameter (Pop) enables country allocations per inhabitant to be converted into total country allocations. Countries with relatively high populations receive higher resource allocations in absolute terms. The PPA measures problematic projects as a percentage of the country’s total portfolio using quarterly data.



## Box 2: Steps in calculating the formula for ADF13

There are currently four steps involved in calculating basic allocations:

- 1- Calculation of initial allocations
- 2- Individual cap at 10% of total resources and reallocation of excesses
- 3- Reallocation of the 50% deduction for blend countries and the reduction for graduating countries
- 4- Individual cap at 10% of total resources and reallocation of excesses

All of these indicators, exponents and adjustments made over time are the result of subtle negotiations and compromises. The available data (particularly in terms of GNI per capita) is sometimes only approximate, especially in the case of extremely fragile countries. While the CPIA can be an effective tool for dialogue with governments, it faces multiple challenges, having seen an overall inflation of ratings (see Box 3) which is likely to alter its relevance. In the end, it is a quantitative exercise, whereas it should principally serve as a qualitative tool. This rising trend can also be seen in fragile countries. While some institutions are trying to promote data transparency, the level of transparency is not consistent and, above all, it is partial since users only have access to the final sum allocated without being able to genuinely undertake exhaustive research and comparison work.

Box 3: CPIA ratings for all African countries, 2004-2013 (a)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Cluster A</b>	3.39	3.44	3.49	3.68	3.80	3.82	3.86	3.83	3.90	3.90
<b>Cluster B</b>	3.21	3.23	3.27	3.38	3.46	3.49	3.49	3.40	3.44	3.36
<b>Cluster C</b>	3.17	3.20	3.23	3.32	3.44	3.44	3.44	3.37	3.45	3.42

Source: African Development Bank

CPIA ratings for the 18 fragile countries in Africa, 2004-2013 (b)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Cluster A</b>	2.79	2.81	2.76	3.02	3.10	3.10	3.18	3.24	3.20	3.11
<b>Cluster B</b>	2.74	2.78	2.84	2.88	2.84	2.92	2.94	2.93	2.93	2.82
<b>Cluster C</b>	2.59	2.68	2.69	2.82	2.82	2.80	2.79	2.77	2.79	2.72

Source: African Development Bank

Above all, reality (health and food crises, climate disruption, support for endemically fragile and vulnerable regions) has introduced, over the course of various replenishment cycles, a number of a posteriori adjustments – whether to allocate funding based on exceptional circumstances (the Crisis Response Window provided by the WB and the ADB, or the Fragile States Facility operated by the AfDB) or to target priorities such as regional integration projects through the AfDB's window specifically set up for this purpose. Since then, the stacking up of waivers and set asides has only made the allocation framework more cumbersome, rendering the whole system opaque and

complex. There is a large volume of literature on this subject, demonstrating the need to take greater account of countries' structural vulnerability (Guillaumont, 2013) in a bid to make the system intrinsically fairer and more effective. Today, the current performance-based system allocates little more than 50 percent of resources granted and only 40 percent of ADF countries, for example, receive their allocations solely through PBA (Guillaumont, Jeannaney and Wagner, 2015). Finally, it has been shown that this system contributes to the volatility of aid, a factor in the reduced effectiveness of development insofar as a 10 percent change in the CPA results in a 35 percent change in the PBA score.

For all that, it is striking to note how difficult this system is to reform, beyond minor tweaks. Recent developments (the introduction of an infrastructure development index (AIDI) under ADF13; the reduction in the weighting of performance under IDA17, from an exponent of 5 to 4) show a degree of openness that was unheard of before the beginning of the 2010s. Any reform of the allocation process should logically be part of an overall reform of concessional windows to ensure consistency and sustainability.

**1.4 The debt sustainability framework is challenged by economic changes**

With regard to debt management, the debt sustainability framework (DSF) is used to determine each country's risk of debt distress (Annex 2).

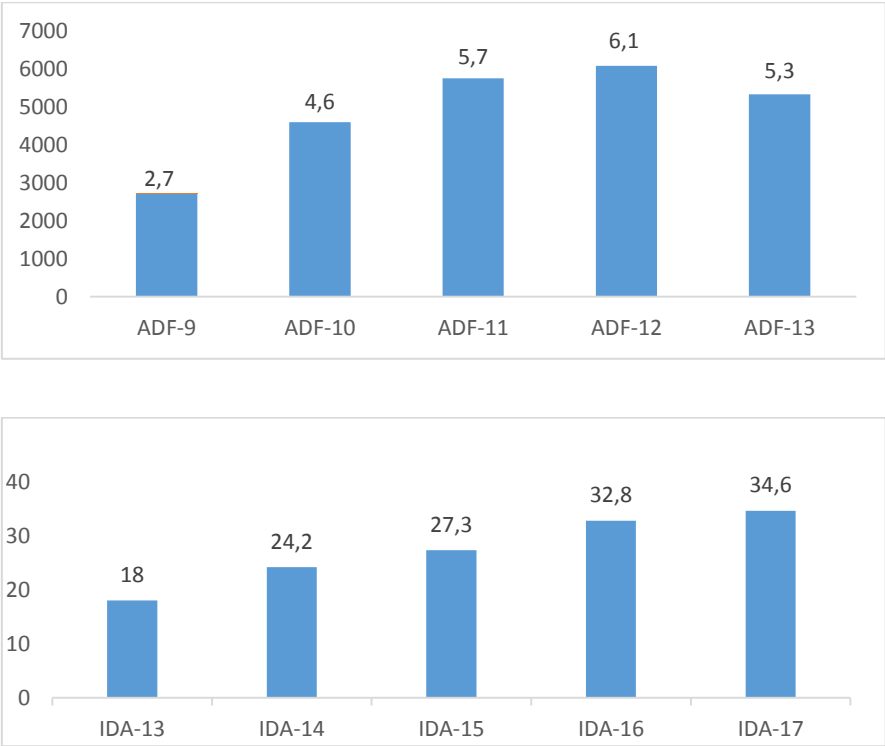
**Box 4: The role of the DSF in calculating allocations**

