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World Bank: Funding IDA's Assistance Program

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Summary

During the past decade, the World Bank's concessional loan facility, the International Development Association (IDA), has relied increasingly on loan repayments ("reflows") to fund its assistance program. By committing future reflows to fund current projects as they are disbursed, the World Bank and its member countries have raised to nearly 40% the share of IDA's current loan program funded with reflows. In future years as the stock of future anticipated reflows becomes increasingly obligated to pay for projects approved earlier, IDA will be relying more on its reserves to fund its future lending program. Under current policies, IDA's cash balance will decline from \$11.78 billion (2001) to about \$1.4 billion (2013) and then will roughly stabilize for several decades. The World Bank and its member countries anticipate that loan repayments will account for 70% of the resources needed to fund IDA's loan program between 2032 and 2041.

This effort is complicated by the parallel effort of the World Bank and its member countries to provide debt forgiveness to heavily indebted poor countries (HIPC). To date, the World Bank has forgiven over \$9 billion in IDA debt owed by HIPC countries. It has booked most of this debt but – because most of the repayments are not due for many years – it has not yet realized most of the loss. The World Bank's plan to make IDA mostly self-sustaining in the future assumes that donor countries will reimburse its HIPC debt forgiveness in full. If the forgiven loan reflows are not restored, IDA will deplete its cash balance in 2009 and need to start shrinking its aid program. The cost of funding the lost reflows will be roughly \$500 million to \$600 million a year for the next 20 years. The United States typically has provided about 20% of the money to fund HIPC multilateral debt relief, thus making this an important issue for Congress.

Likewise, the Administration and others have proposed that IDA adopt a major grant program for poor countries. The scope and details of the plan are currently under negotiation by donor countries. A grant program will need to be funded by contributions from donor countries or IDA will need to start reducing the size of its future program in anticipation of lost reflow income. Estimates of the size of the cost of the Administration's proposed grant program differ. Much of the difference in the estimates is due to the methods used for presenting the estimates rather than to major differences in the size of the expected costs. CRS and GAO both estimate that the cost of the Administration's grant program could be funded in full if donors contributed between 1.6% and 1.8% more each year (compound interest). As such, they would need to contribute between \$64 billion and \$71 billion more during the next 40 years. This would be a 40% to 45% increase in the donors' overall contributions to fund the IDA program. Based on prior practice, the United States would likely be asked to provide 20% of that total.

Basically, the goal of making IDA more self-funding through reflows and the goal of reducing recipient countries' repayment obligations are incompatible. The United States and other donor countries may need to decide which goal to favor – whether to fund IDA debt forgiveness and grants with increased contributions or to allow the overall size of IDA's assistance program diminish in future years.

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World Bank: Funding IDA's Assistance Program

Introduction

The International Development Association (IDA) is the component of the World Bank that makes concessional loans to the world's poorest countries. IDA gets most of the new money it uses to fund its assistance programs from contributions by donor countries such as the United States, European countries, and Japan. IDA lends on easy repayment terms, with no interest charge and repayments stretched over 35 to 40 years, including a ten year grace period. It levies a 3/4 of 1% service charge on the disbursed balance for its loans to help offset IDA administrative expenses.

This paper analyzes the way IDA's assistance program is funded and at the effort by donor countries and the World Bank to have loan repayments ("reflows") carry an increased share of IDA costs. It also explores the potential long-term effects that debt forgiveness and a major grant program might have on IDA's finances. IDA has forgiven substantial amounts of debt owed to it by heavily indebted poor countries (HIPC's). The question whether the costs of that debt relief will be borne by IDA or by donor countries has not yet been resolved. Likewise, President Bush has proposed that IDA institute a major program of grants to poor countries. Currently, IDA makes only loans. The costs of this initiative and the way it would be funded have likewise not yet been determined. In its examination of the two issues – debt forgiveness and grants – the paper discusses the likely cost the United States and other donors would need to bear if they chose to support the costs of IDA debt forgiveness or IDA grants themselves.

