

**ELIGIBILITY OF EXPENDITURES IN
WORLD BANK FINANCING**

**FY05 REPORT ON
IMPLEMENTATION EXPERIENCE**

**OPERATIONS POLICY AND COUNTRY SERVICES
OCTOBER 3, 2005**

ABBREVIATIONS AND ACRONYMS

BP	Bank Procedure
CAS	Country Assistance Strategy
CDD	Community-driven development
ESSD	Environmentally and Socially Sustainable Development Network
FY	Fiscal year
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDC	Interest during construction
ISN	Interim Strategy Note
LICUS	Low-Income Countries Under Stress
MDB	Multilateral development bank
OP	Operational Policy
OPCS	Operations Policy and Country Services Network
PAD	Project Appraisal Document
PIU	Project implementing unit
PREM	Poverty Reduction and Economic Management Network
PRSC	Poverty reduction support credit
RVP	Regional vice president
SWAp	Sectorwide approach
TA	Technical assistance

**ELIGIBILITY OF EXPENDITURES IN WORLD BANK FINANCING:
FY05 REPORT ON IMPLEMENTATION EXPERIENCE**

CONTENTS

	Page
I. Introduction	1
II. Country Financing Parameters.....	2
A. Cost Sharing	4
B. Recurrent Cost Financing	6
C. Local Cost Financing	7
D. Financing of Taxes and Duties.....	8
III. Trends in Bank Financing	9
A. Cost Sharing	9
B. Recurrent Cost Financing	11
C. Local Cost Financing	11
D. Financing of Taxes and Duties.....	12
E. Financing of Other Expenditures.....	12
F. Application to Ongoing Projects.....	15
G. Deviations from Country Financing Parameters	15
IV. Implementation Arrangements	15
 Annexes	
Annex A. Countries for which Country Financing Parameters have not been Established by September 30, 2005.....	21
Annex B. Country Arrangements for Cost-Sharing	23
Annex C. Country-Level Limits on Recurrent Cost Financing	29
 Boxes	
Box 1. Typology of Country Cost Sharing Strategies	5
Box 2. Recurrent Cost Financing: Typology of Country-Level Limits	7
Box 3. Taxes and Duties Identified as Ineligible for Bank Financing.....	9
Box 4. Financing of Land.....	13
Box 5. Financing of Severance Payments	14
Box 6. New Forms of Expenditures Financed by the Bank.....	14
 Tables	
Table 1. Country Financing Parameters Established by September 30, 2005	3
Table 2. Bank Financing Share in Investment Lending, FY01-05.....	10
Table 3. Range of Bank Financing Share in Investment Lending, FY01-05.....	10
Table 4. Recurrent Cost Financing, FY01-05.....	11

ELIGIBILITY OF EXPENDITURES IN WORLD BANK FINANCING: FY05 REPORT ON IMPLEMENTATION EXPERIENCE

I. INTRODUCTION

1. The World Bank is engaged in a broad effort to modernize and realign its operational policies and practices.¹ Its aims are to help borrowers achieve the Millennium Development Goals and other development objectives, and to harmonize the Bank's procedures with those of other donors to better support country capacity and reduce transaction costs. As part of this process, on April 13, 2004, Executive Directors approved changes to the policies that determine the expenditures that the Bank may and may not finance in investment lending.² The changes were aimed at eliminating a disconnect that had emerged, over time, between the expenditures that borrowers need to incur to achieve their development goals, and those that the Bank could finance under its previous policies. The new policy, set out in Operational Policy (OP) and Bank Procedure (BP) 6.00, *Bank Financing*, allows the Bank to finance the expenditures that are needed to meet the development objectives of the operations that it supports, within an overall framework that addresses risks to fiscal sustainability and the appropriate use of Bank resources, in the context of specific country conditions.

2. **Management Commitments.** In introducing the new policy statement, Management committed to put in place review processes appropriate to the risks associated with the different forms of expenditures; issue guidelines to assist staff in determining whether, to what extent, and how to finance the different expenditure types; and, for each of the first two fiscal years after introduction of the new policy, to prepare for discussion with Executive Directors a review of implementation experience and identify any areas where changes were needed. This is the first report, covering the period since the approval of the new policy to the end of FY05.³

3. **Implementation Overview.** Implementation so far has proceeded as foreseen. The new policy became effective in April 2004, and Management review procedures and guidance to staff were also put in place at that time.⁴ The new policy is applied to

¹ See *World Bank Lending Simplification and Modernization* (SecM2004-0465), October 22, 2004.

² See *Eligibility of Expenditures in World Bank Lending: A New Policy Framework* (R2004-0026/1), April 1, 2004. Also see *Eligibility of Expenditures in World Bank Lending - A New Policy Framework: Initial Implementation Experience* (OM2004-0057/1), September 17, 2004.

³ Management also reports to Executive Directors semiannually during the first two years of implementation on the incidence of recurrent costs in newly approved loans. The report on recurrent costs for the second half of FY05 is integrated into this report. For the report on the incidence of recurrent costs for the first half of FY05, see *Eligibility of Expenditures in World Bank Lending: Incidence of Recurrent Cost Financing – July to December 2004* (SecM2005-0169), April 6, 2005.

⁴ See Kiosk Announcement *Eligibility of Expenditures in World Bank Financing*, April 18, 2004; OP/BP 6.00, *Bank Financing*, April 2004; *Bank Financing: Guidelines to Staff*, April 16, 2004; and the Operational Memorandum *Impact of Eligibility Reforms on Disbursement*, April 19, 2004. As appropriate, statements in the Bank's Operational Manual were amended to reflect the changes to the Bank's policies.

projects in a country after the country financing parameters for the country are established. During FY05, the major activity under the new policy involved establishing the individual country framework for the application of the policy, including communications and consultation with partner countries, and preparation of country notes to establish the country financing parameters. Following the establishment of the country frameworks, in FY05 the policy was applied to a total of 121 newly approved projects in 81 eligible countries, accounting for investment lending commitments of about \$7.42 billion (about 48.4 percent of total FY05 investment lending commitments).⁵ In addition, the policy was also applied to about 60 selected projects and trust funds (about 4 percent of the investment lending portfolio) under implementation in those eligible countries.

4. ***Feedback.*** Feedback from borrowers, development partners, and staff has been positive. The main benefits reported are increased development effectiveness and reduced transaction costs. As far as can be judged given the limited implementation experience at the project level to date, there have been no major changes in the aggregate composition of Bank financing in FY05—as was anticipated in the 2004 policy paper. As was also anticipated, the new policy has allowed the Bank and the country to focus more on substantive considerations in Bank financing decisions and has given the Bank the flexibility to respond better to borrowers’ needs by adapting to individual project and country circumstances. There is an increasing differentiation among individual projects, reflecting their different needs and characteristics, within the overall country parameters.

5. ***Structure of the Report.*** This report focuses mainly on the country-level work leading to the adoption of country financing parameters (Section II), followed by a review of the emerging trends in Bank financing based on the still-small sample of projects approved under the new policy (Section III). Section IV reviews implementation arrangements and future steps in implementation.

II. COUNTRY FINANCING PARAMETERS

6. Application of the new policy is based on (a) the country context under which projects are implemented, and (b) the characteristics of each project. The country context is reflected in country financing parameters that cover four aspects of project financing: cost sharing, recurrent cost financing, local cost financing, and financing of taxes and duties. The Bank establishes the country financing parameters in consultation with the borrower, communicates them to the Executive Directors, and posts them, together with supporting analysis, on the Bank’s internal website.⁶ Country financing parameters are reviewed during the preparation of the Country Assistance Strategy (CAS) and reflected in the CAS or similar documents such as Interim Strategy Notes (ISNs).

⁵ Total investment lending commitments in FY05 were \$15.33 billion. This amount does not include IBRD and IDA guarantees amounting to \$0.41 billion, which are included in Bankwide investment lending commitments reported from FY05 but not in the analysis in this paper, since the new policy does not apply to guarantees.

⁶ See <http://opcs.worldbank.org/eligibility/cp-All.html>

7. **Establishment of Parameters.** Establishment of country financing parameters proceeded smoothly. As of June 30, 2005, the Bank had established country financing parameters for 81 countries. Since then the Bank has established country financing parameters for 6 additional countries, raising the total number of countries for which parameters have been established to 87 (see Table 1). Country financing parameters have not been established yet for about 37 active countries (see Annex A). The individual country notes present the financing parameters and supporting analysis and include additional information and guidance to task teams on how to apply the parameters to individual projects in each country. For 20 countries, country financing parameters were reflected in CAS/CAS Progress Reports.⁷ This section reviews the main findings for each of the four parameters.