For each country, a debt sustainability analysis (DSA) is carried out on the basis of two criteria: institutional strength and the quality of policies to withstand debt distress; and country-specific debt burden indicators (that is, the net present value (NPV) of the debt/GDP ratio, the NPV of the debt/exports ratio, and the debt service/exports ratio). Countries are classified using three traffic lights – red, yellow and green. Red indicates a high risk of debt distress, yellow indicates a moderate risk and green, a low risk. Countries in the red category qualify for 100% grants, those in the green category qualify for 100% loans, and those in the yellow category qualify for a mix of 50% grants and 50% loans. Countries considered to be 'gap' countries (countries which are above the operational cut off but are not creditworthy), blend countries and graduating countries are not eligible for grants, regardless of their DSF status. The modified volume formula is applied in calculating these allocations. The main aim of this formula is to cover, in advance, the administrative costs associated with allocations in the form of grants and to strengthen the incentive structure of the PBA system. The modified volume formula involves applying a 20% reduction to all grants. This reduction breaks down into a 15% portion to cover the charges and a 5% portion linked to incentives. The proportions according to the basic PBAs are then used to reallocate the incentives portion to all exclusively ADF countries and gap countries, in order to strengthen the PBA system's incentive structure. This reallocation does not affect fragile states.

The DSF was revised recently, to take better account of existing concessional financing (IMF, 2012). Criticised both in principle and for the ways in which it is applied (Panizza, 2015), it also leads to uncertainties about the future. Concessional loan maturities (Annex 3) are such (50 years not long ago, 40 years since 2014 or 25 years for blend countries with, normally, grace periods of between 5 and 10 years and favourable amortisation rates (higher amortisation from the middle of the period)) that it will be particularly from 2020-2025 that the significant rise in loans granted between 2005 and

2015 (see Figure 3) will have an impact on the public finances of borrowing countries. It would therefore be in the interests of the DSF to cross-check this data in order to better identify risks of debt distress during the period 2020-2025, at a time when huge fluctuations in the prices of raw materials are undermining numerous budget estimates and domestic resource mobilisation remains low.

Figure 3: Increase in the WB (IDA13-IDA17) and AfDB (ADF9-ADF13) concessional financing windows, 2004-2014 (billions of UAs or SDRs)



This situation may leave countries vulnerable to external shocks, all the more so in the case of those countries which also borrowed from capital markets but on much more expensive terms – these loans will mature at the same time (see Box 5: African countries’ access to capital markets, 2012-2015).

The acceleration of countries completing the debt cancellation processes (HIPC and MDRI), combined with the acceleration of global economic changes, is generating various paradoxical situations where countries eligible for concessional financing windows can, at the same time, gain access to capital markets.

Box 5: African countries' access to capital markets, 2012-2015

Country	Status	Issue date	Maturity (years)	Amount (US\$ millions)	Yield	Subscr. (times)
Zambia (green light)	Blend for AfDB; IDA-only for WB	Aug-12	7	750	5.625%	16
Rwanda (green light)	IDA and ADF-only	May-13	10	450	6.875%	9
Nigeria (green light)	Blend for WB and graduating for AfDB	Jul-13	10	500	6.625%	4.5
Ghana (yellow light)	IDA and ADF-only	Aug-13	10	1,000	7.875%	2.7
Côte d'Ivoire (yellow light)	IDA and ADF-only	July-14	10	750	6.875%	9
Ghana (yellow light)	IDA and ADF-only	Sept-14	10	1,000	8.225%	4.5
Ethiopia (green light)	IDA and ADF-only	Dec-14	10	1,000	6.625%	2.6
Tunisia	AfDB/IBRD country	Jan-15	10	1,000	5.675%	4
Côte d'Ivoire (yellow light)	IDA and ADF-only	Feb-15	13	1,000	6.625%	4,25

Seventy-four developing countries currently have a credit rating which allows them to borrow on the financial markets. If we focus on Africa, foreign investors believe in the capacity of some countries to develop, as the oversubscription indicator shows, in a context where the profitability of these investments is higher than that of the sovereign bonds issued by advanced economies where interest rates are very low and there are substantial available liquid assets.

However, economic analyses (IDA, 2012) tend to show that early access to financial markets is not a guarantee of managed development; on the contrary, it could undermine the growth trajectory due to a lack of control over the increased costs of managing the associated debt. The risk is, therefore, that countries will drop back to IDA-only status, having previously been graduated. Since the IDA was created, 36 countries have graduated but 17 of them, having been declared creditworthy and transitioned to blend country status, dropped back to IDA-only. It has also been shown that half of the developing countries which issued bonds between 1980 and 2000 experienced a period of debt crisis (Jahjah and Yue, 2004). There is always a cost when a country is downgraded, both for the financial institution and for the country, insofar as the country will need to make an even greater effort to benefit again from a reclassification.

Consequently, these paradoxes lead to unconventional policies such as that followed by the AfDB in May 2014, where ADF countries were allowed access, under certain conditions, to AfDB resources. This reorientation challenges the barrier which defined the credit policy established in 1995, whereby each country had to stay within its credit classification in order to avoid the bad habits of the past which had led to a succession of unsustainable debt issues. The HIPC initiative launched in 1996 was the result of this situation. The WB went down the same path.

Box 6: Changes to the AfDB's credit policy allowing ADF countries access to non-concessional financing under certain conditions

Adopted in May 2014, the change to the credit policy enabling ADF countries to gain access to non-concessional resources does not constitute an automatic drawing right. Eligibility for these resources is determined on a case-by-case basis according to the following criteria:

- . the country must present a low (green light) or moderate (yellow light) risk of debt distress
- . the country must enjoy a certain amount of room for manoeuvre in terms of non-concessional borrowing, as determined by the DSA and in line with IMF policy on external debt limits for countries whose programmes are supported by the IMF and with the AfDB's policy on accumulation of non-concessional debt. Financing must never exceed the limit of sustainable lending or its room for manoeuvre for non-concessional borrowing, whichever of these two levels is lower
- . the macroeconomic situation in the country must be viable
- . the financing request submitted by the country must be approved by the AfDB's Credit Risk Committee, based on the country risk assessment.

This paradox is all the more pronounced in a context where very low interest rates make the case for easier access to non-concessional windows at reduced costs (the cost of accessing IBRD or AfDB resources is calculated as a function of the London Interbank Offered Rate (LIBOR) plus 40 or 60 base points depending on the institution) , a rate which is potentially between 6 and 10 times lower than available market rates. It would therefore seem consistent and even desirable to promote access for IDA and ADF countries to the banks' non-concessional resources, but to do so within an overall framework which takes account of the access certain IDA and ADF countries have to capital markets.