For fiscal 2003, the Administration has requested appropriations of \$874 million for contribution to IDA. Contribution levels will likely remain at this level, or perhaps increase, in future years. In recent years, Congress has also appropriated about \$775 million to fund multilateral debt forgiveness to HIPC countries. Proposals for further HIPC debt relief and a new IDA grant program are currently under consideration and will likely require additional U.S. contributions in future years. Future U.S. contributions or changes in IDA or the HIPC program will need the consent of Congress. Shifts in the way these programs are funded could have a substantial impact on prospective levels of support.

Funding IDA's Current Program

Every three years, as IDA's stock of uncommitted resources declines, donors meet to negotiate terms for a replenishment of IDA's resources. Since IDA was created in 1960, there have been twelve such replenishments. A new replenishment plan (IDA 13) -- to fund IDA operations during the next three year period -- is

currently being negotiated. Legislation to authorize U.S. participation and U.S. contributions to the plan likely will be submitted to Congress in June 2002.

In the past, most of the money IDA had available to lend during each replenishment period (the three years funded by a replenishment plan) typically came from donors. Funds from loan repayments were also used to support new loans, but the amount received annually from this source was relatively small. During the past decade, however, the volume of reflows has increased substantially. In 1992, the IDA donor countries adopted a new plan (in IDA 10) to enhance through “advanced commitment” the role that reflows will play in IDA’s operations. IDA previously waited until reflows were in hand before adding them to the stock of resources available to finance future loans. Under the advanced commitment plan, reflows received during the next decade are counted as support for an IDA replenishment plan if they are used to pay for disbursements on projects approved during that replenishment period. Because IDA only releases funds as implementation goes forward, the disbursements for an IDA project may be stretched out over a six to eight year period.

Even though the amount being received as reflows during a three-year replenishment period is relatively small, the share of IDA disbursements funded by reflows has increased substantially. In IDA 10, IDA loan commitments made during the period 1994 to 1996 were funded with \$16.3 billion in new contributions from donors and \$3.1 billion in advanced commitments of reflows.¹ In other words, reflows accounted for about 16% of the resources used to fund IDA 10. In IDA 11 (1997 to 1999), IDA’s loan program received \$9.86 billion in new contributions from donors and \$6.5 billion in advanced commitment of reflows. (Another \$1.63 billion in IDA 11 projects was funded with money carried over from earlier replenishments.) On this basis, omitting the carryover to avoid double counting, reflows accounted for 40% of IDA disbursements during the IDA 11 period. However, since actual reflows received during those three years amounted to only \$2.39 billion, IDA needed to use \$3.1 billion in future reflows to fund disbursements on IDA 11 projects.

In IDA 12 (2000 to 2002), new contributions amounted to \$12.44 billion while reflows covered \$6.4 billion in future IDA 12 disbursements. In effect, reflows provided about 34% of the funds needed to pay for IDA 12 loans. As IDA was scheduled to receive \$4.46 billion in reflows during that three year period, IDA would need \$1.94 billion in future reflows to pay IDA 12 costs. In IDA 13, currently under negotiation, donors (including the IBRD) would provide \$13.7 billion in new money and “internal resources” (reflows plus reserves, a point to be discussed later) would comprise \$8.9 billion. On this basis, reflows and other “internal” IDA resources would account for over 47% of IDA 12's total cost.

¹Throughout this paper, one SDR is valued at \$1.253. This makes easier the comparison of numbers from one replenishment to the other. The World Bank has used this procedure in its consultations with member countries about long-term IDA funding plans.

IDA's ability to commit future reflows to fund its current loan program is facilitated by the nature of IDA reflows. On average, 95% of the amount due from borrowers is repaid on time and in full. Most of the countries not paying have (in effect) no national government or their government is seriously estranged from the world system.

