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PROGRESS REPORT ON APPLICATION OF THE DEBT SUSTAINABILITY FRAMEWORK

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PROGRESS REPORT ON APPLICATION OF THE DEBT SUSTAINABILITY FRAMEWORK

I. Introduction

1.1 The purpose of this report is to review the experience of the African Development Fund (ADF) in the application of the Debt Sustainability Framework (DSF). The DSF was formulated jointly by the IMF and the World Bank, but with full collaboration of the Bank Group (and other MDBs) in the development and application of the Framework. The DSF seeks to ensure that external financing in support of low-income countries' development efforts for the attainment of the Millennium Development Goals (MDGs) does not lead to unsustainable debt burdens.

1.2 Application of the DSF has involved two main approaches. The first approach is a static mechanistic methodology of matching indicative policy-dependent debt burden thresholds with actual past debt burden ratios to determine countries' risk of debt distress. The second approach involves a dynamic process of determining a country's risk of debt distress through application of forward-looking Debt Sustainability Analysis (FL-DSA) of countries in the field. The experience of the ADF in applying the static DSF for the 2005 DSF country risk rankings, and the application of the FL-DSA for most of the 2006 DSF risk rankings are reviewed in this report.

1.3 The paper has five main sections. Following this Introduction, Section II presents the background information on the formulation of the DSF. Section III covers application of the static DSF to determine the 2005 performance-based country allocations (PBAs). Section IV examines the application of the new forward-looking DSAs in determining the 2006 PBAs. Section V covers the impact of the MDRI on the DSF. Section VI examines the implications on the DSF on four emerging issues. The final section presents the concluding remarks and recommendations for consideration by ADF Deputies.

II. Background: Formulation of the Debt Sustainability Framework

2.1 While the DSF was developed jointly by the IMF and the World Bank, it is a product of extensive consultations that took the form of a series of high level policy seminars and conferences organized jointly by the two Bretton Woods Institutions, the Commonwealth Secretariat, and Paris Club Secretariat, among others, during 2003 and 2004. Bank Group representatives participated actively in these meetings, together with various other stakeholders, including representatives of other MDBs, government and NGO officials from regional member countries, and representatives from the media, labor unions, the private sector, religious organizations, and others[1].

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[1] See BTOR, Joint IMF/World Bank Workshop on Debt Sustainability in Low Income Countries held in Washington DC, 11-12 September 2003; also Chairman's Summary on Meeting of Multilateral Creditors held at OPEC Fund Headquarters, Vienna, Austria, October 22-23, 2003; and BTOR on Multilateral Development Banks' Annual Meeting, held in Washington, DC, 23-24 June 2004.

2.2 Cross country empirical studies by the World Bank, corroborated by the IMF, provide useful insights for assessing the sustainability of countries' current and projected indebtedness. The studies suggest that among the factors that influence a country's risk of debt distress, the quality of policies and institutions turns out to be a key determinant and has a crucial bearing on the debt levels associated with debt distress[2]. The studies show that countries operating in a weaker institutional and policy environment are likely to experience debt distress at significantly lower debt ratios, as such countries tend to be more prone to misuse and mismanagement of funds, and less capable of using their resources productively.

2.3 During 2004 and early 2005, there were extensive inter-agency consultations involving IDA, IMF, ADF, AsDB and other IFIs and stakeholders regarding the order of magnitude of the indicative policy-dependent thresholds that form the bedrock of the Debt Sustainability Framework. During the IMF/World Bank Spring 2005 meetings, a consensus emerged on the level of the thresholds deemed by all stakeholders to be relatively more conservative and prudent (see Table 1 below). The thresholds serve as the benchmark against which data on a country's actual debt burden ratios are assessed to determine the risk of debt distress in which the country can be classified.

The Static DSF Approach

2.4 The so-called static and mechanistic DSF approach is based on two pillars: (i) the indicative country specific external debt burden thresholds that are related to a country's policies and institutions; and (ii) the country's actual debt burden indicators (i.e. NPV of debt/GDP ratio, NPV of debt/exports ratio, and debt service/exports ratio). A comparison is then made between the indicative thresholds and the actual debt burden indicators under a baseline scenario, and under probable "stress scenarios" which incorporate a country's vulnerability to exogenous shocks. While adopting the DSF as the basis for the ADF-X financing terms, the ADF Deputies agreed for the Fund to use its own CPIA ratings for classifying RMCs according to policy performance.

