IDA15

IDA15 FINANCING FRAMEWORK

International Development Association
Resource Mobilization (FRM)

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ABBREVIATIONS AND ACRONYMS

AfDF	African Development Fund
AsDF	Asian Development Fund
CFO	Chief Financial Officer
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
MDRI	Multilateral Debt Relief Initiative
SDR	Special Drawing Right

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EXECUTIVE SUMMARY

Debt relief provided by IDA under the Multilateral Debt Relief Initiative (MDRI) since July 2006 has increased IDA's dependency on donor financing. It is currently estimated that over the first 10 years of MDRI implementation lost credit reflows will amount to USD 6.7 billion. These resources are no longer available to support disbursements on credits and grants to recipient countries. Firm donor financing for the MDRI amounts to USD 3.8 billion so far, leaving a gap of USD 2.9 billion. The gap is to be filled by drawing on additional internal resources of IDA in order to prevent a drop in IDA14 commitment authority. This lowers IDA's available internal resources and increases the need for donor contributions for IDA15.

Under the donor baseline, donor resources in IDA15 would represent the equivalent of USD 24.6 billion (subject to foreign exchange rates)**.** Of this amount, USD 16.3 billion would constitute the agreed donor baseline for regular contributions, set at the IDA14 level in real SDR terms per the MDRI replenishment agreement. Based on current estimates of debt relief costs, donors would also provide USD 2.2 billion for HIPC costs over the IDA15 commitment period (FY09-11). Moreover, USD 6.1 billion would be needed to cover MDRI costs over the IDA15 disbursement period (FY09-19), including the firm financing gap for the MDRI from IDA14.

Under the baseline, total IDA15 commitment capacity would be about USD 32.1 billion, close to the current size of IDA14 (USD 32.5 billion). Funding under the baseline includes donors' baseline contributions of USD 24.6 billion; IBRD transfers of USD 1.6 billion (assumed to be constant at the original IDA14 level); and internal resources of IDA of USD 5.9 billion.

To fully satisfy the estimated financing needs for poor countries during IDA15, of USD 39.3 billion, donors would need to provide further resources, in addition to the baseline amounts. Regular contributions in IDA15 would equal USD 22.1 billion, net of the structural financing gap. Donors would also provide resources for covering IDA's cost of HIPC/ MDRI debt relief (USD 8.3 billion) and to finance arrears clearance operations (USD 1.4 billion).

Donors are requested to consider the options available for lowering the structural financing gap in donors' burden shares. While the concept of a gap in donors' regular IDA contributions would in itself be inconsequential from an operational and financial risk point of view, the paper offers options to lower the structural gap in IDA15. For IDA's cost of debt relief, it is proposed that donors scale up their HIPC and MDRI burden shares proportionally to close the gap.

Donors are requested to consider the options available regarding the *pro rata* provision (deferment clause). As experience has shown that the incentive provided by this provision has been weak and that is has inordinately lowered the amount of resources available to recipient countries, expanding its use by lowering the threshold to cover a greater subset of donors would not seem judicious. It is therefore proposed to discontinue the use of the *pro rata* provision if the donor burden shares in IDA15 are similar to those in IDA14, i.e. without a single lead donor.

IDA's expected move to U.S. GAAP would affect the reported volume of paid-in capital for donors accelerating encashment of their contributions. However, this would have no impact on donors' voting rights, their withdrawal rights from IDA or IDA's commitment authority.

IDA15 FINANCING FRAMEWORK

I. INTRODUCTION

1. The IDA15 companion paper on "Financing Requirements from IDA for Poor Countries during IDA15" sets out projections for the total volume of assistance commitments during the IDA15 commitment period (FY09-11). This paper provides a financing framework for IDA15 which would underpin these projected assistance commitments.

2. The paper is organized as follows. Section II summarizes the original financing framework for IDA14 and describes subsequent changes to the framework, primarily resulting from IDA's implementation of the Multilateral Debt Relief Initiative (MDRI). Section III sets out the baseline amounts for external funding from donors for the IDA15 replenishment, reflecting the commitments made by donors for financing IDA's cost of providing debt relief and grants. Section IV illustrates the resulting size of IDA15 under the baseline. Section V develops the IDA15 financing framework, including the volume of donor resources required to cover the financing needs over the IDA15 period. This section also discusses the structural financing gap in IDA replenishments; the *pro rata* provision for donors' contributions to IDA; and the practice of accelerated encashment of donor contributions. Section VI offers issues for discussion by donors.

3. The analysis in this paper is based on the core parameters for IDA's long-term financial projections as discussed at the first IDA15 meeting in March 2007 in Paris.[1] Data on debt relief provided by IDA and donor resources received for debt relief financing are as of December 31, 2006, as presented at the same meeting in March 2007.[2] For ease of reference, IDA's SDR-based financial data are provided in USD-equivalent terms in this paper.[3]

II. IDA14 FINANCING FRAMEWORK

A. Original IDA14 Framework

4. **As originally agreed at the start of the IDA14 period, the funding framework for IDA14 was to provide the equivalent of USD 32.8 billion (SDR 22.4 billion) of total resources**. This amount included USD 32.1 billion of resources for new IDA credits and grants

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1 *IDA' Long-term Financial Capacity*, Resource Mobilization Department, Washington, DC, February 2007.

2 *Multilateral Debt Relief Initiative (MDRI): Update on Debt Relief by IDA and Donor Financing To Date,* Resource Mobilization Department, Washington, DC, February 2007. Another update of IDA's debt relief costs is planned as of June 30, 2007, which would provide the basis for donors' new financing pledges to IDA15 and the MDRI.

3 Data for IDA14 are based on the IDA14 foreign exchange reference rate of USD/SDR 1.46365. Data for IDA15 use the spot foreign exchange rate as of January 10, 2007 of USD/SDR 1.49429, which is consistent with the exchange rate used in the IDA financial papers presented at the first IDA15 meeting in Paris in March 2007. The applicable foreign exchange reference rates for IDA15 will be based on the average daily exchange rates over the period April 1 – September 20, 2007, as agreed by IDA Deputies at the first IDA15 meeting. Refer to the note prepared for that meeting: *Effective Foreign Exchange Rates for Use in the IDA15 Replenishment,* Resource Mobilization Department, Washington, DC, February 2007.

to be extended during IDA14 (i.e., the amount of IDA14 commitment authority during FY06-08), and an additional amount of USD 0.7 billion of donor financing of forgone charge income resulting from IDA13 grants. The latter amount is the present value of the charge income that IDA is not collecting due to the making of IDA13 grants rather than regular IDA credits. These donor resources provided in IDA14 will be applied towards covering IDA's share of allocated Bank administrative expenses relating to IDA13 grants. For IDA14 grants, forgone charge income is being financed through the volume discount on IDA14 grants, without the need for additional donor financing.

5. **Of the original amount of IDA14 commitment authority of USD 32.1 billion, donors were to provide 55 percent (USD 17.7 billion) of the funding needed**. Donor resources include regular contributions, additional contributions from accelerated encashment, supplemental and incentive contributions, contributions for compensation of IDA's forgone credit reflows due to the HIPC Initiative, as well as carry-over amounts relating to unpaid donor contributions in prior IDA replenishments. Internal resources of IDA were to provide 40 percent (USD 12.7 billion) of the required funding for IDA14 commitments. Internal resources include credit reflows from IDA's borrowers, income on IDA's liquid asset investments, and a draw-down of IDA's stock of liquid assets.[4] IBRD net income transfers provided the balance of 5 percent (USD 1.6 billion) of IDA14 commitment authority.[5] A detailed presentation of the original IDA14 financing framework is available in Annex 1, Table A.

6. Following the conclusion of the IDA14 discussions, two main developments affected the IDA14 funding framework: (i) IDA's participation in the Multilateral Debt Relief Initiative (MDRI); and (ii) increased financing contributions from IBRD and IFC. The changes to the original financing framework for IDA14 commitment authority are illustrated in Chart 1. A detailed presentation of the revised, current IDA14 financing framework is available in Annex 1, Table B.

B. Impact of the MDRI on the IDA14 Framework

7. **In the spring of 2006, donors and shareholders approved IDA's participation in the MDRI, which provides 100 percent cancellation of eligible debt owed to IDA by countries reaching the HIPC completion point**. Starting on July 1, 2006, over the 40-year period of the MDRI, IDA is cancelling an estimated USD 36.4 billion (SDR 24.6 billion) of credit reflows from currently 40 HIPC countries, based on eligible debt outstanding and disbursed at end-

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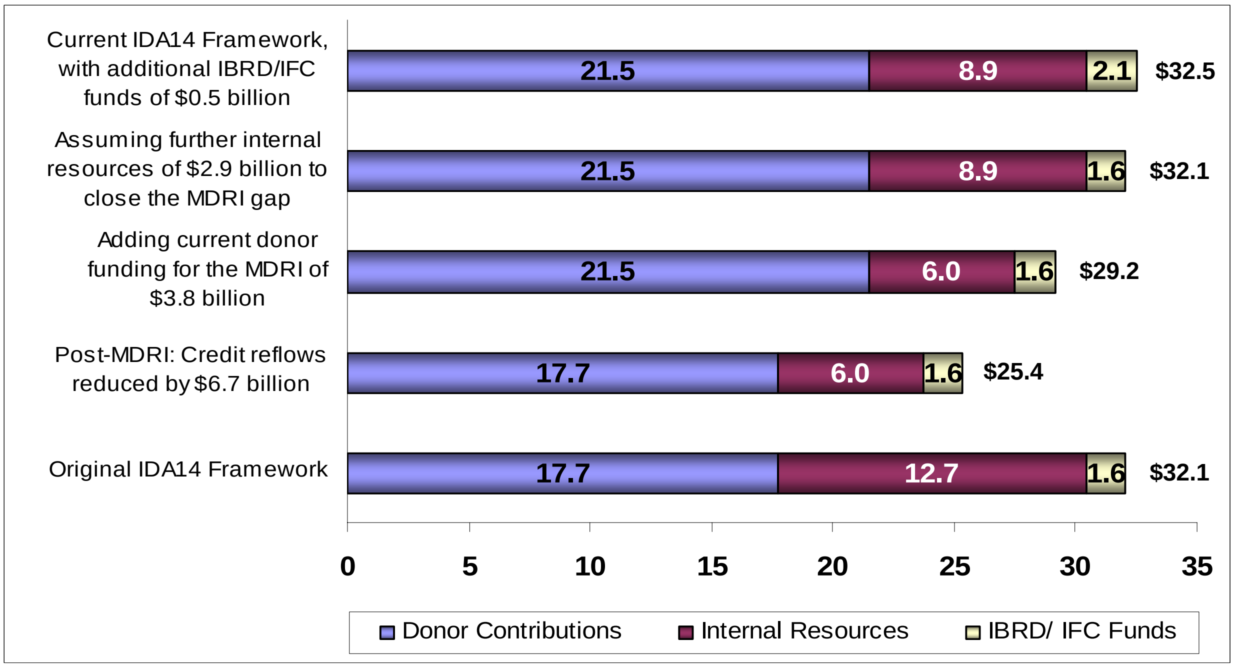
[4] For a discussion of internal resources of IDA, refer to the IDA15 paper: *IDA' Long-term Financial Capacity*, IDA, Washington, DC, February 2007, paras. 11-17. A full presentation of IDA's financial structure and its financial policies is available in the following document: *Compendium of IDA's Financial Policies*, Resource Mobilization Department, October 2006.

[5] IBRD is expected to provide net income transfers of USD 500 million per year on average. The actual time profile is as follows: USD 400 million from FY05 net income, which has been paid to IDA in FY06; USD 500 million from FY06 net income, which has been paid in FY07; and USD 600 million from FY07 net income, which is expected to be approved by IBRD's Board of Governors in the fall of 2007, for payment during FY08. The up-front, accelerated IBRD payment profile of these transfers leads to additional investment income by IDA, because IBRD's funds are made available prior to the disbursement on associated IDA credits and grants. As a result, IBRD is estimated to provide about USD 1.6 billion of IDA14 commitment capacity.

December 2003.[6] Under the financing package for the MDRI, donors have committed to compensate IDA's MDRI costs on a 'dollar-for-dollar' basis. The Board of Executive Directors of IDA approved IDA's participation in the MDRI on March 28, 2006.[7] On April 21, 2006, IDA's Board of Governors adopted the Resolution authorizing an increase in IDA resources to cover MDRI-related costs.[8] IDA's Executive Directors approved IDA's implementation of the MDRI as of July 1, 2006, the beginning of fiscal year 2007.[9] The MDRI replenishment of IDA became effective as of August 4, 2006.