Table 1. Projected IDA Cash Flow and Cash Balance, 2002-41
(Billions of US Dollars)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Commitments	6.28	7.35	7.35	7.35	7.87	7.87	7.87	8.43	8.43	8.43
Contributions	--	4.51	4.51	4.51	4.39	4.39	4.39	4.39	4.39	4.39
Contrib old	4.00	2.00	1.62	1.62	--	--	--	--	--	--
Net Op Income	0.81	0.83	0.86	0.89	0.89	0.82	0.76	0.75	0.72	0.70
Reflows	1.30	1.40	1.60	1.80	1.90	2.10	2.30	2.50	2.70	2.90
Total income	6.55	9.18	9.05	9.29	7.67	7.80	7.95	8.16	8.34	8.53
Disbursmnts new		1.43	2.91	4.30	5.48	6.40	7.15	7.70	8.10	8.21
Disbursmnts old	6.49	7.51	6.08	5.32	4.11	3.01	1.11	1.34	0.81	-0.51
Total Costs	6.93	9.39	9.45	10.09	10.07	9.90	8.76	9.55	9.43	8.24
Net annual cash	-0.38	-0.20	-0.40	-0.80	-2.40	-2.10	-0.81	-1.39	-1.10	0.29
Balance	11.40	11.20	10.80	10.00	7.60	5.50	4.70	3.30	2.20	2.50
	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Commitments	9.02	9.02	9.02	9.66	9.66	9.66	10.34	10.34	10.34	11.07
Contributions	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39
Net Op Income	0.74	0.73	0.74	0.80	0.85	0.87	0.94	0.96	0.99	1.07
Reflows	3.30	3.50	3.80	4.00	4.30	4.50	4.80	5.10	5.30	5.60
Total income	8.98	9.19	9.51	9.78	10.09	10.34	10.72	11.05	11.29	11.69
Disburs new	8.40	8.58	8.74	8.98	9.19	9.36	9.61	9.83	10.02	10.29
isb correction	0.73	0.45	-0.51	0.81	0.26	-0.60	0.73	0.52	-0.54	0.67
Total Costs	9.68	9.59	8.80	10.38	10.00	9.33	10.92	10.95	10.09	11.58
Net annual cash	-0.70	-0.40	0.71	-0.60	0.09	1.01	-0.21	0.10	1.20	0.10
Balance	1.80	1.40	2.10	1.50	1.60	2.60	2.40	2.50	3.70	3.80
	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2030</u>	<u>2031</u>
Commitments	11.07	11.07	11.85	11.85	11.85	12.69	12.69	12.69	13.58	13.58
Contributions	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39
Net Op Income	1.10	1.12	1.14	1.17	1.20	1.24	1.24	1.24	1.24	1.24
Reflows	4.83	5.19	5.51	5.87	6.22	5.43	5.79	6.16	6.52	6.88
Total income	10.96	11.35	11.71	12.11	12.52	11.78	12.15	12.54	12.92	13.30
Disburs new	10.53	10.72	11.01	11.27	11.48	11.79	12.07	12.29	12.62	12.92
Disb correction	--	--	--	--	--	--	--	--	--	--
Total Costs	11.17	11.37	11.68	11.95	12.18	12.51	12.80	13.04	13.39	13.70
Net annual cash	-0.21	-0.02	0.03	0.16	0.34	-0.72	-0.65	-0.50	-0.46	-0.40
Balance	3.60	3.58	3.61	3.76	4.10	3.38	2.73	2.23	1.77	1.37
	<u>2032</u>	<u>2033</u>	<u>2034</u>	<u>2035</u>	<u>2036</u>	<u>2037</u>	<u>2038</u>	<u>2039</u>	<u>2040</u>	<u>2041</u>
Commitments	13.58	14.54	14.54	14.54	15.57	15.57	15.57	16.67	16.67	16.67
Contributions	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39	4.39
Net Op Income	1.25	1.22	1.24	1.26	1.29	1.31	1.33	1.35	1.37	1.39
Reflows	6.00	6.39	6.78	7.20	7.62	7.34	7.79	8.24	8.68	9.14
Total income	12.44	12.82	13.25	13.71	14.17	13.94	14.43	14.92	15.41	15.92
Disburs new	13.16	13.52	13.83	14.09	14.47	14.81	15.08	15.49	15.85	16.15
Disb correction	-0.15	-1.52	-1.42	-1.24	-1.17	-1.78	-1.57	-1.50	-1.40	-1.22
Total Costs	13.81	12.82	13.25	13.71	14.18	13.93	14.43	14.93	15.41	15.91
Net annual cash	-1.37	0.00	-0.00	0.00	-0.01	0.01	-0.00	-0.00	-0.00	0.00
Balance	-0.00	-0.00	-0.00	0.00	-0.00	0.00	0.00	-0.00	-0.00	-0.00

