

An overview of IDA: Concessional Financing for the Poorest Countries

This paper provides an overview of IDA, the World Bank's concessional lending arm and explores some of the recent IDA developments that may be relevant to structuring market guarantees and other financial mechanisms for vaccine development and use.

What is IDA? The International Development Association, IDA, is the World Bank's concessional lending window. IDA provides zero interest loans to countries that had a per capita income of less than \$885 in 2000 and lack the necessary creditworthiness to borrow from IBRD. At present, 79 countries are eligible to borrow from IDA. Together these countries are home to 2.5 billion people, comprising half of the total population of the developing countries.

IDA eligibility is meant to be a transitional arrangement giving the poorest countries access to substantial resources needed for economic investment before these countries can obtain financing from global capital markets. Countries 'graduate' from IDA once per capita income has reached \$885.

IDA credits have maturities of 35 or 40 years with a 10-year grace period on repayment of principal. There is no interest charge, but credits do carry a small service charge of 0.75 percent on disbursed balances. Since 1960, IDA has lent \$107 billion to 106 countries. It lends, on average, about \$6-7 billion a year for different types of development projects especially those that address peoples' basic needs, such as primary education, basic health services, and clean water and sanitation. In fiscal year 2001, IDA committed a total of \$6.8 billion, spread over 134 new operations in 53 countries.

IDA Funding: Whereas IBRD raises most of its funds on the world's financial markets, IDA is funded by contributions from the governments of the richer member countries (roughly 50% of total IDA), as well as from IBRD income and the repayments from earlier IDA credits (reflows). The donors review IDA policy and replenish IDA funds every three years. Funding for the current replenishment period (IDA12 – from FY99 to FY01) allows IDA to lend about \$20 billion. The largest pledges in IDA12 were made by the United States, Japan, Germany, France, United Kingdom, Italy and Canada. Discussions on the 13th replenishment of IDA are now underway and would provide the resources needed to assist the world's poorest countries during the fiscal years 2003-05 beginning on July 1, 2002.

IDA's national focus: IDA has historically lent only to national governments for projects focused on national objectives. IDA has had only a very limited ability to address regional or global issues which may span the interests of one or more countries even if these issues may ultimately increase the effectiveness of IDA operations at the country level. For example, the control of many communicable diseases has large cross-border implications which often exceed the national benefits of control or costs of inaction. Similarly, the development of a vaccine against malaria or rotavirus disease would have tremendous benefits for many countries. However, the costs of development should not be borne by one government. National governments may invest more in the control of these diseases and the development of these products if the global benefits of such investments were recognized by the international community through lowering the cost of the necessary financing.

Making IDA more flexible: Discussion for IDA13 have included proposals to make IDA more flexible and better positioned to address global public good concerns, mainly by enabling IDA to

provide grant financing. The World Bank has the capacity to work with governments to better address cross-border issues like communicable disease control through both its policy dialogue with government and its planning and financial support for comprehensive projects. Providing resources on grant terms would offer governments additional incentives to invest in activities that benefit not only the country but also the region or the world. Offering grant terms through IDA enables efficient use of the Bank's operational systems and relationships with governments.

IDA grants

- How would it work? The existing Bank systems would be used with operational teams working with governments to identify and prepare projects which address global public good concerns.
- What is the status of the discussions? Discussion by the Deputies is centering around which sectors should be supported by grants and what percentage of IDA might be grant. Given its global public good character, communicable disease control is one of the prime examples for what might receive grant funding.
- What are the pros? There are many advantages to IDA grants, however, the benefits linked to the global public goods debate surrounding immunization and investment in vaccine R&D are realized at the global, regional and national level. Addressing these cross-border issues in the health sector is very likely to improve the effectiveness of country operations (e.g. the development of an HIV/AIDS vaccine will improve national efforts to control HIV/AIDS).
- What are the cons? Some have expressed concerns that grants may cause governments to implicitly devalue investment in key sectors by allowing or even encouraging governments to demand grants for health while re-directing national investments to other sectors. In addition, there is some concern that unless the decline in IDA repayments (reflows) is matched by an increase in donor funding, the shift to grants could deplete IDA's capital in future years.

In addition to the discussions on IDA grants, the World Bank is also exploring a second strategy to achieve grants through third party financing called IDA buy-downs.

