IDA14

Debt Sustainability and Financing Terms in IDA14: Further Considerations on Issues and Options

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Selected Abbreviations and Acronyms

CPIA	Country Policy and Institutional Assessment
DSA	Debt Sustainability Analysis
GDP	Gross Domestic Product
GFATM	Global Fund to Fight AIDS, Tuberculosis, and Malaria
GNI	Gross National Income
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
MDG	Millennium Development Goals
MVA	Modified Volume Approach
NPV	Net Present Value
PBA	Performance-Based Allocation
PV	Present Value

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I. Introduction

1. This paper responds to the requests made by Participants at the third meeting of the IDA14 negotiations for more work on selected elements of the proposal[1] to make the primary grant eligibility criterion in IDA14 a country's risk of debt distress. At this meeting, Deputies stressed that while addressing the broad issue of debt sustainability, the new grant allocation system for IDA14 should, to the maximum extent, preserve the performance and incentive aspects of IDA's PBA system, as well as provide poor countries with an adequate volume of resource transfers in order to accelerate progress towards the MDGs.

2. Like the two previous papers, this one takes as its starting point the joint Bank-Fund work on a debt sustainability framework which provides the analytical foundation for the link between debt sustainability and grant eligibility.[2] While the principles underpinning this work have been broadly endorsed by the Deputies, there is also a clear preference for lowering the policy-dependent debt and debt-service thresholds to help lower the overall risk of actual debt distress situations.

3. The paper is organized according to the same road-map as the previous papers, starting with issues related to eligibility criteria, followed by grant allocation issues and lastly financing issues. Section II of this paper assesses the implications of the revised set of thresholds proposed by the staffs of the Bank and the Fund for IDA14 grant eligibility and for the overall grant share. It also contains a discussion on other grant eligibility issues, including exceptional HIV/AIDS grants for IDA-only countries that would be ineligible for grants under a debt distress criterion; grants for regional projects; and the "free rider" problem. Section III examines different options for reallocating the resources from the volume discount on grants associated under the proposed Modified Volume Approach.[3] Section IV focuses on grant-financing issues and discusses the workings of a "hard terms" window proposed to be set up using the charges-related portion of the volume discount. Summary conclusions are presented in Section V and suggested issues for discussion are outlined in Section VI. Updated external debt information and country rankings are presented in the tables in Annex 1. The implications of adopting five, rather than three, grant eligibility categories are examined in Annex 2.

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[1] Refer to IDA(2004a). *Debt Sustainability and Financing Terms in IDA14*, IDA/SecM2004-0327, Washington, D.C., June 24; and IDA (2004b). *Debt Sustainability and Financing Terms in IDA14: Technical Analysis of Issues and Options*, IDA/SecM2004-0640, September 22.

[2] See IMF and World Bank (2004a*), Debt Sustainability in Low-Income Countries – Proposal for an Operational Framework and Policy Implications,* Washington, D.C., February 2004. Henceforth referred to as the "Framework Paper." See also IMF and World Bank (2004b), *Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework and Policy Implications*, Washington, D.C., September 2004, referred to here as the "Modalities Paper".

[3] Box 2 summarizes the main features of the Modified Volume Approach.

II. Grant Eligibility issues: The Impact of Revised Assumptions

4. The Bank-Fund debt sustainability framework links the risk of debt distress to the quality of policies and institutions in low-income countries. A key element of this approach is the use of a set of indicative thresholds of external debt-burden indicators that take into account countries' policies and institutions as well as their vulnerability to exogenous shocks. The Framework Paper (IMF and World Bank [2004a]) uses the Bank's Country Policy and Institutional Assessment (CPIA) index to measure countries' policy and institutional quality and to establish the debt thresholds accordingly. The grant eligibility proposal presented in Hanoi and Washington (IDA [2004a, 2004b]) was based in the original Framework Paper's thresholds.

5. During the Washington, D.C., discussions in October, Deputies stated a preference for more conservative thresholds than those presented in the Framework Paper. More specifically, Deputies asked staff to assess, jointly with the IMF, the implications of setting the debt and debt-service thresholds at levels consistent with a lower overall probability of debt distress. The results of this work – presented in a joint Bank-Fund note[4] to their respective Boards of Executive Directors - and its implications for grant eligibility in IDA14 are summarized in subsection A.

6. Although debt distress risk is proposed to remain the primary grant eligibility criterion in IDA14, a number of other issues may have an impact on eligibility. They include HIV/AIDS operations in countries which are ineligible for grants under the debt-distress criterion, regional projects, and the "free rider" problem. These issues are discussed in subsection B.

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[4] IMF and World Bank (2004c). *Choice of Indicative Debt-Burden Thresholds – Alternative Options*, OM2004-0091, Washington, D.C., November 2004.

Box 1. The "Traffic Light" Grant Eligibility System

The country ranking system proposed in the Hanoi and Washington, D.C. discussions (see IDA [2004a, 2004b]) takes as its starting point a matrix of policy-dependent debt-burden thresholds. This matrix has been updated since the original version (see IMF and World Bank [2004a, 2004c]), and it now contains a more conservative set of debt thresholds (see Table 1 in the main text).

The matrix is converted into a country ranking system through a four-step process:

Step 1: Appropriate debt-burden indicators are selected.

- Revenues-based indicators are excluded due to data availability/comparability issues, as well as the risk of moral hazard.
- The following debt ratios are selected: NPV of debt-to-exports, NPV of debt-to-GDP, and debt service-to-exports.

Step 2: Countries' relative positions with respect to the debt-burden thresholds are measured.

- Percentage distances between actual debt-burden indicators and their respective thresholds are calculated.

Step 3: A decision rule for the debt-burden indicators is established.

- Two variables are computed and compared: (i) the average of the percentages distances of the two stock indicators (NPV of debt-to-GDP and NPV of debt-to-exports ratios) to their respective thresholds; and (ii) the relative distance of the debt service-to-exports ratio to its threshold.
- The number that yields the most conservative (prudent) decision in terms of debt-distress classification is chosen.

Step 4: A "traffic light" is assigned to countries according to the risk of debt distress.

- A "green light" indicates a low risk of debt distress; a "red light" indicates a high risk of debt distress; and a "yellow light" indicates a medium risk of debt distress.

It is important to bear in mind that, once the debt sustainability framework is fully implemented, the mechanism above will give way to a ranking system fully based on the insights generated by debt sustainability analyses (DSAs).

A. Eligibility Based on Revised Debt Thresholds

7. The original policy-dependent debt and debt-service thresholds presented in the Framework Paper were derived from the results of empirical analyses carried out independently at the Bank and the Fund.[5] While this work is robust from an analytical point of view, "it bears emphasizing that the implicit choice of distress probabilities remains a policy decision" as noted in the Framework Paper (*op. cit*., p. 21).

8. Lower thresholds can be generated by reducing the overall probability of distress used to calculate the thresholds, or by classifying countries according to performance in a different manner. The two methods can also be combined. The latter procedure is proposed by Bank and Fund staffs and would imply NPV of debt-to-exports thresholds of 100/150/200.[6] In line with a more cautious approach to the overall probability of debt distress, and with absolute CPIA cut-

[5] For the Bank's empirical analysis, see Kraay, A. and V. Nehru (2004). "When is Debt Sustainable?", *World Bank Policy Research Working Paper*, No. 3200. For the Fund's, see Gottschalk, J. and B. Loko (2003), "Debt Thresholds in Low-Income Countries", *mimeo*, partially replicated as Appendix I of the Framework Paper.

[6] See IMF and World Bank (2004c). Compared to other options considered, the one proposed by Bank and Fund staffs "has the advantage of presenting an internally consistent approach to the tolerable risk of debt distress between the HIPC Initiative and the forward-looking framework, applied to the 'average' country." (p. 2).

offs of 3.25 (weak to medium performance) and 3.75 (medium to strong performance), Table 1 below shows the new proposed thresholds for the NPV of debt-to-exports, as well as for the NPV of debt-to-GDP and debt service-to-exports consistent with the former.

Table 1. Revised Indicative Policy-Dependent Debt and Debt-Service Thresholds

Performance Category	**Debt and Debt-Service Thresholds (%)**		
	NPV of debt-to-GDP	NPV of debt-to-exports	Debt service-to-exports
Weak (CPIA≤3.25)	30	100	15
Medium (3.25<CPIA<3.75)	40	150	20
Strong (CPIA≥3.75))	50	200	25

9. The new CPIA cut-offs imply that fewer countries would be classified as strong performers compared to the previous IDA14 papers on debt sustainability and financing terms (see IDA [2004a, 2004b]). In addition, performance categories would no longer be defined in terms of percentiles. Table 2 shows which countries are now grouped into each performance category.

Table 2. Country Groupings Under New CPIA Cut-Offs

Performance Category	Countries
Strong	(12)
	Armenia, Bhutan, Cape Verde, Grenada, Maldives, Mauritania, Samoa, Sri Lanka, St. Lucia, St. Vincent and the Grenadines, Tanzania, Uganda.
Medium	(32)
	Albania, **Azerbaijan**, Bangladesh, Benin, Bolivia, Bosnia and Herzegovina, **Burkina Faso**, Cameroon, Dominica, Ethiopia, **Ghana**, Guyana, **Honduras**, **India**, **Indonesia**, Kenya, Kyrgyz Republic, Lesotho, **Madagascar**, Malawi, Mali, Mongolia, Mozambique, Nepal, **Nicaragua**, **Pakistan**, Rwanda, **Senegal**, Serbia and Montenegro, **Vietnam**, **Yemen**, Zambia.
Weak	(37)
	Afghanistan, Angola, Burundi, **Cambodia**, CAR, Chad, Comoros, Congo DR, Congo Rep., **Cote d'Ivoire**, **Djibouti**, **Eritrea**, **The Gambia, Georgia**, **Guinea**, Guinea-Bissau, Haiti, Kiribati, Lao PDR, Liberia, **Moldova**, Myanmar, **Niger**, Nigeria, Papua New Guinea, Sao Tome and Principe, **Sierra Leone**, Solomon Islands, Somalia, Sudan, **Tajikistan**, Timor-Leste, Togo, Tonga, Uzbekistan, **Vanuatu**, Zimbabwe

Note: Countries in bold are those that moved from one category to the next compared to IDA(2004b).