Source: Created by CRS using data supplied by World Bank, as discussed in text.

At the beginning of July 2001, IDA had uncommitted financial resources on hand totaling \$11.78 billion. It also had \$9.24 billion in donor pledges in non-negotiable non-interest bearing notes which had not yet been encashed. IDA cannot require that its donors turn their contribution pledges into actual money right away. Rather, the donors' notes must be drawn down over a 9 year period according to a specified schedule. IDA's cash balance (uncommitted financial resources) has grown gradually over the years because contributions have come in at the scheduled rate, reflows have increased, and disbursements seem to have been somewhat less than originally expected. The latter appears to be due partly to difficulties the Bank has had implementing complex projects in difficult contexts (IDA had over \$20 billion in undisbursed loans commitments in 2002, some 19% of all loan commitments to date) and partly to the dip in IDA loan commitments which occurred in the late 1990s.

Table 1 seeks to present a picture of IDA's financial situation for the next 40 years. As with all projections, the data are strongly dependant on the accuracy of the original numbers and the strength of the underlying assumptions. The calculations here are based on data or assumptions provided by the World Bank.² Contributions include planned future transfers from IBRD net income as well as contributions from governments. Operations and administrative costs would increase by 2.3% annually, per the expected rate of inflation. Contributions from donors would remain the same in nominal terms. Investment held in the cash balance are assumed to earn 5% annually. Income from the IDA service charge would continue to be 3/4 of 1% of the disbursed balance. Disbursement figures were the only data not specifically defined by World Bank data or assumptions. The U.S. General Accounting Office (GAO) provided estimates for annual disbursements from future replenishments, based on standard World Bank procedures. The author adjusted disbursement levels for years 2002 to 2021 (funded with new and old money) in order to keep IDA's cash balance each year at the level projected by the Bank. Future disbursement data reflows (for 2022 to 2041) were generated by the assumptions built into the model. Estimates for future reflows were calculated using the disbursement data for the first two decades and standard disbursement and repayment formulas.

According to the World Bank, IDA will fund much of its future loan program through substantial reductions in its cash balance. Over the next 12 years, IDA plans to reduce its cash balance from \$11.78 billion (2001) to \$1.4 billion (2013). During those years, IDA will disburse \$1 billion or more annually than it receives in income.

² World Bank. *IDA Funding Scheme and Financial Projections: IDA13 Replenishment*. Powerpoint slides distributed to IDA donor countries, late fall 2001. Unpublished.

IDA's cash balance will remain favorable through most of the 2020s, but will begin sinking in the last years of the decade. According to the model, disbursements will need to be constrained in the 2030s if IDA is not to run out of money. IDA's cash balance is its protection against contingencies, its "margin of error" against unexpected events. Whether IDA's future assistance program will be funded substantially by "reflows" in the next two decades is a matter of semantics, given the many sources of funds that have contributed to the current cash balance. A major share of IDA's reflows during the next decade have already been committed to fund earlier replenishments.

The World Bank assumes that IDA resources in real terms will remain the same size they are now for the next 40 years. Loan disbursements and administrative costs will grow by 2.3% annually (per expected inflation), while donor contributions would remain flat in nominal terms. The Bank presumes that, all else being equal, loan disbursements and other non-donor sources of revenue will provide 70% of the money IDA will need to fund its loan program during the last decade (2032 to 2041) of this period.