2.5 The debt burden indicators and their corresponding indicative thresholds adopted under the CPIA class categories for the ADF-X period are shown in Table 1 below. The table illustrates the consensus achieved, in terms of the three debt-burden indicators, together with the three CPIA country groupings, associated with their relevant indicative thresholds. The table indicates that countries with different levels of policy performance (weak, medium and strong policies) can accommodate distinct levels of debt burden (low, medium, and high respectively). Thus, for example, a country X, which is classified by its CPIA as among RMCs with medium policy performance (3.25 <CPIA< 3.75), can accommodate more concessional loans, rather than grants, as long as the NPV of its debt/exports ratio is 10 percent less than the threshold, which in this case is set at 150

[2] See Kraay and Nehru (2004): "When is Debt Unsustainable?", World Bank Policy Research Working Paper No: 3200. Also see IMF/IDA: "Debt Sustainability in Low Income Countries - Proposals for an Operational Framework and Policy Implications", February 2004.

percent[3]; otherwise its financing would all be in grants, or a combination of loans and grants.

Table 1. Indicative Policy-Dependent Debt and Debt-Service Thresholds (in Percentages)

Debt Burden Indicators	Assessment of Institutional Strength and Quality of Policies		
	Weak CPIA≤ 3.25	Medium 3.25 <CPIA< 3.75	Strong CPIA≥ 3.75
NPV of Debt to GDP	30	40	50
NPV of Debt to Exports	**100**	**150**	**200**
Debt Service to Exports	15	20	25

Source: *Possible Implications for ADF-X Financing Terms of Adopting Revised Debt Thresholds and Placing a Cap on Grants*, ref.: ADF-X/CM.4/2004/01/Add. Paper presented at the Final ADF-X Replenishment Consultations held in Copenhagen, Denmark, 16-17 December 2004.

2.6 Essentially, after the performance-based allocation (PBA) system determines a country's ADF allocation envelope for the 3-year ADF cycle, the actual loan/grant financing terms are then determined by the degree of debt distress associated with the country. A country will be classified under high risk of debt distress if its debt burden indicator exceeds the relevant threshold by more than 10 percent; in such a case, the country's allocation is provided in 100 percent grants. On the other hand, a country will be classified under low risk of debt distress if its debt burden indicator falls below the relevant threshold by more than 10 percent; in this case the country qualifies for 100 percent loans only. In the same vein, a country is assessed to have a moderate risk of debt distress if its debt burden indicator is smaller or greater than the relevant threshold by less than 10 percent; in this final case, the allocation is split and provided in 50/50 loan/grant proportions. The above decision rule is characterized as the Pure Volume Approach.

2.7 After extensive discussion by the ADF Deputies during the ADF-X replenishment consultations, the Deputies decided to support the adoption of a Modified Volume Approach (MVA) which includes the application of a 20 percent volume discount, sub-divided into two components. The first component is an incentives-related portion (8 percent) to help maintain the strength of the ADF incentive system as reflected in the PBA system. The second component of the volume discount is a charges-related portion (12 percent) on the ADF grants. The Deputies agreed that post-conflict countries would be subject to only the surcharge-related volume discount[4]. Section 3 below examines how the 2005 performance-based allocation exercise applied the static DSF approach in determining the loan/grant financing terms for the eligible ADF countries.

The Dynamic DSF Approach

2.8 During the final meeting of the ADF-X replenishment consultations, the Deputies also agreed that the system of determining financing terms based on the above static mechanistic DSF assessment of matching individual debt burden ratios with indicative

[3] A similar analysis is undertaken with respect to the two other debt burden thresholds and indicators.

[4] *Report on the Tenth General Replenishment of the Resources of the African Development Fund*, dated 19 January 2005, ref.: ADF/BD/WP/2005/06, paras 7.13-7.18.

debt burden thresholds should give way to a ranking system to be based on insights generated by forward looking debt sustainability analyses. The forward-looking DSA-based assessment (FL-DSA) incorporates country-specific features, including integration of the fiscal and external macroeconomic indicators, impact of exogenous shocks, and a deeper analysis of the evolution and composition of the existing debt stock, with reliance on judgemnt rather than mechanistic analysis of debt ratios. For the medium-long term, beginning with the 2006 performance-based allocation (PBA) exercise, results from the joint IMF/IDA FL-DSA will be applied, as is examined in Section 4 below, to determine the loan/grant financing terms for each of the 38 ADF-only countries.

III. Application of the DSF for the 2005 Country PBAs

3.1 The static DSF, as described in paras 2.5-2.7 above was the basis, in general, for determining the ADF-X financing terms applied to the 38 ADF-only RMCs during the 2005 PBA exercise This is reported in the Board document, ref.: ADF/BD/IF/2005/116, dated 28 June 2005. Based on the 2005 DSF country risk rankings, the ADF-X loan/grant financing terms for the eligible RMCs are the following:

- 100 percent grants for 21 RMCs;
- Loans/grants in various proportions for 5 RMCs; and
- 100 percent loans for 14 RMCs.