The rapidly developing economic situation in countries calls for more structural reforms – this is preferable to making adjustments which risk becoming obsolete by the next replenishment cycle. The AsDB made the right choice in this regard when it opted to merge these two windows and propose an alternative way forward. This cannot really be adopted by its sister institutions, particularly the WB and AfDB, insofar as the situation of the AsDB was unique (see Box 7). The model does not seem transferable as such, due to the pre-emerging, even emerging status of many Asian countries, but it opens the way for bold and structural reforms aimed at going beyond the traditional classification of public windows (concessional or non-concessional).

### Box 7: Merger of AsDB's two windows

The AsDB announced in 2014 that it was merging its two windows. This decision can be explained fundamentally by two factors. Firstly, the AsDB's fully paid-up capital is fairly limited, while the AsDF has substantial resources. Secondly, the economic landscape in Asian countries has transformed the geography of poverty, meaning that many countries have become middle-income countries, likely to borrow on less concessional financial terms.

In concrete terms, a large proportion of the AsDF's balance sheet would merge with the AsDB's ordinary capital resources (OCRs). AsDB loans would be transferred to the OCR balance sheet. The unused portion of the resources which formerly belonged to the AsDF would be used to offer somewhat concessional terms for AsDB loans, which should significantly strengthen its overall lending capacity. The goal is to have the new AsDF (AsDF12) ready to begin operations in January 2017.

#### **1.5 The comparative advantage offered by core MDBs is being questioned as well as the coordination between development institutions**

The generalist (multi-sectorial) nature of MDBs also represents a major challenge. This is obvious with regard to the WB, due to its universal mandate, but it is also the case for regional development banks. While defending a comparative advantage approach, they retain broad areas of intervention. For example, the AfDB's Strategy for 2013-2022 retains eight priority areas: (i) infrastructure development; (ii) regional economic integration; (iii) private sector development; (iv) governance and accountability; (v) skills and technology; (vi) fragile states; (vii) agriculture and food security; and (viii) gender – not to mention any obligations which topical events might create (for example, the US\$ 150 million allocated to manage the Ebola crisis), even if these activities were not supposed to be included in the institution's initial set of priorities. The result is more diffuse impacts and, above all, difficulty in mobilizing around several clear themes insofar as each contributor to the concessional windows seeks to defend their own sectorial interests or strategies (for some this is infrastructure, for others – gender, still others concentrate on fragile states, or regional integration, etc.). Under these conditions, the banks are faced with competition from every side: bilateral agencies, specialist multilateral institutions and trust funds. The need to define their comparative advantages more narrowly is therefore pressing.

Against this background, the accelerating trend of creating competing institutions makes it essential to take a more consistent approach to development based on the Paris Declaration principles. While the challenge relates more to issues of global governance (Chervelier, 2015), the fact that the WB and the AfDB will have more or less the same client countries eligible for concessional window financing represents a very concrete operational challenge over the next ten years (Moss and Leo, 2011).

## Section II: The arguments in favour of maintaining concessional financing remain strong

The large number of disadvantages and dysfunctions in the current system could call into question the relevance of maintaining concessional financing within MDBs. There may be some arguments in favour of this position, insofar as the resources available to countries are increasing and are principally the result of non-concessional financing commitments, like the announcements made by China and Japan in 2013 that they would allocate US\$20 billion and US\$ 32 billion respectively in loans to the African continent, or the recent success of bond issues in several countries eligible for concessional financing. However, this approach would be erroneous. The arguments in favour of maintaining concessional financing are strong; rather, it is the way in which they are mobilized and allocated that needs to be fundamentally rethought.

The primary role of development banks lies in eradicating extreme poverty. Their relevance therefore relates to the way in which they seek to tackle the challenges faced by low-income countries. A Center for Global Development working group, led by Jean-Michel Severino and Todd Moss,<sup>1</sup> reported its findings in October 2012, suggesting that the WB take a fresh approach. In particular, the report put forward a radical recommendation: that there was nothing to fear from a decline in IDA funding in future cycles, and that plans should be made for a transitional window.

Firstly, although several countries should escape the poverty trap by 2025, around 30 others are expected to remain in the low-income category, in other words below the GNI per capita threshold established annually by the WB. In 2014, this threshold was set at US\$ 1,215 per inhabitant per year.<sup>2</sup> Most of these countries will be in Sub-Saharan Africa, a region that will also see the most significant demographic growth over the next ten years. Secondly, the estimate of the number of countries eligible for the concessional financing window does not take account of exogenous shocks, natural or health disasters or political and military crises, which have the potential to undermine or even halt growth in countries that are still structurally vulnerable. The development of the Ebola crisis in Guinea, Liberia and Sierra Leone shows the extent to which growth trajectories can remain fragile in this group of countries.<sup>3</sup>

According to recent available estimates (World Bank, 2014),<sup>4</sup> forecasts suggest that levels of extreme poverty will remain high in several cases in 2030, and half of such poverty is likely to be concentrated in Sub-Saharan Africa, in fragile states. As of today, almost half of ADF countries are fragile and of the 82 countries eligible for IDA financing in 2015, 40 are in the fragile and conflict-affected states category. Finally, according to the AfDB's forecasts, by 2022, 60% of ADF-window countries (31) will be fragile.

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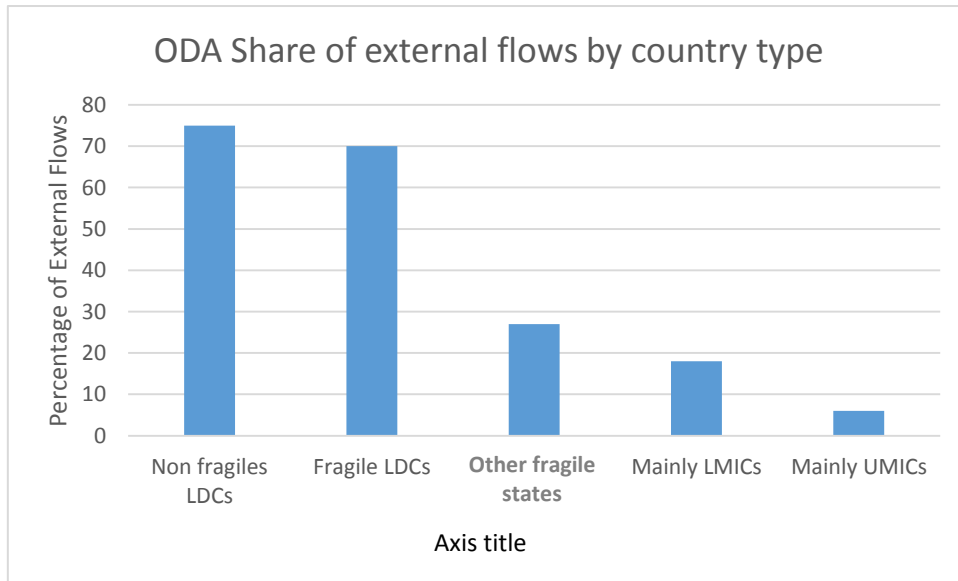
<sup>1</sup> Center for Global Development, October 2012, *Soft Lending without Poor Countries, Recommendations for a New IDA*.