Chart 1: IDA14 Commitment Authority – Evolution of the Financing Framework (USD equiv. billion)



8. **Over the first decade of MDRI implementation (FY07-16), MDRI debt relief deprives IDA of credit reflows of about USD 6.7 billion that had already been committed in advance for disbursements under IDA14 and previous IDA replenishments**. In FY89,[10] the Board authorized IDA to make advance commitments against future reflows and other internal resources. The *Advance Commitment Scheme*[11] was established in recognition of the fact that

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[6] In addition to the MDRI, IDA provides further debt relief of about $17 billion under the HIPC Initiative.

[7] *IDA's Implementation of the Multilateral Debt Relief Initiative*, IDA/R2006-0042, March 17, 2006.

[8] *Additions to Resources: Financing the Multilateral Debt Relief Initiative*, Resolution No. 211 adopted on April 21, 2006.

[9] *Implementation Start Date of the Multilateral Debt Relief Initiative (MDRI)*, IDA/R2006-0122, June 9, 2006.

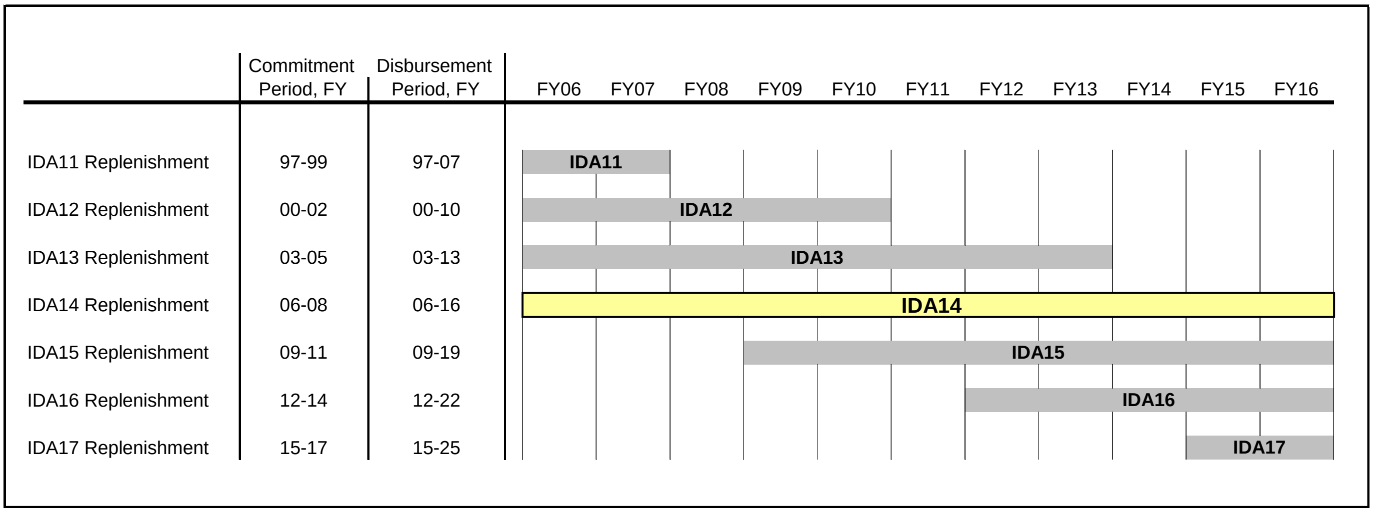
[10] *The Use of IDA Reflows*, IDA/R88-106, September 16, 1988.

[11] Credits which disburse over a period of up to 9 years do not have to be fully cash funded at the time of their approval by the Executive Directors. This allows donor promissory notes to be encashed over several years and internal resources to be committed in advance of their anticipated receipt.

credits disburse over several years and therefore cash in hand is not needed at the time of commitment.[12]

9. **Through the Advance Commitment Scheme, IDA is able to maximize the volume of available funds for new credits and grants, lowering the need for donor funds**. For example, new IDA credits approved during the three-year commitment period of IDA11 (FY97-99) lead to subsequent disbursements over a total of 11 years (FY97-07, see Chart 2). In implementation since July 1, 2006, the MDRI reduces the amount of credit reflows available to satisfy disbursements as of FY07, the last year of the IDA11 disbursement period. In the same way, the MDRI impacts on IDA's ability to disburse against credits and grants already approved during IDA12 through IDA14 (including credits and grants to be approved during the last two fiscal years of IDA14, in FY07 and FY08).

Chart 2: Time Profile of IDA Commitments and Disbursements



10. **Under the Advance Commitment Scheme, future credit reflows of IDA have been committed in advance over the 11-year disbursement period of the current replenishment.** Advance commitment is, however, less than 100 percent in the most outer years when the bulk of the IDA-financed development projects reach their completion and associated disbursements on credits and grants gradually come to an end. Deputies have reviewed the extent of IDA's advance commitment of credit reflows at the September 2005 meeting in Paris when discussing the proposed implementation arrangements for the MDRI.[13]

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12 To determine the appropriate level of internal resources during a replenishment period, the IDA financial projections model is used to ensure that IDA's cash flow risk is managed, based on a set of underlying assumptions. The key assumptions relate to future IDA lending volumes, level of donor contributions and percentage of non-collectable credits. Currently, it is assumed that 5 percent of principal credit repayments are not collectable on time, based on IDA's long-term non-accrual history.

13 See Annex Table 2, page 38, in: *The G8 Debt Relief Proposal: Assessment of Costs, Implementation Issues, and Financing Options*, The World Bank, Washington DC, September 2005.

11. **As a result of the MDRI, funds available for commitment during the IDA14 period fell by USD 6.7 billion, to USD 25.4 billion, with internal resources in IDA14 falling to USD 6.0 billion**. The financing frameworks of IDA11-13 could not be altered retroactively to account for the MDRI, so as to reduce the internal resources available and committed in these prior replenishments, because credits and grants under IDA11-13 were already approved in full at the time when MDRI implementation started. Therefore, the loss of credit reflows for IDA11-13 starting from FY07 will need to be accounted for entirely under IDA14.

12. **The loss of credit reflows has been partially off-set through firm (i.e., unqualified) donor financing commitments towards the MDRI of about USD 3.8 billion over the IDA14 disbursement period** (as of December 31, 2006)**.**[14] These donor funds bring the total resources available for commitment in IDA14 to USD 29.2 billion.

13. **To maintain IDA14 commitment authority unchanged, at the originally agreed volume of USD 32.1 billion, an additional amount of USD 2.9 billion will need to be made available from IDA's internal resources (i.e., liquidity)**. When approving the MDRI, donors and shareholders reached an understanding that the IDA14 commitment authority envelope should not be cut even if donors failed to commit to fully compensate IDA for the loss of credit reflows over the IDA14 disbursement period. Based on current donor financing commitments, this understanding will require making available an additional USD 2.9 billion (SDR 2.0 billion) of internal resources of IDA, bringing the total volume of internal resources to be used in IDA14 to USD 8.9 billion.

14. **The commitment of internal resources of IDA is the prerogative of the Executive Directors**. In June 2005, the Executive Directors of IDA approved the use of internal resources equivalent to USD 12.7 billion for IDA14.[15] Due to the loss of credit reflows under the MDRI, an amount of USD 6.7 billion of these approved internal resources is no longer available. The Executive Directors will be requested to approve the use of an additional USD 2.9 billion of internal resources for IDA14 at the time of their annual review of the IDA14 commitment authority framework, in early FY08.

15. **If approved by the Executive Directors, the increase of internal resources for IDA14 will lower IDA's ability to make available further internal resources to support IDA15**. To avoid a reduction of IDA15 commitment authority, donors will need to provide additional financing commitments towards replacing the credit reflows lost due to the MDRI.

C. Additional Funds from IBRD and IFC

16. **Total financing from Bank Group income for IDA14 has increased to about USD 2.1 billion, increasing IDA14 commitment authority to USD 32.5 billion**. At the September 2006 Annual Meetings, IBRD's Board of Governors authorized a transfer of an additional USD 0.3

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[14] This assumes that all qualified donor contributions for the first two years of MDRI costs (FY07-08) would become unqualified. Firm donor financing commitments for the MDRI Replenishment are provided through unqualified Instruments of Commitments, after the required legislative and parliamentary approvals have been obtained by a donor government. Annual cash payments from donors will occur over time and mirror the annual profile of the credit reflows lost by IDA due to the MDRI.

[15] *IDA14 Commitment Authority Framework (FY06-08)*, IDA/R2005-0133, June 8, 2005.

billion from surplus to IDA, over and above the three IBRD transfers of USD 0.5 billion each expected over the IDA14 period. Moreover, IFC has designated and transferred USD 0.15 billion from retained earnings for grants to IDA. These additional resources from IBRD and IFC increase total IDA14 commitment authority from the originally agreed USD 32.1 billion to about USD 32.5 billion (SDR 22.2 billion, see Annex 1, Table B).

III. BASELINE RESOURCES FOR IDA15

17. The size of the IDA15 replenishment will depend on the volume of new financing commitments from the donors (including compensation for debt relief costs), contributions from Bank Group net income, and the volume of internal resources that IDA can provide after the reduction of credit reflows due to debt relief and grants. A starting point for this analysis is the set of core financial assumptions for IDA's long-term financial planning, as presented at the first IDA15 meeting in March 2007 in Paris.[16] Based on these assumptions, this Section establishes donors' baseline contributions to IDA15 as well as donors' compensation commitments for IDA's forgone reflows due to debt relief and grants.

A. Regular Donor Contributions under the Baseline

18. **Under the recent replenishment of IDA's resources with respect to the MDRI, donors agreed to a contribution baseline, representing the floor for their future financial support to IDA**. The contribution baseline serves to establish the actual additionality of donor financing of forgone credit reflows due to debt relief provided by IDA. Specifically, in the context of the MDRI replenishment, donors "*committed themselves to fully finance the costs to IDA of providing MDRI debt relief over the 40-year time span of the MDRI. They agreed that financing of MDRI costs should be fully additional to regular IDA contributions in order to provide the greatest benefit to poor countries and preserve IDA's financial strength. They agreed that the level of IDA14 donor contributions, measured in real terms, will serve as the baseline on which the additionality of donor financing for the MDRI will be assessed over time. They recognized that the ability to provide binding financial commitments for the entire duration of MDRI varies from donor to donor, and committed themselves to make every effort possible to translate their full political commitment for the outer as well as earlier years into as firm and far-reaching financial pledges as allowed for by their legislative processes.*"[17]

19. **The donor baseline has been set at the volume of *regular* donor contributions to IDA14, to be maintained in real SDR terms during future replenishments**. Regular contributions exclude additional donor contributions from accelerated encashment as well as supplemental and incentive contributions in IDA14 and the structural financing gap. In the context of the MDRI replenishment, donors agreed that the baseline amount *"would continue to increase by the SDR inflation rate for subsequent replenishments. The actual SDR inflation rate over the preceding three years would be used to determine the baseline volume of regular*

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[16] See Table 1, page 8, in: *IDA's Long-term Financial Capacity*, Resource Mobilization Department, Washington, DC, February 2007.

[17] See para 5, page 2 in: *Additions to Resources: Financing the Multilateral Debt Relief Initiative*, Resolution No. 211 adopted on April 21, 2006.

contributions in each future replenishment."[18] The actual average inflation rate based on the SDR basket of currencies was 2.34 percent per year, in calendar years 2004-2006.[19] Compounded over three years, regular contributions in IDA15 would therefore increase by 7.28 percent over each donor's regular contributions to IDA14, in SDR terms.

20. **The baseline amount for regular donor contributions to IDA15 would be equivalent to USD 16.3 billion**. In IDA14, regular donor contributions – excluding the structural financing gap and net of accelerated, supplemental and incentive contributions – amount to SDR 10,181 million. Increasing this amount by 7.28 percent would lead to a baseline amount for regular donor contributions in IDA15 of SDR 10,922 million. This would be equivalent to USD 16,321 million (see Table 1).

Table 1: IDA15 Baseline Resources From Donors
(SDR million and USD equiv. million)

Sources of Funds	Baseline Framework	
	SDR million	*USD equiv. million* [a/]
Donor Baseline contributions (net of structural gap) [b/]	10,922	*16,321*
Donor HIPC contributions - for IDA15 commitment period (FY09-11)	1,486	*2,220*
Donor MDRI contributions - firm financing commitments required		
> gap for IDA14 disbursement period (FY09-16)	1,989	*2,972*
> additional amount for IDA15 disbursement period (FY17-19)	2,095	*3,131*
Subotal MDRI contributions	4,084	*6,103*
Total IDA15 baseline resources from donors	**16,492**	**24,644**

Note: Details may not add up due to rounding.
Source for MDRI data: *Multilateral Debt Relief Initiative (MDRI): Update on Debt Relief by IDA and Donor Financing To Date*, Feb. 2007.
a/ USD equivalent amounts are expressed at the spot FX rate of January 10, 2007 of USD/SDR 1.49429.
b/ The donor baseline is set at +2.34% p.a. over each donor's IDA14 regular contributions, in SDR terms.