Funding IDA's Program: HIPC

This is the point in the present discussion where the issue of debt forgiveness to poor countries through the HIPC program and possible IDA grants becomes important. Both initiatives would reduce the amount of reflows that IDA receives in future years – shifting the burden either to donors (a need for increased contributions) or to recipients (a smaller IDA assistance program). The data provided by the World Bank (shown in Table 1) assume that there will be no significant IDA

grant program and that IDA is reimbursed in full (by donor countries) for all the debts it has forgiven the HIPC countries.³

Through December 31, 2001, the World Bank has forgiven or is forgiving \$10.2 billion in debt owed to IDA through the HIPC program. To offset some of these costs, it received \$778 million in reimbursements from the HIPC trust fund. The cost to IDA for debt forgiveness occurs not in the year when the forgiveness is announced, but in the year when IDA would have otherwise received the loan repayment. IDA has booked a net loss of \$8.6 billion in HIPC forgiveness (more will be booked in the future), but to date it has only realized a small portion of the loss.

Table 2. Projected IDA Cash Balance, 2002-2021
Without HIPC Reimbursement
 (Billions of U.S. Dollars)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
HIPC lost reflows	0.32	0.36	0.44	0.48	0.52	0.55	0.58	0.58	0.55	0.57
Balance	11.29	10.82	9.97	8.65	5.33	2.24	0.39	-1.96	-3.90	-4.37
	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
HIPC lost reflows	0.58	0.59	0.57	0.55	0.55	0.55	0.55	0.55	0.45	0.35
Balance	-5.83	-6.96	-6.94	-8.25	-8.83	-8.50	-9.43	-10.05	-9.47	-9.96

Source: Created by CRS using HIPC reflow data from World Bank and Table 1 data.

Table 2 shows (based on Table 1) the effect of that HIPC debt forgiveness will have on IDA's cash balance if the lost reflows from HIPC are not reimbursed and IDA has to absorb the cost from its own resources. For simplicity, only the results of the calculation are presented.⁴ IDA's cash balance will become negative in 2009 in that situation. The difference between the annual balances in Table 2 and those in Table 1 represent the cumulative amount IDA would need to receive from some other source if it were to hold the size of its aid program unchanged despite the shortfall in reflows. The World Bank was unable to provide data on the impact that HIPC would have on IDA reflows beyond 2021. The World Bank says that it plans to contribute between \$200 million and \$220 million to HIPC in the next four years

³ World Bank. *IDA Funding Scheme...*, p. 9. Among the specific assumptions for the Bank's funding plan is a statement that "Costs of HIPC debt service forgiveness [are] covered by IBRD net income pledge and subsequently by additional donor contributions." Future IBRD contributions to IDA are included in the model but not future IBRD contributions to HIPC. The Bank assumes that coverage of past and future HIPC forgiveness by the IBRD and by new donor contributions is a prerequisite (not included in the data) to the arrangements specified in its new 40 year plan.

⁴ Table 2 shows the key changes that would occur in Table 1 if the reduction in reflows caused by HIPC debt forgiveness were added to IDA costs. If that additional cost were added to Table 1, the cash balance (bottom line) figure would change to reflect the data shown in Table 2.

(through 2005), completing its pledge to provide substantial IBRD contributions to that program.⁵ This amount is included in the income calculation for Table 2.

There appear to be three ways IDA can deal with that situation. First, it can shrink the size of its annual IDA aid program by an amount equivalent to the lost HIPC reflows. Second, the lost reflows can be reimbursed to IDA by donor countries. Third, IDA can seek funds from some other source, in the World Bank or in another international financial institution to cover the shortfall.

Reducing the size of the IDA program could save money but it could also have negative effects on recent HIPC graduates and other poor countries. If donors wish to offset the lost HIPC reflows, they would need to contribute \$8.64 billion over 20 years.⁶ If they fund the loss each year as it occurs, they would need to contribute the amounts shown in Table 2. Alternatively, if they chose to fund the lost revenues up front, they could make a one-time payment of \$5.6 billion. Invested at 6.3%, this would generate enough revenue (principal and interest) to offset the lost revenues in each future year. Based on recent precedents, the likely cost to the United States in either case would be about 20% of the total.