Table 1: Country Financing Parameters Established by September 30, 2005

Africa	East Asia and Pacific	Europe and Central Asia	Latin America and Caribbean	Middle East and North Africa	South Asia
<ul style="list-style-type: none"> • Angola • Benin • Burkina Faso • Burundi* • Cape Verde • Cameroon • Chad • Democratic Republic of Congo • Republic of Congo • Gabon • Madagascar • Malawi • Mali • Mozambique • Niger* • Nigeria • Rwanda • Sao Tome and Principe • Senegal • Sierra Leone • Tanzania • Uganda* • Zambia 	<ul style="list-style-type: none"> • Cambodia • China • Indonesia • Lao PDR • Philippines • Timor Leste • Vietnam 	<ul style="list-style-type: none"> • Albania • Armenia • Azerbaijan • Belarus • Bosnia and Herzegovina • Croatia* • FYR Macedonia • Georgia • Kazakhstan • Kyrgyz Republic • Moldova • Poland • Romania* • Russia • Serbia and Montenegro • Slovak Republic • Tajikistan • Turkey • Ukraine • Uzbekistan 	<ul style="list-style-type: none"> • Antigua and Barbuda • Argentina • Brazil • Bolivia • Chile • Colombia • Dominica • Dominican Republic • Ecuador • El Salvador • Grenada • Guatemala • Guyana • Haiti • Honduras • Jamaica • Mexico • Nicaragua • Panama • Paraguay • St. Kitts and Nevis • St. Lucia • St. Vincent and the Grenadines • Uruguay 	<ul style="list-style-type: none"> • Djibouti • Egypt • Iraq* • Morocco • Tunisia • West Bank and Gaza 	<ul style="list-style-type: none"> • Afghanistan • Bangladesh • Bhutan • India • Nepal • Pakistan • Sri Lanka

* Parameters established after June 30, 2005.

⁷ This includes six countries for which parameters were established for the first time through the CAS process. Because of the timing of CASs, country financing parameters were mostly established through stand-alone country notes.

A. Cost Sharing

8. The Bank's new policy on cost sharing reiterates the need for borrower commitment and ownership, which the borrower may demonstrate by, among other things, providing funding from its own resources. Under the new policy, as part of assessing borrower commitment and ownership, the Bank judges the adequacy of borrower funding from its own resources of its overall development program and its program in the sectors on which Bank assistance would focus in particular.⁸ The new policy also recognizes that borrower ownership and commitment can be judged from aspects other than borrower contribution to individual projects/activities financed by the Bank. Thus, at the country level, the new policy aims at a more strategic approach to cost sharing, based on individual country circumstances, and gives the Bank the flexibility to finance higher proportions of projects costs, in some cases up to 100 percent.

9. *Country Cost Sharing Strategy.* The country notes reflect the cost sharing strategy for a country, and discuss how this strategy will be applied across the Bank's portfolio in the country. In setting the country financing parameter for cost sharing, the Bank takes into account such aspects as the proportion of the country's overall development program that it finances from its own resources and the proportion financed by development partners, including the Bank; the degree of alignment of the projects financed by the Bank with the borrower's overall development plans; the extent to which Bank-financed projects are integrated into the borrower's budget and budget processes; the quality of budget management (budget formulation, execution, and monitoring); and the performance track record of ongoing projects. The Bank also takes into account the country's public finance strategy and preferences (e.g., the country's strategy for financing of subnational governments, financing of recurrent costs by user charges or other non-debt sources, partial financing by users/beneficiaries or the private sector in some sectors; preferences for different levels of Bank financing across sectors or types of projects). The country note also outlines how the Bank's financing share in individual projects in the lending pipeline and portfolio would be managed within the Bank's overall country lending envelope, after considering trade-offs regarding the number and size of projects.

10. *Parameters.* For 85 of the 87 countries for which the Bank, in consultation with the borrower, has established country financing parameters, this parameter gives the Bank the flexibility to finance up to 100 percent of project costs. For the other 2 countries, the limit was agreed at 90 percent.⁹ In almost all countries, the country notes setting out the financing parameters indicate that the Bank expects to use the maximum limit selectively, using a number of mechanisms to achieve this selectivity: (a) differentiating across sectors and types of projects, e.g., by specifying sectors in which Bank financing is expected to be low, moderate, or high (or 100 percent), or those in which the Bank would not finance 100 percent and would expect counterpart funding

⁸ In the past, cost sharing limits at the country level were based on the country's per capita income and ranged from 50 percent to 90 percent, applied on a three-year rolling basis. There was also an expectation of a minimum borrower contribution of 10 percent in individual projects.

⁹ Dominican Republic and Sao Tome and Principe.

from the government; (b) participating in sectorwide approaches (SWApS), in which Bank's financing share is typically low; (c) cofinancing with other development partners; (d) requiring financing from beneficiaries and other sources; or (e) managing the Bank's aggregate financing share at specified levels. (See Box 1 for a typology of country cost sharing strategies, and Annex B for a more detailed listing by country.)

Box 1. Typology of Country Cost Sharing Strategies

Differentiation across sectors and types of projects. In some countries (e.g., Egypt, El Salvador, Nigeria, Pakistan, Senegal), the Bank's financing share is expected to vary across sectors—e.g., higher in social sectors and lower in infrastructure. In other countries (e.g., Angola, China, Honduras, Malawi, Moldova), the Bank has identified sectors such as infrastructure or projects executed by revenue-generating entities, in which counterpart funding could be expected, and therefore the Bank generally would not provide 100 percent financing. In some countries (e.g., Bosnia and Herzegovina, Cape Verde, Chile, Egypt, Ecuador, Gabon, Niger, Slovak Republic), the Bank does not generally expect to finance 100% in any or most projects or sectors. Finally, in many countries, the Bank has identified the sectors in which the Bank might finance high levels or 100 percent (e.g., HIV/AIDS in Burkina Faso; social sector projects in poor provinces or grant-financed small TA projects in China; education, social development, and health in Djibouti; regional or grant-based activities in Kazakhstan; social sectors and rural sector in Lao PDR; emergency credits and selected social sector interventions in Madagascar; social sector development, governance, and capacity building in Sierra Leone).

Impact of SWApS. In many countries (e.g., India, Malawi, Philippines, Romania, Sri Lanka), the proportion of SWApS in the portfolio is expected to increase gradually; because the Bank's financing share in SWApS is typically low, this would contribute to a lowering of the Bank's aggregate financing share across the portfolio.

Partnerships with other donors. In most countries, the Bank expects to continue to cofinance many projects with other development partners, and its financing share would be less than 100 percent.

Financing from beneficiaries and other sources. In many countries (e.g., Benin, Cameroon, Kyrgyz Republic, Pakistan, Philippines, Rwanda) contributions from beneficiaries, local governments, and other sources (such as Road Funds) are required by sector or project design considerations, and would continue to be considered in determining project cost sharing arrangements.

Managing the Bank's aggregate financing share. In some countries (e.g., Albania, Argentina, Kazakhstan, Vietnam), the Bank expects to manage its financing share across individual projects to maintain the Bank's aggregate financing share at specified levels.

Countries experiencing fiscal stress such as LICUS/fragile states. In some countries experiencing fiscal stress (e.g., Afghanistan, Democratic Republic of Congo, Republic of Congo, Haiti, West Bank and Gaza), the Bank considered that it would be unrealistic to expect significant counterpart funding, or that counterpart funding *per se* was not a good indicator of ownership and commitment in such environments; and that the Bank would rely on other indicators of ownership and commitment.

11. ***Project Level.*** At the individual project level, the project financing plan and the Bank's financing share are increasingly driven by substantive project-specific considerations such as a project design that may require contributions by beneficiaries/user groups in some cases; cofinancing by other development partners; the borrower's financing strategy that calls for financing of some costs (e.g., maintenance expenditures) from non-debt sources; financial contributions by utilities and other entities based on debt-equity considerations; and the borrower's financing from its own resources of the sector concerned. As this trend continues, one of the main goals of the new policy

will be achieved—having cost sharing arrangements and project financing plans being based on substantive project considerations within the country framework rather than largely determined by the Bank’s expenditure eligibility policies. The Bank also relies on alternative, more substantive indicators to assure borrower ownership and commitment to projects, rather than relying on counterparty funding alone.¹⁰

B. Recurrent Cost Financing

12. The Bank’s new policy provides that the Bank may finance recurrent costs, after taking into account the impact on fiscal and debt sustainability at the appropriate levels, including that of the project entity or entities. The policy aims to address new challenges in development effectiveness, such as those identified in the Education for All initiative, in which about two-thirds of the financing gap was recurrent costs, and the unanticipated distortions generated in infrastructure and other sectors by the earlier exclusive focus of development financing on capital costs, which created an incentive to defer maintenance in order to obtain fresh capital.