B. Donor Contributions for HIPC Costs

21. **IDA14 was the first replenishment in which donors began to finance forgone credit reflows due to the HIPC Initiative**. Prior to IDA14, IDA's HIPC costs were primarily financed by transfers from IBRD net income to the HIPC Trust Fund. Donors' HIPC contributions in IDA14 were included within the financing framework of the IDA14 replenishment, without establishing a separate, new replenishment framework for HIPC-related contributions. Under the current compensation arrangements, donor financing of HIPC costs occurs on a pay-as-you-go basis, over the 3-year commitment period of IDA replenishments.

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18 See para 37, page 10 in: *Additions to Resources: Financing the Multilateral Debt Relief Initiative*, Resolution No. 211 adopted on April 21, 2006

19 The SDR-based inflation rate was 2.15 percent in 2004; 2.43 percent in 2005; and 2.54 percent in 2006, respectively. CPI data for the four component currencies of the SDR basket are based on the IMF's International Financial Statistics.

22. **Over the 3-year commitment period of IDA15 (FY09-11), donor contributions for HIPC costs are estimated at USD 2.2 billion**.[20] Over this period, IDA is currently estimated to forgo credit reflows due to HIPC debt relief of USD 2,499 million. Required donor contributions are projected at USD 2,220 million (see <u>Table 1</u>), after a carry-over amount of USD 279 million reflecting the projected reduction of the estimated HIPC costs during the IDA14 period.

C. Donor Contributions for MDRI Costs

23. **To replace IDA's forgone credit reflows due to the MDRI, donors established a separate MDRI replenishment, spanning four decades (FY07-44)**. Starting from IDA14, IDA's commitment authority will *de jure* and *de facto* be backed by two simultaneous replenishments: The financing items that become available under the latest regular IDA replenishment, and additional donor commitments provided under the ongoing MDRI replenishment. MDRI costs and related donor financing contributions and their payment schedules will be updated at least every three years, in conjunction with regular IDA replenishments. The last update of IDA's MDRI and HIPC costs occurred as of December 31, 2006. For donors' financing pledges to IDA15, the debt relief costs of IDA will be updated once again, as of June 30, 2007. This cost update will be provided to donors prior to the third IDA15 meeting.

24. **To preserve IDA's financial capacity following implementation of the MDRI, donors acknowledged the need to provide unqualified, firm financing commitments over a rolling decade, thereby matching the disbursement period of each future IDA replenishment.** Specifically, in the context of the MDRI replenishment, donors recognized that: *"It will be critical to provide an Unqualified Commitment for subscriptions and contributions in FY07 and 08"*. For the remainder of the first decade of MDRI implementation (FY09-16), donors recognized that: *"Firm, Unqualified Commitments are also needed over this period. Participants recognized that some donors would require periodic approval of their contributions over this period, resulting in the provision of some portion of Qualified Commitments. ... Participants encouraged IDA's donors to take all necessary steps in successive replenishments to provide firm financing on a rolling basis."* [21]

25. **It should be noted that, under regular IDA replenishments, all donors are making firm financing commitments to provide a 9-year cash flow to IDA (i.e., the standard IDA encashment schedule) similar to what would be required under the MDRI.** Most donors approve their entire 9-year IDA contribution up-front, while others appropriate the aggregate contribution amount over three years, in three equal annual tranches. Donors could use the same, established procedures for MDRI financing purposes.

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[20] See Table 3, page 15, in: *IDA's Long-term Financial Capacity*, Resource Mobilization Department, Washington, DC, February 2007.

[21] See paras 19.(a) and 19.(b), page 5 in: *Additions to Resources: Financing the Multilateral Debt Relief Initiative*, Resolution No. 211 adopted on April 21, 2006.

26. **Over the 11-year disbursement period of IDA15 (FY09-19), the need for additional, firm MDRI donor financing commitments is currently estimated at the equivalent of USD 6.1 billion (SDR 4.1 billion)**.[22] This financing requirement of USD 6.1 billion is broken down into two amounts, as follows (see also Table 1): (i) USD 2,972 million of lost MDRI reflows during FY09-16 relating to IDA14 disbursements, which remain uncovered by firm financing commitments from a number of donors, but would not trigger additional contributions from the majority of donors who have already provided a firm financing commitment over the first decade; and (ii) USD 3,131 million of lost MDRI reflows during FY17-19 relating to IDA15 disbursements, which would be covered through new, firm financing commitments from most donors.[23]

D. Donor Contributions to Replace Reflows Forgone due to IDA Grants

27. **Financing of forgone principal reflows due to IDA grants will start in IDA16**. Within the context of IDA14, donors committed to replace forgone principal reflows due to the making of grants over time, on a pay-as-you-go basis. In view of the 10-year grace period on regular IDA credits, IDA16 would be the first replenishment for the financing of forgone principal reflows due to grants extended in IDA13.

IV. BASELINE COMMITMENT CAPACITY FOR IDA15

28. Section III provided the volume of baseline resources from donors during IDA15. Section IV will discuss possible financing contributions from Bank Group net income and establish the volume of internal resources that IDA could make available for commitment during IDA15. Combining donor and non-donor resources will lead to the total volume of IDA15 commitment capacity that would be available under the baseline.

A. Contributions from IBRD and IFC

29. **For IDA15, transfers from IBRD net income are currently assumed to continue at the same level as originally agreed for IDA14, at USD 500 million per year, with an up-front draw-down** (i.e. over three years rather than the standard 9-year encashment schedule). It is assumed that IBRD would make annual cash transfers to IDA, over the three years of the IDA15 period. This would provide USD 1.6 billion (SDR 1.1 billion) of IDA15 commitment authority. IBRD's actual transfers in support of IDA15 will depend on various factors, including IBRD's future net income situation, which is dependent on market interest rates and IBRD's need for loan loss provisions, among other factors. Bank management will review this topic after the IBRD net income allocation decisions for FY07 have been taken by the IBRD Board of Governors, in the autumn of 2007. Any decisions about future IBRD net income transfers will be subject to approval by IBRD's Executive Directors and the IBRD Board of Governors.

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[22] See Table 4, page 16, in: *IDA's Long-term Financial Capacity*, Resource Mobilization Department, Washington, DC, February 2007.

[23] A few donors have already provided up-front, unqualified financing commitments over the entire four decades of the MDRI; these donors would not need to provide additional MDRI financing commitments during IDA15.

30. **Predictions about possible future grants from IFC in support of IDA15 are not possible at this time**. Unlike for IBRD which has a long history of financial support to IDA, the IFC contribution to IDA of US$ 0.15 billion that was authorized in September 2006 was the first such grant from IFC. Moreover, IFC's net income is likely to display a higher year-to-year volatility than that of the IBRD, given IFC's private sector mandate and its resulting risk exposure. Decisions about future IFC contributions to IDA will be subject to further approvals by IFC's shareholders, based on an assessment by IFC management.

B. Internal Resources of IDA

31. **The future level of IDA's liquidity becomes the binding constraint when determining the volume of internal resources that are available for IDA15**. Internal resources consist primarily of IDA's future credit reflows after debt relief and the projected investment income on IDA's liquid assets. If the internal resources committed for a given replenishment exceed these two sources of funds, then IDA's liquid assets will fall over time in order to satisfy IDA's disbursement needs under a given replenishment.

32. **IDA's current liquidity level of about USD 17 billion is projected to decrease to a minimum prudential level of USD 3-4 billion over the next decade**.[24] [25] There are two main factors driving this projected decrease in IDA's liquid assets: First, by design the level of internal resources that were committed for IDA13 and IDA14 exceeded the projected volume of credit reflows and investment income available over the disbursement period of these two replenishments. This was agreed with donors so as to draw down IDA's core liquidity over time, net of the additional liquidity built up as a result of accelerated encashment of donors' IDA contributions. Second, it is assumed conservatively that donors would not accelerate the encashment of their contributions to future IDA replenishments. Accelerated encashments account for nearly 60 percent of IDA's current liquid assets at this time, and it is assumed that the accelerated payment balance would be drawn down over the disbursement horizon of IDA14. If donors continue accelerating the encashment of their contributions in future replenishments, IDA's total liquidity balance would not decrease as projected. However, the accelerated portion of IDA's liquidity would not be available to support additional credit and grant commitments under the current replenishment, as these funds need to generate investment income so as to recover the encashment discount provided to the donors. Annex 2 provides detailed background information on IDA's cash flows, the structure of liquid assets, the historical evolution of accelerated encashment by donors, and the projected future level of IDA's liquidity.

33. **With liquidity projected to decrease towards minimum levels over the next decade, fewer internal resources could be committed during IDA15**. This is exacerbated by the need

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[24] The minimum prudential level of IDA's liquidity is set at one third of annual gross disbursements on credits and grants over a rolling 3-year period. For further details refer to *Investment of IDA's Liquid Assets: A Review*, AC2005 -0057, June 22, 2005.

[25] While IDA is allowed under its Articles to borrow from the market, it does not do so as a matter of policy since market borrowing would entail a net financial cost, given that IDA charges no interest on its credits while it would need to pay market interest rates on borrowed funds, hence reducing IDA's resources available for poor countries. Without access to borrowed funds, IDA needs to manage its level of liquidity so as to ensure that sufficient liquid funds are readily available for IDA to disburse against approved credits and grants.

to add another USD 2.9 billion of internal resources (i.e., liquidity) for IDA14 in order to maintain total IDA14 commitment authority at the originally agreed level, following the loss of reflows under the MDRI and taking into account the gap in donors' firm MDRI compensation to date (see Section II). The need to add additional internal resources to support IDA14 lowers the amount of internal resources that are available for IDA15 even further.

34. **For IDA15, the maximum amount of internal resources available would be about USD 5.9 billion (SDR 3.9 billion)** (see Chart 3). This compares with internal resources in the revised IDA14 financing framework of USD 8.9 billion. Internal resources of USD 5.9 billion in IDA15 would result in a projected draw-down of IDA's liquidity to about USD 2.6 billion by FY15, one third below the minimum prudential guideline level at that time of about USD 3.9 billion (see Chart 4).

35. **Adding additional internal resources for IDA15 would either cause a further reduction of projected liquidity below the prudential minimum, or it would require a reduction of the internal resources available for the IDA16 replenishment.** Even under the baseline, total commitment capacity in IDA16 would already fall to USD 30 billion, unless donors provide additional funding, over and above the baseline amounts. Increasing internal resources for IDA15 beyond USD 5.9 billion, and thereby lowering further the projected internal resources and total commitment capacity for IDA16, would compromise the objective of providing a predicable stream of new IDA resources to recipient countries over time.

B. Baseline Commitment Capacity for IDA15

36. **The total commitment capacity for IDA15 under the baseline is estimated at USD 32.1 billion (SDR 21.5 billion)** (see Chart 3). In dollar terms this volume is nearly as large as the current volume of IDA14 commitment authority of USD 32.5 billion. The difference between both amounts reflects two main factors: (i) the additional resources for IDA14 provided by IBRD and IFC in September 2006, which are not assumed to be provided under the IDA15 baseline funding; and (ii) the additional resources for IDA14 provided by donors from accelerated encashment as well as from supplemental and incentive contributions; these additional donor contributions are not included in the agreed donor baseline amount for IDA15.[26]

37. **The total baseline resources for IDA15 include donor financing for forgone charge income due to IDA's provision of debt relief**. Over the IDA15 commitment period, IDA will on average forgo some USD equiv. 300 million per year of service charge income which is no longer available due to debt relief under the HIPC Initiative and the MDRI. This lost income will be replaced annually by donor financing so as to allow IDA to cover its allocated annual share of World Bank administrative expenses. The volume of internal resources in the baseline commitment capacity has been determined assuming that all donor compensation for debt relief

[26] In SDR terms, the baseline commitment capacity for IDA15 of SDR 21.5 billion is some SDR 700 million lower than current, revised IDA14 commitment authority of SDR 22.2 billion. This SDR difference is larger than the difference in USD equivalent terms (of about USD 400 million). This is because of the currency depreciation of the USD vs. the SDR since IDA14, which results in a relatively larger USD equivalent envelope for IDA15, and hence leads to a smaller reduction of the IDA15 envelope vs. the current IDA14 envelope when expressed in USD equivalent terms.

(for both forgone principal reflows and charges) would be allocated towards IDA15 commitment authority, with liquidity (i.e., internal resources) financing the loss of charge income. To fully account for the forgone charge income due to the debt relief, the effective amount of donor financing becoming available for IDA15 *commitment authority* would fall by about USD equiv. 900 million, while the effective amount of internal resources allocated for IDA15 commitment authority would increase by the same volume.