IDA buy-downs

- How would it work? An IDA credit would be provided on standard IDA terms. Once approved by the Bank's Board and signed by a given country government, IDA would arrange with the government to sell the IDA credit to a trust fund established and financed by a donor. The trust fund would be managed by the Bank and would be used exclusively for buying down the cost of the agreed project. After purchasing the credit at its net present value (NPV, calculated using CIRR¹ rates), the trust fund would cancel the credit, thus effectively making it a grant for the borrowing country. A similar mechanism has been used to deliver debt relief to eligible countries under the Heavily Indebted Poor Countries (HIPC) initiative. The cost scenarios for both IDA buy-downs and IBRD buy-downs are illustrated in Graphic 1 and 2. Graphic 1 shows the NPV cost of reducing the non-grant element of IDA credits. Graph 2 shows the NPV cost of reducing IBRD interest rates from 5% to 0.75% (equal to effective IDA terms).

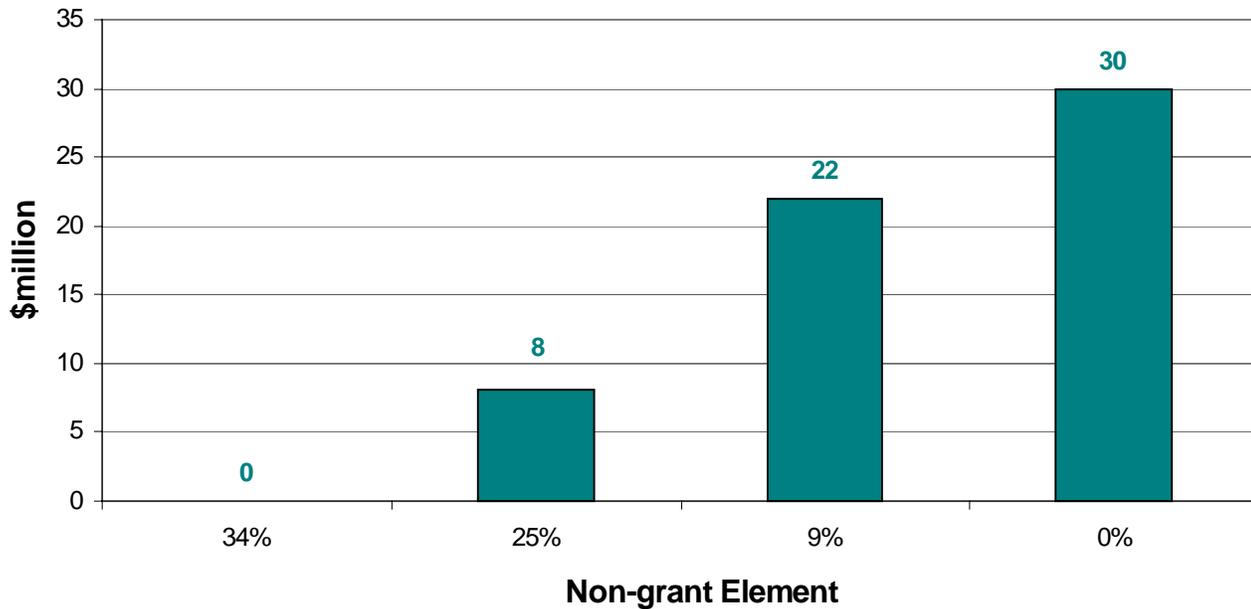
¹ Commercial Interest Reference Rate

- What is the status of the discussions? The Gates Foundation has pledged \$50 million for buy-downs (\$25 million for IDA buy-downs – probably for polio activities and \$25 million for IBRD buy-down – potentially for HIV/AIDS activities in Africa) contingent on one-to-one matching pledges from other donors. The U.K has expressed a great deal of interest and hopes to pledge its support in January 2002. Rotary International is extremely interested and plans to raise funds.
- What are the pros? Greater financial support would be available for global public goods that benefit the country, region and world. Addressing these cross-border issues in the health sector is very likely to improve the effectiveness of country operations. In addition, IDA and IBRD financial mechanisms can be structured so that the special “buy-down” terms are linked to achieving reasonable health performance targets. The mechanism has a built in leveraging ratio which is attractive to donors (e.g. \$1 of donor funds results in \$3 of IDA grant).
- What are the cons? Governments may implicitly devalue investment in health, refusing to invest national resources in the sector and instead demanding only grants. Trying to structure the buy-downs on a performance basis may be too difficult to implement.