13. *Establishing the Parameter.* In establishing the recurrent cost financing parameter, the Bank takes into account aspects such as the borrower’s actual and expected economic and public finance performance (e.g., fiscal and debt situation and prospects), the share of financing from the Bank and other official development assistance in the borrower’s development expenditures, the adequacy of the borrower’s budget preparation and execution processes, and the borrower’s commitment and ability to sustain the financing for recurrent expenditures after Bank financing is completed, as well as the expected type and level of recurrent cost financing for the Bank’s program in the country. The country financing parameter on recurrent cost financing indicates any country-level limit on the recurrent expenditures that the Bank may finance in the country. For each specific project, the Bank also examines sustainability issues at the project and sector levels.

14. *Strategic Approach.* As in the area of cost sharing, the new policy is leading toward a more strategic approach regarding recurrent cost financing. While the emphasis on sector and project level sustainability issues continues, it is strengthened by consideration of the country’s overall fiscal and debt situation and the Bank’s CAS for that country. For 66 of the 87 countries for which country financing parameters have been established, the country notes did not introduce a country-level limit on overall recurrent cost financing. For the other 21 countries, the Bank qualified the recurrent cost financing parameter—for example, not allowing recurrent cost financing for sectors in

¹⁰ For instance, in projects with high levels of Bank financing in FY05, the Bank also judged borrower commitment and ownership by such other indicators as: (a) well-performing ongoing government programs that were continued or scaled up through the project; (b) implementation of key sector reforms/policy actions, and up-front development of key strategic frameworks; (c) high level of borrower activities during the project preparation process, including project activities initiated by borrower and financed from its own resources; (d) endorsement of the project and its principles in key government documents; (e) satisfactory implementation of prior projects; (f) integration of implementation arrangements into sector ministries/agencies; and (g) community involvement, and participatory design and implementation.

which user-fee arrangements are considered essential, restricting recurrent cost financing to particular types of expenditures such as human capital spending or to specified circumstances, restricting or not financing salaries, or specifying fiscal and budget management criteria for recurrent cost financing. (See Box 2 for a typology of country-level limits, and Annex C for specific country examples.) In 45 of the 87 countries, the country notes indicate that, given expected project and sector conditions or country preferences, recurrent cost financing is expected to stay at modest levels, and hence the fiscal and debt sustainability impacts will be limited.

Box 2. Recurrent Cost Financing: Typology of Country-Level Limits

Restrictions on recurrent cost financing in some sectors. In Madagascar, Mozambique, Tanzania, Uganda, and Zambia, in determining the appropriateness and level of recurrent cost financing for projects in such sectors as health, urban, water, electricity, or roads, the Bank will take into account the country's sector strategy of financing recurrent costs through user fees, tariffs, or other revenue-generating mechanisms. In determining recurrent cost financing in India, the Bank will take into account the CAS guidelines for Bank lending in key sectors, which include sector financing strategies.

Restrictions on financing salaries. In Afghanistan, Bolivia, Cambodia, Chad, Croatia, Djibouti, Indonesia, Lao PDR, and Romania, the Bank will not finance salaries or salary supplements, or will finance them only in specified circumstances (e.g., funding salaries only as part of a civil service reform program; or funding PIU salaries only in the context of integration into line ministries or other measures that ensure sustainability).

Country preferences. In Ecuador, the country's public finance strategy restricts recurrent cost financing to specific types of expenditures (e.g., human capital spending). In Turkey, the Government is not currently interested in Bank financing of civil servant salaries.

Limiting recurrent cost financing to specific circumstances. In Russia, the Bank will finance recurrent costs only to assist in the implementation of reform, if there is evidence of the efficiency and effectiveness of the government institution that would receive recurrent cost financing.

Fiscal and budget management criteria. In Bosnia-Herzegovina, Brazil, and Nicaragua, the Bank has specified criteria relating to fiscal and budget management for recurrent cost financing.

15. **Monitoring.** At the country level, the Bank will continue to monitor the fiscal and debt situation in borrower countries and its implications for recurrent cost financing, and make any adjustments as warranted (including in countries such as LICUS/fragile states, where recurrent cost financing is considered essential to implementation and to achieving project development objectives).

C. Local Cost Financing

16. In recent years, the proportion of Bank financing used for local currency expenditures has grown steadily, accounting for a substantial majority of all investment lending: in FY98 it accounted for 68 percent of disbursements in investment lending, and in FY03 for 73 percent. The new policy states that the Bank may finance local costs when (a) financing requirements for the country's development program would exceed the public sector's own resources (e.g., from taxation and other revenues) and expected domestic borrowing; and (b) the financing of foreign expenditures alone would not enable the Bank to assist in the financing of individual projects. Thus the policy on financing of local expenditures continues to hinge on both macroeconomic (or country)

and project considerations. The expectation when the new policy was approved was that macroeconomic conditions in borrower countries were such that most countries would meet these two criteria. The country notes concluded the two criteria were met in 86 of the 87 countries for which parameters have been established.¹¹

D. Financing of Taxes and Duties

17. The new policy allows the Bank to finance reasonable costs of taxes and duties. Recognizing that taxes and duties are part of the normal cost structure of economic activity, the new policy aims to reduce the level of transaction costs and eliminate the incentive to differential treatment and economic distortions through exemptions for Bank-financed activities that resulted from the previous prohibition on financing taxes and duties.

18. *Establishing the Parameter.* The country financing parameter indicates whether there are any taxes and duties in the country that are assessed as unreasonable and hence not eligible for Bank financing. In establishing this, the Bank examines the rates of major taxes and duties in the country—such as customs/import duties, value-added tax, sales tax, excise duties, corporate income tax, and personal income taxes—judging whether any of them are excessive, particularly in the context of that country’s overall fiscal agenda, and in some cases in comparison to similar countries or countries in the region. The Bank also takes into account whether items with high tax rates are material in Bank-financed activities and whether the country taxes Bank-financed projects at its normal rates.

19. *Country Notes.* Among the 87 countries for which the country financing parameters have been established, the country notes state that in 71 there are no taxes that are considered unreasonable, and hence all taxes and duties in that country are eligible for Bank financing. For 7 countries, the country notes state that the Bank would monitor local tax regimes to determine their eligibility for Bank financing, although national taxes were considered reasonable and eligible for Bank financing. For the remaining 9 countries, the Bank has identified some taxes and duties that were judged to be unreasonable and not eligible for Bank financing (see Box 3). In all countries, the Bank monitors major changes in the country’s tax regime and reviews them for any implication for Bank financing of taxes and duties. For all countries to which the new expenditure eligibility policy applies, in determining financing of taxes and duties in individual projects the Bank also examines whether taxes and duties constitute an excessively high share of project costs.

¹¹ In Antigua and Barbuda, where the Bank does not have a financing program, the country financing parameter states that the second criterion would be examined at the project level.

Box 3. Taxes and Duties Identified as Ineligible for Bank Financing

Examples of taxes and duties identified in country financing parameters as unreasonable and therefore ineligible for Bank financing include the following:

- Import duties above a certain limit (Argentina, Brazil, Ecuador, Paraguay, Uruguay)
- Customs duties, excise taxes and Road Fund charges on vehicles that are considered excessive or non-transparent (Uzbekistan)
- Export tax and financial transactions tax that are judged to be distortionary (Argentina)
- Differential tax charged on foreign consultant services (Kyrgyz Republic)
- Taxes on amounts provided by donors that are treated as taxable income (Belarus)
- State sales tax for Lagos state in Nigeria, which is considered double taxation.

In seven countries (Cambodia, China, Indonesia, Lao PDR, Mali, Philippines, Senegal), the Bank would monitor local tax regimes to determine their eligibility for Bank financing, although national taxes were considered reasonable and eligible for Bank financing.

III. TRENDS IN BANK FINANCING

20. As noted above, the main activity under the new policy has involved preparing country analysis and establishing country parameters. In addition, 121 new projects have been approved under the new policy, accounting for investment lending commitments of about \$7.42 billion (about 48.4 percent of total FY05 investment lending commitments). Although implementation of these projects is still at a very early stage, an aggregation of their specific cost sharing arrangements, recurrent cost financing, local cost financing, and financing of taxes and duties can provide an early assessment of the financing trends, and of their similitude or divergence from previous trends. On average, the new policy has not changed the trends in these areas. As expected, and as discussed in Section II, the principal change it has introduced is greater differentiation across individual projects, reflecting specific project characteristics as well as sector and country conditions.