3.2 Table 2 below presents a breakdown of the above results by the specific ADF-eligible countries:

Table 2. Classification of RMCs based on the 2005 DSF Risk Ranking

Classification	Countries
Loans Only (14)	Burkina Faso, Cape Verde, Djibouti, Ghana, Kenya, Madagascar, Mali, Mozambique, Mauritania, Niger, Nigeria, Senegal, Tanzania and Zimbabwe
Combination of Loans & Grants (5)	Benin, Ethiopia, Lesotho Uganda and Zambia
Grants Only (21)	Angola, Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, Republic of Congo, Comoros, Cote D'Ivoire, Eritrea, Gambia, Guinea, Guinea Bissau, Liberia, Malawi, Rwanda, Sao Tome & Principe, Sierra Leone, Somalia, Sudan and Togo.

3.3 The DSF risk rankings of countries is illustrated in Annex 1 by applying the DSF "traffic light system", signifying *Green* for low risk of debt distress corresponding to 100 percent loan; *Yellow* for moderate risk corresponding to 50/50 loan/grant combination; and *Red* for high risk corresponding to 100 percent grant. The Annex also shows the results of the ADF country rankings juxtaposed against the results obtained by IDA. It is evident that the rankings of almost all the ADF-eligible countries have been harmonized. This has been achieved through a series of consultations between the Fund and IDA

officials, during which agreement was reached on the CPIA classifications and the DSF rankings of some of the countries. For a few exceptions, see Box 1 below.

<u>Box 1</u>: Exceptions to ADF/IDA Harmonization

Two exceptions are observed in the ADF and IDA DSF rankings. In the treatment of Somalia and Djibouti, IDA excludes Somalia from any allocation under the PBA system in view of data unavailability, but the Fund provides a minimum PBA for Somalia under ADF-X based on a notional GNI per capita, and the country is classified for 100 percent grants only. Regarding Djibouti, IDA considers it as a "hardened-term" country with GNI per capita above the IDA-only threshold, and therefore it is treated outside of the PBA system, but eligible for 100 percent loans only. Under ADF-X, however, Djibouti is included among the countries in the PBA framework, and the DSF ranking of green for 100 percent loans yields the same results as in IDA. For the two blend countries, Nigeria and Zimbabwe, the treatment is harmonized between ADF and IDA. While the DSF classifications would imply the *Red* traffic light for both RMCs, by virtue of their classification as blend, they were both assessed as eligible for 100 percent loans only.

3.4 It may be noted that while the static DSF was the basic underlying framework for classifying all countries during the 2005 PBA exercise, for three of the countries (Mauritania, Ethiopia and Zambia), available data from joint IMF/IDA forward-looking DSAs was applied against the DSF thresholds, while some judgement was also used. For Mauritania, the green traffic light was based on its available DSA which shows a downward trajectory of the NPV of debt to exports ratio. This reflects the country's upcoming oil production in the fields of Chinguetty which started in 2006. In the case of Ethiopia, from its HIPC completion point DSA, the debt burden indicators of 2003 and 2004 reflect a green light. However, from 2005 onwards the country would be assigned yellow light, driven by a high NPV of debt to exports ratio, if IDA grants were excluded. The decision was therefore taken to classify Ethiopia as a yellow light country. For Zambia, the NPV of debt-to-exports ratio in its completion point DSA for 2003 indicates a red light. However, the country would be assessed a green light based on the completion point projections from 2005 onwards. Taking a conservative view, a yellow light was assigned to the country.

<u>Box 2</u>: Determining the 2005 Performance-based Allocations

First, the initial total country allocations derived by the PBA system are assigned per country according to their individual DSF loan/grant financing terms. Then the 20 percent discount on all grant receipts are deducted, separating the 8 percent incentives-related portion from the 12 percent charges-related portion, and applying only the charges related portion to the 6 post-conflict countries (see para 2.7 above). This is then followed by a second allocation, the reallocation of the 8 percent incentives-related portion, to all ADF-only countries by the PBA methodology. Finally, the initial and second allocations are summed up to determine each country's final allocation envelope for the ADF-X period. In the final column for "Revised Allocation Shares", the DSF loan/grant financing terms are preserved indicating countries receiving 100 percent loans, 100 percent grants, or loans/grants in various proportions.