Chart 3: Projected Commitment Capacity under the Baseline, IDA14 – IDA17 (USD equiv. billion)

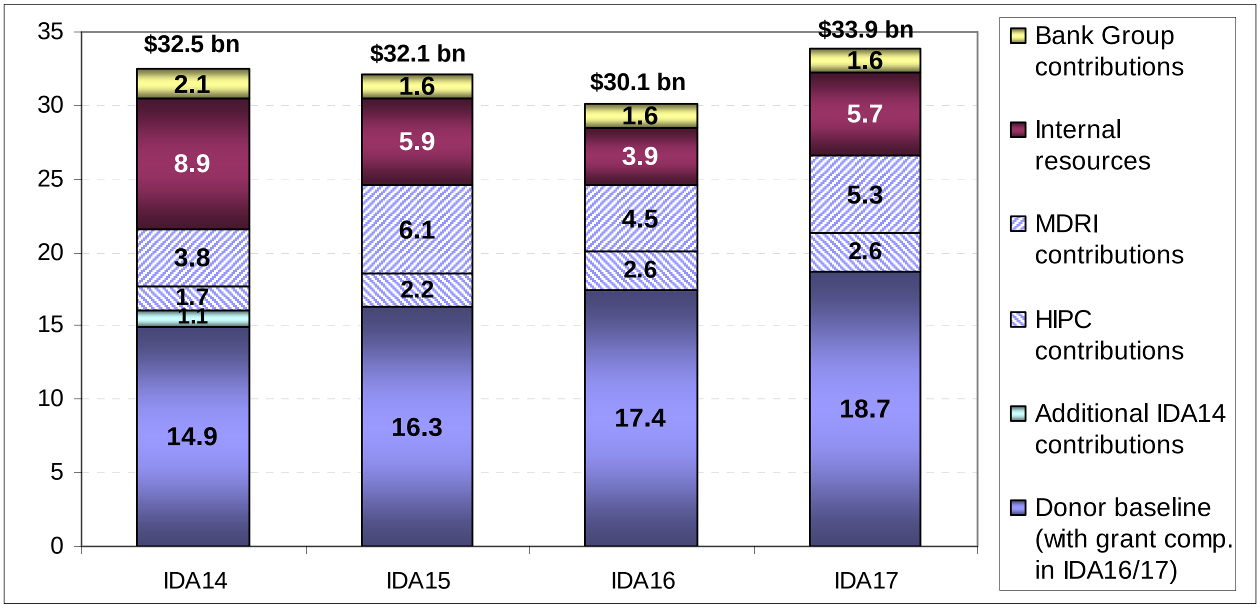
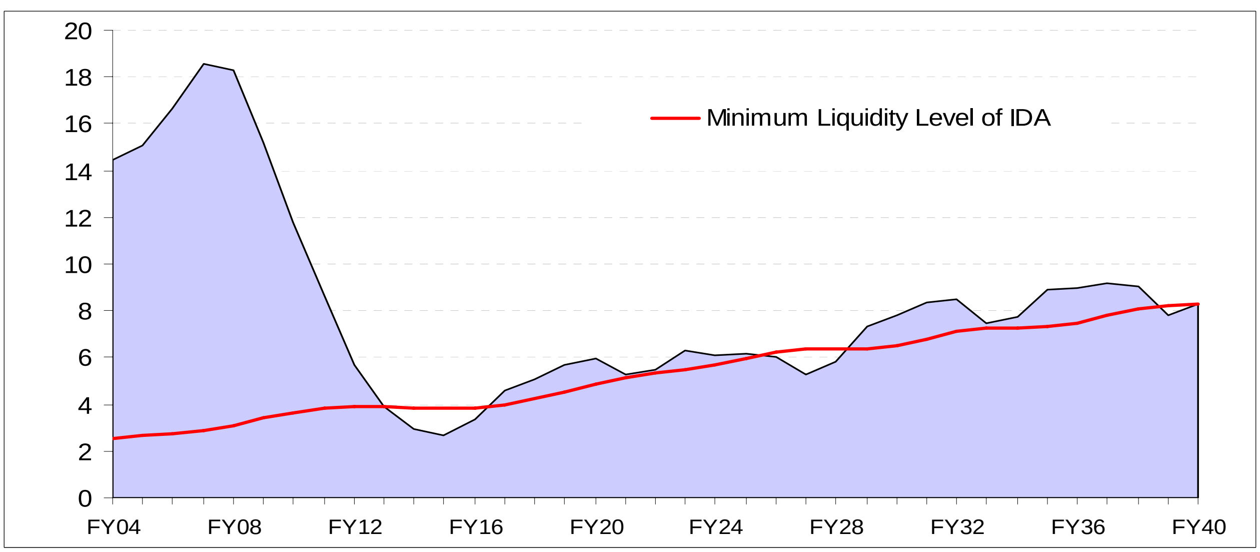


Chart 4: Projected Liquidity Level of IDA under the Baseline (USD equiv. billion)



V. IDA15 FINANCING FRAMEWORK

A. Resource Needs and Donor Funds Required

38. **The estimated financing needs for poor countries during IDA15 are estimated at USD equiv. 39.3 billion (SDR 26.3 billion), equivalent to a 20 percentage points increase over the original volume of IDA14 commitment authority (SDR 21.9 billion)**. This is the proposed volume of the IDA15 replenishment as set out in the companion paper for the second IDA15 meeting ("The Demand for IDA15 Resources and Strategy for their Effective Use"). That paper also discusses trade-offs should the volume of IDA15 come out at 10 percentage points higher or lower level than that proposed by management. These trade-offs are illustrated in Annex 3 of this paper.

39. **These financing needs exceed the maximum volume of available IDA15 commitment capacity of USD 32.1 billion under the baseline, as developed in Section IV**. The incremental resources required to satisfy the IDA15 financing needs would have to come primarily from donors, above and beyond their baseline contributions and their compensatory contributions for IDA's costs due to the HIPC Initiative and the MDRI. Another source could be higher net income contributions from the Bank Group than those expected under the baseline, subject to net income availability and required Board approvals.

40. **To satisfy the IDA15 financing needs, regular donor contributions in IDA15 would need to equal some USD 22.1 billion, net of the structural financing gap** (see Table 2). In addition, donors would provide resources for covering IDA's cost of debt relief in IDA15, including: (i) compensatory contributions for financing HIPC costs (USD 2.2 billion); (ii) compensatory contributions for financing MDRI costs (USD 6.1 billion); and (iii) contributions to finance arrears clearance operations (USD 1.4 billion).

B. Structural Financing Gap and Burden Sharing

41. Over time, the donor financing shares in IDA14 have reflected changing donor circumstances. On a net basis, some donors have reduced their share without a compensating increase by other donors. This has created a "structural financing gap" in the burden sharing scheme. The volume of donor financing required for IDA15 is expressed net of the structural financing gap that currently exists in donors' IDA burden shares. This means that these amounts of financing need to be actually paid by the donors so as to enable IDA to approve new credits and grants in the desired overall volume and to disburse fully on these credits and grants.

Gap in Regular Donor Contributions

42. **In the IDA14 replenishment, the actual amount of regular contributions that donors make available to IDA equals 81.45 percent of the total target amount, leaving a structural**

financing gap of 18.55 percent (equivalent to USD 3.4 billion).[27] For IDA15, if donors choose to apply the same regular burden shares as in IDA14, the same structural gap would arise.[28]

Table 2: IDA15 Financing Framework
(SDR billion and USD equiv. billion)

Sources of Funds	IDA14 Revised		IDA15 As Proposed	
	SDR bn	*USD bn* [a/]	**SDR bn**	***USD bn*** [b/]
Regular donor contributions (net of structural gap) [c/]	10.9	*16.0*	**14.8**	***22.1***
Donor financing for Debt Relief Costs				
Donor HIPC contributions	1.2	*1.7*	**1.5**	***2.2***
Donor MDRI contributions	2.6	*3.8*	**4.1**	***6.1***
Donor financing of arrears clearance operations	0.0	*0.0*	**0.9**	***1.4***
Total donors	14.7	*21.5*	**21.3**	***31.8***
Bank Group net income contributions	1.4	*2.1*	**1.1**	***1.6***
Internal resources (reflows, investment income)	6.1	*8.9*	**3.9**	***5.9***
Total commitment authority	22.2	*32.5*	**26.3**	***39.3***

Note: Details may not add up due to rounding.
a/ USD equivalent amounts for IDA14 are expressed at the IDA14 foreign exchange reference rate of USD/SDR 1.46365.
b/ USD equivalent amounts for IDA15 are expressed at the spot FX rate of January 10, 2007 of USD/SDR 1.49429.
c/ IDA14 contributions include accelerated/ supplemental/ incentive donor contributions plus the donor carry-over from IDA13.

43. **The concept of the structural gap in donors' regular contributions would in itself be inconsequential from an operational and financial risk point of view**. IDA's commitment authority will only take into account the actual financing contributions to be received from the donors, net of any gap. Nevertheless, at the first IDA15 meeting in Paris, donors have expressed concern about the size of the structural financing gap in IDA14.

44. **There are various alternatives available to reduce or eliminate the structural financing gap in donors' regular contributions for IDA15**. The primary reason for the substantive widening of the structural gap from IDA13 to IDA14 was the reduction of burden shares of certain major donors. Therefore, an effective option for IDA15 would be for these donors to increase their individual burden shares vs. IDA14. The gap could also be lowered somewhat through additional funding from potential new donors that may join the IDA15

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27 See column (1), Table 1, page 77 in: *Additions to IDA Resources: Fourteenth Replenishment*, March 10, 2005. The original structural gap in regular IDA14 donor contributions was 18.46 percent. Subsequent minor adjustments in donor contributions change the current actual gap to 18.55 percent.

28 Mathematically, the target volume for donors' regular contributions would be scaled up to 100 percent so as to mobilize the actual donor funding required for IDA15 (see Annex 3, Table B). To determine their actual contributions, donors would then multiply this higher total target volume expressed in SDRs with their regular IDA14 burden share and convert this into local currency amounts at the IDA15 foreign exchange reference rates.

replenishment.[29] A third option is to recalculate the burden shares for all donors, once final donor pledges to IDA15 are known, so as to recalibrate – or "normalize" – the sum of all burden shares back to 100 percent. This would mean an upward adjustment in the reported burden share for all donors.

45. **A fourth option would be to accelerate the encashment of regular contributions for all donors without encashment discounts, for example to a 6-year encashment schedule**. The interest income to be earned by IDA could lower the structural financing gap by about 3 percentage points, without changing the regular IDA burden shares of individual donors. This 6-year acceleration approach was chosen by donors in the IDA12 replenishment. As in IDA12, exceptions would be allowable for donors who are unable to encash on an accelerated schedule.

46. **Under any of these options, it should be noted that maintaining a limited, residual financing gap in donors' regular contributions would be desirable**. A residual financing gap of, say, less than ten percent would allow accommodating a potential increase in individual donor financing shares from one replenishment to the next, without the need to recalibrate all burden shares at every new replenishment. Once the likely volume of donors' financing commitments to IDA15 will be known, the various options to lower the financing gap for regular donor contributions could be considered.

Gap in Donors' HIPC Contributions

47. **In IDA14, donors used their IDA13 burden shares to finance IDA's forgone reflows due to the HIPC Initiative, leaving a structural financing gap of 9.2 percent**. Not covering this gap when financing IDA's lost HIPC reflows during IDA14 would mean lowering the amount of resources available for IDA's commitment authority. To help lower the structural gap for financing HIPC costs during IDA14, twelve donors agreed to "scale up" their IDA13 burden shares proportionally. The remaining financing gap for HIPC costs during FY06-08 was closed through an additional contribution from Norway in an amount equivalent to USD 49 million. Without full replacement of the forgone credit reflows due to debt relief, commitment authority in IDA15 would be reduced. For HIPC costs in IDA15, during FY09-11, donors are again requested to consider scaling up their IDA13 burden shares proportionally to eliminate the structural financing gap.

Gap in Donors' MDRI Contributions

48. **Under the initial MDRI replenishment, donors also agreed to apply their IDA13 burden shares to finance IDA's forgone reflows due to the HIPC Initiative.** Over the first two years of MDRI financing (FY07-08), a number of donors used customized burden shares. For the IDA15 disbursement period (FY09-19), even with all donors delivering on their financial pledges at the agreed MDRI burden shares, a structural financing gap of 8.0 percent remains, equivalent to USD 730 million. Over the entire 40-year financing period of the MDRI, the

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[29] However, it should be noted that the estimated cumulative amount of IDA15 contributions from all potential new donors would be rather small (less than USD 500 million), as measured against their capacity to contribute based on per-capita income and size of the economy. Therefore, this would be insufficient to reduce the large structural gap in the IDA14 burden shares in a substantial way.

structural financing gap is equivalent to USD 2.9 billion.[30] As proposed for HIPC-related costs, donors are requested to consider scaling up their MDRI burden shares proportionally to eliminate the structural financing gap over the IDA15 disbursement period (FY09-19).