A. Cost Sharing

21. The Bank's aggregate financing share in investment projects from FY01-05 has been about 55 percent of project costs, except for FY04 when a number of large SWAs with substantial borrower and other donor financing reduced the ratio to less than 40 percent (see Table 2). For all projects approved in FY05, the Bank's aggregate financing share was 53 percent, which suggests there has been no major shift in the aggregate financing share since the introduction of the new expenditure eligibility policy. The Bank's financing share in the 121 projects approved under the new policy (i.e., after the country financing parameters for the relevant country were established) in FY05 was 62.6 percent of project costs. This is higher than previous Bank financing averages, which may in part reflect Bank financing of taxes permitted by the new policy. Management will continue to monitor and report on this. However, analysis indicates that the key driver of the Bank's share of aggregate financing is the nature and composition of the

investment lending program, in particular the Bank's participation in SWAps, as reflected in the Bank's lower aggregate financing share for FY04.¹²

Table 2. Bank Financing Share in Investment Lending, FY01-05

<i>Year</i>	<i>Bank financing (\$ billion)</i>	<i>Project cost (\$ billion)</i>	<i>Bank financing (%)</i>
FY01	11.49	20.45	56.2
FY02	9.69	17.64	55.0
FY03	12.50	22.45	55.6
FY04	13.93	36.28	38.4
FY05	15.33	28.92	53.0

22. **Individual Projects.** Within the aggregates, individual projects are taking advantage of the new policy's flexibility to selectively provide higher levels of Bank financing: while there has not been a major shift in the aggregate level of Bank financing, there has been a significant increase in the proportion of projects with a high Bank financing share (more than 90 percent Bank financing) (see Table 3). In the 121 projects approved under the new policy in FY05, 37 percent (45 projects) had Bank financing of more than 90 percent. Many of these 45 projects are technical assistance operations, emergency operations, operations that provide support to HIV/AIDS, operations in countries recovering from conflict (where the Bank had previously financed 100 percent as an exception to policy), or relatively small operations. The larger number of projects with high Bank financing ratios, together with the observed average Bank financing proportion, confirms the expected trend toward greater differentiation across projects. And as was also expected, increased Bank financing in some projects has been compensated for by a lower Bank financing share in other projects—driven by factors such as limited country financing envelopes, borrower preferences and incentives that encourage Bank engagement across a broad range of sectors, and cofinancing with other donors.

Table 3. Range of Bank Financing Share in Investment Lending, FY01-05
(% of total projects)

<i>Year</i>	<i>Very low 0-20%</i>	<i>Low 20-60%</i>	<i>Moderate 60-90%</i>	<i>High 90-100%</i>
FY01	29	32	23	16
FY02	21	33	24	22
FY03	24	38	22	16
FY04	29	31	20	20
FY05	27	24	18	31

¹² In SWAps the Bank and other donors finance a portion of the overall sector expenditures, so the Bank's financing share typically tends to be low. The Bank's aggregate financing share in the 116 projects approved in FY05 before country financing parameters were established was 46.3 percent. This is very significantly influenced by the reflection in this percentage of the \$4.3 billion Bangladesh Health Population and Nutrition Sector Program, a large SWAp in which the Bank's financing share is 7 percent.

B. Recurrent Cost Financing

23. Between FY01 and FY04, recurrent cost financing ranged between 4 and 6 percent of total investment lending commitments (see Table 4).¹³ In FY05, recurrent cost financing amounted to \$563.02 million and represented 3.7 percent of total investment lending commitments of \$15.33 billion; and in the 121 projects approved under the new policy, recurrent cost financing was 4.1 percent of Bank financing. The new policy has provided the flexibility to finance recurrent costs where needed and appropriate. The unchanged level of recurrent cost financing during the initial year of implementation of the new policy may be due in part to lead times involved in project preparation, but it could also reflect other factors that influence the extent of recurrent cost financing: (a) the sectoral composition of investment lending; (b) borrower preferences and public finance strategies (e.g., limiting or not borrowing for recurrent spending); (c) Bank assistance strategies in some countries to move social sector lending, notably health and education, from investment lending to poverty reduction support credits (PRSCs); and (d) extent of SWAps, especially in the social sectors, where it is typically difficult to clearly separate Bank financing for capital and recurrent expenditures. Management will continue to monitor and report semi-annually to Executive Directors on the incidence of recurrent costs in newly approved operations.

Table 4. Recurrent Cost Financing, FY01-05
(% of investment lending commitments)

<i>Year</i>	<i>Recurrent cost financing (%)</i>
FY01	5.8
FY02	5.0
FY03	4.3
FY04	3.5
FY05	3.7

C. Local Cost Financing

24. The proportion of Bank financing used for local currency expenditures has accounted for a substantial majority of all investment lending disbursements (about 70-75% in recent years). Country notes establishing financing parameters indicate that this trend is expected to continue. Under the new policy framework, when a country meets the criteria for local cost financing, foreign and local costs only need to be estimated separately at appraisal when the distinction is expected to have a material impact on overall costs; and normally they are not required to be reported separately in the cost estimates and financing plan at appraisal.¹⁴ The information available from the 86

¹³ See *Eligibility of Expenditures in World Bank Lending—A New Policy Framework: Initial Implementation Experience* (OM2004-0057/1), September 17, 2004.

¹⁴ See *Eligibility of Expenditures in World Bank Lending: Implementation Arrangements* (OM2004-0012), February 23, 2004. In addition, the Bank has now discontinued the practice of collecting and reporting on source of supply (and correspondingly local and foreign costs) on disbursements. This was based on the growing acceptance that in today's global economy, source of supply reporting at the disbursement level placed a heavy administrative burden on borrowers and the Bank and was not very meaningful, especially given many simplifying assumptions made in the data collection and aggregating processes that could lead to misleading presentation.

projects approved under the new policy in FY05 for which foreign and local cost financing were separately reported confirms the previous trend in financing of local costs: local cost financing was estimated at about 59 percent of investment lending commitments in those projects.

D. Financing of Taxes and Duties

25. Under the new policy framework, where the Bank has not identified any taxes and duties that are not eligible for Bank financing, taxes and duties are normally not estimated separately at appraisal nor required to be reported separately in project documentation.¹⁵ The information available from the 41 projects approved under the new policy in FY05 in which taxes were separately reported indicate that, in the aggregate, taxes and duties were a modest share of project costs: taxes and duties were estimated at about 9 percent of project costs in those projects.

E. Financing of Other Expenditures

26. The new policy also allows for Bank financing of some project expenditures—land, severance payments, and other expenditures—that had been limited by policy or practice. Consistent with the principle that the Bank should be able to finance the expenditures necessary to meet the development objectives the operations it supports, the policy eliminated the blanket limitations or restrictions and clarified certain policies, and Management provided guidance to staff on how to assess the appropriateness of each of these categories of expenditures. This section examines the actual financing of these expenditures in FY05 projects.

27. *Land.* Since 2002, the Bank's policy had allowed for financing of land in the context of community-based land reform projects, as an exception to the general policy prohibition on financing of land. A pilot scheme was launched and a Bankwide Land Committee was established to screen potential projects and advise Management on their appropriateness for Bank financing of land. The additional changes in the new policy on eligibility of expenditures expanded the scope of the pilot scheme, maintaining the Bankwide Land Committee to review each proposal. In financing land, the Bank takes into account such aspects as the productivity of land purchase; the quality of the land market and the strategy for addressing any existing distortions; the arrangements for channeling of money to avoid misuse of funds; the risks, including political risks; and arrangements for monitoring and evaluating the land purchases and objectives of the project. Since approval of the new policy, the Land Committee gave its approval to four proposals (see Box 4).

¹⁵ Ibid.