<sup>2</sup> July 2014, Annex D, World Bank Operational Policies.

<sup>3</sup> A study by the WB in October 2014 estimated that the disease has already had a negative impact on growth in West Africa that could be as high as US\$ 32 billion by the end of 2015, or 0.5% of the continent's GDP. The figure was revised and should be lower but a strong negative impact remains.

<sup>4</sup> 2014, World Bank, *Prosperity for All: Ending Extreme Poverty*.

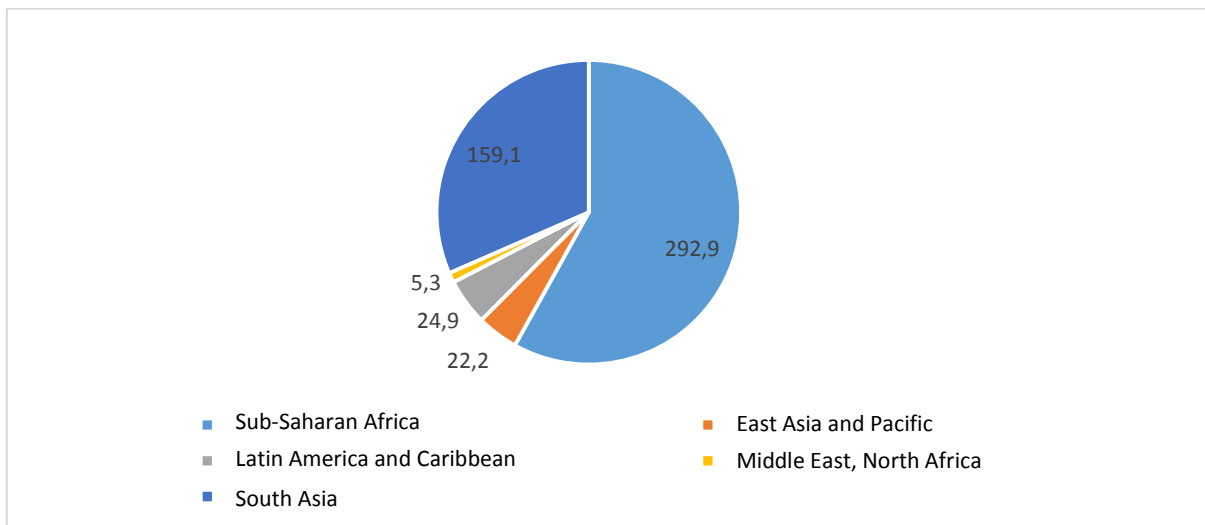
Figure 4: ODA share of external flows by country type



Source: OECD, 2014

In concrete terms, according to the chart below, estimates put the number of people living in poverty at 504 million in 2025, 58 percent of whom are likely to be in Sub-Saharan Africa. This proportion rises to 81 percent if India, which accounts for most poverty outside Africa, is excluded.

Figure 5: Number of people living in poverty by geographical region in 2025 (millions)



Source: Calculations based on PovcalNet and IMF WEO (2013)

The variety of resources available to recipients remains highly inequitable. While some low-income countries (IDA-eligible) are seeking to diversify their external financing (via foreign direct investment (FDI) and capital markets), ODA remains the main source of revenue in the poorest and most fragile countries. It is worth noting, however, that today, three quarters of extreme poverty is found in middle-income countries, but a consensus exists (Collier, 2011) around the fact that this is a challenge for the countries themselves, and aid is not a part of the equation here. The existence of substantial pockets of regional poverty within large countries (Brazil, China, Indonesia and India) had led some to envisage allocating resources at a supranational level (ODI, 2013). This potentially



attractive idea faces an operational and above all conceptual challenge with regard to the necessary selectivity of concessional financing. The existence of significant poverty – although it is more or less confined to specific geographical areas – within emerging and even advanced countries tends more to raise questions about the growth model and the inequalities which it produces, than to lead to appeals for international generosity.

Under these conditions, the difficulty would seem to be in maintaining a comprehensive approach in a world where responses and tools need to be increasingly aligned with specific countries and situations to be effective. The *'one size fits all'* approach has had its day; more granularity is needed. The challenge lies more in establishing a system which is sufficiently clear and appropriate without ending up being too complex.

### **Section III: How can the magic triangle of concessional financing be reformed?**

It is fairly clear that the current system is no longer capable of responding to contemporary challenges. The need to allocate concessional financing remains and it would be wrong to neglect it given the still substantial number of poor and very vulnerable countries that will exist in ten years. The most relevant and innovative solutions are likely to be found in a comprehensive approach where the three elements of the magic triangle (resources, allocation, debt) are reformed at the same time.

#### **3.1 The mobilisation of concessional financing should be based on high-level political consensus**

The increased importance of sectorial funds (the Global Fund, GAVI, the Green Climate Fund), their political representation at the highest level (in general at the Heads of State and Government level) and the growing resources that they have been able to leverage over the last five years offer interesting food for thought.

On the one hand, this is proof, if it were needed, of the political appropriation of these issues. While the leaders of the WB – whose President participates in all G20 and other major international meetings – AfDB and ADB have high-level dialogues with their government shareholders, decisions on the amounts allocated during concessional financing window replenishment cycles are often, bizarrely, still taken at the ministerial or even administrative (Deputies) level, and there is no guarantee of coordination between the various ministerial departments (often, three different ministries are responsible for WB, IMF, regional development bank and specialist fund administration at the country level). This results in different approaches and positions, sometimes highlighting a lack of overall vision.

