



IDA14

Modalities of IDA13 Grant Financing
Technical Note

International Development Association
March 2004

1. During the IDA14 discussions on February 18-20, 2004 in Paris, Deputies reaffirmed their commitment to maintain and safeguard IDA's financial strength. With this in view, Deputies decided to explore a grant financing proposal for IDA13 grants which would provide a commitment for full financing in IDA14 of foregone charges, and financing of foregone principal reflows as these arise over the longer term.
2. Specifically, the proposal is to approach the financing of IDA13 grants in two segments:
 - The first segment would consist of foregone service and commitment charges reflecting IDA's costs of doing business. These foregone charges would be financed by donor contributions in IDA14 which will be additional to donors' regular IDA14 contributions.
 - The second segment would consist of foregone principal reflows associated with IDA13 grants. These foregone reflows (which occur over a time frame of 11-40 years) would be financed by additional donor contributions as they arise (i.e., on a pay-as-you-go basis).
3. Deputies have asked IDA Management to prepare a technical note detailing the proposal on IDA13 grant financing by donors. This note builds on the detailed technical analysis of two earlier notes which were prepared by Management for the IDA13 Mid-Term Review in November 2003¹ and the IDA14 meetings in Paris in February 2004.² Specifically, this note follows up on the above-mentioned proposal for IDA13 grant financing and illustrates how the financing of foregone charges would translate into additional donor contributions in IDA14. The modalities for converting the financing of foregone principal reflows into donor contributions would be addressed by Deputies during future IDA replenishments, as and when foregone reflows arise.

I. Background

4. Assuming that IDA will deliver 19.5% of the total envelope of development assistance as grants during the IDA13 period (FY03-05), IDA will forego about SDR 4.1 billion of nominal reflows over a 40-year period.³ Since IDA credits do not carry interest charges and are of a very long maturity, the NPV of these foregone reflows is significantly lower, equivalent to approximately SDR 1,436 million.⁴

¹ *Compensating IDA for the Cost of IDA13 Grants*, IDA, October 2003.

² *Further Options for IDA13 Grant Financing*, IDA, January 2004.

³ The value of 19.5% is the mid-point of the agreed share of grants of 18-21% of total IDA13 resources.

⁴ Regular IDA credits have a maturity of 40 years with a grace period of 10 years. NPVs (Net Present Value) represent the value today of a future stream of payments. They are calculated using a 5% discount rate per annum and have been valued as of the start of the IDA14 period in FY06, that is, as of July 2005. A 5% discount rate has been used in all prior discussions and notes on the subject of IDA13 grant financing.

5. Of this amount, SDR 1,064 million represents the NPV of foregone principal repayments, while the balance of SDR 371 million represents the NPV of foregone service charge (SDR 324 million) and commitment charge (SDR 47 million) income.⁵ Table 1 shows the detailed breakdown of foregone credit reflows due to IDA13 grants by principal repayments, service charge income and commitment charge income.

Table 1: Estimated Foregone Reflows due to IDA13 Grants

Item	Nominal Terms		NPV Terms 1/	
	(SDR million)	(in %)	(SDR million)	(in %)
Principal Repayments Foregone	3,413	84%	1,064	74%
Service Charge Income (0.75%) Foregone	603	15%	324	23%
Commitment Charge Income (0.50%) Foregone	50	1%	47	3%
Total Foregone Reflows from IDA13 Grants	4,065	100%	1,436	100%

1/ NPVs are valued as of July 2005 (FY06)

II. Additional Donor Contributions During IDA14

6. To finance the foregone charge income of SDR 371 million (in NPV terms), donors would make financing contributions in addition to their regular IDA14 contributions. The specific amount of additional donor commitments in IDA14 would vary depending on the time schedule for encashments to be applied for these donor contributions. The longer the period of encashment, the larger the resulting nominal amount of additional donor commitments.⁶

7. In the note prepared for the IDA13 Mid-Term Review in November 2003, Management used a 3-year encashment schedule for illustrative purposes, assuming three equal annual payments of donors' additional IDA14 commitments.⁷ Under this 3-year encashment schedule, the nominal amount of additional IDA14 donor commitments would equal approximately SDR 410 million.

8. In recent IDA replenishments, donors have used both 6-year and 9-year encashment schedules. Table 2 provides the encashment profiles for these schedules. The choice of encashment schedule is typically not finalized until the last meeting of a replenishment round. As was the practice during previous IDA replenishments, individual countries would have the option to agree with IDA on alternative encashment schedules while maintaining the present value of their payments. Grant financing contributions by donors

⁵ It is assumed that IDA grants continue to carry no commitment charge, while IDA credits would carry a service charge of 0.75% p.a. and a commitment charge of 0.5% p.a. as is currently the case.

⁶ A longer encashment schedule would result in more substantial discounting of donor payments in outer years due to the discount rate applied, therefore reducing the present value of these payments.

⁷ Compensating IDA for the Cost of IDA13 Grants, IDA, October 2003, paras. 18-20.

would carry IDA voting rights and burden-sharing arrangements for IDA13 grant financing would follow those in IDA13.

9. As shown in Table 2, when applying a 6-year encashment schedule, additional donor commitments in IDA14 would equal approximately SDR 450 million in order to reach the agreed target NPV value (SDR 371 million) for foregone service and commitment charge income due to IDA13 grants. When applying a 9-year encashment schedule, additional donor commitments in IDA14 would equal approximately SDR 470 million.