Box 4. Financing of Land

- ***Vietnam Mekong Delta Water Resources Development Project.*** This project supports improving irrigation and drainage, flood mitigation, drinking water supply and sanitation system in the Mekong Delta areas of Vietnam. Shortage of funds for compensation became an obstacle to timely implementation of the overall project and its resettlement plan. Bank financing for land compensation is expected to speed up the implementation of the resettlement action plan (in which 7,000 families are to be compensated) and contribute directly to achieving project objectives.
- ***Mexico Access to Land for Young Farmers Project.*** Bank financing of land would help achieve the project's objectives of establishing a beneficiary-driven mechanism that allows poor young farmers to acquire or rent underutilized farm lands and implement productive investments. The project is expected to benefit about 15,000 families and significantly increase their income and welfare.
- ***(Proposed) Bolivia Land for Agricultural Development Project.*** Bank financing of land would help achieve the project's objectives of establishing a decentralized beneficiary-driven mechanism that allows organized landless or poor farmers to acquire underutilized agricultural lands and implement investments to raise their productivity. The project is expected to benefit between 1500 and 3000 households.
- ***(Proposed) Poland Odra River Basin Flood Protection Project.*** Bank financing for land, buildings, and other resettlement costs is considered fundamental for meeting project objectives of protecting more than 2.5 million people in the Odra River Basin against loss of life and damage caused by severe flooding. Bank financing of land and property compensation would facilitate prompt negotiation and payment, which is crucial for smooth implementation of the resettlement action plan and timely completion of the project. This would also enable residents to make informed decisions regarding their future and plan accordingly, reducing anxieties and controversies and the prospect of having to resort to expropriation.

28. ***Severance Payments.*** The Bank may finance severance pay, and typically does so in the context of public enterprise reform operations that are expected to result in an increase in productivity after restructuring (examples of recently approved projects with Bank financing of severance payments are listed in Box 5).¹⁶ In financing severance pay, the Bank considers such factors as the impact and sustainability of the public sector reform program of which proposed retrenchments are a part, and carries out economic analysis of the costs and benefits. The Bank also ensures that the downsizing component's benefits are sustainable by giving particular attention to the risks of adverse selection, overpayment, and moral hazard; and it takes into consideration legal aspects, political economy considerations (including the affordability and replicability of the compensation package), and social impacts. The Bank also takes into account the size of severance pay financing relative to total Bank financing, and measures to ensure appropriate determination of severance payments.

¹⁶ The policy on financing of severance pay did not change under the new policy framework. The contents of the previous Operational Memorandum on financing severance pay were updated and reissued as guidance to staff.

Box 5. Financing of Severance Payments

Examples of projects with Bank financing of severance payments include:

- Armenia Health Systems Modernization Project
- Armenia Municipal Water and Wastewater Project
- Bangladesh Enterprise Growth and Bank Modernization Project
- Croatia Science and Technology Project
- FYR Macedonia Irrigation Rehabilitation and Restructuring Project
- Ghana Urban Water Project
- India Madhya Pradesh Water Sector Restructuring Project
- Nigeria Economic Reform and Governance Project
- Turkey Railways Restructuring Project
- Turkey Second Privatization Social Support Project

29. ***Other Expenditure Types.*** In projects approved in FY05 there were limited instances of financing other expenditures types on which blanket prohibitions or restrictions were removed under the new policy.

- There were no instances of financing food expenditures, late payment penalties, secondhand goods, leased assets, and cash compensation or other resettlement compensation paid in cash.
- In one case—the Pakistan Taunsa Barrage Emergency Rehabilitation and Modernization Project—the Bank financed \$10.3 million of interest during construction (IDC) on the IBRD loan, which was part of the costs needed to bring the barrage to its productive use.
- There were some instances of financing of other new forms of expenditures that were not traditionally financed by the Bank (see Box 6 for examples).

Box 6. New Forms of Expenditures Financed by the Bank

Examples of new forms of expenditure financed by the Bank include:

- ***Capital payments for balance sheet restructuring of commercial banks.*** In the Pakistan Banking Sector Restructuring and Privatization Project, the Bank financed the costs of balance sheet structuring of commercial banks to help Pakistan continue the implementation of its banking reform program. The project focused on restructuring of nationalized commercial banks to improve their prospects for sale to qualified strategic investors, and on completing the privatization of partially privatized banks. Balance sheet restructuring was considered necessary to pave the way for eventual privatization of commercial banks. The Bank financed \$111.50 million of the total cost of balance sheet restructuring of \$850 million.
- ***Contingent debt facility.*** In the Mongolia Index-Based Livestock project, IDA credit proceeds finance a contingent debt facility of US\$5 million that would be used to fund any indemnity payments under the Disaster Response Product (a social safety net product that is linked to mortality rates exceeding a certain level) and to meet any cumulative shortfall in the insurance reserve fund. This is required to support the project's development objectives of ascertaining the viability of index-based livestock insurance to reduce the impact of livestock mortality for herders.

F. Application to Ongoing Projects

30. The Bank may apply the new expenditure eligibility policy to projects under implementation in countries where country financing parameters are established, if the borrower so requests, and the Bank agrees. Changes to ongoing projects under the new policy follow normal Bank procedures for changes to projects under implementation.¹⁷ In making any change to ongoing projects, the key consideration is whether the change would help achieve project development objectives. The Bank also ensures that there are sufficient funds available in the loan/credit to accommodate increases in the Bank's financing share, evaluates possible trade-offs in terms of project scope/size, and examines the benefits and costs of making changes to ongoing projects. The new policy has been applied to about 60 projects and trust funds, accounting for a small proportion of the Bank's portfolio (about 4 percent of the investment lending portfolio). Such retrofitting aimed at relieving implementation constraints, simplifying procedures, and thereby facilitating improved project implementation. In many cases, the new policy was applied to ongoing projects as part of broader project restructuring.

G. Deviations from Country Financing Parameters

31. Bank financing in a project exceeding the country financing parameters needs to be approved by the Regional Vice President, and justified and disclosed in the Project Appraisal Document. There has been only one instance of a deviation from country financing parameters: in the Central Asia AIDS project (a regional project covering four countries), Management approved a deviation from the country financing parameters for Kyrgyz Republic to allow for the financing of all taxes on consultant services (the country financing parameters did not allow for financing of differential taxes on foreign consultant services). This approval was based on the project's exceptional circumstances: the indivisible nature of project activities in a regional project, implementation arrangements being critical to the project's objectives, and the need for 100 percent Bank financing of all costs.

IV. IMPLEMENTATION ARRANGEMENTS

32. Within the Bank, the Regions are responsible for implementing the new policy framework, including determining the arrangements for and setting the country financing parameters, and for the quality of analysis and decisionmaking in support of individual operations. Country directors have overall responsibility for developing and consulting with borrowers on the country financing parameters, which the Regional vice presidents (RVPs) approve. Typically, country economists, portfolio managers/operations advisers, and country management unit staff, along with other members of the country teams, are involved in the process. PREM staff in the Regions, supported as needed by the PREM Anchor, play a key role in handling country fiscal sustainability analysis, which is an area

¹⁷ See BP 13.05, *Project Supervision*, paras. 16-20, and BP 13.25, *Use of Project Cost Savings*, paras. 2-3.

of major attention. Project teams have the key role in sustainability analysis at the project level. To ensure coordination in these activities, and to support implementation of the new policy, each Region has designated one or more staff as focal points.

33. ***Central Units' Roles.*** Operations Policy and Country Services (OPCS) plays a supportive and coordinating role in rolling out the policy: developing resource materials, communications, and learning programs; working with other central units; and maintaining a website and Help Desk on the new policy. OPCS also provides guidance and support to Regions as they prepare the country financing parameters. To ensure cross-Regional and cross-country consistency, the first round of country financing parameters for each country are set in consultation with OPCS, before they are approved by the RVP. Other central units—such as Disbursement and Legal, which are responsible for other key Bank processes—also support implementation. No changes to these implementation arrangements are planned.

34. ***Process for Country Financing Parameters.*** The country financing parameters are expected to be mainstreamed into regular Bank processes: they would be reviewed, and updated if necessary, in the context of preparing each new CAS (or similar strategy documents such as ISNs). They may also be reviewed and updated between CAS periods if country circumstances change. The second and subsequent rounds of country financing parameters for a country would follow normal Bank review processes; Management does not consider it necessary to continue OPCS's cross-country consistency check past the first set for each country.