With this in mind, there would appear to be a need for political re-appropriation of WB and regional development bank replenishment. Consequently, it would be desirable to hold the last replenishment meeting during the Annual Governors' Meetings, in other words mainly at ministerial level. Having prepared the negotiations at the technical level over the preceding months, the Deputies would hand over to their ministers for the final negotiating phase to determine financial

allocations. This would improve participation by recipient countries since the plenary session would include governors from all countries. It would encourage ownership, where there is still room for improvement despite joint working groups and the ad hoc involvement of countries by region on a rotating basis. To sum up, this would remove the feeling of duality in the system, between Deputies and the Boards of Governors, and in doing so, would affirm recognition of the role of the Deputies working group as being to serve the Governors. Finally, a ministerial presence from donor countries would strengthen the high-level political mandate within their own countries.

### **3.2 The division of effort between development institutions should be rethought to identify obvious comparative advantages**

The first challenge for generalist institutions is to establish the best position between genuine selectivity and organizing the work among themselves. Simple coordination – the leaders of the main MDBs meet on a regular basis – is not sufficient; there would need to be a return to the spirit of founding fathers that Romeo Horton (former Governor of the Central Bank of Liberia and one of the founding fathers of the AfDB) described so well in his memoirs, where the mandate of the AfDB, for example, was to target regional integration projects, while the WB would focus on national projects. This separation of tasks appears to be even more crucial for these two institutions in particular, as the majority of IDA countries are set to become ADF countries within the next ten years, but it is clearly not limited to the WB and the AfDB. In the same vein, it is possible to take the view that national projects should primarily be the prerogative of bilateral development agencies, allowing MDBs to focus on global, cross-cutting and regional challenges.

While the scarcity of concessional financing makes the case for optimisation of these resources, it would be fairly unrealistic to believe that a multilateral organisation would completely disengage at the national level. However, a refocus on projects with a broader scope and regional projects would seem to be a direction that should be supported. Stronger differentiation would help to both target regional integration projects and ensure an allocation for the various national projects involved. For the AfDB, for example, most national efforts could focus on the major challenges facing the continent over the next ten years: the population explosion and the requirement for jobs and therefore training that this will entail. With this in mind, and given the creation of new international institutions since the beginning of the 2000s – principally the Global Fund, GAVI and the Green Climate Fund – and the resources they have been able to leverage, it would seem sensible for the generalist institutions (the WB and all regional development banks) to disengage from these sectors.

Secondly, while the dialogue between development institutions is critical, it cannot replace the mandate granted by their shareholders. For the reasons already discussed, it would be useful to improve coordination between ministerial agencies in capitals. This is why it would seem relevant – insofar as IDA and ADF countries will converge over the next ten years – to organize in the margins of the WB's spring meetings and the AfDB's annual meetings, on an alternate basis, a joint meeting bringing together representatives from both institutions with the authority to discuss objectives and priorities that can then be taken to their respective boards. From an operational point of view, the length of the WB and AfDB cycles could be reviewed: the three-year cycle seems short (how many

initiatives have been launched without any chance that there would be enough time to actually implement them!). Moreover, measuring institutional efficiency more often involves measuring means (has the tool been implemented?) than outcomes (measuring the impact of the tool). It would therefore seem desirable to opt for a longer period of time (four years), which would have the side effect of producing budgetary gains. The question of transition with the next cycle therefore arises, to avoid a loss of resources for the WB and the ADF who would implement it. For IDA18 and ADF14, a call for contributions over two years with a further replenishment meeting during the mid-term review could be one avenue to explore.

### **3.3 Country classification needs to be improved and there should be an increased focus on financing sectorial priorities**

Country allocation has demonstrated its limits, particularly due to the threshold effects that it produces, and it is now recognised that the existence of a single threshold (GNI per capita with an operational cut off of US\$ 1,215 for the 2015 fiscal year) and creditworthiness indicator used to qualify all countries eligible for concessional financing is not relevant (IDA-only or ADF-only) due to the heterogeneous nature of IDA and ADF countries. The level of the current threshold (operational cut off of GNI per capita of US\$ 1,215 for the 2015 fiscal year) can be questioned. Across all IDA-only (excluding Latin America and the Caribbean), AsDF-only and ADF-only countries, 46 percent have a GNI of less than US\$ 800 per capita, and 91 percent of them are in Africa (Annex 4). In addition, 77 percent have a GNI per capita of less than US\$ 1,500; this increases to 95 percent if only African countries are taken into account. Projections for graduation show that by 2022, the operational cut off – according to trajectories based on the IMF World Economic Outlook’s 2013–2022 assumptions – will be around US\$ 1,415 per capita. Among African countries alone, five countries could end up with gap status, just surpassing this cut off. These aspects are hardly satisfactory for at least three reasons: the first, as already mentioned, stems from the relative statistical reliability of the data, which has already been subject to variation and correction in the past, making it possible to use mechanisms with less definitive threshold effects; the second relates to the very small gap which exists between the atypical countries liable to reach gap status and the others, while their economic and budgetary strength does not necessarily match these gaps (Mauritania is expected to have a GNI per capita of US\$ 1,788 by 2022, while Benin’s will not exceed US\$ 1,420, so Mauritania’s status is likely to change, while Benin’s will not); finally, the question of overall consistency remains, particularly with regard to debt sustainability and the recent exceptions introduced in the implementation of institutions’ credit policies.

The idea of creating an IDA+ window is a step towards better classification. To limit the perverse effects of such thresholds as far as possible, it would probably be worth exploring a further refined classification, with IDA-only, IDA+ and IDA++ windows.

The IDA-only window would include countries which are not creditworthy and are very poor (GNI per capita below the operational cut off (US\$ 1,215 in 2015)). It would be split – following the rule introduced during ADF13 – into two groups: the first (ordinary) for those where GNI per capita is less than the average of countries below the operational cut off. These countries would have access to

financing with the highest level of concessionality. The second group (advanced) would include countries with a GNI per capita above this average, and would receive financing on less concessional terms.

The IDA+ window would include on the one hand, countries with a GNI per capita fluctuating between the operational cut off and US\$ 1,965, and on the other hand, countries with a GNI above US\$ 1,965, with different finance terms (ordinary+ and advanced+). They would be able to gain conditional access to some non-concessional resources (IBRD window) in line with the terms set out by the credit policy waivers.