Finally, if successful, these mechanisms may ultimately provide new ways to promote the investment in future public goods as they may provide a means to assure manufacturers that a future market will exist for key products like an malaria vaccine. Such assurances, which might even take the form of a purchase guarantee, require balancing the credibility of future funding with the need to minimize the opportunity cost of tying-up money. IDA can not be earmarked, however, IDA buy-downs might be a means to combine the targeted funding from donors with the credibility associated with the vast resources and management of IDA. Only a small share of the total resources would be needed up front² to guarantee that donors will sponsor IDA buy-downs to purchase the vaccine once it is developed and available. The result may be a credible, low cost way to assure financing of priority vaccines.

² The non-grant element of an IDA credit would need to be covered, amounting to roughly 35% of the credit presently.

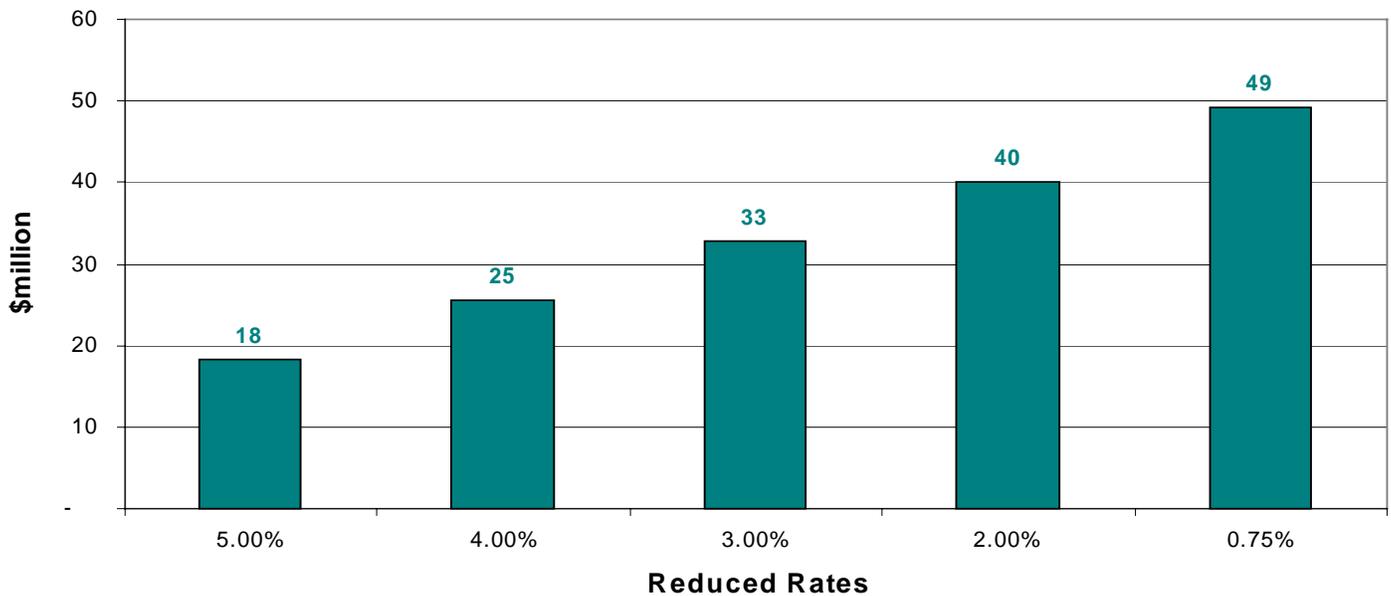
Graph 1. NPV Cost of Reducing the Non-grant Element of a \$100m IDA Credit



- 34% - Standard IDA credits with 40-year maturity and 10-year grace period
- 25% - IDA credits with service charges waived
- 9% - IDA credits with principle repayments forgiven
- 0% - IDA grants (both service charges and principle repayments forfeited)

Note: These estimates are for illustrative purposes only and are based on a set of simplified assumptions. Actual cost may vary depending on disbursement period and schedules, repayment schedules, future fee structures, investment return of the trust fund, discount rates etc.

Graph 2. NPV Cost of Reducing IBRD Rates of a \$100m Loan



Note: These estimates are for illustrative purposes only and are based on a set of simplified assumptions. Actual cost will depend a number of project-specific parameters including the type of loan products (fixed-rate, fixed-spread etc), actual disbursement period and schedules, repayment schedules, capitalized front-end fee, commitment fee, the currency of the loan, current and future LIBOR rates, investment return of the trust fund, discount rates, interest waiver etc.