35. ***Review Processes.*** Management put in place review processes appropriate to the risks associated with different forms of expenditure. In particular, for any project, Bank financing of particular types of expenditures—those considered to pose particular risks or those that would likely benefit from inputs from a broader group—are subject to authorization additional to that for normal project processing. Bank financing of land (including compensation for land acquisition), and cash compensation and other assistance paid in cash for involuntary resettlement is reviewed and authorized by a Bankwide Land Committee, chaired by a representative of Environmentally and Socially Sustainable Development (ESSD) and comprising staff from OPCS, the Legal Department, and several Regions; financing of severance payments, food expenditures, and interest during construction (other than that payable to IBRD) is reviewed and authorized by the RVP; and financing of monetary compensation to vendors for late payments and secondhand goods is reviewed and authorized by the Regional procurement adviser. Adjustments to these arrangements are made as needed: for example, Management decided in June 2004 that through the end of FY05 the Managing Director for Operations would review all operations in which the financing of severance payments was proposed.¹⁸

36. ***Guidance to Staff.*** Taking into account suggestions made by Executive Directors, Management issued guidelines to assist staff in making sound decisions relating to Bank financing of different types of expenditures. Management also presented

¹⁸ See *Severance Payments in Bank Operations – Information Note* (OM 2004-0025), June 7, 2004.

several outreach and learning programs, regularly posted reference material and guidance documents on the Bank’s internal website, and developed easy-to-use reference material on operational issues—for example, a tip sheet for country financing parameters, and a note on aspects to be considered in applying the new policy to projects under implementation. Several Networks are preparing resource material to help staff apply the new policy—for example, the ESSD Land Thematic Group is preparing material on the financing of land, and the Procurement Sector has issued guidance on procuring secondhand goods and leased assets.¹⁹ The PREM Network’s Public Sector Governance Group supports staff in conducting the analysis needed to underpin decisions on financing severance payments.

37. **Feedback.** The Bank has communicated the changes to partner countries and has posted information about the policy changes on its external and internal websites. Feedback from partner countries and Bank staff has been very positive. The new policy is viewed as one of the Bank’s most substantive changes in its simplification and modernization initiative, and as a progressive step that facilitates the Bank’s partnership with the country in achieving the country’s overall development objectives. Bank and country staff alike see the main benefits as increased development effectiveness and reduced transaction costs through such aspects as

- the Bank’s greater flexibility to finance the costs needed to meet project development objectives; this facilitates project design and financing arrangements to be better aligned with the project’s development objectives and country needs;
- easing of counterpart funding constraints, particularly in countries experiencing fiscal pressures;
- a greater focus on the substantive aspects of projects—sustainability, appropriateness of project expenditures, country capacity—than on the mechanistic application of eligibility rules;
- alleviation of the distortionary impacts of Bank operational policy; and
- simplification of operational procedures—for example, no need to identify taxes and duties at the transaction level; flexibility to adapt disbursement categories to project circumstances; no need to set declining disbursement percentages, and differential disbursement percentages for local and foreign costs and across categories; avoiding *pari passu* government contribution at the transaction or disbursement category level—and the cascading impacts of these on simplifying project record-keeping, financial reporting, and auditing.

38. **Sharing Lessons Learned.** The Bank has provided information and support to development partners who are considering adopting similar policies, including sharing

¹⁹ See *Eligibility of Expenditures in World Bank Financing – Procurement Guidance*, June 7, 2004.

information on the policy changes with members of the MDB Roundtable on Harmonization. In the past year the Inter-American Development Bank and the Asian Development Bank have made similar changes to their policies governing financing for investment projects in November 2004 and August 2005 respectively. Harmonization on this policy will further the process of aligning donor policies to support good institutional practices in borrower countries and to reduce borrower costs.

39. ***Impact on the Bank's Administrative Budget.*** It is anticipated that the major costs savings from the new policy would accrue to borrowing countries, through reduced costs of doing business with the Bank. During FY05 the new framework was implemented within planned Bank administrative budget envelopes in the aggregate and for the units concerned, and Management proposes to continue this approach. In reviewing the impact of the new policy on the Bank's administrative budget, Management has taken the following considerations into account:

- Transitional costs to the Bank in the first year of implementation were related to amending operational policy statements and guidelines; communications, training, and implementation support; analysis, consultations, and reviews needed to establish country financing parameters; reviews of financing of some previously restricted expenditures; and monitoring and reporting arrangements for Management and Executive Directors. There will continue to be some additional costs to implement the new policy—for updating country financing parameters, review arrangements, implementation support, and monitoring and reporting—but they will be lower than in the first year.
- Over time, Management expects the new policy to generate cost savings in the amount of staff time to dealing with such areas as funds flow issues, disbursement processing, drafting the disbursement schedule of loan agreements, and reviewing statements of expenditure, accounting systems, and audit reports. These cost savings can be redirected to more substantive aspects to enhance effectiveness and to ensure appropriate oversight in an environment of greater flexibility. For example, on recurrent costs, procedural controls, such as declining basis financing, are being replaced by more substantive tests of sustainability; in the fiduciary area, clerical *eligibility* reviews are being replaced by more substantive tests of *appropriateness* and on building country capacity to reduce fiduciary risks.

In practice, of course, it is difficult to isolate the cost implications arising from this new policy alone, since it is implemented in conjunction with various other operational policies of the Bank and other modernization and simplification initiatives. Administrative cost savings and their redirection will be phased over time, as changes are occurring gradually and as projects in the existing portfolio are replaced by new ones.

40. ***Further Steps in Implementation.*** Going forward, a priority area of activity at the country-level will be establishing country financing parameters for the remaining active countries. Management will continue to emphasize basing the country financing

parameters on individual country circumstances and the Bank's CAS, and ensure that the parameters reflect the Bank's financing strategy for the country (e.g., on cost sharing and recurrent cost financing). Management will also continue to emphasize the quality of project-level analysis and sustainability issues in Bank financing decisions, and will continue to monitor key elements crucial to implementation of the policy—notably country ownership, fiscal sustainability, and satisfactory fiduciary oversight. It will also continue to provide staff with guidance and support in implementing the policy.

41. ***Disclosure of Country Financing Parameters.*** Country financing parameters are posted on the Bank's internal website (together with supporting analysis). They are publicly available when included in Country Assistance Strategies. Since September 2005, country financing parameters established through stand-alone notes are also disclosed on a case-by-case basis after Management notifies the Board of such disclosure. To ensure consistency of treatment of the parameters, following the discussion of this paper Management intends to separately seek the approval of the Executive Directors to disclose routinely all country financing parameters (together with the supporting analysis), including those that have already been established.

**COUNTRIES FOR WHICH COUNTRY FINANCING PARAMETERS HAVE NOT BEEN
ESTABLISHED BY SEPTEMBER 30, 2005**

<i>Africa</i>	<i>East Asia and Pacific</i>	<i>Europe and Central Asia</i>	<i>Latin America and Caribbean</i>	<i>Middle East and North Africa</i>	<i>South Asia</i>
Active countries					
<ul style="list-style-type: none"> • Central African Republic • Côte d'Ivoire • Eritrea • Ethiopia • Gambia • Ghana • Guinea • Guinea-Bissau • Liberia • Mauritania • Kenya • Lesotho • Mauritius • Namibia • Sudan • Zimbabwe 	<ul style="list-style-type: none"> • Mongolia • Papua New Guinea • Pacific Island member states (Fiji, Micronesia, Kiribati, Marshall Islands, Palau, Solomon Islands, Samoa, Tonga, and Vanuatu) 	<ul style="list-style-type: none"> • Bulgaria • Kosovo 	<ul style="list-style-type: none"> • Costa Rica • Peru 	<ul style="list-style-type: none"> • Algeria • Iran • Jordan • Lebanon • Yemen 	<ul style="list-style-type: none"> • Maldives
Less active countries					
<ul style="list-style-type: none"> • Botswana • Comoros • Equatorial Guinea • Seychelles • Somalia • South Africa • Swaziland • Togo 	<ul style="list-style-type: none"> • Korea • Malaysia • Myanmar • Thailand 	<ul style="list-style-type: none"> • Czech Republic • Estonia • Hungary • Latvia • Lithuania • Turkmenistan 	<ul style="list-style-type: none"> • Belize • Suriname • Trinidad and Tobago • Venezuela 	<ul style="list-style-type: none"> • Syria 	