The IDA++ window would be reserved for creditworthy countries or those which have turned to the financial markets in the two years preceding the allocation. These countries would have access to non-concessional resources (IBRD window) up to 50%. An additional innovation would offer access to non-concessional resources to countries which have resorted to bond issues in the last two years. Countries would benefit from this status for a temporary period (four years, for example), enabling them to improve their creditworthiness. A creditworthiness analysis would have to be carried out before any country was moved definitively into the blend or IBRD category according to its GNI per capita.

Box 8: New classification of IDA-only, IDA+, IDA++/ADF-only, ADF+ and ADF++ countries

	Creditworthy for AfDB/IBRD or access to capital markets in the two years preceding the allocation	
	No	Yes
GNI per capita less than average of countries below operational cut off	IDA-only (ordinary group with highest level of concessionality in financing)	IDA++ with access to non-concessional resources up to 50%; blend category if declared creditworthy
GNI per capita above average of all IDA-only countries	IDA-only (advanced group with less concessional financing terms)	As above
GNI per capita between operational cut off and US\$ 1,965	IDA+, with access to concessional resources subject to credit policy conditions (ordinary+ financing terms)	IBRD
GNI per capita higher than US\$ 1,965	IDA+, with access to concessional resources subject to credit policy conditions (advanced+ financing terms)	

The AfDB could pursue the path embarked upon under ADF13 by reclassifying the group of advanced countries into the ADF+ window and creating a third category, ADF++, which would allow countries that had turned to capital markets to be integrated into the same structure. This would help to

promote overall consistency in changes to credit policies, and limit threshold effects and the paradox of having IDA-only/ADF-only countries with access to financial markets. This classification would encourage countries to optimise use of funds raised from capital markets by limiting the moral uncertainty insofar as graduation would be provisional.

At the sectorial level, granularity could be introduced according to the country category. Financing a road using concessional funds in a country which is eligible for access to non-concessional financing for the project does not currently represent the best use of a rare resource. National infrastructure projects would be funded through concessional financing only in countries where concessional resources make up the primary external funding available. On the other hand, infrastructure projects with a regional component could continue to benefit from concessional financing for all eligible countries.

In the same vein, according to institutional priorities, some sectors could benefit from more concessional financing than others. If we consider that the major challenge facing Africa over the next ten years will be demographic growth and absorbing this growing population, educating a new generation of young people and helping to create jobs, then projects in this area should benefit from a higher level of concessionality. There would be two possible options. Firstly, an ad hoc window could be created where a percentage of resources would be negotiated and agreed during the replenishment cycle negotiations with conditions of use allowing a leverage effect to be created (the project would be financed from the country allocation budget and the sectorial budget), much like the approach which already exists for regional integration projects financed by the ADF. A second option would be to have sector-country finance terms, not just country terms. The level of concessionality would then vary according to sector. Calculation is based on following lending terms: service charge (0.75%), interest rates (0%) and commitment fees (0.50%). For advanced countries in IDA+ and ADF+ and ADF++/IDA++ windows, interest rates (1%) would be applied.

Box 9: Generic financing terms (Table 1) and financing terms with a higher level of concessionality for priority sectors (Table 2)

Multisector	Maturity	Grace period	Interest Rates	Commitment Fees	Service charge	1st period amortisation rate	2nd period amortisation rate
ADF/IDA-only (ordinary)	35	8	0%	0.50%	0.75%	3% (9-16)	4%(17-35)
ADF/IDA-only (advanced)	35	5	0%	0.50%	0.75%	3% (6-15)	3.5% (16-35)
IDA+/ADF+ (ordinary)	30	5	0%	0.50%	0.75%	3% (6-15)	4.66% (15-30)
IDA+/ADF+ (Advanced)	28	5	1%	0.50%	0.75%	3% (6-15)	5.4% (16-28)
IDA++/ADF++	25	5	1.25%	0.50%	0.75%	3.3% (6-15)	6.7% (16-25)

Priority sector	Maturity	Grace period	Interest rates	Commitment Fees	Service charge	1st period amortisation rate	2nd period amortisation rate
IDA/ADF-only	40	10	0%	0.50%	0.75%	2% (11-20)	4% (21-40)
ADF/IDA-only (advanced)	40	5	0%	0.50%	0.75%	2.9% (11-20)	2.9% (21-40)
IDA+/ADF+ (ordinary)	35	5	0%	0.50%	0.75%	3% (6-15)	3.5% (16-35)
IDA+/ADF+ (advanced)	32	5	1%	0.50%	0.75%	3% (6-15)	3.8%(16-35)
IDA++/ADF++	30	5	1.25%	0.50%	0.75%	4% (6-20)	4% (21-30)

### 3.4 The principles behind allocation should be rethought to take account of these changes

The first measure would be to start to move progressively away from the CPIA as a rating used to calculate allocations, and instead to employ it primarily as a tool for political dialogue. Rating inflation, combined with the fact that more than half of countries eligible for concessional financing are fragile states or countries in crisis, renders the current system obsolete as well as excessively complicated. The trend over the next ten years will be even more pronounced. In such conditions, the inclusion of a vulnerability indicator makes perfect sense (Guillaumont, 2015). On the other hand, it would seem desirable to retain the principle of the governance indicator, while simplifying it, and the portfolio review, without which it would be impossible to assess project quality.

### Conclusion

The reform of MDB concessional windows is part of a comprehensive reform of the mandate of development institutions and the development finance agenda. The main challenge lies in tackling each of the elements within the magic triangle in order to create a new framework (Resources–Allocation–Debt) which will be effective and sustainable.

The proposed reforms, summarised at the beginning of this paper, address these three elements concomitantly, taking account of the profound economic changes which countries are experiencing and the constraints faced by development institutions. But no reform is possible without the political will to lead it.

It is therefore first and foremost for capitals and for shareholders to demonstrate the courage to lead an ambitious and strategic reform agenda for the next decade.