The World Bank has substantial assets in its reserves. However, these are assets of its near-market loan facility, the International Bank for Reconstruction and Development (IBRD). Transferring them to IDA may be difficult from a legal and political perspective. It would require a super-majority vote of the membership, it may engender lawsuits by Bank bondholders, it would likely drive up interest rates the Bank would need to pay to borrow funds, and – if a distribution of assets is triggered – it would require an appropriation by Congress to transfer the U.S. share of those assets (several billion dollars) to the IDA.

Funding IDA's Program: Grants

⁵ The World Bank promised its member countries that it would contribute \$2.15 billion in net present value (NPV) terms over time to the HIPC trust fund. To date, the World Bank has transferred \$1.4 billion from IBRD net income (not reserves) to the HIPC trust fund. The remainder would be contributed by 2005. See: World Bank. *Heavily Indebted Poor Countries (HIPC) Initiative: Status of Implementation*. March 22, 2002. IDA/SecM2002-0155. Prepared for the Development Committee Meeting, April 21, 2002. See paragraph 23. Also available from the Bank web site. The Bank says that this will permit the IDA component of the HIPC Trust Fund to reimburse IDA for IDA debt through the end of IDA 13. The Bank says that it expects that IDA donors will consider the future needs for funding IDA's HIPC costs in the IDA 14 negotiations. During IDA 13 (upcoming), the IDA donors also reportedly plan to contribute \$627 million to cover such costs during the IDA 13 replenishment period. This amount is not included in the income data for Table 2. The donor countries reportedly plan to cover subsequent shortfalls in HIPC funding on a pay-as-you-go basis, though final agreement on this point has been postponed until the negotiations on IDA 14 in 2005.

⁶ The total reduction in IDA reflows due to HIPC for the years 2002 to 2021 is \$10.24 billion, with a net present value (NPV) of \$5.6 billion. Not all of this cost has yet been booked. The World Bank has identified sources of funding for some of this. However, its unfunded HIPC liability is \$8.6 billion in nominal terms, about \$4.5 billion in NPV terms.

In July 2001, President George W. Bush proposed that up to half the aid the World Bank provided to poor countries in future years should be in the form of grants rather than low-cost concessional loans. The President said that such a change in IDA procedures would help lessen the debt burden on poor countries, provide means for greater effectiveness and accountability, and put increased emphasis on assistance for education, health and sanitation. Critics of the proposal say it could lead to conflict and competition with other international programs, divert attention from poverty-alleviation and other concerns, and require substantial new contributions by donors. If the proposed grant program is not funded, they add, it would substantially undercut the financial basis of IDA and force substantial cuts (or termination) of its aid program in future years. The British and other European governments have been particularly critical of the proposed plan. Negotiations to seek a compromise and resolution of the issue are currently underway. For further discussion, see CRS Report RL31136, *World Bank: IDA Loans or IDA Grants*.

Many analysts have sought to determine the likely cost and financial feasibility of the President's proposal for IDA grants. The World Bank says the cost would be about \$100 billion, in nominal dollars. Of this, \$59 billion was actual lost repayments and \$41 billion was foregone interest income IDA would have received if those reflows had been invested (until used) through IDA's cash balance. GAO says the cost would be \$15.6 billion, in net present value (NPV) terms for the whole \$100 billion and \$9.7 billion in NPV terms for the actual lost reflows.⁷ It is important to note that the GAO and World Bank estimates are basically the same. The Bank's approach counts the cost as it occurs over the 40 year period. The GAO concept accounts for the time value of money. In effect, it presumes that the costs identified by the Bank could be covered if a \$9.7 billion fund were established today and the proceeds in that fund were used to offset future losses in reflows as they occur.