Donor Contributions to Finance Arrears Clearance Operations

49. **Arrears clearance operations would be part of IDA's overall new financing commitments during IDA15.** Therefore, these operations could be financed by donors using their burden shares for regular donor contributions. However, this would leave a potentially large structural financing gap, meaning a lack of resources for required financial support to allow arrears clearance operations to proceed.

50. **An alternative would be to apply scaled-up HIPC burden shares or MDRI burden shares for the financing of arrears clearance operations, so as to eliminate any financing gap.** There is a strong economic linkage between arrears clearance and the provision of debt relief under the HIPC Initiative in view of the fact that successful arrears clearance is a prerequisite for reaching the HIPC decision point. Moreover, since arrears clearance operations are of a quick-disbursing budget-supporting nature, the respective donor contributions should be encashed on an accelerated basis, in line with the three-year schedule that is being used for encashment of donors' HIPC-related contributions. Therefore, donors are requested to consider using their scaled-up HIPC burden shares to finance arrears clearance costs.

C. *Pro rata* Provision

51. **The *pro rata* provision (deferment clause) for donors was introduced in IDA7**. Over the three years of a new IDA replenishment, donor contributions become available in three equal annual tranches. It is the practice of some donors to deposit a qualified Instrument of Commitment to IDA, and as a result, payments are subject to annual legislative approvals. In view of this, since IDA7, donors, under the *pro rata* provision, have restricted the use of part of their contributions in the event of any shortfall from those whose contributions exceed 20 percent of the donor total.[31] IDA14 was the first replenishment when the *pro rata* provision was not applicable, as no donor exceeded a burden share of 20 percent in IDA14, even though the *pro rata* provision itself was included in the IDA14 Resolution. Box 1 provides further historical information on the *pro rata* provision.

52. **The primary purpose of the *pro rata* provision has been to facilitate fair burden sharing between a lead donor who provides a qualified financing commitment and the other donors**. The intention is to protect the interests of all other donors in the event of delayed or reduced parliamentary approvals of the lead donors' pledges to an IDA replenishment. In the

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30 See Table 9b, page 23 in *Multilateral Debt Relief Initiative (MDRI): Update on Debt Relief by IDA and Donor Financing To Date*, Resource Mobilization Department, Washington, DC, February 2007.

31 Specifically, donors have the right to instruct IDA to defer the commitment of the second and third tranches of their subscriptions and contributions if a donor whose subscription and contribution represents more than 20 percent of the total replenishment resources has not unqualified at least 66 percent of its total subscriptions and contributions by the date specified in the replenishment Resolution, or 31 days after the Replenishment Effectiveness Date, whichever is later.

past, donors have defined a lead donor as one that provides more than 20 percent of total donor financing. A second purpose of the *pro rata* provision is to provide possible incentives to the lead donor to expedite necessary financial approvals of its IDA contribution, so as to ensure the timely provision of the donor's financing for the new replenishment. However, the *pro rata* provision appears to have had little, if any, actual impact against this second purpose.

Box 1: *Pro Rata* Provision in IDA – A Historical Perspective

The pro rata issue has been discussed by donors since IDA5. In IDA5, the mechanism of qualified Instruments of Commitment for the delivery of IDA contributions was introduced in order to accommodate the legislative requirements of the United States of America. IDA5 introduced an effectiveness threshold of 80 percent for the IDA replenishment, to ensure that IDA5 would not become effective without the contribution from the United States which, at that time, had an IDA burden share of 31.2 percent.

In the IDA6 replenishment report of January 1980, the IDA Deputies defined the concept of a "major donor" as a donor contributing 20 percent or more to the replenishment. Deputies introduced restrictions for IDA management to extend new financing commitments under IDA6 to the extent that a "major donor" has not unqualified its contribution commitments to the replenishment.

In IDA7, the current *pro rata* provision was introduced. It gives donors the right to restrict the use of part of their contributions if a donor whose contribution represents more than 20 percent of total contributions has not unqualified its respective contributions. This *pro rata* provision has been included in all subsequent IDA replenishments, other than the special replenishment for financing of the MDRI. At present, Austria, France and Germany are exercising their pro rata rights under the IDA12 and IDA13 replenishments, currently lowering IDA14 commitment authority by about USD 70 million. This withheld amount of donor contributions adds to the underlying amount of unpaid IDA contributions from the United States of currently USD 378 million, therefore lowering IDA14 commitment authority by a total amount of nearly USD 450 million.

53. **The established contribution threshold of 20 percent ensures that the *pro rata* provision captures only the largest donors without which the replenishment could not proceed as planned.** The possible alternative of lowering the contribution threshold that defines a lead donor to less than 20 percent could imply that a number of donors in IDA15 could become "major donors".[32] A lower threshold could increase the likelihood of the *pro rata* provision triggering a possible withholding of contributions from other donors. With a higher likelihood of other donors exercising their right to restrict the use of their contributions to IDA, recipient countries could see delays and eventual reductions in available IDA commitment authority, an outcome that would run counter to the original intention of the *pro rata* clause.

54. **If the donor burden shares in IDA15 are similar to those in IDA14, i.e. with no single lead donor, management recommends discontinuing the use of the *pro rata* provision for IDA15 so as to ensure predictability of resources and therefore to protect the interests of IDA recipient countries**. As experience has shown that the incentive provided by the clause has been weak and that is has inordinately lowered the amount of resources made available to recipient countries, expanding its use to cover a greater subset of donors would not seem

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[32] For example, a contribution threshold of 10 percent would have included three lead donors in IDA14, i.e., the United States, the United Kingdom and Japan. Their total IDA14 burden shares were as follows: United States – 13.78%; United Kingdom – 13.18%; Japan – 12.24%.

judicious. Moreover, the IDA15 replenishment is expected to include the customary donor contribution threshold for making the overall replenishment effective. This would provide additional assurances that the majority of donor financing commitments have been provided before drawing on the donor contributions received.

D. Accelerated Encashment of Donor Contributions

55. **Donor contributions are normally encashed over 9 years, corresponding to the disbursement profile of IDA's credits and grants**.[33] By drawing down on donors' contributions at the rate of IDA's disbursement needs under a replenishment, IDA's liquid assets will remain stable over time. However, donors may adjust encashments to reflect their particular legal and budgetary requirements. Should unavoidable delays occur, IDA's encashment requests of the affected donor are adjusted to take into account past payment delays and the related loss of investment income to IDA, thus maintaining the present value of a donor's contributions.

56. **When donors accelerate their encashments, they have the option to receive a payment discount**. The discount rate is set to match the expected rate of return on IDA's liquid assets over the standard 9-year encashment horizon.[34] IDA invests the portion of donor funds received ahead of need. The objective is to replicate the discount rate and generate sufficient income to reach the full value of a donor's contributions, over the disbursement horizon of the replenishment. IDA provides a *de facto* investment management service for donors choosing to accelerate encashment of their contributions. IDA also guarantees the investment return, and takes the investment risk, because the discount is agreed up-front, even if actual returns over time should fall short of expectations. Higher than expected investment returns will benefit poor countries by way of higher internal resources becoming available for commitment by IDA.

57. **Over the past seven years, accelerated encashment by donors has more than doubled IDA's total liquidity**. The incremental cash balance held by IDA due to accelerated donor encashments has increased from less than USD 100 million in FY00 to an estimated USD 8.9 billion at of end-FY07. After adding accelerated encashment by IBRD on its IDA14 contributions, total liquidity from accelerated encashment is projected at USD 10.1 billion as of end-FY07, representing 58 percent of total IDA liquidity of USD 17.3 billion projected as of that date (see Annex 2, Table A).

58. **IDA's expected move to U.S. GAAP (generally accepted accounting principles) as of July 1, 2007 will affect the paid-in subscriptions and contributions in IDA's balance sheet of those donors accelerating the encashment of their IDA contributions**. Under IDA's current special purpose reporting format, the agreed encashment discount on accelerated contributions is amortized over the regular encashment period of a replenishment. Once amortized, a donor's paid-in subscriptions and contributions will equal its committed (i.e., gross) IDA contribution amount before any discount. In contrast, under U.S. GAAP, discounts relating

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33 In fact, disbursements resulting from a given replenishment extend out over a total period of 11 years, since new credits and grants are approved during each of the 3 years of a replenishment period. As disbursements in years 10 and 11 are small, donors have agreed to a 9-year encashment period for their IDA contributions. Donors will review the standard encashment schedule for IDA15 at the third and fourth replenishment meetings.

34 For IDA13, the discount rate is 5.5 percent per year; for IDA14 the discount rate is 3.5 percent per year.

to subscriptions and contributions cannot be amortized through the income statement: Future investment income earned on accelerated donor encashments represents IDA's income and becomes part of IDA's retained earnings; therefore, the mere passage of time does not lead to an increase in a donor's paid-in capital in IDA, beyond the cash amounts which the donor has actually paid to IDA. Note that the same principle will apply for encashment *credits*, whereby donors pay their full, unreduced contribution amount on an accelerated basis and use the resulting investment income (i.e., the acceleration credit) to increase their IDA burden share or finance a required contribution under another IDA replenishment, such as the MDRI.

59. **The move to U.S. GAAP accounting will have no impact on donors' voting rights, their withdrawal rights from IDA or the way IDA's commitment authority is determined**. IDA voting rights and withdrawal rights will continue to be based on the gross, committed contribution amount of the donor accelerating the encashment of its IDA contributions. Voting rights are allocated in accordance with IDA's voting rights system[35], while IDA's Articles of Agreement make detailed provisions for the exercise of members' withdrawal rights.[36] In accordance with current practice, the volume of committable donor resources under a given replenishment will be based on the gross contribution amount from the donors using an accelerated encashment schedule.

60. **For contributions to IDA15, assuming that IDA moves to financial reporting under U.S. GAAP, donors choosing to accelerate encashment of their contributions could continue to make their payments directly to IDA, as is currently the case**. The total paid-in subscriptions and contributions will be reported in IDA's balance sheet based on the amounts actually paid to IDA, net of the acceleration discounts by donors. In the supplemental schedule of subscriptions and contributions to the IDA financial statements, the <u>gross</u> (committed) amount of each donor's subscriptions and contributions will continue to be reported (before any discount). To reconcile to the net amount reported in IDA's balance sheet, a subsequent deduction referring to the cumulative applicable discount will be presented at the bottom of the supplemental schedule of subscriptions and contributions to arrive at the <u>net</u> (paid-in) amount of total donor subscriptions and contributions. Donors planning to use an accelerated encashment schedule for IDA15 are requested to confirm whether these reporting arrangements under U.S. GAAP would be acceptable to them.

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[35] IDA's Articles of Agreement provide that the Board of Governors can determine voting rights for subscriptions other than the initial subscriptions to IDA. IDA's voting rights system was established in IDA3 and has been applied in subsequent replenishments. In each replenishment resolution, the Board of Governors makes provision for the allocation of voting rights. It has been IDA's practice to allocate voting rights for the full undiscounted amount of a donor's accelerated contribution. Since this arrangement is independent of any accounting standards for financial reporting, it would not change when IDA's financial statements are presented under U.S. GAAP.

[36] If a member withdraws from IDA, the Articles of Agreement provide that the withdrawing member and IDA proceed to a settlement of accounts and agreement is reached on the amount recoverable by the member. If no agreement is reached, default provisions apply (Article VII, Section 4(c)) including the return, subject to certain conditions, of the amount paid in "on account of its subscription". IDA's Articles of Agreement allow IDA to count the gross, committed contribution of an accelerated contribution as the amount paid "on account of its subscription". Since this arrangement is independent of any accounting standards for financial reporting, it would not change when IDA's financial statements are presented under U.S. GAAP.

61. **An alternative for donors who aim to increase their paid-in IDA subscriptions and contributions beyond the discounted amounts would be to establish a separate trust fund to be managed by IDA (or to use the services of a commercial asset manager)**. The trust fund would invest the paid-in resources, generating investment income over the 9-year encashment period so as to recover the discount. On the date when the payment was originally due as per the replenishment agreement, both the initial cash received and the investment income earned to date would be transferred from the trust fund to IDA. Actual trust fund returns, however, would be uncertain and the final amount of paid-in IDA subscriptions and contributions would not be known up-front. The trust fund option would also involve administrative costs for the donors. Moreover, it may lead to complexities in terms of foreign exchange risk management as donor resources held in trust fund accounts may not be available to support IDA's liquidity-based approach of hedging its foreign exchange exposures. Management therefore recommends that donors choosing to accelerate encashment of their contributions in IDA15 would continue to pay to IDA directly.