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## Annex 1: Classification of low-income countries according to an assessment of their debt sustainability

**List of LIC DSAs for PRGT-Eligible Countries  
As of May 07, 2015**

Country	Per latest DSA publication			Latest DSA discussed by the Executive Board but not yet published <sup>2/</sup>	Minimum Grant Element
	Latest publication date	Risk of debt distress <sup>1/</sup>	Joint with the World Bank		
Afghanistan	5/21/2014	High	Yes	...	*
Bangladesh	6/2/2014	Low	Yes	...	35
Benin	1/11/2013	Low	Yes	...	*
Bhutan	7/1/2014	Moderate	Yes	...	*
Bolivia <sup>3/</sup>	2/10/2014	Low	No	...	*
Burkina Faso	7/21/2014	Moderate	Yes	...	35
Burundi	4/1/2015	High	Yes	...	50
Cambodia	2/4/2014	Low	Yes	...	*
Cameroon <sup>3/</sup>	7/17/2014	Moderate	Yes	...	*
Cape Verde <sup>3/</sup>	9/25/2014	Moderate	Yes	...	*
Central African Republic	6/16/2014	High	Yes	...	35
Chad	9/16/2014	High	Yes	4/27/2015	35
Comoros	2/13/2015	Moderate	Yes	...	*
Congo, Democratic Republic of	9/30/2014	Moderate	Yes	...	*
Congo, Republic of <sup>3/</sup>	9/4/2014	Low	Yes	...	*
Côte d'Ivoire	12/22/2014	Moderate	Yes	...	35
Djibouti	3/21/2013	High	No	1/30/2015	*
Dominica <sup>3/</sup>	1/28/2013	Moderate	Yes	...	*
Eritrea	...	...	...	12/7/2009	*
Ethiopia	10/3/2014	Low	Yes	...	*
Gambia, The	4/22/2015	Moderate	Yes	...	35
Ghana	4/21/2015	High	Yes	...	35
Grenada <sup>3/</sup>	12/30/2014	In debt distress	No	...	35
Guinea	2/17/2015	Moderate	No	...	35
Guinea-Bissau	11/7/2014	Moderate	No	...	35
Guyana	9/25/2014	Moderate	Yes	...	*
Haiti	4/29/2014	High	Yes	...	*
Honduras	12/24/2014	Moderate	No	...	35
Kenya	2/5/2015	Low	No	...	35
Kiribati	5/27/2014	High	Yes	...	*
Kyrgyz Republic	5/14/2015	Moderate	Yes	...	35
Lao P.D.R.	2/26/2015	Moderate	Yes	...	*
Lesotho	7/11/2014	Moderate	Yes	...	*
Liberia	2/27/2015	Low	No	...	35
Madagascar	7/2/2014	Low	Yes	...	*
Malawi	3/30/2015	Moderate	Yes	...	35
Maldives	3/11/2015	Moderate	Yes	...	*
Mali	12/11/2014	Moderate	Yes	...	35
Marshall Islands	2/3/2014	High	Yes	...	*
Mauritania	2/12/2015	High	Yes	...	*
Micronesia	5/15/2015	High	Yes	...	*
Moldova <sup>3/</sup>	7/8/2014	Low	Yes	...	*
Mongolia <sup>3/</sup>	4/30/2015	High	Yes	...	*
Mozambique	5/30/2014	Moderate	Yes	...	35
Myanmar	10/6/2014	Low	Yes	...	*
Nepal	7/18/2014	Low	Yes	...	*
Nicaragua	12/27/2013	Moderate	Yes	...	*
Niger	3/11/2015	Moderate	Yes	...	35
Nigeria <sup>3/</sup>	3/30/2015	Low	Yes	...	*
Papua New Guinea <sup>3/</sup>	12/2/2014	Low	Yes	...	*
Rwanda	12/12/2014	Low	Yes	...	35
Samoa	6/14/2013	High	Yes	...	*
São Tomé and Príncipe	1/6/2014	High	Yes	...	50
Senegal	1/14/2015	Low	Yes	...	*
Sierra Leone	3/24/2015	Moderate	No	...	35
Solomon Islands	1/22/2014	Moderate	Yes	...	35
Somalia	...	...	...	...	*
South Sudan	12/17/2014	Moderate	Yes	...	*
St. Lucia <sup>3/</sup>	9/9/2011	Moderate	No	10/17/2011	*
St. Vincent and the Grenadines <sup>3/</sup>	12/23/2014	Moderate	No	...	*
Sudan	12/30/2014	In debt distress	Yes	...	*
Tajikistan	6/13/2011	High	Yes	7/19/2013	*
Tanzania	5/15/2014	Low	Yes	...	35
Timor Leste <sup>3/</sup>	12/2/2013	Low	No	9/15/2014	*
Togo	2/7/2014	Moderate	Yes	...	*
Tonga	4/30/2015	Moderate	Yes	...	*
Tuvalu	8/28/2014	High	Yes	4/29/2015	*
Uganda	12/30/2013	Low	No	...	35
Uzbekistan <sup>3/ 4/</sup>	...	...	...	...	*
Vanuatu	6/21/2013	Low	Yes	...	*
Vietnam <sup>3/</sup>	10/16/2014	Low	Yes	...	*
Yemen, Republic of	9/24/2014	Moderate	Yes	...	35
Zambia	1/9/2014	Low	Yes	...	*
Zimbabwe <sup>3/</sup>	7/11/2014	In debt distress	Yes	...	*

<sup>\*/</sup> While there is no binding minimum concessionality requirement in the absence of a Fund-supported program, concessional flows remain the most appropriate source of external finance for LICs, highlighting the need for continued efforts by the international community to improve the availability and predictability of concessional financing (PIN No. 06/136).

<sup>1/</sup> As of May 07, 2015 and based on the most recently published data, 3 countries are in debt distress, 16 countries are at high risk, 30 countries are at moderate risk, and 22 countries are at low risk of debt distress.

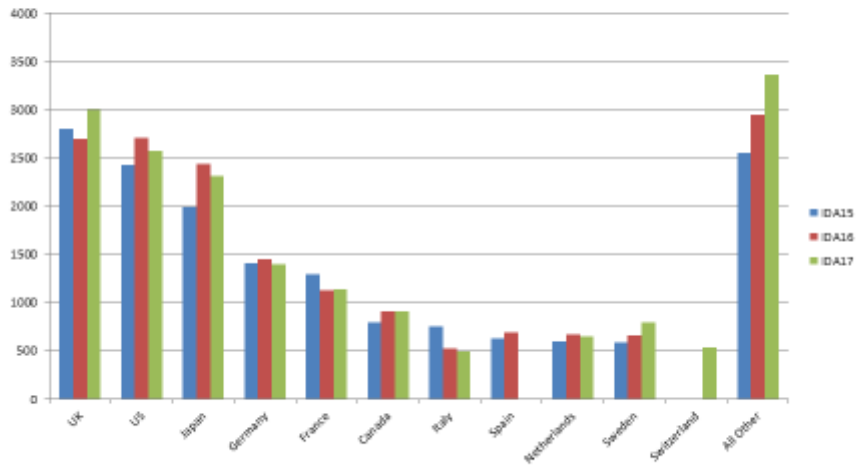
<sup>2/</sup> May reflect usual lags in the publication. Includes DSAs presented to the Executive Board on lapse of time basis.