Table 3 (below) provides another estimate, based on the analysis in Table 1, of the likely cost (in nominal dollars) of lost reflows due to grants.⁸ According to Table 3, the actual reflows lost if IDA instituted a grant program comparable to that proposed by the Administration would be about \$64 billion. This is comparable in concept to the World Bank's figure of \$59 billion). Costs are counted only in the year in which they are incurred. Table 3 does not include any estimate for the imputed cost of lost income which might be generated by those lost reflows.⁹

⁷U.S. General Accounting Office. *Developing Countries: Switching Some Multilateral Loans to Grants Lessens Poor Country Debt Burdens*. April 2002. GAO-02-593. The present author thanks GAO analysts for several helpful suggestions received during his preparation of this CRS report. .

⁸ The methodology for Table 3 is the same as that for Table 2. It shows the changes which would occur in IDA's bottom line (cash balance) if the lost reflows attributable to a grant program (comparable to that proposed by the Administration) were added to IDA's costs.

⁹ Not shown in Table 3 are the likely consequences (according to the model) if IDA tried to do HIPC debt relief and a major grant program simultaneously without offsetting contributions by donors. In that case, IDA's cash balance would become negative in 2009 and the total would reach minus \$10 billion by 2021. Without data on HIPC losses beyond that point, it is impossible to determine what the balance would be in 2041. It would likely be more substantial, though, than that shown in Table 3.

The important thing is not the differences among the numbers, which are relatively small given the fact that they are all projections over 40 years. The important thing is the fact that a grant program will have costs, either to the donors (more contributions) or to IDA's beneficiaries (a smaller program) which will need to be considered if the program is put into effect.

Table 3. Projected IDA Cash Balance, 2002-2041
With Unfunded Grants
 (Billions of U.S. Dollars)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Lost reflows	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Balance	11.40	11.25	10.86	10.06	7.63	5.46	4.57	3.05	1.79	1.90
	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Lost reflows		0.06	0.13	0.19	0.28	0.35	0.41	0.47	0.54	0.59
Balance	0.45	-0.78	-0.96	-2.50	-3.35	-3.29	-4.54	-5.53	-5.46	-6.57
	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2030</u>	<u>2031</u>
Lost reflows	0.66	0.79	0.91	1.05	1.20	1.33	1.47	1.61	1.74	1.88
Balance	-7.86	-9.09	-10.41	-11.76	-13.11	-15.74	-18.42	-21.08	-23.82	-26.64
	<u>2032</u>	<u>2033</u>	<u>2034</u>	<u>2035</u>	<u>2036</u>	<u>2037</u>	<u>2038</u>	<u>2039</u>	<u>2040</u>	<u>2041</u>
Lost reflows	2.03	2.19	2.33	2.50	2.66	2.81	2.99	3.16	3.33	3.52
Balance	-30.79	-34.44	-37.47	-40.63	-43.97	-47.53	-51.28	-55.21	-59.34	-64.58

Source: Created by CRS using Table 1 data and standard disbursement/reflow formulas.

GAO proposed that, instead of making contributions to defray the cost of grants as they occur, donors might make advanced contributions to a special fund. The principal and interest in that fund could be used to defray the future cost of lost reflows due to grants. GAO said that the cost of grants could be offset if donor countries increased their contribution to IDA by 1.6% annually over the next 40 years. This is compound interest. Over the course of 40 years, using the financial model presented in Table 1, donors would contribute \$64 billion, a 40% increase over planned contribution levels.

Table 3 shows that, unless IDA grants are funded with increased contributions from donors, IDA's cash balance will dip into the negative in the first year in which repayments would have been otherwise due for grants made in 2003.¹⁰ The growing negative balance reflects the cumulative amount IDA would need to receive in donations to keep its aid program at planned levels despite the drop in reflow

¹⁰ The World Bank estimated that IDA's cash balance would become negative (absent any funding for a grant program comparable to that proposed by the Administration) in 2015. World Bank. *IDA Funding Scheme...*, p. 14. The Bank also estimated that, if IDA instituted an unfunded 10% grant program, the total cost in lost reflows would be about \$2 billion and IDA's cash balance (though small) would remain positive through 2021. It made no estimate for the cost or impact on IDA's cash balance for later years (when, by most estimates, the bulk of the losses would be incurred.).

income.¹¹ The table assumes that IDA will levy a small commitment fee (here charged as 1.5% of the total in the year the grant is made) to cover administrative costs. This approximates on an NPV basis the IDA commitment fee for grants which the World Bank reportedly has under consideration.) Over time, as the size of IDA's outstanding loan balance grows more slowly (because more of its aid takes the form of grants), IDA will likewise receive less income annually from the service charge it levies on those loans.