Table 2: IDA Encashment Schedules and IDA14 Financing Amounts

Fiscal Years	Donor Encashments (in %)			
	Upfront	3-year Schedule	6-year Schedule	9-year Schedule
1	100.0	33.3	5.4	3.0
2	-	33.3	13.1	10.0
3	-	33.3	22.0	16.0
4	-	-	24.5	18.0
5	-	-	23.4	16.0
6	-	-	11.6	13.0
7	-	-	-	10.0
8	-	-	-	8.0
9	-	-	-	6.0
Total Encashments	100	100	100	100
Discount Rate Applied		5.0%	5.0%	5.0%
Total in NPV Equivalent		90.8	83.2	79.2
IDA14 Financing Amounts for IDA13 Grants				
(SDR Million nominal)	371	410	450	470

10. The specific SDR amounts for each donor relating to the additional donor contributions in IDA14 can only be determined once Deputies have decided on the type of encashment schedule for IDA14. Annex 1 lists the SDR amounts to be contributed by each donor under a 6-year and a 9-year encashment schedule.⁸ Donor commitments would be expressed in SDR terms. SDR commitments would be converted into the same payment currencies, and at the same exchange rates, as applicable for donors' regular contributions to the IDA14 replenishment.

11. As in previous replenishments, the IDA13 arrangements included a "structural financing gap" of about 9% of total donor contributions.⁹ For the IDA13 grant financing payments, that gap amounts to between SDR 42 million and SDR 44 million, depending on whether a 6-year or 9-year encashment schedule is selected. To fill this gap, the following IDA13 resources would be used: (i) an amount of about SDR 29 million (representing the pro-rata share for charge income) from the GBP 100 million (SDR 112.9 million) financing contribution made by the United Kingdom contingent upon agreement by

⁸ Deputies would, in any event, discuss and agree on burden-sharing terms for their regular IDA14 contributions during the IDA14 discussions, as has been the practice in previous IDA replenishments.

⁹ The structural financing gap arises because the burden shares of all donors do not add up to 100%.

Deputies on financing IDA13 grants; and (ii) an amount in the range of SDR 13 million and SDR 15 million (depending on whether a 6-year or 9-year encashment schedule is used) from the SDR 100 million allocation set aside during IDA13 as a carry-over item from IDA12 to finance the long-term cost of IDA13 grants. Details on the proposed use of these two financing items are provided in Annex 1.

III. Additional Donor Contributions During Subsequent IDA Replenishments

12. As described above, donors would finance foregone income from service charge and commitment charge through additional contributions in IDA14. By contrast, foregone principal reflows due to IDA13 grants would be financed over time as they arise (i.e., on a pay-as-you-go basis). Table 3 summarizes the expected profile of foregone principal reflows over 40 years.¹⁰ The modalities for converting these foregone principal reflows into donor contributions would be addressed by Deputies during future IDA replenishments.

Table 3: Foregone Principal Reflows due to IDA13 Grants

Fiscal Years	Annual Principal Reflows (in SDR million nominal)
2013	23
2014	46
2015-2022	68
2023	91
2024	114
2025-2042	137
2043	91
2044	46
Total Volume	3413

¹⁰ Foregone credit reflows are based on the assumption that IDA13 grants would be provided in equal annual volumes during fiscal years 2003-2005.

**Annex 1: IDA14 Donor Contributions for IDA13 Grant Financing
using 6-year and 9-year Encashment Schedules
based on IDA13 Basic Shares**

Contributing Members	IDA13	IDA14 Donor Contributions	
	Basic Share (%)	6-year Encashments SDR Million	9-year Encashments SDR Million
Argentina	0.05%	0.23	0.24
Australia	1.46%	6.57	6.86
Austria	0.78%	3.51	3.67
Belgium	1.55%	6.98	7.29
Brazil	0.61%	2.75	2.87
Canada	3.75%	16.88	17.63
Czech Rep.	0.05%	0.23	0.24
Denmark	1.58%	7.11	7.43
Finland	0.60%	2.70	2.82
France	6.00%	27.00	28.20
Germany	10.30%	46.35	48.41
Greece	0.12%	0.54	0.56
Hungary	0.06%	0.27	0.28
Iceland	0.04%	0.18	0.19
Ireland	0.18%	0.81	0.85
Israel	0.10%	0.45	0.47
Italy	3.80%	17.10	17.86
Japan	16.00%	72.00	75.20
Korea	0.91%	4.10	4.28
Kuwait	0.14%	0.63	0.66
Luxembourg	0.10%	0.45	0.47
Mexico	0.05%	0.23	0.24
Netherlands	2.60%	11.70	12.22
New Zealand	0.12%	0.54	0.56
Norway	1.52%	6.84	7.14
Poland	0.03%	0.14	0.14
Portugal	0.20%	0.90	0.94
Russia	0.08%	0.36	0.38
Saudi Arabia	0.39%	1.76	1.83
Singapore	0.14%	0.63	0.66
Slovak Republic	0.01%	0.06	0.06
South Africa	0.08%	0.36	0.38
Spain	1.80%	8.10	8.46
Sweden	2.62%	11.79	12.31
Switzerland	2.43%	10.94	11.42
Turkey	0.09%	0.41	0.42
United Kingdom	10.14%	45.63	47.66
United States	20.12%	90.54	94.56
Venezuela	0.03%	0.14	0.14
Sub-total	90.63%	407.85	425.98
<i>Structural financing gap</i>	<u>9.37%</u>	<u>42.15</u>	<u>44.02</u>
Total additional contributions	<u>100.00%</u>	<u>450.00</u>	<u>470.00</u>
<i>Proposed coverage of structural financing gap</i>			
(i) UK supplemental funds (up to SDR 112.9 Million total)		29.17	29.17
(ii) IDA12 carry-over item (up to SDR 100 Million total)		12.98	14.85
Structural financing gap		<u>42.15</u>	<u>44.02</u>