10. **Impact on Overall Grant Eligibility.** On the basis of the three-category "traffic light system"[7] originally proposed, 47 countries would become grant-eligible,[8] as indicated in Table 3,

[7] Annex 2 spells out the implications of using a five-category eligibility system under the revised assumptions.

[8] Newly eligible countries are: Uganda, Samoa, Nicaragua, Senegal, Burkina Faso, Kenya, Georgia, Niger, Chad and Tonga. Having reached its Completion Point under the HIPC Initiative on October 20, 2004, Madagascar would be classified as a "green light" country under the "traffic light" system.

up from 37 in the eligibility scenario presented in October (see IDA[2004b]).[9] This increase in the number of countries eligible for IDA grants has a significant impact on the overall share of grants in IDA14 (section III).

Table 3. Grant Eligibility Under the Revised Assumptions

	Number of Countries[10]
Green	19
Yellow	5
Red	40
Special Transitional Cases[11]	2
Number of Grant-Eligible Countries[12]	47

11. It is important to note that the classification presented here is likely to change over the course of IDA14 as the implementation of the second pillar of the of the joint Bank-Fund debt sustainability framework gets underway. This pillar will take a more dynamic view of the risk of debt distress through DSAs.

B. Other Eligibility Issues

12. **Exceptional HIV/AIDS Grants.** A concern with the debt-distress based approach to grant allocation proposed for IDA14 is that it would exclude several *"green light"* IDA-only countries previously eligible under IDA13 for 100 percent grants for HIV/AIDS projects. Deputies may wish to consider whether there remains a case for the provision of 100 percent grant financing for HIV/AIDS operations for "green light" IDA-only countries during the IDA14 period as well as for regional HIV/AIDS operations, or whether the demand for additional HIV/AIDS grants could be met by other available mechanisms such as the Global Fund to Fight AIDS, Tuberculosis, and Malaria (GFATM).

13. Such potential extension of grant eligibility for HIV/AIDS would enable to continue with the policy approach for IDA-only countries[13] in this matter taken in IDA13, but it would also represent an exception to the proposed principle that grants would be allocated on the basis of countries' risk of debt distress. A preliminary estimate of such an exception is that it would increase the grants envelope in IDA14 by about SDR 300 million, based on the FY05 volumes allocated to date to HIV/AIDS operations in "green light" countries and for regional HIV/AIDS programs under IDA13. This corresponds to about 1.3 percent of the base case level proposed for IDA14. The resources for these HIV/AIDS operations would come from countries' regular

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9 Including Kosovo and Timor-Leste.

10 Table 3 excludes blend or hardened-term countries.

11 Kosovo and Timor-Leste. See IDA(2004b, p. 12).

12 Excludes Myanmar for which IDA allocation for FY06-08 is zero.

13 It is assumed that "yellow light" countries would finance HIV/AIDS operations from the grant portion of their allocation.

IDA allocations. Furthermore, to avoid increased costs to IDA in terms of foregone charge income, a 9 percent charges-related volume discount would need to be applied.[14]

14. **Regional Projects**.[15] Deputies may also wish to consider establishing a provision for the grant financing of the portion of the cost of regional projects (other than HIV/AIDS) that is attributable to all IDA-only countries that are eligible for 100 percent grants under the debt-distress criterion (thus excluding those classified as "yellow light"). A reasonable estimate of the associated increase in the grants envelope would be about SDR 495 million, or about 80 percent of the total envelope for regional projects for the IDA14 base case. Again, to avoid additional losses to IDA, a 9 percent volume discount would be applied to the grant component of regional projects.

15. **Restrictions on Grant Eligibility: Blend and "Gap" Countries.** As indicated in previous discussions, grant eligibility would be restricted to IDA-only countries. IBRD/IDA blends, including hardened term "gap" countries and "notional"[16] blends would be excluded. Table 4 below provides a complete list of countries that are grant-ineligible because of their blend status.[17] Given the potential or actual ability of these countries to undertake market-based borrowing, their exclusion from grant eligibility in IDA14 would help allay "free rider" concerns that could be triggered by a grant eligibility mechanism based on the risk of debt distress (see further discussion below on this subject). Other countries subject to IDA lending on hardened terms but which are not IBRD/IDA blends would also be grant-ineligible. They are: Albania, Djibouti, and Honduras.

Table 4: IDA/IBRD Blend Countries

Above operational cut-off	Below operational cut-off	Notional blends
Bosnia-Herzegovina	Azerbaijan	Nigeria
Dominica	Bolivia	Papua New Guinea
Grenada	India	Zimbabwe
St Lucia	Indonesia	
St Vincent	Pakistan	
Serbia & Montenegro	Uzbekistan	

16. **Restrictions on Grant Eligibility: The "Free Rider" Issue.** A possible side effect of the provision of IDA grants to countries with a medium or high risk of debt distress is that these countries' "space for borrowing" from other sources – including export credit agencies – may

[14] See IDA (2004b) and Section IV below for the rationale of applying a charges-related volume discount on grants.

[15] Refer to IDA (2003). *Pilot Program for Regional Projects*. IDA/SecM2003-0532, October 7.

[16] Notional blends are borrowers that have a capacity or history of market-based borrowing and a per capita income below the IDA eligibility threshold, and which are currently unable to borrow from IBRD due to marginal or deteriorating creditworthiness.

[17] Also, refer to Section IV for a discussion on the eligibility issues regarding the access of IBRD/IDA blend countries to a "hard terms" lending window.

expand[18]. Potentially damaging consequences may be associated with the "free rider" issue: first, despite the fact that IDA would be extending grants, the overall risk of debt distress may increase if countries expand non-concessional borrowing in the wake of a reduced share of credits in their IDA portfolios. This is a particularly serious concern for countries that have a history of market-based borrowing. Keeping blend and "gap" countries ineligible for IDA grants alleviates the problem, though there would still be situations in which IDA-only countries are able to borrow on non-concessional terms[19]. Therefore, close coordination among lenders would be needed in order to ensure that grant-making by IDA does indeed help reduce countries' risk of debt distress. Second, if the provision of IDA grants frees up space for increased borrowing from other sources, then IDA would, in effect, be subsidizing other lenders at the expense of its future financial strength.

17. To address this issue, it is proposed that further consideration be given to restricting grant eligibility to those IDA-only countries that are in fact unable or unwilling to borrow commercially. In this vein, staff would continue to explore the feasibility of developing a mechanism whereby a country could cease to be eligible for grants if its government contracts or guarantees new non-concessional loans[20] during any year of IDA14.

III. Grant Allocation Issues: The Incentive-Related Portion of the Volume Discount

18. As discussed in Hanoi and in Washington, under the Modified Volume Approach (see Box 2 for a summary of its main features), it is proposed that an upfront 20 percent discount be applied to grants. This discount would be subdivided in two components, each addressing a different objective: (i) an incentive-related portion (11 percent), to help maintain the strength of IDA's incentive system; and (ii) a charges-related (9 percent) portion, to finance foregone charge income on IDA14 grants. This section focuses on options for reallocating the resources from the incentive-related portion of volume discount.[21] An overview of the main options and issues is presented in subsection A. Details of a PBA-based reallocation mechanism and of set-aside resources to deal with exogenous shocks are presented, respectively, in subsections B and C.

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18 It is important to bear in mind that the "free rider" problem is not exclusively associated with grant-making and already affects IDA to some extent, given the highly concessional terms of its credits. Grants would, however, provide added incentives for "free riders", by creating more fiscal space for non-concessional borrowing, further to the space already produced by concessional IDA lending.

19 This ability may be particularly pronounced in oil-exporting and other mineral-rich low-income countries.

20 A key difficulty is the absence of a unique definition of concessionality. See IMF (2003). *External Debt Statistics: Guide for Compilers and User*, June, pp. 45-46: "There is no unique definition of concessionality, and the *Guide* does not provide nor recommend one. Nonetheless, the definition of the OECD's Development Assistance Committee (DAC) is commonly used. Under the DAC definition, concessional lending (that is, lending extended on terms that are substantially more generous than market terms) includes: (1) official credits with an original grant element of 25 percent or more using a 10 percent rate of discount (that is, where the excess of the face value of a loan from he official sector over the sum of the discounted future debt-service payments to be made by the debtor is 25 percent or more using a 10 percent rate of discount); and (2) lending by the major regional development banks (African Development Bank, Asian Development Bank, and the Inter-American Development Bank) and from the IMF and World Bank, with concessionality determined on the basis of each institutions' own classification of concessional lending. All external debt not classified as concessional should be classified as non-concessional." It is proposed that the DAC definition be used for matters related to IDA14 grants.

21 A proposal on the use of the charges-related portion of the discount on grants is presented in Section IV.

A. Overview of Main Options and Issues

19. The options discussed at the October meeting for using the resources from the 11 percent discount can be subdivided into two groups:[22] (i) mechanisms for automatic reallocation; and (ii) set-aside funds established for a specific purpose.

20. ***Ex Ante* Reallocation Mechanisms.** The first group included the reallocation modality based on an income criterion included in IDA (2004b), as well as a PBA-based reallocation mechanism discussed at the October meeting. While the former would present desirable features such as privileging the poorest countries in the access to additional resources, difficulties in establishing an analytically-justified income cut-off and the overall weakness of the economic rationale behind it would make it less attractive as an operational mechanism, therefore ruling it out as an option. A PBA-based mechanism, on the other hand, would directly address the reasons why an incentive-related volume discount on grants would be made in the first place. Subsection B spells out the implications of a PBA-based reallocation mechanism in detail.