VI. Issues for Discussion

62. **Structural Financing Gap:**

a. Donors may want to discuss the various options for lowering the structural financing gap in donors' regular IDA contributions, as presented in Section V.B. of this paper. These include: (i) an increase in burden shares of individual donors; (ii) funding from new IDA donors; (iii) recalibration of the burden shares for all donors; and (iv) accelerated encashment of donors' IDA15 contributions.

b. For IDA's cost of debt relief, do donors agree to scale up proportionally their respective HIPC (i.e. IDA13) burden shares and their MDRI burden shares, so as to close the structural financing gap?

c. To finance arrears clearance operations, do donors agree to use their scaled-up HIPC burden shares?

63. ***Pro rata* Provision:**

a. In the absence of a single lead donor in IDA15, do donors agree to discontinue the use of the *pro rata* provision so as to ensure predictability of resources and therefore to protect the interests of IDA recipient countries, as presented in Section V.C. of this paper?

64. **Accelerated Encashment of Donor Contributions:**

a. Donors planning to use an accelerated encashment schedule for their IDA15 contributions are requested to confirm whether the reporting arrangements under U.S. GAAP as set out in Section V.D. would be acceptable to them.

Annex 1: IDA14 Financing Framework

Table A: Original IDA14 Financing Framework (as agreed at the start of IDA14)

Sources of Funds	Original Framework	
	SDR million	*USD equiv. million* [a/]
Donor contributions		
Regular contributions (net of structural gap)	10,181	*14,902*
Accelerated, supplemental, incentive contributions	495	*724*
HIPC contributions - IDA14 period (FY06-08)	1,160	*1,693*
Carry-over from IDA13 (from donors)	269	*394*
Subtotal donors	12,105	*17,713*
Internal resources (principal reflows, investment income, liquidity)	8,700	*12,734*
IBRD transfers [b/]	1,111	*1,626*
Total IDA14 commitment authority	**21,916**	***32,073***
Donor contributions to cover forgone charges on IDA13 grants	470	*688*
Total IDA14 resources	**22,386**	***32,761***

Note: Details may not add up due to rounding.

a/ USD equivalent amounts are expressed at the IDA14 foreign exchange reference rate of USD/SDR 1.46365.

b/ IBRD transfers of USD 500 million p.a., drawn-down up-front and generating total commitment capacity equivalent to USD 1.6 billion.

Table B: Current IDA14 Financing Framework (post-MDRI, and after additional funds from IBRD and IFC)

	Sources of Funds	**Framework After MDRI** SDR million	**Framework After MDRI** *USD equiv. million* [a/]
1	Donor contributions		
2	Regular contributions (net of structural gap)	10,181	*14,902*
3	Accelerated, supplemental, incentive contributions	495	*724*
4	HIPC contributions - IDA14 period (FY06-08)	1,160	*1,693*
5	Carry-over from IDA13 (from donors)	269	*394*
6	Subtotal donors, before MDRI	12,105	*17,713*
7	Plus MDRI contributions received from donors as of Dec-31-2006:		
8	Firm financing, in FY07-16, for IDA11-14 disbursements	2,461	*3,636*
9	Qualified financing, in FY07+08, for IDA11-14 disbursements [c/]	124	*185*
10	Sutotal MDRI contributions	2,585	*3,821*
11	**Total donors, after MDRI**	**14,690**	***21,534***
12	Internal resources, available before MDRI	8,700	*12,734*
13	Less: Reflows lost due to MDRI for IDA11-14 disbursements (FY07-16) [d/]	-4,574	*-6,746*
14	**Equals: Internal resources, available after MDRI**	**4,126**	***5,988***
15	IBRD transfers [b/]	1,111	*1,626*
16	**Funds available for IDA14 commitments, post-MDRI**	**19,927**	***29,148***
17	Additional internal resources needed to maintain IDA14 commitment authority	1,989	*2,925*
18	**Original IDA14 commitment authority**	**21,916**	***32,073***
19	Additional IBRD transfer from FY06 net income	205	*300*
20	IFC grant in FY07	102	*150*
21	**Revised IDA14 commitment authority**	**22,223**	***32,523***
22	Donor contributions to cover forgone charges on IDA13 grants	470	*688*
23	**Total IDA14 resources**	**22,693**	***33,211***
24	of which: Internal resources	6,115	*8,913*

Note: Details may not add up due to rounding.
Source for MDRI data: *Multilateral Debt Relief Initiative (MDRI): Update on Debt Relief by IDA and Donor Financing To Date*, Wash. DC, Feb. 2007.

a/ USD equivalent amounts are expressed at the IDA14 foreign exchange reference rate of USD/SDR 1.46365.
b/ IBRD transfers of USD 500 million p.a., drawn-down up-front and generating total commitment capacity equivalent to USD 1.6 billion.
c/ Qualified financing commitments are assumed to become unqualified during the remainder or the IDA14 period (FY06-08).
d/ MDRI cost estimates as of December 31, 2006.

Annex 2: IDA's Liquid Assets

A. IDA's Financial Dynamics and Risks

1. Since IDA does not borrow in the capital markets, its commitments under a given replenishment are limited to funds from donors and contributions from Bank Group income, complemented by credit reflows and other internal resources of IDA. Within these constraints, IDA's ability to disburse committed funds on schedule is essential for developing countries relying on IDA's cash inflows. IDA's liquidity needs to be managed to ensure that future disbursements on credits and grants will be backed by sufficient liquid funds. To achieve this, donor funds are encashed to match the disbursement profile of credits and grants, and future credit reflows are committed in advance so that resulting disbursements will match the time profile of reflows. Comprehensive liquidity projections are used to validate the availability of resources in the future.

2. IDA's key financial risks include foreign exchange and interest rate exposure. Donor funds are provided in a variety of national currencies whereas IDA's credits and grants are provided in SDRs. Management uses IDA's liquid assets to implement a proportional holding approach to keep all of IDA's assets in SDR alignment, matching the currency of its financing commitments. The long-term nature of IDA's disbursements creates the potential for substantial interest rate exposure, which is managed through IDA's liquid asset investment policy.

B. IDA's Cash Flows

3. *Cash Flow Components*. IDA's cash inflows consist of four primary components (see Chart A): (i) encashment of contributions provided by IDA's donor countries; (ii) credit reflows, including principal repayments and charge income; (iii) Bank Group net income transfers; and (iv) investment income on IDA's liquid assets. IDA's cash outflows have two primary components: (i) disbursements on approved IDA credits and grants; and (ii) payments to IBRD for IDA's allocated annual share of Bank administrative expenses.

4. *Mismatches in Cash Flows*. In a dynamic equilibrium, cash inflows and outflows would match in any given year, leaving the balance of IDA's liquid assets unchanged. In practice, however, IDA faces timing mismatches between cash receipts from donors and borrowers and disbursements on new credits and grants, leading to changes in the volume of IDA's liquid assets. To manage such mismatches and ensure an optimal use of development resources, IDA employs a number of financial practices:

- *Encashment of donor funds*: Donor funds and IBRD transfers are generally encashed over time to match the nine-year average disbursement profile of credits and grants;[37]
- *Advance commitment of credit reflows*: Future repayments on existing IDA credits are committed in advance for new credits and grants so that resulting disbursements match the time profile of credit reflows;
- *Advance commitment of expected investment income:* Projected future investment income is committed at the beginning of each replenishment period; and

[37] Donor contributions are encashed on a *pro rata* basis among donors, in accordance with the encashment schedule agreed during the replenishment discussions or as agreed between a donor and IDA. IBRD transfers prior to IDA14 were encashed over 6-9 years. For IDA14, IBRD transfers will be encashed up-front upon approval by IBRD's Board of Governors.

- *Annual adjustments of the IDA commitment charge*: Through annual adjustments of the level of commitment charge on IDA credits, total charge income – including donor compensation for forgone charge income due to debt relief – is projected to equal IDA's administrative expenses in a given year.

Chart A: IDA's Primary Cash Inflows and Outflows

Encashment of donor contributions Principal repayments on IDA credits Bank Group net income transfers Investment income	=	Disbursements on IDA credits and grants
Charge income on IDA credits (including donor compensation on forgone charges due to debt relief and IDA grants)	=	IDA's allocated administrative expenses

5. *Minimum Liquidity*. Beyond these practices, and in view of the fact that IDA does not borrow, IDA needs to be able to address any unexpected demands on its liquidity.[38] This is achieved primarily through a minimum prudent liquidity level for IDA, which is set at one third of annual gross disbursements on credits and grants over a rolling 3-year period. Given IDA's current level of liquidity, maintaining a minimum level of liquidity is of no immediate concern. However, it is an important consideration for IDA's financial planning, including when determining the volume of internal resources to made available in IDA15 and subsequent replenishments.

C. Historical Liquidity Levels of IDA

6. *Relative Liquidity Levels*. Since the mid-1990s, IDA's liquid assets have grown from USD equiv. 5.7 billion at end-FY95 to USD equiv. 16.7 billion as of end-FY06. Much of this growth is the result of IDA's increasing assistance levels over time. In relative terms, IDA's total liquidity has been rather stable over the past decade.

7. The most direct measure of IDA's increasing assistance levels over time is the volume of <u>IDA's annual disbursements</u>. In relative terms, while IDA's liquid assets have increased from FY95 to FY99, they remained stable over the past seven years, from FY00 through FY06, at about twice the volume of annual disbursements of IDA. IDA's liquidity levels vs. annual disbursements have been comparable to or below those of the African Development Fund and the Asian Development Fund (see <u>Chart B</u>).

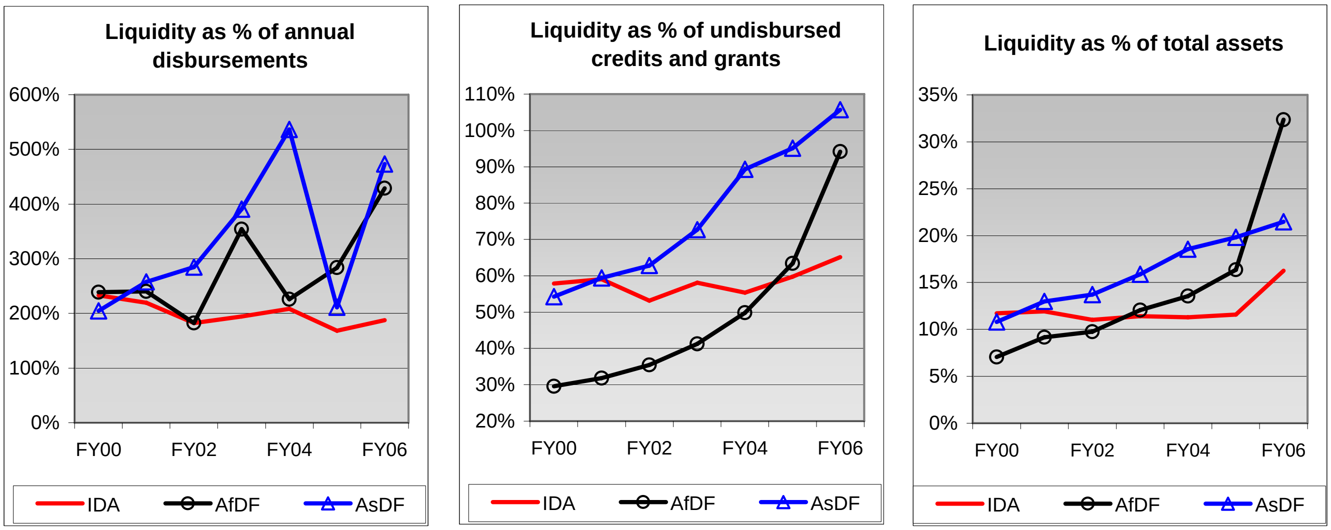
8. A second measure for IDA's increasing assistance levels over time is the volume of <u>undisbursed credits and grants</u>. A main reason for holding liquidity is to disburse against approved, but yet undisbursed IDA credits and grants. On this account, IDA's liquidity levels have fluctuated around 60% of undisbursed balances since FY00, with a slight increase to 65% in FY06, reflecting primarily successful efforts over the past years to further raise disbursement ratios on approved credits and grants.

9. A third measure of the size of IDA's operations is the volume of its <u>total reported assets</u>. Compared against total assets, IDA's liquidity accounted for about 12% of total assets between FY00 and FY05. As of end-FY06, this ratio increased to 16%. This increase is due to the reduction of IDA's

[38] While IDA is allowed under its Articles to borrow, it does not do so as a matter of practice.

assets from USD 130.4 billion at end-FY05 to USD 102.9 billion at end-FY06, following loss provisions recorded in FY06 representing debt relief to be delivered by IDA under the MDRI.