COUNTRY ARRANGEMENTS FOR COST-SHARING

<i>Country</i>	<i>Expected cost sharing arrangements</i>
Afghanistan	Given Government's limited counterpart financing capacity, 100% Bank financing would continue (as was previously done).
Albania	Current financing patterns are expected to continue, with aggregate Bank financing continuing at about 55% and Government financing at about 10%. Bank and other donor assistance is moving towards SWAps, in which the Bank's financing share is typically low.
Angola	100% Bank financing would be applied on selective basis. Projects executed by central Government or by entities with own source of income would typically not have 100% Bank financing. 100% Bank financing is likely for social development projects.
Argentina	On average, the Bank's financing share is expected to remain at previous limit of 60%.
Armenia	In general the Bank's financing share is expected to continue at the previous level of about 90%. 100% Bank financing may be selectively applied in projects such as those involving community development activities.
Azerbaijan	100% financing to be applied selectively, likely for CDD projects and IDF grants.
Bangladesh	The Bank's financing share is expected to be higher in CDD projects, local-level service provision, social, and human development projects; and lower in infrastructure investments.
Belarus	In practice, the Bank's financing share is not expected to be more than 80%.
Benin	Counterpart funding will be generally expected in all projects. Contributions from Government and communities will typically be sought for local development programs. 100% Bank financing is expected for projects supporting HIV/AIDS or malaria programs.
Bolivia	Low to moderate country contributions are expected to continue for most projects, especially for CDD projects and subnational lending.
Bosnia and Herzegovina	The Bank's financing share is expected to be higher in the social sectors and lower in infrastructure and energy sectors. In the majority of cases, Government financing will continue.
Brazil	Bank financing of 100% may take place in selected cases, e.g., for the social sectors, the poorer Northeast region. The Bank's assistance program envisages greater use of SWAps, in which the Bank's financing share is typically low.
Burkina Faso	100% Bank financing is expected to be applied selectively, primarily for projects supporting regional HIV/AIDS programs. Government financing would be expected in projects with revenue-generating mechanisms and in SWAps. The Bank's portfolio is expected to increasingly use SWAps, in which the Bank's financing share is typically low. Community contributions are expected in local development programs.
Burundi	Contributions from beneficiaries are expected in projects implemented at the local level. It is expected that for some projects, particularly during FY06 and FY07, the Bank would finance 100% of costs.
Cambodia	100% Bank financing is expected in social sectors and rural sector. SWAps, in which the Bank's financing share is typically small, are expected to be increasingly used.

<i>Country</i>	<i>Expected cost sharing arrangements</i>
Cameroon	100% Bank financing might be expected in some projects/sectors where urgent actions are required, such as HIV/AIDS, electricity, and environment. Government financing would be expected in sector programs (e.g., health, education, transport, and forestry). In projects providing support to local communities, financing would be sought from beneficiaries.
Cape Verde	Government contributions are expected in most projects. In private sector and infrastructure sectors, about 50% of project costs are expected to be financed from private and other sources.
Chad	100% Bank financing might be expected in some projects/sectors where urgent actions are required, such as energy, cotton, HIV/AIDS, and technical support. Government financing would be expected in sector programs (e.g., health, education, transport). In projects providing support to local communities, financing would be sought from beneficiaries.
Chile	Bank financing of 100% is not expected in any specific project or sector.
China	Significant counterpart funding by provincial/municipal governments is expected in infrastructure projects. In social sector, rural development, and poverty alleviation projects, the Bank's financing share may be slightly higher than 60%. The Bank may finance 100% in a few cases, e.g., social sector projects in the poor provinces, or small grant-financed TA projects.
Croatia	Cases of 100% Bank financing are expected to be few, e.g., in social sectors or economically depressed regions. For larger infrastructure projects, Government counterpart funding will continue. The Bank's financing share would typically be low in SWAp.
Democratic Republic of Congo	Given the current fragile situation and resulting needs, the Bank would continue to finance 100% of project costs.
Djibouti	In general, the Bank will seek counterpart funding in all projects. In some projects the Bank may finance up to 100%, e.g., education, social development, and health.
Dominican Republic	Government financing would be a minimum of 10% of project costs. The Bank's financing share is expected to be up to 90% for social sector projects (health, education, social protection) and lower in infrastructure projects.
Eastern Caribbean States (OECS countries)	In most individual projects, the Bank expects to finance less than 100% of project costs.
Ecuador	Low to moderate country contributions are expected to continue for most projects, especially for CDD projects and subnational lending.
Egypt	The Bank's financing share is expected to be higher in social sectors and lower in infrastructure. The Bank will seek government cofinancing in most projects.
El Salvador	The Bank's financing share is expected to be about 70-85% for land administration and social sector projects, and up to 100% for technical assistance projects.
FYR Macedonia	Bank financing of 100% may occur in some rare cases. The Bank's financing share is expected to be higher in the social sectors and lower in the infrastructure and energy sectors.

<i>Country</i>	<i>Expected cost sharing arrangements</i>
Gabon	Bank financing would be about 90% of project costs in most cases. 100% Bank financing would be applied selectively, e.g., for activities supported by IDF grants.
Georgia	Government counterpart funding would be sought, particularly in infrastructure projects. 100% Bank financing is expected in social sector projects. Community contributions are expected in CDD projects and other projects involving local communities.
Guatemala	The Bank's financing share is expected to be higher (approaching 100%) in the social sectors and in the governance and public sector management areas, and lower in infrastructure.
Guyana	Government financing of 10% is expected in the one new project expected in the current CAS period.
Honduras	Government financing would be expected in infrastructure projects. In SWApS, which are increasingly expected in the social sectors, IDA financing is expected to be a small share of project costs. 100% IDA financing is likely in community participation programs, environment/biodiversity projects, and regional programs.
India	Moderate Government contributions are expected in energy, infrastructure, transport, information technology, finance, and private sectors. Low to moderate Government and beneficiary contributions are expected in rural livelihood, watershed, rural water and rural access, and water sector projects. Up to 100% Bank financing is expected in social sector projects. In national-level projects, where the Bank envisages cofinancing with other development partners under common arrangements, including SWApS, the Bank's financing share is expected to be relatively low.
Indonesia	100% Bank financing expected to be limited to CDD operations or particular components of other projects. 100% Bank financing is not likely for large infrastructure projects.
Iraq	It is expected that the Bank would finance 100% of many projects proposed in the Interim Strategy Note.
Jamaica	In most individual projects, the Bank expects to finance less than 100%.
Kazakhstan	Most projects are expected to have over 30% financing from Government or other sources. The Bank may finance 100% in some regional or grant-based activities. The overall Bank financing share is expected to be maintained at or below the previous level of 60%.
Kyrgyz Republic	Counterpart funding would be encouraged for SWApS, state-owned enterprises, and projects involving subnational governments and municipalities. Contributions from beneficiary communities would be expected in CDD operations.
Lao PDR	The Bank may finance 100% of project costs in some projects in the social sectors and rural sector. SWApS, in which the Bank's financing share is typically small, are expected to be increasingly used.
Madagascar	100% Bank financing may be applied to emergency credits and selected social sector interventions such as HIV/AIDS. Financial, private sector, and infrastructure projects, and projects executed by central Government or entities with their own sources of income are likely to require counterpart funds. Beneficiary contributions are expected in CDD projects.

<i>Country</i>	<i>Expected cost sharing arrangements</i>
Malawi	Counterpart funding will likely be required in infrastructure projects and SWAps. 100% Bank financing may occur in CDD, environment, regional HIV/AIDS, emergency operations, TA projects, and IDF grants. SWAps, in which the Bank's financing share is typically low, are expected in the social sectors.
Mali	Counterpart funding is very likely in projects with revenue-generating mechanisms. Beneficiary contributions are expected in CDD projects. The Bank's assistance program is increasingly focused on SWAps, in which the Bank's financing share is typically small.
Moldova	Beneficiary contributions would be expected in CDD projects. Government counterpart funding will continue in projects with high TA and policy content.
Nepal	An increasing proportion of IDA financing is expected to be for SWAps, in which IDA's financing share is typically low.
Nicaragua	Low to moderate country contributions are expected for most projects. Subprojects benefiting municipalities or communities are expected to include contributions from these beneficiaries.
Niger	Government contributions will continue to average 10% except when adverse conditions warrant otherwise. Contributions from local governments in decentralization and CDD projects are also expected to average 10%.
Nigeria	The Bank's financing share would be moderate in infrastructure sectors—e.g., power, roads, transport—and projects involving commercial parastatals.
Pakistan	Government contribution is expected to be moderate in infrastructure sectors. Low to moderate contributions by Government and beneficiaries are expected in CDD and water sector projects. Bank financing of up to 100% is expected in social sector projects, projects in poor and remote areas, and capacity building projects.
Paraguay	Generally the Bank is expected to finance up to 90% of project costs. In some cases—e.g., road maintenance projects—the Bank would finance a lower share.
Philippines	The Bank's overall financing share is not expected to change significantly, given expected increase in SWAps, in which the Bank's financing share is typically low. Projects implemented by local governments will likely include counterpart funding.
Poland	Bank funding is expected to be below 100% in most investment and/or programmatic lending, especially in SWAps.
Republic of Congo	Given the current country circumstances, the Bank would continue to finance 100% of project costs.
Romania	100% Bank financing will mostly apply to social sector and regional/municipal development programs. Government funding would continue in larger infrastructure reform projects. SWAps, in which the Bank's financing share is typically low, are expected to be increasingly prominent in the Bank's assistance program in the transport, environment, social protection, agricultural restructuring, education, and health areas. Local community contributions are expected in some projects.
Russia	The Government is seeking to increase its financing share of projects (up to 80% and possibly more). The Bank's financing share may be higher in projects in Russia's poorest regions and social sector projects, and lower in projects executed by revenue-generating entities.