21. **Set-asides for Specific Purposes.** The second group included: (i) setting aside resources for grants-based HIV/AIDS operations in countries otherwise ineligible for grants; (ii) creating an incentive mechanism to reward stronger export performance; and (iii) setting aside resources to address exogenous shocks on an *ex post*, contingency basis. As noted in subsection IIB, it would be more practical to practical to fund an exceptional HIV/AIDS grants option for "green light", IDA-only countries from their PBA envelopes, rather than from a set-aside fund for that purpose.[23] Therefore, the discussion that follows will focus only on options (ii) and (iii).

22. Although both an export incentive mechanism and a facility against shocks have distinct advantages and disadvantages, they share one basic common feature. They would require IDA resources to be *earmarked,* which in turn implies a reduction in the level of resources that are allocated through IDA's regular PBA system. Specific earmarks have been avoided in IDA in view of long-standing consensus that IDA resources should be allocated according to broad measures of performance, and be programmed at the country level in accordance with country-driven development priorities.

23. As an incentive mechanism, option (ii) could exacerbate the distortionary aspects of earmarking, since its narrow focus would unduly privilege trade-related issues over and above other elements considered in the much wider PBA system. Therefore, the adoption of such a mechanism for IDA14 is not recommended. The earmarking of resources to address shocks on an *ex post* basis faces similar issues, but would have greater synergy with the proposed debt-distress-based framework. This possibility is examined in greater detail in subsection C below.

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[22] Most of such options are discussed in greater detail in IDA (2004b).

[23] Funding HIV/AIDS grants from countries' regular IDA envelopes rather than from a set-aside fund helps preserve equity across countries and maintain consistency with IDA13 policies, besides facilitating management at the operational level.

Box 2. The Modified Volume Approach

The Modified Volume Approach – discussed in detail in Hanoi and Washington (see IDA [2004a, 2004b]) - can be briefly described in three steps:

Step 1: Allocate volumes based on the Performance Based Allocation system, as is currently the practice.
Step 2: Assign grant and credit shares for each country's volumes, as follows:

- Low risk of debt distress : credits = 100 percent.
- Medium risk of debt distress : grants = 50 percent, credits = 50 percent.
- High risk of debt distress : grants = 100 percent.

Step 3: Apply a 20 percent upfront volume discount on all grants.

Through the upfront volume discount, the Modified Volume Approach provides a balance between needs and incentives in the determination of IDA resource flows to poor countries:

(i) It helps maintain a strong relationship between resource transfers and policy performance; and
(ii) This would be achieved without relying on too drastic a volume cut, which would lessen the impact on countries' prospects of achieving the MDGs.

B. Implications of a PBA-Based Reallocation Mechanism

24. The main concern addressed by the application of the proposed 11 percent incentive-related volume discount on grants would be the preservation of IDA's incentive structure in light of increased concessionality in IDA14, while avoiding excessively large volume cuts that could hamper the progress of the poorest countries in achieving the MDGs.[24] Therefore, the chosen reallocation mechanism for the resources thus generated should strive to minimize the risk of introducing any potential distortions in IDA's incentive system.

25. The most natural and neutral mode of reallocation of the resources from the discount would be through the use of a PBA-based rule. This mechanism is also very simple: the resources from the incentive-related portion of the volume discount would be distributed to all IDA-only countries[25] according to their share in the PBA norm[26] (net of the share in the PBA norm of blends and hardened-term countries). The terms of such reallocation would be determined by the "traffic light system": the credits and grants mix for the reallocated resources would be the same as in the first round of allocation of IDA resources, that is, in accordance with countries' risk of debt distress. Grant eligibility would also continue to be restricted to IDA-only countries. For those countries receiving additional resources in the form of grants, no further volume discount would be applied.

26. The overall grant share in IDA14 using the Modified Volume Approach *and* a PBA-based reallocation mechanism would be determined through the following steps:

- Step 1: Allocate volumes in accordance with the PBA system.

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24 See IDA (2004a), for a fuller discussion of these trade-offs.

25 Redistribution is restricted to IDA-only countries because blend and hardened-term countries were a priori excluded from the pool of grant beneficiary countries for equity reasons. Since they were not among those which could be targeted for volume cuts (given that they are grant-ineligible), blends and hardened-term countries should not benefit from the reallocation of the resources generated by the discount.

26 After taking into account allocation adjustments made for ECA, EAP, and LCR in the FY06-08 base case.

- Step 2: Assign grant and credit shares for IDA-only countries according to the "traffic light" system[27].
- Step 3: Apply a 20 percent upfront volume discount on all grants.
- Step 4: Reallocate resources from the incentive-related portion of the volume discount[28] (11 percent) to IDA-only according to a PBA-based mechanism.
- Step 5: Apply the "traffic light" system to determine the terms of such reallocation.

27. Table 5 shows the grant shares that result from these various steps, using the base case for the FY06-08 IDA14 needs projections[29].

Table 5. Calculating the Overall Grant Share

	Grant Share in the Projected IDA14 Envelope (%)
Before any discount	33.0
After 20% discount	26.4
After reallocation	28.1
After HIV/AIDS Grants	29.3
After regional project grants	31.3
Memo	
Upfront Volume Discount 1/	1596.1
Of which	
Incentive-related Portion 1/	838.6
Charge-related Portion 1/	757.6

Note: 1/ in SDR million. IDA14 base case scenario.

28. **Implications for the Overall Grant Share.** The post-reallocation overall grant share simulated on the basis of IDA's projected FY06-08 envelope would be 28.1 percent, substantially higher than the 22-23 percent shares previously estimated, after the application of steps 1-5 above. It is important to emphasize that the above numbers should be interpreted as indicative, as the grant-credit mix in IDA14 may be affected by factors such as updated external debt numbers, changes in countries' performance, and debt-distress risk ratings emerging from DSAs.

29. The overall grant share is estimated to increase to about 29.3 percent if "green light", IDA-only countries are given exceptional access to up to 100 percent grant financing of HIV/AIDS operations and if HIV/AIDS regional projects are fully grant-financed. If a provision is made for the grant financing of the share in the total cost of non-HIV/AIDS regional projects

[27] Exceptional HIV/AIDS grants and grants for regional projects would be allocated in this step.
[28] Resources from the charges-related portion of the volume discount (9%) would be set aside for a hard terms window and would return to countries only in the form of credits. See discussion in Section IV.
[29] Table A.5 replicates the results of the grant share determination process for the low-case and high-case scenarios.

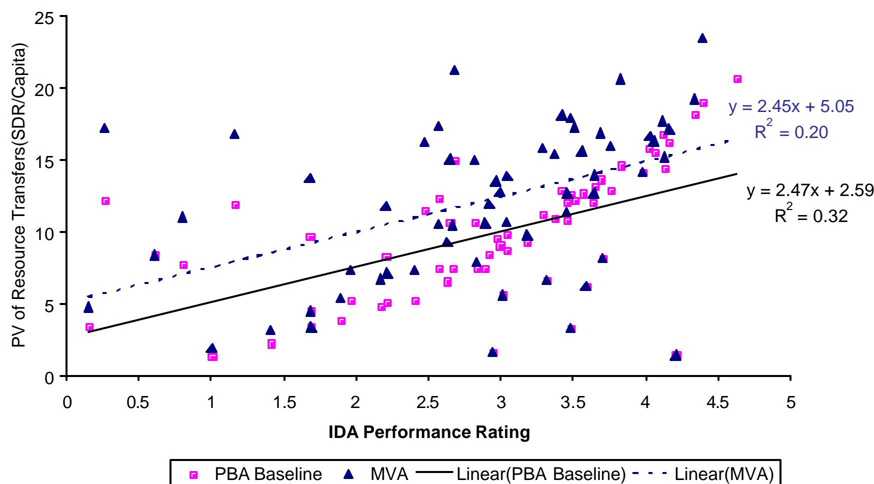
attributable to IDA-only countries eligible for 100 percent grants, the overall grant share would be estimated to rise to 31.3 percent.

30. Given the uncertainty inherent to a system that determines grant allocations endogenously, Deputies raised the possibility of setting a cap on the overall grant share, as discussed in October (see IDA [2004b]). A key policy decision in this regard is the choice of the level at which a cap would be set. If the cap is set at a level which is likely to be reached within the IDA14 period, then a rationing system for grants would need to be put in place and the overall grant share would no longer be completely endogenous. Different rationing options were examined in detail in IDA (2004b).

31. **Impact on Resources from Volume Discount.** A wider country grant coverage and a higher overall grant share would generate larger resources from the 20 percent volume discount – estimated at about SDR1,596 million, compared to SDR 926 million as presented in IDA (2004b). The amount available for a PBA-based reallocation would be SDR 839 million, while the remaining SDR 757 million from the 9 percent charges-related discount would be used for a "hard terms" lending window (see Section IV).

32. **Implications for IDA's Incentive Structure.** The combination of more conservative thresholds, revised CPIA cut-offs, and a PBA-based mechanism to reallocate resources from the volume discount helps maintain the strength of the correlation between the present value of IDA's resource transfers and the IDA performance rating. This is clearly shown in Chart 1, which plots the post-reallocation present value of IDA's resource transfers against performance.

Chart 1. Correlations Between Resource Transfers and Performance After PBA-Based Reallocation



33. The post-reallocation regression line indicates that resource transfers in present value terms would become more responsive to cross-country variations in performance in comparison with the undiscounted volume approach as presented in the first two papers (see IDA [2004a, 2004b]), and would be nearly parallel to the pre-grants PBA baseline regression line (estimated for the FY06-08 base case scenario). This reflects the fact that better-performing IDA-only countries would be the main beneficiaries of the volume redistribution under the PBA-based rule for the reallocation of the resources from the 11 percent discount on grants.