Chart B: Relative Levels of Liquidity of Soft-Loan Windows (IDA, AfDF and AsDF)



10. *Acceleration of Donor Encashments*. Beyond the overall growth of IDA's financing activities, the primary driver for the increase in IDA's liquid assets has been the substantial increase in the number of donors accelerating their IDA encashments. Donors accelerate their IDA encashments either to receive payment discounts or as a way of providing additional resources to IDA. IDA needs to earn the discount rate when investing the accelerated portion of donor funds to generate the target volume of donor contributions for the replenishment.[39]

11. Over the past seven years, accelerated encashment by donors has increased heavily, more than doubling IDA's total liquidity in the process. The incremental cash balance held by IDA due to accelerated donor encashments has increased from less than USD 100 million in FY00 to an estimated USD 8.9 billion at of end-FY07 (see Table A). The most significant increase was during FY06 and FY07 as several major donors are accelerating their IDA14 encashments, without discount, attributing the expected incremental investment income of IDA to cover their share of MDRI payments during FY07 and FY08. In addition, IBRD contributions in IDA14 are encashed up-front, rather than over the standard 9-year profile, adding another USD 1.2 billion of liquidity.

12. As of June 30, 2007, total liquidity from accelerated encashment is projected at USD 10.1 billion, representing 58 percent of total IDA liquidity of USD 17.3 billion projected as of that date. These liquid funds are spoken for and need to be invested at the discount rate to generate sufficient income so as to satisfy future disbursements resulting from IDA14 commitments for credits and grants.

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39 The discount rate varies with market conditions. The rate reflects IDA's expected future return on liquid assets over the 9-year encashment period of donor contributions. For IDA13, the agreed discount rate is 5.5% per year; for IDA14 the discount rate is 3.5% per year.

Table A: Incremental IDA Liquidity Due to Accelerated Encashments (end of fiscal year, USD equiv. million)

	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07 Proj.
Accelerated Donor Encashments, IDA12-14								
Actual encashments	4,062	4,474	4,311	4,879	5,274	5,631	7,620	5,577
Less: Encashments based on regular schedule	3,994	4,155	3,614	3,860	4,266	4,346	4,360	5,192
Net acceleration cash flow	68	319	697	1,019	1,007	1,284	3,259	385
Cummulative acceleration balance	*68*	*388*	*1,084*	*2,103*	*3,110*	*4,395*	*7,654*	*8,039*
Annual investment income on accelerations 1/	1	14	47	154	5	302	9	293
Cummulative investment income	*1*	*15*	*62*	*216*	*222*	*524*	*533*	*826*
Total acceleration balance from donors	*69*	*402*	*1,146*	*2,319*	*3,332*	*4,919*	*8,187*	*8,866*
Accelerated Encashment of IBRD Transfers								
Actual encashments							400	950
Less: Encashments based on regular schedule							22	104
Net acceleration cash flow							378	846
Cummulative acceleration balance							*378*	*1,225*
Annual investment income on accelerations 1/							0	28
Cummulative investment income							*0*	*28*
Total acceleration balance from IBRD							*379*	*1,253*
Total Cumulative Acceleration Balance	**69**	**402**	**1,146**	**2,319**	**3,332**	**4,919**	**8,566**	**10,119**
IDA's total liquidity	10,824	11,742	11,608	13,035	13,087	14,147	15,853	17,300
Acceleration balance in % of total IDA liquidity	1%	3%	10%	18%	25%	35%	54%	58%

1/ Investment returns for FY00-FY06 are based on IDA's actual annual returns; the assumed investment return for FY07 is 3.5%.

D. Projecting Future Cash Flows and Liquidity of IDA

13. *Future Cash Flows of IDA*. IDA's liquidity levels going forward will depend on IDA's future cash inflows and outflows. Projecting these cash flows requires making assumptions, *inter alia*, about the level of future donor contributions to IDA and the level of future Bank Group transfers. For this purpose, management applies a set of core parameters for IDA's long-term financial projections which are rooted in donors' financing commitments made in the context the HIPC Initiative, the Multilateral Debt Relief Initiative, and the IDA13 and IDA14 replenishments with respect to replacing forgone credit reflows due to the making of IDA grants. These core assumptions have been presented and discussed at the first IDA15 meeting in March 2007 in Paris.[40]

14. *Projected Cash Inflows*. IDA's projected annual cash inflows over the next two decades are illustrated in Chart C. The encashment of donor contributions under the IDA13 and IDA14 replenishment follows a highly accelerated profile. In addition, the draw-down of IBRD net income transfers to IDA during FY05-08 is accelerated as well. The result is a peak of total cash inflows of IDA of more than USD equiv. 10 billion in FY06. Assuming conservatively that no donor would accelerate the encashment of its contributions for IDA15 and beyond, total cash inflows are projected to fall to less than USD equiv. 8 billion by FY09, before rising gradually into the future, in line with

40 See Table 1, page 8, in *IDA' Long-term Financial Capacity*, Resource Mobilization Department, Washington, DC, February 2007. Since cash inflows from IDA's charge income (including related donor compensation) and cash outflows for IDA's allocated share of administrative expenses are assumed to match over the long run, per IDA's charge policy, these are excluded from the further cash flow analysis.

IDA's long-term assumptions about the level of future donor contributions. Chart C also illustrates the annual donor contributions required to replace forgone credit reflows due to debt relief and IDA grants.

Chart C: Composition of Projected Annual Cash Inflows, FY05-25 (USD equiv. million)

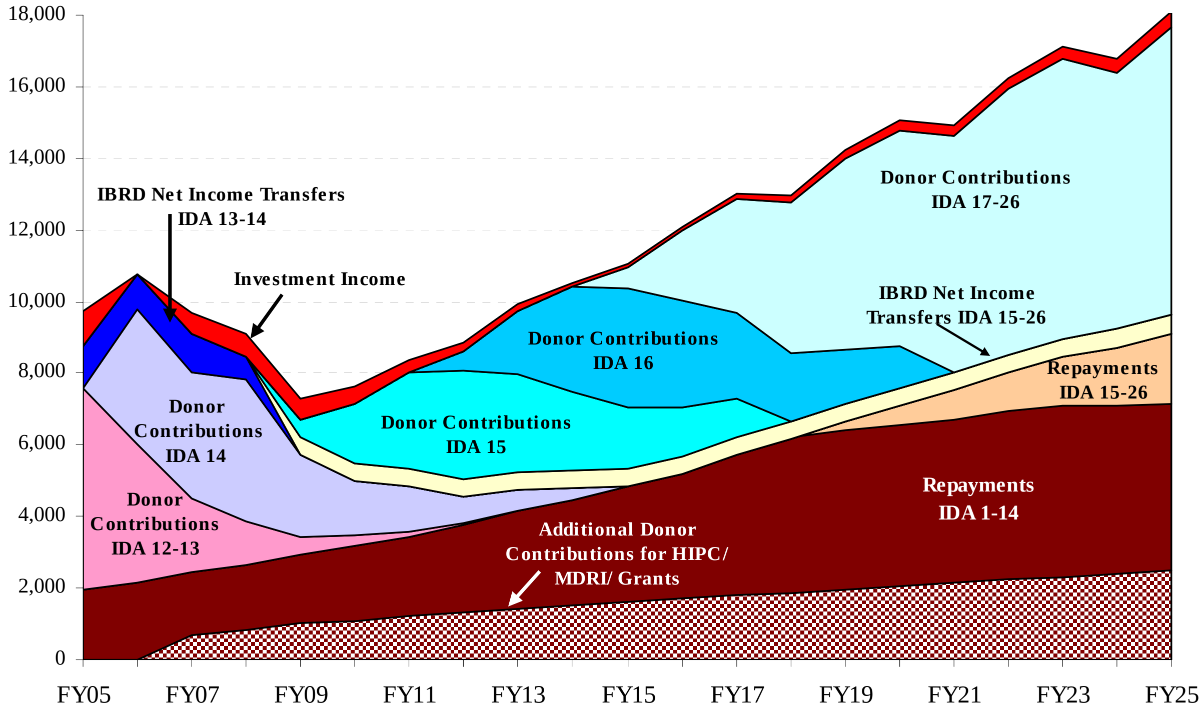
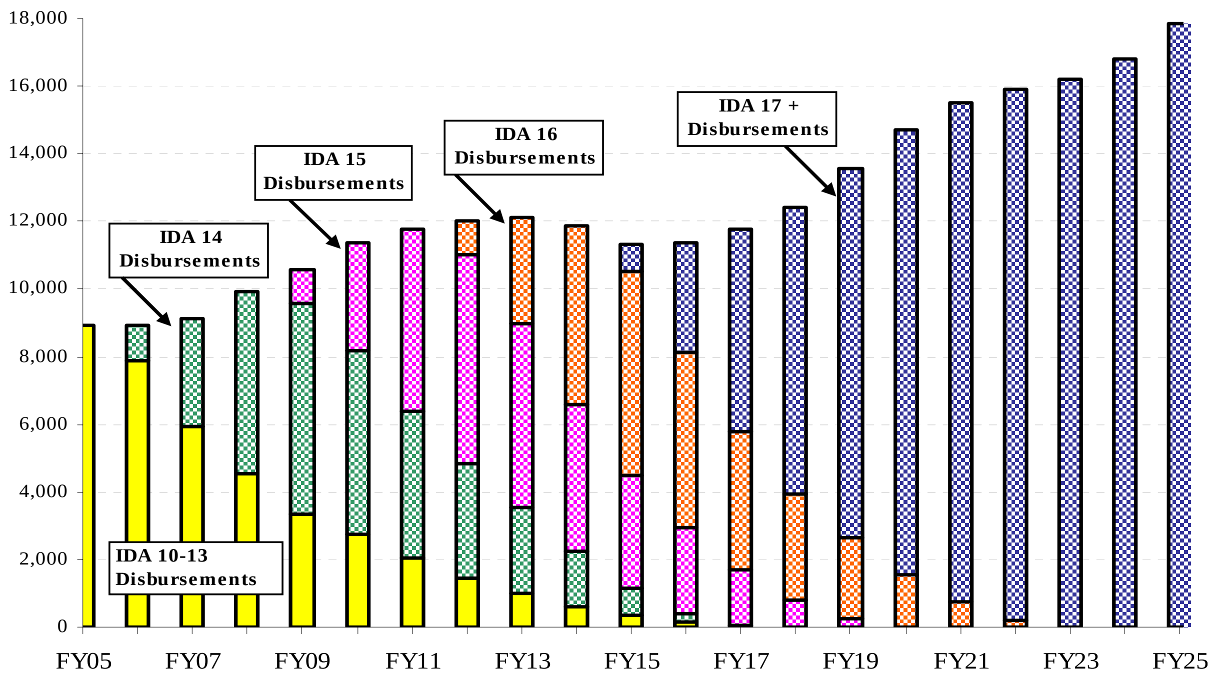


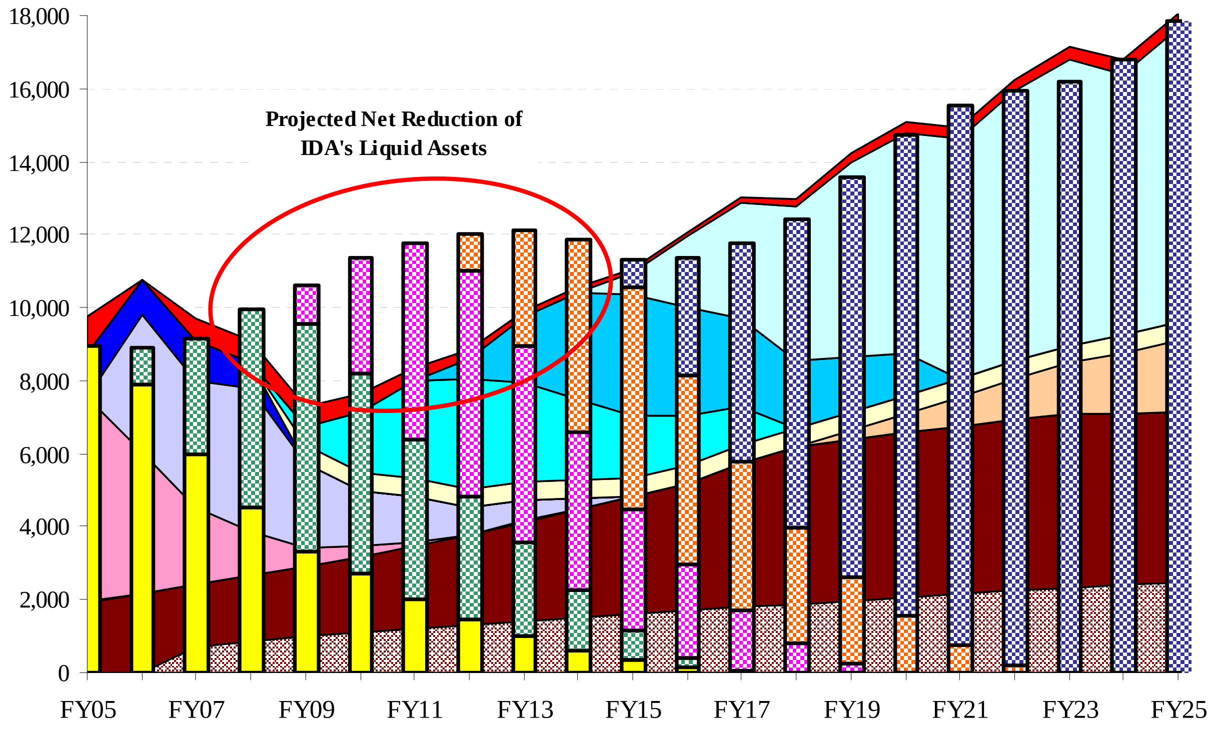
Chart D: Composition of Projected Annual Cash Outflows, FY05-25 (USD equiv. million)



15. *Projected Cash Outflows*. IDA's projected annual cash outflows over the next two decades are illustrated in Chart D. Outflows are driven by disbursements on new credits and grants committed under a given IDA replenishment. As shown in Chart D, disbursements for a specific replenishment extend over a total of 11 years. This is because credits and grants approved today will disburse over an average of 9 years (including the year of approval), and each IDA commitment period extends over a total of 3 years. The result is a staggered profile of future disbursements of IDA. IDA's aggregate disbursements would fall somewhat between FY14-17 because, assuming that donors provide only their baseline contributions, IDA's commitment capacity in IDA16 would be somewhat lower than that in IDA15 and in IDA14 (see Section IV of this paper).