<i>Country</i>	<i>Expected cost sharing arrangements</i>
Rwanda	Beneficiary contributions are expected in projects implemented at the local level. Contributions from other sources (e.g., Road Fund) would be required in some projects. 100% Bank financing can be expected in some projects.
Sao Tome and Principe	Minimum Government contribution of 10% would be required, including for IDF grants and recipient-executed trust funds.
Senegal	Contributions from Government are expected in projects executed by the central Government or by entities with their own sources of income. About 50% contribution is expected from private and other sources in finance, private sector, and infrastructure projects. 100% Bank financing is expected for projects that support social development through decentralized governments or NGOs.
Serbia and Montenegro	In the aggregate, current financing patterns would continue, with the Bank financing about 90% of project costs. Bank financing through SWAps, in which the Bank's financing share is typically low, is being introduced.
Sierra Leone	Projects executed by entities with their own sources of income (e.g., ports or power) are typically expected to include counterpart funding. 100% Bank financing is expected for projects that support social sector development, governance, and capacity building.
Slovak Republic	In general, Bank financing is expected to be below 100%, especially in SWAps.
Sri Lanka	An increasing proportion of Bank financing is expected to be for SWAps, in which the Bank's financing share is typically low. Community contributions are expected in CDD projects. Counterpart funding will continue to be encouraged.
Tajikistan	The Bank's financing share is expected to be low in SWAps. Contributions from beneficiaries and local communities would be generally expected in community-led development projects.
Tanzania	100% Bank financing is expected to be applied selectively, and will be considered when counterpart funding requirements would cause delays in project implementation or involve relatively high transaction costs.
Timor-Leste	The Bank may finance up to 100% of project costs, but in practice expects to finance less than 100% in many projects, given that the Bank expects to cofinance these projects with other development partners.
Turkey	In general, Bank financing is expected to be below 100%, especially in SWAps. The Bank may finance 100% of project costs in social sector projects. In other sectors, the Bank's financing share may continue over the range of past three fiscal years.
Uganda	100% Bank financing is planned in the roads sector. Bank financing will be less than 100% in many projects. Contributions from beneficiaries or local government are expected in some projects. SWAps, in which the Bank's financing share is typically small, are becoming increasingly prominent in the Bank's assistance program.
Ukraine	For most projects, the Bank is likely to finance less than 100% of project costs. For projects implemented by independent revenue-earning entities, the entity's financial position and debt capacity would be taken into account. For those implemented by agencies and subnational arrangements, the prevailing financing arrangements between the Government and the entity would be considered. Contributions from beneficiaries may be required in projects such as CDD and enterprise restructuring projects.

<i>Country</i>	<i>Expected cost sharing arrangements</i>
Uruguay	The Bank's financing share in individual projects is expected to continue at previous levels.
Uzbekistan	Government financing would usually be expected in irrigation, energy, financial sector, and private sector development. 100% Bank financing may occur in such sectors as health, education, and municipal services, in which there is a strong level of agreement on basic approaches and the Government has adopted comprehensive development strategies.
Vietnam	100% Bank financing expected to be applied in a targeted fashion focusing primarily on social sectors, poorer provinces, and decentralized projects. The Bank's financing share may decrease in some areas given the expected use of SWAps. Overall, the government's financing share is expected to stay at previous levels.
West Bank and Gaza	100% Bank financing is expected to continue through FY07.
Zambia	The Bank's financing share in SWAps (toward which Bank program is moving in the social sectors) is expected to be less than 20%.

COUNTRY-LEVEL LIMITS ON RECURRENT COST FINANCING

<i>Country</i>	<i>Country-level limits on recurrent cost financing</i>
Afghanistan	Ad hoc salary top-ups and supplements to civil servants, other than standard Government allowances, would be ineligible for Bank financing under all but the most exceptional circumstances. Any exceptions to this policy would be approved by the country director when (a) there is a credible exit strategy for the arrangement, (b) the top-ups or supplements are essential for a sustainable process of institution-building, (c) there is no feasible alternative for ensuring project implementation, and (d) the Government has confirmed that this will not, in its view, lead to unmanageable distortions in pay policy.
Bolivia	Human capital financing would follow strict government regulations, including salary ceilings.
Bosnia and Herzegovina	Recurrent cost financing will be permitted if the following strategic criteria at the country level have been met: (a) fiscal sustainability; (b) demonstrated commitment to sound fiscal management; and (c) high level of budget management and execution. This policy will be reviewed on an annual basis against these criteria and the country's efforts to raise domestic savings.
Brazil	Recurrent cost financing would be on temporary basis, and after considering the following criteria: fiscal sustainability, demonstrated commitment to sound fiscal management, demonstrated temporary financing need, high level of budget management and execution, and demonstration of sustainability of Bank-financed recurrent activities. Salaries would be financed only with government endorsement. PIU salaries would be financed only in the context of an overall approach on financing of PIUs that is aimed at ensuring sustainability.
Cambodia	The Bank would only finance remuneration where a sustainable and institutionalized program for gradual financing by government is agreed. The Bank would not finance ad hoc salary supplements.
Chad	Bank financing of salaries would be limited to positions that (a) are highly demanding in terms of time and workload and therefore call for appropriate financial incentives; (b) require in-depth knowledge of the administration; and/or (c) involve skills that cannot be found in the private sector.
Croatia	Government employees' salaries would be excluded from Bank financing. PIU salaries would be financed for new projects only if the borrower requests Bank financing.
Djibouti	The Bank would fund remuneration only if it occurs under programmatic lending or in the context of a sectorwide approach. Criteria for funding of remuneration will include fiscal sustainability analysis, institutionalization (i.e., the remuneration component is part of a civil service reform program, and not a stand-alone, ad hoc, arrangement), and agreement that the government contribution would increase over time, eventually taking over the cost obligation. The Bank would fund remuneration that is part of officially endorsed Government programs to accelerate civil service reform, but would not fund ad hoc salary supplements.
Ecuador	Recurrent cost financing would be limited to human capital spending as defined in the country's budget law.

<i>Country</i>	<i>Country-level limits on recurrent cost financing</i>
India	Recurrent cost financing would take into account sector-specific considerations (e.g., based on the CAS guidelines for Bank lending in key sectors).
Indonesia	The Bank would fund salary supplements only where there is clear justification: it is only provided to selected project management staff; rates are based on market comparators; and project staff have signed the Code of Ethics/Integrity Pact and have a satisfactory performance review.
Lao PDR	The Bank would finance civil service remuneration only in the context of programmatic lending or in sectorwide approaches, and if (a) it is part of a civil service reform program including a comprehensive pay and employment strategy; and (b) a sustainable and institutionalized program for gradual increased financing by the Government is agreed.
Madagascar	In determining the level and appropriateness of recurrent cost financing, the Bank would take into account sector strategies that call for revenue-generating mechanisms (e.g., user-fee arrangements) in sectors such as health.
Mozambique	The Bank will not finance recurrent costs in urban, water, electricity, roads, and similar projects for which user fees may be charged, other than in exceptional circumstances.
Nicaragua	The Bank would finance recurrent costs within a framework in which targets for the overall levels of public borrowing and for the overall composition of capital and recurrent expenditures are agreed in the context of macroeconomic policy dialogue.
Romania	The Bank would finance PIU salaries only in the context of full integration in line ministries or an agreed, clear plan to integrate in the line ministries structures, and with clear accountability for management oversight by the Government.
Russia	The Bank would finance recurrent costs financing only when (a) there is clear evidence of the efficiency and effectiveness of the Government institution that would receive the funding; and (b) financial support for the Government agency will assist in the implementation of reform.
Sierra Leone	The Bank would finance staff costs only where there is explicit agreement that Government will assume the cost of permanent positions after Bank financing to the project is completed.
Tanzania	In sectors where a user fee arrangement is considered essential for sustainability—e.g., roads, water, electricity, and other urban sectors—the Bank will take this into account in determining appropriateness and level of recurrent cost financing.
Uganda	In sectors where a user fee arrangement is considered essential for sustainability—e.g., water, electricity, and other urban sectors—the Bank will take this into account in determining appropriateness and level of recurrent cost financing.
Zambia	In infrastructure sectors, Bank financing of recurrent costs is expected to be the exception since revenue-generating mechanisms (through user fees, tariffs) to cover recurrent costs and to ensure sustainability are in place.