34. **Implications of Using a Five-Category Eligibility System.** The introduction of a "five-light" system would increase country grant coverage, facilitating smoother transitions between eligibility categories. Although it would lead to a somewhat higher overall grant share (see annex 2 for details) if only a debt-distress criterion is used, its increased grant coverage would reduce the need for the provision of exceptional HIV/AIDS grants to "green light", IDA-only countries. In fact, seven countries would become newly eligible for grants on the basis of the debt-distress criterion, and could finance eventual HIV/AIDS operations out of their regular debt-distress-based grant allocations. In the end, the overall grant share under a "five-light" system is not expected to differ much from that emerging from the "traffic light" system.

35. However, as discussed in the October meeting, the introduction of additional grant eligibility categories and the relatively greater ease with which countries could move from one "light" to another in-between fiscal years may complicate operational planning both at the program and at the project level and increase uncertainty with respect to the terms applicable to countries. Such operational concerns would tend to weaken the "five-light" system as an alternative to the proposed "traffic-light" mechanism. Therefore, this paper recommends that a three-category grant eligibility system as proposed in Hanoi and in Washington be adopted.

C. Setting Up a Shocks Facility

36. Exogenous shocks are an important explanatory variable in predicting episodes of debt distress. The provision of additional resources to mitigate the impact of shocks would therefore be a logical complement to the debt-distress-based grant eligibility system. Shocks are partly captured through the proposed system (since they affect the macroeconomic variables used to calculate the debt-burden indicators, and consequently the terms of IDA assistance). However, the ability of governments in low-income countries to carry out essential expenditures in the short-term may be hampered in the face of an exogenous shock.[30] Whereas IDA does not necessarily have a comparative advantage in providing short-term assistance for shocks, there has been considerable interest amongst Deputies in making a "shocks facility" available for IDA14. This would be aimed at providing a faster *ex post* volume response to shocks as they occur, conceivably reducing the long-term impact of shocks on growth.

37. To be effectively counter-cyclical, resources in response to a shock need to be provided quickly. In fact, the timeliness and volume of financing in response to a shock seems to be more important than simply changing terms in the event of a shock. As described in the March 2004 Technical Briefing Paper to the Board of Executive Directors on shocks, several instruments designed by the international community to address them in a more systematic way have failed to be fully effective largely due to lack of timeliness. If a decision is made to proceed on the issue of a shocks facility, IDA would need to review and build on past experience with *ex post* shocks facilities.[31]

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[30] For instance, if governments are hit by shocks and lack supplemental finance, this could lead them to adopt short-term adjustment measures such as delaying important longer-term reforms or postponing expenditures in other programs, including possibly poverty-focused spending.

[31] See World Bank (2004). *Exogenous Shocks in Low Income Countries: Policy Issues and the Role of the World Bank*, March 8. Its annexes I and II provide a preliminary assessment of past and current experiences with addressing shocks on an *ex post* basis in the Bank, IMF, and European Union.

38. The frequency and severity of shocks in low-income countries seems to have been increasing over time, and low-income countries are disproportionately affected by shocks. Thus, the *sheer magnitude* of shocks in IDA countries in any given year is likely to lead to costs that would significantly outstrip the resources available from the 11 percent discount. For instance, it is estimated that in 2004 the impact of the oil price shock alone on low-income countries that are net importers was equivalent to approximately over one quarter of total IDA lending for that year. The mismatch between resources needed and available, and the inherent difficulty of predicting shocks, would create a difficult rationing problem to prevent a first-come, first-served allocation. At the same time, some IDA resources could have the potential to catalyze additional grant assistance from bilateral and other donors to help mitigate the impact of shocks.

39. IDA policies (such as OP8.50 and 8.60) have been used to address certain types of shocks, especially natural disasters. However, IDA's ability to respond depends on the availability of unused resources within a given replenishment period. Before IDA12, there was greater flexibility within IDA to provide resources in response to shocks. This flexibility has been reduced by greater capacity among countries to fully utilize their IDA allocations. This lack of flexibility has been particularly noteworthy towards the end of a replenishment period, as reflected in comparatively smaller carry-overs of resources from previous replenishments.[32] Making resources available as a facility for shocks would help address this resource constraint. On the other hand, such an approach would then require *earmarking* a certain volume of IDA when available resources could otherwise be fully utilized for PBA-allocated development purposes.[33]

40. The greatest difficulty of any *ex post* instrument to deal with commodity price shocks is the inherent complexity of shocks and the difficulty in defining upfront what constitutes an exogenous shock for operational purposes.[34] This is further complicated by the need to ensure that such assistance does not prevent adjustment where required, or introduce other distortionary incentives. The difficulty in defining a shock for operational purposes is especially noteworthy for terms of trade fluctuations which are often only pinpointed as shocks with the benefit of hindsight. It can also be difficult to distinguish between temporary fluctuations and structural relative price shifts. These lags in determining the extent of shocks, especially for the slow-onset variety, would affect the ability to provide timely assistance.

41. While analytical work on exogenous shocks and their impact on low income countries is currently underway in both the Bank and the Fund, additional research would be needed in order to explore whether a methodology can be developed to address shocks more systematically. The current Bank work plan follows up on World Bank (2004). Several key areas will be subject to further review, including: a) further analytical work on the impact of shocks on growth, debt and debt distress, and possible mitigation approaches; b) further research to determine what

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[32] As noted in IDA (2004a), the carryover from IDA12 was solely due to exchange rate movements at the end of the replenishment. For IDA13 the carryover is once again expected to be close to zero as all resources are expected to be fully committed.

[33] Given the magnitude of the shocks faced by low-income countries and to avoid diverting IDA assistance away from country assistance strategies, an alternative would be to establish a separate "shocks facility" to be administered by IDA, but funded with resources additional to the proposed IDA14 base case.

[34] See World Bank (2004): "There is no consistent definition of shocks. This is because distinguishing shocks from volatility is largely a matter of degree." (p. 4).

constitutes an exogenous shock, especially a "terms-of-trade" shock; c) an in-depth review of current *ex post* instruments to deal with shocks, and further exploration of potential criteria and limitations for more systematic *ex post* assistance; and d) a review of potential *ex ante* instruments to deal with shocks.

42. Given the uncertainty around the practical aspects of a systematic IDA facility to respond to shocks it is recommended that a PBA-based reallocation mechanism be adopted for the use of the resources from the 11 percent volume discount. Staff will continue to explore the feasibility of using these resources to respond to shocks, and will prepare a paper on this topic for the IDA14 Mid-Term Review. The impact of a shocks facility on the overall grant share would ultimately depend on the specific countries that would receive financial support through this mechanism. Terms of assistance would be determined on the basis of a country's "traffic light" (and grant assistance would continue to be restricted to IDA-only countries).

IV. Grant Financing Issues: The Charges-Related Portion of the Volume Discount

43. The provision of grants by IDA entails lost reflows to IDA from both foregone principal reflows and foregone charge income. During the IDA14 meetings in Hanoi and Washington donors reaffirmed their commitment to finance the foregone principal reflows through additional donor contributions on a pay-as-you-go basis. With respect to the foregone charge income from the provision of grants they asked for further work on how these resources would be used. Foregone charge income equals 9 percent of the face value of a standard IDA credit. This is equivalent to 45 percent of the total volume discount of 20 percent, or SDR 757 million as per the base case for the FY06-08 IDA14 needs projections.[35]

44. The 9 percent volume discount would only address the financing of foregone charge income due to IDA14 grants. Foregone principal reflows resulting from IDA14 grants, which represent some 75 percent of the total value of foregone reflows due to these grants, are not being covered through this volume discount. Foregone principal due to IDA14 grants would again be financed by donors on a pay-as-you-go basis. This Section focuses on the use of resources generated by the 9 percent volume reduction.

45. For IDA13, donors agreed to adopt a two-step approach to finance IDA13 grants. First, donors would provide financing of foregone charge income on IDA13 grants through additional contributions in IDA14. Second, donors would provide financing for foregone principal as and when these losses are incurred, on a pay-as-you-go basis.[36]

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[35] The 9% volume discount represents the NPV of foregone service charges (fixed 0.75 percent per annum) and commitment charges (assumed at 0.50 percent per annum) on a regular IDA credit. The level of IDA commitment charges varies from year to year in the range of 0 to 0.50 percent to ensure coverage of IDA's administrative expenses. If commitment charges were to be set at 0 percent, the NPV of foregone charges would fall to about 8%. For FY05, IDA's commitment charge has been set at 0.35 percent per annum, and it is expected that commitment charges for FY06-08 would range between 0.30 percent and 0.50 percent. Therefore, the NPV of foregone charges would be set at 9 percent level for the IDA14 period.

[36] "Modalities of IDA13 Grant Financing: Technical Note", May 2004.

46. There are two possibilities with respect to the resources from 9 percent discount: (i) to invest these resources as part of IDA's liquid assets; or (ii) to find a development oriented purpose for these resources. It was the latter possibility that generated the most interest during the October meeting, specifically the possibility of making the resources available for lending to IBRD/IDA blend countries, by creating a "hard terms" lending window. This would constitute an "investment" for IDA, and is an approach that could also be used for donors' contributions to cover foregone charges on grants in IDA13.

47. In effect, to ensure adequate financing of IDA for foregone charge income due to IDA grants, the use of grant financing resources would need to follow two general principles: (i) achieving a rate of return on investment that is similar to the discount rate applied to calculate the net present value of foregone losses; and (ii) matching the investment horizon to the long-term cash flow profile from foregone reflows under IDA credits. These objectives could be accomplished by hardening the lending terms through an interest rate charged on top of standard IDA charges.

48. It should be noted that if Deputies decide not to use the 9 percent volume reduction for lending to blend countries at hard terms, then the corresponding SDR volume of IDA14 resources would reduce the IDA14 commitment authority envelope by an equivalent amount, because these resources would remain invested in IDA's liquid assets. Furthermore, unlike for other credit reflows, all future reflows (including principal payments) resulting from lending at "hard terms" would be used to cover the share of IDA's administrative expenses related to IDA14 grants; they would not be available to support new IDA assistance commitments under future replenishments.