16. *Net Reduction of Liquidity*. Combining projected cash inflows and outflows leads to projections about IDA's future net cash flows, as shown in Chart E. Over the period FY08-14, annual cash outflows would exceed annual cash inflows, leading to net cash outflows over that period and, therefore, a commensurate reduction of IDA's liquid asset balance. This is illustrated in Chart F in the following section.

Chart E: Combining Projected Cash In- and Outflows, FY05-25
(USD equiv. million)



17. IDA's actual future cash flows and liquidity levels are likely to differ from the current projections due to a variety of factors. Beyond the level of future donor contributions to IDA, which is inherently uncertain, one key variable is the extent of accelerated donor encashments in future IDA replenishments. The current cash flow projections assume conservatively that donors would not accelerate their future encashments. Other variables affecting cash inflows include the volume of future Bank Group contributions to IDA and the actual investment returns on IDA's liquid assets. Cash outflows may differ from projections depending primarily on the actual rate of disbursements on

approved credits and grants, which is partly dependent on the ratio of investment operations vs. development policy operations in future years. Furthermore, IDA's reported cash inflows and outflows in USD equivalent terms will be impacted by the prevailing USD/SDR foreign exchange rate.

E. Investment Policy and Liquidity Tranching

18. *Investment Authorization*. The General Investment Authorization[41] for IDA approved by the Executive Directors in January 2001 provides the basic authority for the investment of IDA's liquid assets and sets broad parameters for the duration and types of investment. The CFO issues Investment Guidelines that detail operational restrictions within the framework set by the General Authorization. The investment strategy for IDA's portfolio is described in IDA's Investment Policy.[42]

19. *Investment Policy Objectives.* The primary objective in the management of the liquid assets of IDA is to provide a ready source of liquidity when needed by IDA to meet projected net cash requirements. Consistent with the primary objective, IDA also seeks to maximize returns subject to loss constraints to generate investment income which can be added to IDA's resources.[43] In line with the above, IDA's assets are invested so that their duration closely matches the duration of net liabilities, defined as projected net cash outflows.

20. *Liquidity Tranching*. Under the current Investment Policy, IDA's liquidity is divided into two tranches:

- Tranche 1 ('the cash flow immunization portfolio'), which is constructed to ensure IDA is able to cover its projected net cash requirements as defined by IDA's financial projections. The size of Tranche 1 is set to equal the present value of IDA's future net cash outflows. Tranche 1 is invested to immunize IDA from interest rate risks relating to the projected draw-down of IDA's liquid assets due to IDA's financing commitments. Only contracted cash flows are considered for this purpose, represented by commitments under prior and the current replenishment. Tranche 1 comprises two sub-tranches:
    - liquidity arising from accelerated encashment of donor and Bank Group contributions (the acceleration sub-tranche); and
    - the projected volume of liquidity needed to fund prior and current financing commitments (the immunization sub-tranche).

- Tranche 2 ('the return maximization portfolio'), which represents the difference between IDA's total liquid assets and the amount of liquidity that is required to cover IDA's projected net cash requirements (Tranche 1). Its investment objective is to maximize investment returns subject to risk and loss constraints. Tranche 2 also comprises two sub-tranches:
    - minimum liquidity required for IDA's financial operation; and
    - residual liquidity (if available) for future commitments, to be provided as "internal resources" in support of future IDA replenishments.

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41 "IDA General Investment Authorization," IDA-R2001-6, January 10, 2001.

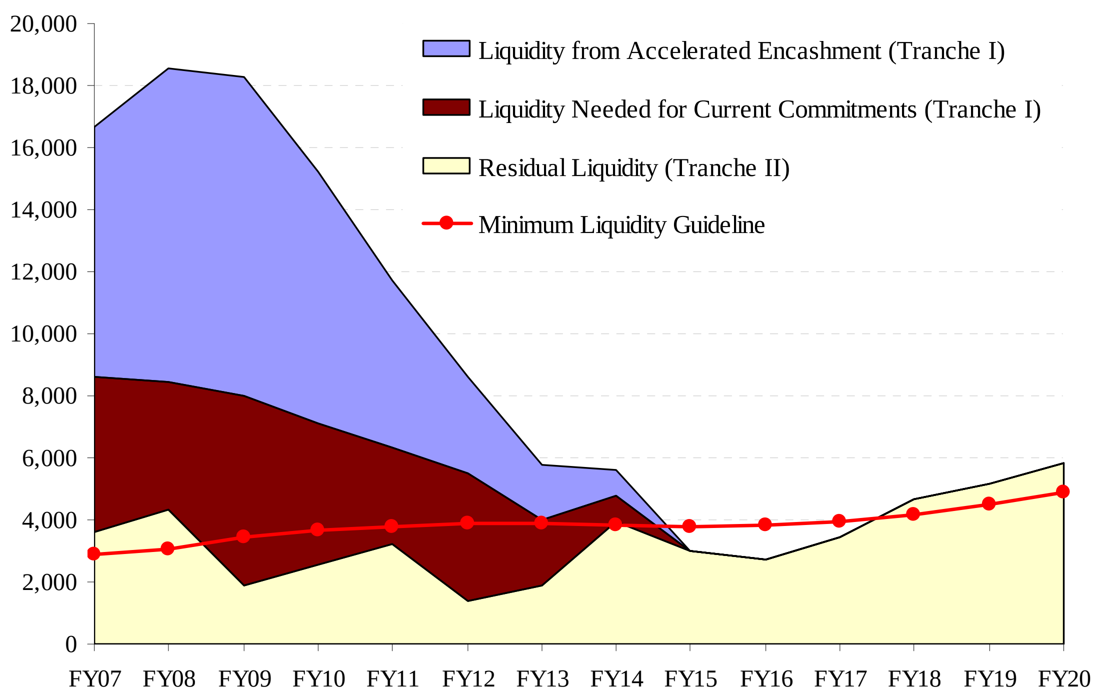
42 "IDA Investment Policy," IDA/R2001-0006, January 10, 2001. A subsequent review of the policy took place in June 2005: "Investment of IDA's Liquid Assets: A Review," AC2005 -0057, June 22, 2005.

43 "IDA Liquid Assets Investment Guidelines", November 6, 2003.

21. *Size of Liquidity Tranches*. The sizes of the individual Tranches depend on market rates and the core assumptions underlying the financial projections and therefore are reviewed periodically. Tranche 1 includes a cash portion to be invested in a short-term cash portfolio so as to provide for IDA's immediate and short-term disbursement needs. Several factors have an impact on the volume of IDA's liquid assets, including inter alia: the speed of donor encashments; the overall volume of IDA's annual commitments and disbursements; the pace of credit and grant disbursements; the level of investment income; volatility concerning Bank Group net income transfers; and the share and volume of Bank administrative expenses allocated to IDA. Moreover, since IDA's liquidity is reported in USD terms, while IDA's liquid assets are invested in the four component currencies of the SDR basket, a depreciation (appreciation) of the USD vs. the SDR will lead to a higher (lower) reported USD equivalent liquidity balance of IDA.

22. Chart F illustrates the projected total liquidity level of IDA and the associated liquidity tranching. In Chart F it is assumed conservatively that donors would not accelerate the encashment of their future contributions to IDA. As a result, the acceleration sub-tranche is projected to disappear by FY15.

Chart F: Projected Liquidity Tranching, FY07-FY20
(USD equiv. million)



23. Table B shows the historical investment returns on IDA's liquid assets. Liquidity invested in Tranche 1 matches the profile of the expected net cash outflows of IDA in the future. As a result, Tranche 1 features a relatively high duration (i.e., interest sensitivity). This leads to lower (higher) portfolio returns in years when market interest are rising (declining), in view of the inverse relationship between fixed income asset prices and market interest rates. Actual reported investment returns on Tranche 1 are financially inconsequential in so far as the increase (decrease) of the marked-to-market value of the Tranche 1 bond portfolio will be off-set by a decrease (increase) of the present value of the contracted net cash outflows of IDA.

<u>Table B</u>: Investment Portfolio Returns of IDA (since FY98)

	Portfolio Size at 03/31/2007 (USDeq. Million)	Portfolio Returns				
		FY07 through 03/31/2007 (non-annualized)	Prior Year (FY06) (annualized)	Three Years ended FY06 (annualized)	Five Years ended FY06 (annualized)	FY98 to date (annualized)
Total IDA	17,612	3.35%	0.18%	2.46%	4.52%	4.92%
Tranche 1	13,874	3.30%	0.14%	2.62%	4.81%	5.10%
Tranche 2	3,738	3.49%	0.38%	1.66%	3.07%	4.19%

Annex 3: IDA15 Financing Framework – Trade-offs

Table A: IDA15 Financing Framework (SDR million)

Sources of Funds	Lower Scenario (IDA14 +10.4%)	**IDA15 as Proposed (IDA14 +20.0%)**	Higher Scenario (IDA14 +30.0%)
Regular donor contributions (net of structural gap)	12,672	**14,785**	16,977
Donor financing for Debt Relief Costs			
Donor HIPC contributions	1,486	**1,486**	1,486
Donor MDRI contributions	4,084	**4,084**	4,084
Donor financing of arrears clearance operations	925	**925**	925
Total donors	19,167	**21,280**	23,472
IBRD transfers	1,088	**1,088**	1,088
Internal resources (reflows, investment income)	3,931	**3,931**	3,931
Total IDA15 commitment authority	24,186	**26,299**	28,491

Note: Details may not add up due to rounding.

Table B: Total Target Volume of Regular Donor Contributions for IDA15 (SDR million)

Based on IDA14 regular burden shares	Lower Scenario (IDA14 +10.4%)	**IDA15 as Proposed (IDA14 +20.0%)**	Higher Scenario (IDA14 +30.0%)
Regular donor contributions:			
Total target volume, i.e. 100%	15,559	**18,153**	20,844
Net amount of resources required, i.e. 81.45% after structural financing gap of 18.55%	12,672	**14,785**	16,977

<u>Table C</u>: IDA15 Financing Framework (USD equiv. billion)

Sources of Funds	Lower Scenario (IDA14 +10.4%)	**IDA15 as Proposed (IDA14 +20.0%)**	Higher Scenario (IDA14 +30.0%)
Regular donor contributions (net of structural gap)	18.9	**22.1**	25.4
Donor financing for Debt Relief Costs			
Donor HIPC contributions	2.2	**2.2**	2.2
Donor MDRI contributions	6.1	**6.1**	6.1
Donor financing of arrears clearance operations	1.4	**1.4**	1.4
Total donors	28.6	**31.8**	35.1
IBRD transfers	1.6	**1.6**	1.6
Internal resources (reflows, investment income)	5.9	**5.9**	5.9
Total IDA15 commitment authority	36.1	**39.3**	42.6

Note: Details may not add up due to rounding.
USD equivalent amounts are expressed at the spot FX rate of January 10, 2007 of USD/SDR 1.49429.