<sup>3/</sup> PRGT-eligible IDA-blend countries.

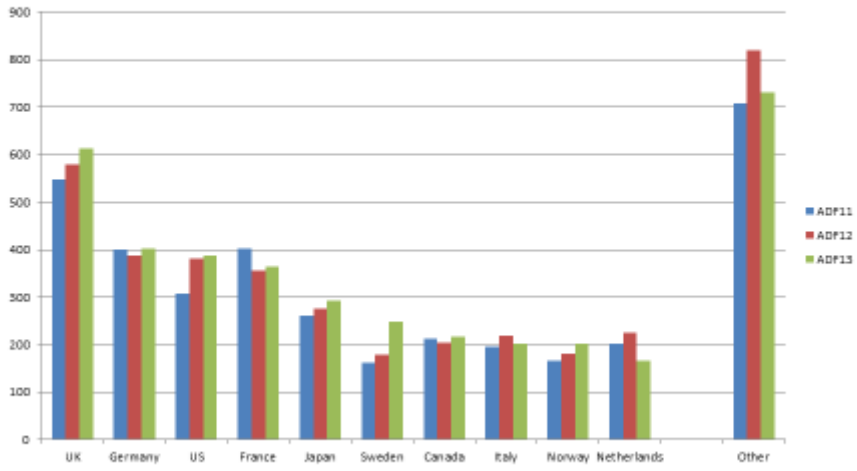
<sup>4/</sup> A market-access countries (MACs) DSA has been completed and published within the past 24 months.

Annex 2: Top ten donors to the IDA, ADF and Global Fund, 2004-2014

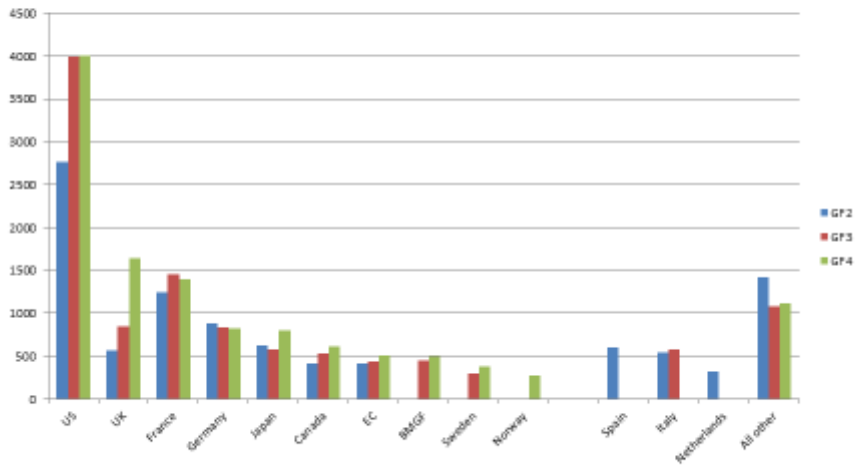
Top 10 donors for IDA (2006-2014)



### Top 10 donors for the AfDB (2006-2014)



### Top 10 donors for the Global Fund (2006-2014)



**Annex 3: Financing terms for concessional loans offered by the World Bank,  
African Development Bank and Asian Development Bank**

Concessional loans		Maturity	Grace period	1st period amortisation rate (years)	2nd period amortisation rate (years)	Service charge (%)	Commitment charge (bp)	Interest charge	Concessio nality
ADF	Regular	40	10	2% (11-20)	4% (21-40)	0.75%	50	0	60%
	Advance	40	5	2.9%	2.9%	0.75%	50	0	55%
	Blend	30	5	4%	4%	0.75%	50	1%	35%
IDA	Regular	38	6	3.125%	3.125%	0.75%	0	0	54%
	Blend	25	5	3.3% (6-15)	6.7% (16-25)	0.75%	0	1%	32%
	Hard term lending	25	5	3.3% (6-15)	6.7% (16-25)	0.75%	0	1.40%	27%
AsDF	Regular and blend	32 for project loans	8	4.17%	4.17%	0	0	1% during grace period	39%
		24 for program loans	8	6.25%	6.25%	0	0	1.5% during amortisati on period	28%

**Annex 5: GNI per capita for IDA (excl. Latin America and the Caribbean),  
AsDF and ADF-only countries (constant US\$ in 2013, Atlas method)**

<b>Concessional window</b>	<b>GNI per capita</b>
Afghanistan (FS)	700
Benin	790
Bhutan	2,460
Burkina Faso	670
Burundi (FS)	280
Cambodia	950
Comoros (FS)	880
Côte d'Ivoire (FS)	1,380
Eritrea (FS)	490
Ethiopia	470
Gambia	510
Guinea	460
Guinea-Bissau (FS)	520
Marshall Islands (FS)	4,200
Solomon Islands (FS)	1,610
Kenya	930
Kiribati (FS)	2,620
Lesotho	1,550
Liberia (FS)	410
Madagascar (FS)	440
Malawi	270
Maldives	5,600
Mali	670
Mauritania	1,060
Mozambique	590
Myanmar (FS)	1,144*
Nauru	6,746*
Nepal	730
Niger	410
DRC (FS)	400
Laos	1,460
Central African Republic (FS)	320
Kyrgyzstan	1,200
Rwanda	620
Samoa	3,430
Senegal	1,070
Sierra Leone (FS)	680
Somalia (FS)	210**
Sudan (FS)	1,130
South Sudan (FS)	1,120
Tajikistan	990
Tanzania	630
Chad (FS)	1,020
Togo (FS)	530
Tonga	4,490
Tuvalu	6,630
Vanuatu	3,130

\*United Nations data, 2011; \*\*United Nations data, 2009



*“Sur quoi la fondera-t-il l'économie du monde qu'il veut gouverner? Sera-ce sur le caprice de chaque particulier? Quelle confusion! Sera-ce sur la justice? Il l'ignore.”*

Pascal



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