A. Establishing the 9 Percent Volume Reduction on Grants

49. In calculating the cost of IDA14 grants, Management applied a 6 percent discount rate. This rate represents the long-term average return on IDA's liquid assets and is the same as the current fixed-rate equivalent of the IBRD lending rate.[37]

50. When applying the 6 percent discount rate for IDA14, the net present value (NPV) of foregone service charges (fixed at 0.75 percent per annum) and commitment charges (assumed fixed at 0.50 percent per annum) is about 9 percent of the face value of an IDA grant. This NPV calculation assumes a regular IDA credit, with a 40-year maturity and a 10-year grace period, because this would be the alternative use of funds in the absence of grants in IDA14.

B. Investing in Blend Borrowers at "Hard Terms"

51. **Current IDA Terms**. IDA lending terms to IBRD/IDA blend borrowers feature 35 years of maturity including 10-years of grace, zero interest, 0.75 percent per annum fixed service

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[37] The average return on IDA's investment portfolio over the 10-year period FY1994-2004 was 5.8%. The fixed-rate equivalent of IBRD's USD-based lending products is used as a proxy for the alternative cost of SDR-based borrowing for IDA countries. The swap rate between a 30-year US Treasury security (the longest maturity available) and 3-month LIBOR was around 5.4% as of Sept. 30, 2004, and IBRD's USD-based lending products currently feature a 57 bp average all-in spread over LIBOR, making the fixed-rate equivalent around 6%.

charge on outstanding balances, and 0 – 0.50 percent per annum variable commitment charge on undisbursed balances.[38] Starting in IDA13, IDA introduced "hardened terms", reducing IDA credit maturity to 20 years including 10 years of grace, with standard IDA charges. These terms are applicable for borrowers with per capita income above the operational cut-off of $895 (in FY05) for more than two consecutive years.[39]

52. **Interest Rate on Outstanding Balances**. The grant element measures the degree of concessionality of IDA credits. For a standard 35-year credit to a blend country, the grant element at a discount rate of 6 percent is about 57 percent. In today's dollars, for a $100 credit to a blend country, IDA would therefore receive reflows over the 35 year maturity period of $43, resulting in a $57 economic loss to IDA. Table 6 below establishes the 57 percent grant element for the standard 35-year maturity of blend borrowers. The table shows various lower grant elements when applying interest rates of between 1.0 and 4.9 percent per annum, to be charged on top of standard IDA service and commitment charges. As shown, to arrive at a grant element of zero percent, the interest rate would need to be 4.9 percent.

53. To ensure sufficient borrower interest in a hard terms IDA lending window, the interest rate to be charged should be sufficiently more concessional than the prevailing IBRD lending rate, converted into fixed-rate equivalents.[40] Therefore, IDA could set the interest charge for hard terms at a certain spread below the IBRD lending rate. Using a possible spread of 200 basis points below the IBRD lending rate in fixed-rate terms, this would mean an interest rate of currently about 4.0 percent. At this rate, IDA would forego about 11 percent of the economic value needed to ensure full financing of charges, as shown in Table 6. This could be regarded as an acceptable loss level for being able to extend additional IDA financing to blend countries at concessional lending rates, rather than investing these resources as part of IDA's liquid assets. This loss would be covered through IDA's internal resources (future investment income), hence slightly reducing IDA's future lending capacity.

54. The interest rate for the hard terms window would be re-set annually for the next fiscal year, using the end-of-fiscal-year IBRD fixed-rate equivalent lending rate over 40 years. This would occur in conjunction with the annual determination of the level of IDA commitment charges for the following fiscal year[41].

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38 An acceleration clause has been included in IDA's credit agreements, since 1987 and modified in 1996, which enables a doubling of repayments to IDA from borrowers where per capita income has exceeded the operational cut-off for three consecutive years.

39 No acceleration clause is provided for these credits. For a complete list of IDA/IBRD eligibility and lending terms, go to www1.worldbank.org/operations/wbopcs/Preports/Report_Annex_D.asp.

40 Note that even the "harder terms" proposed would still fall within IDA's mandate under its Article of Agreement of providing financing on terms that "bear less heavily on the balance of payments than conventional loans", and would still be on terms that could not be provided by the IBRD.

41 An alternative approach to hard term lending that would be financially equivalent would be to reduce the amount to be disbursed by a certain percentage to be deducted from the credit principal, while keeping the nominal interest charge at zero percent and requiring the full repayment of the principal at standard IDA terms. In order for IDA not to incur a loss, the up-front reduction would have to be 57% of the amount to be disbursed. This option is not being considered due to the resulting large reduction in disbursed funds.

Table 6: Interest Rates and Resulting Grant Elements

Interest rate	Grant element
0.0%	57%
1.0%	46%
2.0%	34%
3.0%	22%
4.0%	11%
4.9%	0%

C. Eligibility for Lending at "Hard Terms"

55. Blend countries represent a special category of countries with access to both IDA and IBRD resources. While blend countries are IDA-eligible based on the income criterion, they also have limited creditworthiness for IBRD lending. There are three groups of blend countries in IDA: six middle-income blends above the operational IDA cut-off, including some small-island economies; six low-income blends below the operational cut-off; and three so-called 'notional' blends. Current blend countries along these three categories are listed in Table 4.

56. When investing the grant financing resources in blend countries, as an alternative to investments in IDA's liquid assets, IDA faces significant country credit risk. To reduce these risks, lending through the hard terms window would be restricted to creditworthy blend countries with per capita incomes below the operational cut-off for IDA but with an active IBRD lending program.[42] This would currently include Indonesia, India, and Pakistan.

57. As mentioned in the previous notes on this subject, the resources under the hard terms lending window would be additional to country allocations under IDA's performance-based allocation system. Allocating these resources in proportion to the performance-based allocations in IDA14 for the above three eligible blend countries would result in the following: 57.8 percent for India, 36.4 percent for Pakistan, and 5.8 percent for Indonesia.

58. In view of the limited volume of the resources from the 9 percent discount on grants, this window is not expected to have any material impact on the demand for IBRD lending by blend countries.

59. Should the actual demand for IDA credits on hard terms be lower than the resources available under the proposed new window, then the balance of resources would be invested in IDA's liquid assets to generate the required investment returns.

[42] As evidenced in the base-case lending scenario in the CAS.

V. Conclusions

60. The revised debt and debt-service thresholds and the new absolute cut-offs for the CPIA, when combined with the "traffic light" system for grant eligibility would imply a broader country grant eligibility coverage, leading to a higher pre-volume discount grant share (33.3 percent) than that presented in Hanoi and Washington (22 – 23 percent).

61. The provision of grants by IDA runs the risk of increasing countries' space for additional borrowing from other sources, including non-concessional ones. To help reduce such risk, it is recommended that a mechanism be devised whereby a country could cease to be eligible for grants if its government contracts or guarantees new non-concessional loans during any year of IDA14.

62. After the application of a 20 percent volume discount, but before any reallocation of resources from such discount, the overall grant share becomes 26.6 percent. Since the grant share is higher, the 20 percent volume discount generates a higher level of resources than those shown in IDA (2004b). Under the current scenario these resources amount to approximately SDR 1,540 million.

63. If a PBA-based reallocation mechanism for the resources from the 11 percent discount is adopted, and provisions are made for exceptional HIV/AIDS grants as well as for regional project grants, *an overall grant share of 31.3 percent would result*. This percentage should be treated as indicative, since factors such as changes in country performance, updated external debt information, and debt distress risk ratings from DSAs may affect the grant-credit mix of the IDA envelope. In addition, this reallocation mode helps restore the strength of the relationship between the present value of IDA resource transfers and the IDA performance rating vis-à-vis the pre-grants PBA baseline.

64. An alternative use of the resources from the incentive-related portion of the volume discount would be to set aside resources to help provide an *ex post* response facility to shocks on a contingency basis. This would help address a key determinant of a country's risk of debt distress, which has not thus far been addressed in the grant allocation system. However, there are major unanswered questions and issues (as noted in subsection IIIB) and, therefore, it is recommended that further work be conducted to develop a systematic approach to determining eligibility for accessing these resources. A PBA-based rule for the reallocation of the resources would need to be adopted as an interim measure, while a possible alternative eligibility system for the set-aside resources is being explored. The overall grant share resulting from this option is estimated to range from 26.4 to 31.3 percent of the IDA envelope, depending on the countries – and their applicable IDA terms from the "traffic light" system – that would benefit from assistance under a shocks facility.

65. **On balance, given the operational intricacies involved in developing the eligibility criteria for a successful shocks facility, a PBA-based mechanism for reallocating the resources from the 11 percent volume discount seems to be the appropriate course of action for IDA14**. This could be reevaluated in light of emerging results from the ongoing review of shocks in the Bank, which would be discussed with Deputies at the Mid-Term Review.

66. The complexity and innovative nature of the proposed debt-distress-based grant-allocation system may require further refinements and some degree of fine-tuning once its implementation is underway. Again, the Mid-Term Review will provide an opportunity to assess the extent to which the proposed system will meet Deputies' expectations, and a progress report will be produced by the time of the Review to facilitate their assessment.

VI. Issues for Discussion

67. Deputies may wish to comment on the implications for grant eligibility of revised assumptions regarding CPIA cut-offs and debt thresholds, as well as on the paper's recommendations on different reallocation options for the resources from the proposed 20 percent volume discount on grants.