Using data that was not available originally to GAO, CRS did a separate analysis of the amount that would be needed in additional contributions to offset the likely costs of an IDA grant program. This found that the donor countries would need to increase their contributions to IDA at an annual rate of 1.776% during the next four decades to offset the cost of a major grant program. Again, as with the GAO calculation, this would be compound interest. On this basis, using the financial model presented in Table 1, donors would contribute an additional \$72 billion to IDA (a 45% increase over current plans) during the next 40 years. This is somewhat more than GAO calculated. However, the differences between the two estimates are not significant due to differences in methodology and the difficulty of estimating costs over such a long period of time. Were the IDA donors to agree on a contribution plan of this sort, to offset the future costs of grants, the World Bank – having more complete data on IDA finances – should be able to determine an annual contribution rate sufficient to accomplish that goal.

The United States currently contributes about 20% of the new money provided to IDA during each replenishment period. Given the relative size of the U.S. economy, it seems unlikely that other countries will agree to increase their contribution levels in order that the United States may decrease its. Should the U.S. contribution share remain at that level for the next four decades, it is likely that the United States will be asked to contribute an extra \$13 billion to \$14 billion (over and above the \$32 billion it would give if donor contribution levels remained flat in nominal terms during that period) to cover the cost of IDA grants.

Balancing Multiple Goals

IDA's capacity to fund a major program of assistance to developing countries in the coming decades is heavily dependant on the way the World Bank and the IDA donor countries handle its finances. Under current plans, loan repayments ("reflows") would provide much of the money IDA needs to fund its operations during the next 40 years. Contributions from donors would bear a declining share of the load. In nominal terms, donors would be asked to contribute the same amounts annually during each of those years even though the IDA program would be growing in nominal terms to compensate for anticipated inflation. In real terms, given the

¹¹ In Table 3, IDA's cash balance is somewhat higher in the first decade than that shown in Table 1 because IDA would receive an up-front commitment fee from grants made during that period. Correspondingly, the IDA cash balance in Table 3 is smaller in later years than that shown in Table 3 because – in addition to lost reflows – IDA would not be receiving the normal 3/4 of 1% service charge during that period on the disbursed balance for aid released as grants rather than loans. The commitment fee used for the calculations embodied in Table 3 is worth considerably less in NPV terms than the usual service fee.

effects of inflation, the actual cost of the IDA program to donors would decline by 2.3% annually during the entire period.

In addition to the goal of reducing the cost of the IDA program to donors, many people also hope that the cost to the recipient countries may be reduced as well. The program of HIPC debt forgiveness for poor countries seeks to reduce the amount that poor countries must pay to IDA each year as a consequence of earlier loans. Likewise, the proposal for a major IDA grant program would reduce – if not eliminate – much of the cost that recipient countries must bear as a consequence of IDA aid.

Ultimately, the goal of making IDA more self-financing through reflows and the goal of reducing the recipient countries' debt repayment burdens are incompatible. Any debt repayments that are forgiven (through HIPC) or eliminated (through grants) will reduce the amount that IDA receives in future years as reflows to fund its future aid program. Without additional contributions from donor countries, either to offset the cost of IDA's regular assistance program or to offset the cost of HIPC debt forgiveness or grants, the resources available to fund IDA's assistance program will gradually decline. In that case, IDA will have no real alternative but to shrink the size of its new assistance program in proportion to the amount it is providing its beneficiary countries through debt relief and grant assistance. In either context, the donor countries will need to decide whether they wish to reduce the size of the IDA program in future years or to increase (in real terms) the size of their annual contributions.