- Do Deputies agree that, on balance, a three-category "traffic light" system outweighs an alternative five-category eligibility system on the grounds of practical implementability?
- Would Deputies consider an option in which, consistent with practice under IDA13, HIV/AIDS programs for "green light" IDA-only countries and regional HIV/AIDS projects would be fully financed by grants?
- Would Deputies contemplate making a provision for the grant financing of the share attributable to grant-eligible, IDA-only countries in the total cost of non-HIV/AIDS regional projects?
- Would Deputies consider making a provision for the grant financing of the portion of the cost of regional projects (other than HIV/AIDS) attributable to IDA-only countries eligible to 100 percent grants under the debt-distress criterion?
- Do Deputies agree that a mechanism be developed whereby a country could cease to be eligible for grants if its government contracts or guarantees new non-concessional loans during any year of IDA14?
- In light of the uncertainty regarding the overall level of grants in IDA14, would Deputies consider the introduction of a cap on the overall grant share, along the lines discussed in Hanoi and Washington, D.C.?
- Do Deputies agree that, on balance, a PBA-based reallocation mechanism for the resources from the 11 percent volume discount seems to be the appropriate course of action for IDA14?

68. Deputies may wish to express their views on the options presented in the paper for using the resources from the charges-related portion of the volume discount on grants (9 percent discount) for a hard-term lending window in IDA14, as an alternative to investing the funds as part of IDA's liquid assets.

- Do Deputies agree that the resources generated by the 9 percent volume reduction on IDA14 grants could be used for a hard terms lending window, at regular blend credit terms, with an interest rate set at 200 basis points below the long-term fixed-rate equivalent of the IBRD lending rate, to be reset annually?

- Do Deputies agree that country eligibility would be restricted to blend countries with sufficient IBRD creditworthiness, as well as with a per capita income below the operational cut-off for IDA, and that resources be allocated on a pro-rata basis according to IDA's performance-based allocation system?

Annex 1. Tables

Table A. 1. Policy-Dependent Debt and Debt-Service Thresholds Applied to Low-Income Countries

	NPV/GDP [1/]	NPV/EXP [2/]	DS/EXP [2/]
Strong (CPIA≥3.75)	50	200	25
Cape Verde	42.0	155.3	12.7
Sri Lanka	47.0	125.7	11.7
St. Lucia [3/]	61.3	106.5	6.9
St. Vincent and the Grenadines [3/]	46.9	95.3	7.4
Uganda	33.1	288.4	10.2
Grenada [3/]	71.7	136.9	11.8
Tanzania	23.1	156.2	3.5
Armenia	31.7	133.3	13.2
Maldives	32.8	44.0	4.8
Samoa	64.3	211.2	9.8
Bhutan	58.4	267.0	4.9
Mauritania	79.9	213.2	7.5
Medium (3.25<CPIA<3.75)	40	150	20
Nicaragua	38.8	161.1	10.4
Senegal	38.8	138.3	8.7
Honduras [4/]	46.8	124.5	16.0
India [3/]	16.1	119.9	19.0
Vietnam	32.3	64.9	6.8
Pakistan [3/]	43.7	256.8	27.6
Burkina Faso	23.3	233.2	5.9
Ghana	41.0	101.1	5.8
Indonesia [3/]	75.7	199.6	25.9
Madagascar [5/]	26.8	136.6	5.6
Yemen, Rep.	34.1	87.0	4.2
Azerbaijan [3/]	18.2	46.5	7.8
Bangladesh	23.2	159.5	10.5
Bolivia [4/]	37.7	196.4	23.4
Nepal	31.2	123.0	7.0
Benin	29.6	145.4	5.6
Mali	43.4	178.6	8.4
Bosnia and Herzegovina [4/]	33.9	135.5	12.0
Rwanda	39.7	540.6	17.3
Serbia and Montenegro [4/]	78.4	448.3	5.5
Albania [4/]	18.5	106.2	7.1
Dominica [3/]	74.6	143.4	8.4
Kenya	37.0	153.4	15.5
Lesotho	59.2	130.7	20.3
Cameroon	53.4	184.0	13.6
Mongolia	56.6	119.8	8.8
Malawi	46.6	175.7	7.3
Zambia	116.3	423.1	30.5
Kyrgyz Republic	81.3	225.7	29.4
Mozambique	34.5	74.6	2.8
Guyana	80.1	85.2	2.6
Ethiopia [6/]	35.1	216.2	11.4

	NPV/GDP [1/]	NPV/EXP [2/]	DS/EXP [2/]
Poor (CPIA£3.25)	30	100	15
Moldova	76.2	169.1	31.3
Georgia	41.5	171.7	16.0
Gambia, The	76.0	104.8	6.8
Niger	26.6	176.1	11.2
Chad	31.6	217.4	10.3
Guinea	45.1	176.2	16.7
Sierra Leone	90.8	771.5	24.8
Cote d'Ivoire	80.4	210.9	18.6
Djibouti [4/]	37.0	98.3	5.4
Tonga	36.0	171.7	9.5
Eritrea	52.6	253.0	7.6
Vanuatu	23.4	37.0	1.5
Cambodia	66.7	156.1	1.3
Tajikistan	74.3	120.4	10.6
Congo, D.R.	147.3	818.9	90.3
Congo, Rep.	162.1	201.3	1.0
Burundi	104.4	1324.8	41.1
Papua New Guinea [3/]	85.9	108.4	12.5
Lao PDR	85.2	291.1	9.1
Nigeria [3/]	72.3	153.3	7.3
Guinea-Bissau	211.3	735.7	23.9
Comoros	75.0	567.0	14.2
Sao Tome and Principe	223.4	681.2	37.0
Uzbekistan [3/]	44.8	132.7	22.4
Togo	84.1	263.6	3.0
Sudan	117.4	857.3	1.3
CAR	71.2	704.2	0.8
Haiti	23.3	174.4	5.8
Angola	86.1	131.3	11.6
Zimbabwe [3/]	47.1	194.0	2.9
Solomon Islands	54.1	104.3	4.6
Liberia	438.7	1765.7	0.6
Myanmar	0.8	164.9	15.3
Afghanistan	11.3	202.8	..

Notes:
1/ In ratios, both the numerator and denominator refer to 2002 data.
2/ In ratios, the numerator refers to 2002 data and the denominator refers to the three-year average of 2000-2002.
3/ Blend-term country.
4/ Hardened-term country.
5/ Ratios reflect full delivery of debt relief under the HIPC initiative ("Memorandum and Recommendation of the President of the IDA to the Executive Directors on Assistance to the Republic of Madagascar under the Enhanced HIPC Initiative", Table 14, p.41, the World Bank, Oct. 2004).
6/ NPV/GDP and NPV/Exp ratios are those excerpted from its DSA (2004). As per discussion in Box 1 in the main text of IDA (2004a), Ethiopia's debt stock ratios are those of its updated DSA insofar as it indicates that the ratios will breach their respective thresholds within the IDA 14 period.

.. Not available.
* Ratios are in percent.
* Grey highlights indicate ratios above the indicative thresholds.
* NPV of debt and debt service data for completion-point HIPCs are the latest available. Uganda's NPV-of-debt data reflects its latest DSA.

* NPV of debt data for decision-point HIPCs do not reflect unconditional delivery of debt relief under the initiative.
* Exports comprise the total value of goods and services exported as defined in the IMF Balance of Payments Manual, Version 5 (BPM5).

Table A.2. Percentage Distances from Indicative Thresholds and Rankings Based on Individual Indicators

	Percentage Distances from Indicative Threshold			Ranking of Debt Distress [3/]		
	NPV/GDP	NPV/EXP	DS/EXP	NPV/GDP	NPV/EXP	DS/EXP
Strong (CPIA ≥ 3.75)						
Cape Verde	16.0	22.3	49.1	1	1	1
Sri Lanka	6.0	37.2	53.2	2	1	1
St. Lucia [1/]	-22.7	46.8	72.4	3	1	1
St. Vincent and the Grenadines [1/]	6.3	52.4	70.2	2	1	1
Uganda	33.8	-44.2	59.1	1	3	1
Grenada [1/]	-43.3	31.6	52.8	3	1	1
Tanzania	53.8	21.9	86.1	1	1	1
Armenia	36.7	33.4	47.2	1	1	1
Maldives	34.4	78.0	80.8	1	1	1
Samoa	-28.5	-5.6	60.7	3	2	1
Bhutan	-16.8	-33.5	80.3	3	3	1
Mauritania	-59.8	-6.6	70.1	3	2	1
Medium (3.75<CPIA<3.25)						
Nicaragua	3.0	-7.4	48.1	2	2	1
Senegal	3.1	7.8	56.3	2	2	1
Honduras [2/]	-17.0	17.0	20.0	3	1	1
India [1/]	59.8	20.1	5.1	1	1	2
Vietnam	19.2	56.7	66.2	1	1	1
Pakistan [1/]	-9.3	-71.2	-38.0	2	3	3
Burkina Faso	41.7	-55.5	70.6	1	3	1
Ghana	-2.6	32.6	70.9	2	1	1
Indonesia [1/]	-89.2	-33.1	-29.5	3	3	3
Madagascar	32.9	8.9	72.2	1	2	1
Yemen, Rep.	14.7	42.0	79.0	1	1	1
Azerbaijan [1/]	54.5	69.0	60.9	1	1	1
Bangladesh	42.0	-6.3	47.5	1	2	1
Bolivia [2/]	5.7	-31.0	-16.8	2	3	3
Nepal	21.9	18.0	64.9	1	1	1
Benin	25.9	3.0	72.1	1	2	1
Mali	-8.6	-19.1	58.2	2	3	1
Bosnia and Herzegovina [2/]	15.3	9.7	39.8	1	2	1
Rwanda	0.8	-260.4	13.6	2	3	1
Serbia and Montenegro [2/]	-96.1	-198.9	72.4	3	3	1
Albania [2/]	53.7	29.2	64.4	1	1	1
Dominica [1/]	-86.5	4.4	58.1	3	2	1
Kenya	7.6	-2.3	22.7	2	2	1
Lesotho	-47.9	12.9	-1.7	3	1	2
Cameroon	-33.6	-22.7	32.0	3	3	1
Mongolia	-41.6	20.1	56.1	3	1	1
Malawi	-16.4	-17.1	63.7	3	3	1
Zambia	-190.7	-182.0	-52.4	3	3	3
Kyrgyz Republic	-103.1	-50.5	-47.0	3	3	3
Mozambique	13.8	50.3	86.0	1	1	1
Guyana	-100.1	43.2	87.2	3	1	1
Ethiopia	12.2	-44.2	43.1	1	3	1

	Percentage Distances from Indicative Threshold			Ranking of Debt Distress [3/]		
	NPV/GDP	NPV/EXP	DS/EXP	NPV/GDP	NPV/EXP	DS/EXP
Poor (CPIA£3.25)						
Moldova	-153.9	-69.1	-108.7	3	3	3
Georgia	-38.2	-71.7	-7.0	3	3	2
Gambia, The	-153.2	-4.8	54.5	3	2	1
Niger	11.2	-76.1	25.6	1	3	1
Chad	-5.4	-117.4	31.1	2	3	1
Guinea	-50.5	-76.2	-11.3	3	3	3
Sierra Leone	-202.7	-671.5	-65.0	3	3	3
Cote d'Ivoire	-168.1	-110.9	-24.0	3	3	3
Djibouti [2/]	-23.2	1.7	64.0	3	2	1
Tonga	-20.1	-71.7	36.9	3	3	1
Eritrea	-75.2	-153.0	49.3	3	3	1
Vanuatu	22.0	63.0	90.1	1	1	1
Cambodia	-122.3	-56.1	91.1	3	3	1
Tajikistan	-147.8	-20.4	29.2	3	3	1
Congo, D.R.	-391.0	-718.9	-502.1	3	3	3
Congo, Rep.	-440.4	-101.3	93.4	3	3	1
Burundi	-247.9	-1224.8	-174.2	3	3	3
Papua New Guinea [1/]	-186.3	-8.4	16.4	3	2	1
Lao PDR	-183.9	-191.1	39.5	3	3	1
Nigeria [1/]	-141.1	-53.3	51.6	3	3	1
Guinea-Bissau	-604.4	-635.7	-59.2	3	3	3
Comoros	-150.0	-467.0	5.5	3	3	2
Sao Tome and Principe	-644.6	-581.2	-146.9	3	3	3
Uzbekistan [1/]	-49.2	-32.7	-49.1	3	3	3
Togo	-180.4	-163.6	80.2	3	3	1
Sudan	-291.4	-757.3	91.6	3	3	1
CAR	-137.3	-604.2	94.5	3	3	1
Haiti	22.3	-74.4	61.1	1	3	1
Angola	-187.0	-31.3	22.9	3	3	1
Zimbabwe [1/]	-56.9	-94.0	80.9	3	3	1
Solomon Islands	-80.4	-4.3	69.4	3	2	1
Liberia	-1362.4	-1665.7	95.7	3	3	1
Myanmar	97.4	-64.9	-2.1	1	3	2
Afghanistan	62.5	-102.8	100.0	1	3	1

Notes:
.. Not available.
1/ Blend-term country.
2/ Hardened-term country.
3/ Based on option 2 of the classification system, whereby "1" indicates green light, "2" yellow light, and "3" red light (see Annex 2.C in IDA (2004a)).

Table A.3. Composite Index for Countries According to Risk of Debt Distress

	Percentage Distances from Indicative Threshold				Debt Distress Country Ranking [3/]
	NPV/GDP	NPV/EXP	Two-Stock Average (a)	DS/EXP (b)	(a) or (b), according to the decision rule
Strong (CPIA≥3.75)					
Cape Verde	16.0	22.3	19.2	49.1	1
Sri Lanka	6.0	37.2	21.6	53.2	1
St. Lucia [1/]	-22.7	46.8	12.1	72.4	1
St. Vincent and the Grenadines [1/]	6.3	52.4	29.3	70.2	1
Uganda	33.8	-44.2	-5.2	59.1	2
Grenada [1/]	-43.3	31.6	-5.9	52.8	2
Tanzania	53.8	21.9	37.9	86.1	1
Armenia	36.7	33.4	35.0	47.2	1
Maldives	34.4	78.0	56.2	80.8	1
Samoa	-28.5	-5.6	-17.0	60.7	3
Bhutan	-16.8	-33.5	-25.1	80.3	3
Mauritania	-59.8	-6.6	-33.2	70.1	3
Medium (3.75<CPIA<3.25)					
Nicaragua	3.0	-7.4	-2.2	48.1	2
Senegal	3.1	7.8	5.4	56.3	2
Honduras[2]	-17.0	17.0	0.0	20.0	2
India [1/]	59.8	20.1	39.9	5.1	2
Vietnam	19.2	56.7	37.9	66.2	1
Pakistan [1/]	-9.3	-71.2	-40.3	-38.0	3
Burkina Faso	41.7	-55.5	-6.9	70.6	2
Ghana	-2.6	32.6	15.0	70.9	1
Indonesia [1/]	-89.2	-33.1	-61.1	-29.5	3
Madagascar	32.9	8.9	20.9	72.2	1
Yemen, Rep.	14.7	42.0	28.3	79.0	1
Azerbaijan [1/]	54.5	69.0	61.8	60.9	1
Bangladesh	42.0	-6.3	17.8	47.5	1
Bolivia [2/]	5.7	-31.0	-12.6	-16.8	3
Nepal	21.9	18.0	20.0	64.9	1
Benin	25.9	3.0	14.5	72.1	1
Mali	-8.6	-19.1	-13.9	58.2	3
Bosnia and Herzegovina [2/]	15.3	9.7	12.5	39.8	1
Rwanda	0.8	-260.4	-129.8	13.6	3
Serbia and Montenegro [2/]	-96.1	-198.9	-147.5	72.4	3
Albania [2/]	53.7	29.2	41.4	64.4	1
Dominica [1/]	-86.5	4.4	-41.0	58.1	3
Kenya	7.6	-2.3	2.6	22.7	2
Lesotho	-47.9	12.9	-17.5	-1.7	3
Cameroon	-33.6	-22.7	-28.1	32.0	3
Mongolia	-41.6	20.1	-10.7	56.1	3
Malawi	-16.4	-17.1	-16.8	63.7	3
Zambia	-190.7	-182.0	-186.4	-52.4	3
Kyrgyz Republic	-103.1	-50.5	-76.8	-47.0	3
Mozambique	13.8	50.3	32.0	86.0	1
Guyana	-100.1	43.2	-28.5	87.2	3
Ethiopia	12.2	-44.2	-16.0	43.1	3

	Percentage Distances from Indicative Threshold				Debt Distress Country Ranking [3/]
	NPV/GDP	NPV/EXP	Two-Stock Average (a)	DS/EXP (b)	(a) or (b), according to the decision rule
Poor (CPIA£3.25)					
Moldova	-153.9	-69.1	-111.5	-108.7	3
Georgia	-38.2	-71.7	-54.9	-7.0	3
Gambia, The	-153.2	-4.8	-79.0	54.5	3
Niger	11.2	-76.1	-32.4	25.6	3
Chad	-5.4	-117.4	-61.4	31.1	3
Guinea	-50.5	-76.2	-63.3	-11.3	3
Sierra Leone	-202.7	-671.5	-437.1	-65.0	3
Cote d'Ivoire	-168.1	-110.9	-139.5	-24.0	3
Djibouti [2/]	-23.2	1.7	-10.8	64.0	3
Tonga	-20.1	-71.7	-45.9	36.9	3
Eritrea	-75.2	-153.0	-114.1	49.3	3
Vanuatu	22.0	63.0	42.5	90.1	1
Cambodia	-122.3	-56.1	-89.2	91.1	3
Tajikistan	-147.8	-20.4	-84.1	29.2	3
Congo, D.R.	-391.0	-718.9	-555.0	-502.1	3
Congo, Rep.	-440.4	-101.3	-270.9	93.4	3
Burundi	-247.9	-1224.8	-736.4	-174.2	3
Papua New Guinea [1/]	-186.3	-8.4	-97.4	16.4	3
Lao PDR	-183.9	-191.1	-187.5	39.5	3
Nigeria [1/]	-141.1	-53.3	-97.2	51.6	3
Guinea-Bissau	-604.4	-635.7	-620.1	-59.2	3
Comoros	-150.0	-467.0	-308.5	5.5	3
Sao Tome and Principe	-644.6	-581.2	-612.9	-146.9	3
Uzbekistan [1/]	-49.2	-32.7	-40.9	-49.1	3
Togo	-180.4	-163.6	-172.0	80.2	3
Sudan	-291.4	-757.3	-524.4	91.6	3
CAR	-137.3	-604.2	-370.7	94.5	3
Haiti	22.3	-74.4	-26.0	61.1	3
Angola	-187.0	-31.3	-109.1	22.9	3
Zimbabwe [1/]	-56.9	-94.0	-75.4	80.9	3
Solomon Islands	-80.4	-4.3	-42.3	69.4	3
Liberia	-1362.4	-1665.7	-1514.0	95.7	3
Myanmar	97.4	-64.9	16.2	-2.1	2
Afghanistan	62.5	-102.8	-20.2	100.0	3

Notes:
1/ Blend-term country.
2/ Hardened-term country.
3/ Based on option 2 of the classification system, whereby "1" indicates green light, "2" yellow light, and "3" red light (see Annex 2.c in IDA (2004a)).

Table A.4. Volume Allocations and Grant Shares, using the Modified Volume Approach

		Modified Volume Approach				
		Allocation			*Memo*	
Country	FY06-08 Norm (a)	After a 20% Discount on Grants (b)	Final Volume after PBA-based Reallocation (c)	Grants Share in Final Volume	20% Discount (a)-(b)	Reallocation of 11% (c)-(b)
Strong (CPIA³3.75)						
Cape Verde	19	19	20	0%	0	1.0
Sri Lanka	451	451	476	0%	0	24.3
St. Lucia[1/]	7	7	7	0%	0	0.0
St. Vincent & the Grenadines[1/]	5	5	5	0%	0	0.0
Uganda	735	661	701	45%	73	39.6
Grenada[1/]	4	4	4	0%	0	0.0
Tanzania	1057	1057	1114	0%	0	57.0
Armenia	82	82	87	0%	0	4.4
Maldives	6	6	7	0%	0	0.3
Samoa	6	5	5	100%	1	0.3
Bhutan	34	27	29	100%	7	1.8
Mauritania	96	77	82	100%	19	5.2
Medium (3.75<CPIA<3.25)						
Nicaragua	112	100	106	45%	11	6.0
Senegal	213	192	203	45%	21	11.5
Honduras [2/]	134	134	141	0%	0	7.2
India[1/]	2590	2590	2590	0%	0	0.0
Vietnam	1231	1231	1297	0%	0	66.4
Pakistan[1/]	1550	1550	1550	0%	0	0.0
Burkina Faso	266	240	254	45%	27	14.4
Ghana	522	522	550	0%	0	28.2
Indonesia [1/]	585	585	585	0%	0	0.0
Madagascar	455	455	479	0%	0	24.5
Yemen, Republic of	332	332	350	0%	0	17.9
Azerbaijan[1/]	199	199	199	0%	0	0.0
Bangladesh	1674	1674	1764	0%	0	90.3
Bolivia[2/]	119	119	119	0%	0	0.0
Nepal	526	526	554	0%	0	28.3
Mali	229	183	195	100%	46	12.3
Benin	169	169	178	0%	0	9.1
Bosnia-Herzegovina[2/]	82	82	82	0%	0	0.0
Rwanda	197	157	168	100%	39	10.6
Serbia & Montenegro[2/]	86	86	86	0%	0	0.0
Albania[2/]	51	51	51	0%	0	0.0
Dominica[1/]	3	3	3	0%	0	0.0
Kenya	448	403	427	45%	45	24.2
Lesotho	29	23	25	100%	6	1.6
Cameroon	192	153	164	100%	38	10.3
Mongolia	45	36	39	100%	9	2.4
Malawi	224	179	191	100%	45	12.1
Zambia	188	150	160	100%	38	10.1
Kyrgyz Republic	81	65	69	100%	16	4.4
Mozambique	366	366	386	0%	0	19.7
Guyana	18	15	16	100%	4	1.0
Ethiopia	1426	1141	1218	100%	285	76.9

Country	FY06-08 Norm (a)	Modified Volume Approach				
		Allocation			*Memo*	
		After a 20% Discount on Grants (b)	Final Volume after PBA-based Reallocation (c)	Grants Share in Final Volume	20% Discount (a)-(b)	Reallocation of 11% (c)-(b)
Poor (CPIA£3.25)						
Moldova	64	51	54	100%	13	3.4
Georgia	45	36	38	100%	9	2.4
Gambia, The	22	17	19	100%	4	1.2
Niger	141	113	120	100%	28	7.6
Chad	68	54	58	100%	14	3.7
Kiribati[3/]	3	3	4	0%	0	0.2
Guinea	84	67	71	100%	17	4.5
Sierra Leone	92	73	78	100%	18	4.9
Cote d'Ivoire	231	185	197	100%	46	12.5
Djibouti [2/]	9	9	9	0%	0	0.5
Tonga	3	2	3	100%	1	0.2
Eritrea	76	61	65	100%	15	4.1
Vanuatu	4	4	4	0%	0	0.2
Cambodia	79	63	67	100%	16	4.2
Tajikistan	78	62	66	100%	16	4.2
Congo, DR	1021	817	872	100%	204	55.1
Congo, Republic of	65	52	55	100%	13	3.5
Burundi	175	140	150	100%	35	9.4
Papua New Guinea[1/]	31	31	31	0%	0	0.0
Lao PDR	43	35	37	100%	9	2.3
Nigeria[1/]	1029	1029	1029	0%	0	0.0
Guinea-Bissau	11	9	9	100%	2	0.6
Comoros	5	4	5	100%	1	0.3
Sao Tome & Principe	4	3	4	100%	1	0.2
Uzbekistan[1/]	95	95	95	0%	0	0.0
Togo	18	14	15	100%	4	0.9
Sudan	634	507	541	100%	127	34.2
Central African Republic	9	7	7	100%	2	0.5
Haiti	106	85	91	100%	21	5.7
Angola	223	178	190	100%	45	12.0
Zimbabwe [1/]	187	187	187	0%	0	0.0
Solomon Islands	3	2	2	100%	1	0.1
Afghanistan	563	450	480	100%	113	30.3
Liberia	69	55	59	100%	14	3.7
Myanmar	0	0	0	0%	0	0.0
Somalia	0	0	0	0%	0	0.0
Timor-Leste[4/]	31	25	27	100%	6	1.7
Kosovo [5/]	10	8	9	100%	2	0.5
Total[6/]	**22172**	**20648**	**21486**	**28.1%[7/]**	**1525**	**839**

Notes:

* As in IDA 13, it is assumed that blend and hardened-term countries would be excluded from grant eligibility.
* Unit: in SDR million unless otherwise specified.

1/ Blend-term country (100% credits).
2/ Hardened-term country (100% credits).
3/ No data on debt available. 100% of credits assumed.
4/ Special transitional case. 100% grants assumed (see IDA, 2004b).
5/ Part of Serbia and Montenegro under UN administration. 100% grants assumed (see IDA, 2004b).
6/ Excludes regional projects and the provision for Iraq.
7/ Excludes grants for regional projects as well as exceptional HIV/AIDS grants.

Table A.5. Overall Grant Shares for Low and High Case Scenarios in FY06-08

	Low	**High**
Before any discount	33.1	32.3
After 20% discount	26.5	25.8
After reallocation	28.3	27.5
After HIV/AIDS grants	29.6	28.6
After regional project grants	31.7	30.4
Memo		
Upfront Volume Discount	1485.3	1678.9
Of which		
Incentive-related Portion (11%)	777.6	884.1
Charges-related Portion (9%)	707.7	794.8

Annex 2. Replicating the Analysis under a "Five-Light" Eligibility System

As described in Section IIA of IDA (2004b), a debt-distress-based ranking system with five categories would have different cut-offs. A "green light" is assigned to countries with relevant debt indicators between 25 percent below the applicable threshold and lower; a "blue light" to countries between 10 and 25 percent below the threshold; a "yellow light" to countries between 10 percent below and 10 percent above the threshold; an "orange light" to countries between 10 and 25 percent above the threshold; and a "red light" to countries 25 percent above the threshold and higher.

For IDA-only countries, the grant-credit mix in this system would be determined as follows:

- "Red": 100 percent grants.
- "Orange": 75 percent grants, 25 percent credits.
- "Yellow": 50 percent grants, 50 percent credits.
- "Blue": 25 percent grants, 75 percent credits.
- "Green": 100 percent credits.

In terms of country grant coverage, seven IDA-only countries would become newly-grant eligible compared to the results from the "traffic light" system discussed in Section III of the main text. They are: Bangladesh, Benin, Cape Verde, Ghana, Madagascar, Nepal, and Sri Lanka. Those are "green light" countries under a three-category structure that become "blue light" under a five-category system. They would be assigned 25 percent rather than zero grants. In addition, seven IDA-only countries would move from a "red light" under the "traffic light" system to an "orange light" under the five-category scheme. They are: Afghanistan, Ethiopia, Lesotho, Malawi, Mali, Mongolia, and Samoa. They would be assigned 75 percent rather than 100 percent grants[43].

The net effect of these changes would be a small, but not negligible, increase in the overall grant share, for all FY06-08 scenarios. These results are shown in Table A.6 below.

[43] After a 20% volume discount is applied, and a PBA-based reallocation of the resources from the incentive-related portion of the discount takes place, the post-reallocation grant percentages applicable to different country categories would be: (i) "greens": 0 percent; (ii) "blues": 21 percent; (iii) "yellows": 45 percent; (iv) "oranges": 71 percent; and (v) "reds": 100 percent.

Table A.6. "Five-Light" System: Grant Shares for Different FY06-08 Scenarios

Grant Share in the Projected FY06-08 Envelope (%)	Low	Base	High
Before any discount	34.44	34.35	33.7
After 20% discount	27.6	27.5	26.9
After reallocation	29.5	29.4	28.8
Memo			
20% Volume Discount 1/	1470.4	1589.3	1677.4
Of which			
Incentive-related Portion (11%) 1/	808.7	874.1	922.6
Charges-related Portion (9%) 1/	661.7	715.2	754.8

Note: 1/ in SDR million. Excludes grants for regional projects as well as exceptional HIV/AIDS grants.

The base-case scenario would result in a post-reallocation overall grant share of 29.4 percent, compared to 28.1 percent under the "three-light" system. The resources from the 20 percent volume discount would also increase from SDR1,525 million to SDR1,589 million. In part, these results would reflect the fact that Ghana and Madagascar, despite having recently reached their Completion Points under the Enhanced HIPC Initiative, would still be eligible for some grants under IDA14.

Chart A.1 indicates that IDA's incentive system would be somewhat strengthened vis-à-vis a three-category system. In fact, the post-reallocation regression line indicates that per capita resource transfers in present value terms would become more responsive to cross-country variations in performance in comparison with that obtained under the "traffic light system" (Chart 1 in the main text). The regression line becomes clearly steeper than the pre-grants PBA-baseline regression. This is explained mainly by the fact that resource transfers in present value terms increased (decreased) to relative better (worse) performers, namely, formerly "green" ("red") countries that became "blue" ("orange").

Chart A.1. Correlations Between Resource Transfers and Performance After PBA-Based Reallocation in the Five-Light System