3.5 On the basis of the CPIA classifications and the DSF country rankings for the 2005 PBA exercise, Annex 2 shows the step by step process by which the final ADF-X country allocations were determined. See Box 2 for details of the process.

3.6 As demonstrated in Annex 2, the overall share of grants in the total ADF-X replenishment, by application of the static DSF in 2005, is **34.29 percent**. This may be compared with the overall share of grants under the ADF-IX replenishment which amounted to 18.3 percent, within the required range of 18-21 percent. It must be underscored that under ADF-X, there is no such requirement, as the overall share of grants is endogenously determined.

IV. Application of the DSF for the 2006 Country PBAs

4.1 In determining the ADF-X financing terms for the 2006 PBA exercise, the risk of debt distress for 50 percent of the ADF-only countries (19 of 38 RMCs) have been assessed through the new forward-looking debt sustainability analysis (FL-DSA). About 40 joint IMF/IDA FL-DSAs had been carried out by June 2006, and the implementation experience based on 23 FL-DSAs was presented in a recent report[5]. According to the report, it was agreed that in all cases where there was a conflict between the static DSF and FL-DSA outcomes, the FL-DSA traffic lights prevailed. Annex 3 presents the final DSF risk rankings recommended for the IDA performance-based allocations for the FY07 period.

4.2 Based on the findings in the IMF/IDA report, the FL-DSA related DSF assessment prevailed over the mechanistic debt-indicator-based assessment in 12 of the 19 ADF-only countries assessed. Among these, for 3 of the countries (Niger, Rwanda and Chad) the FL-DSA based assessment recommended 100 percent grants against 100 percent loans from the mechanistic assessment. In the case of Niger, for example, a drought that had triggered a food crisis in the country and weakened economic performance in 2004 and 2005 reversed the mechanistic assessment. Similarly, for 2 of the countries (Zambia and Mauritania), the FL-DSA based assessment recommended 100 percent loans against 100 percent grants from the mechanistic assessment. As noted earlier (para 3.4), for Mauritania, this reflects the country's upcoming oil production in the fields of Chinguetty which started in 2006.

Key Features of the FL-DSA

4.3 The objective of the new forward-looking DSAs is to monitor the evolution of a country's debt burden indicators in order to guide ADF financing terms and strategies. The new FL-DSAs consist of standardized, forward-looking analyses of external and public debt and debt-service indicators under a baseline scenario based on realistic medium and long term macroeconomic assumptions, other underlying economic factors and standardized shocks. In cases where the various indicators give different signals,

[5] See IDA/IMF: *Review of Low-income Country Debt Sustainability Framework and Implications of the MDRI*, dated 27 March 2006, Box 2 and paras 11-20.

there is need for careful interpretation and judgment. Country-specific features are also incorporated through alternative customized scenarios and stress tests to capture sensitivities to various shocks. Recent FL-DSAs for MDRI-eligible countries explored the impact of MDRI relief explicitly in an alternative scenario, and in about half of the assessments, the additional scenarios and stress tests were useful or crucial in qualifying the conclusions of the baseline.

4.4 The current institutional arrangements for carrying out the FL-DSAs involve joint IMF/IDA assessments. While it was not possible in the past for ADF staff to participate in the joint FL-DSA field missions, growing consensus on the need for ADF staff to participate, on a selective basis, in future joint FL-DSAs, resulted for the first time in ADF staff taking part in joint FL_DSAs in Central African Republic (CAR) Liberia in November 2006.. Box 3 reviews the current institutional arrangements for participation in the joint FL-DSAs.

Box 3: Institutional Arrangements for FL-DSAs

Over the past, the institutional arrangements for conducting the FL-DSAs involved only IMF/IDA assessments during IMF Article IV consultations, and latest reviews under the IMF supported PRGF and SMP arrangements. The timing of the joint DSAs was often determined by the IMF's needs which in several cases proved problematic for World Bank staff. And there have been difficulties with respect to reconciling diverging DSA timing requirements and matching the IDA staffs' work schedules to pressing IMF deadlines. These difficulties also did not make it possible for ADF staff to participate in joint IMF/IDA teams to carry out FL-DSA field missions. It is nevertheless now acknowledged that ADF and IDA share the common 40 client RMCs which correspond to over 80 percent of the HIPC and MDRI-eligible countries on which FL-DSAs are required, on an annual basis. Accordingly, after a series of consultations, there is growing consensus on the need for ADF staff to participate, on a selective basis, in future joint IMF/IDA FL-DSAs to build the requisite capacity. It was underscored that such DSA exercises are vital as inputs to facilitate ADF's dialogue with its RMCs. Accordingly, for the first time, two ADF staff from the Resource Mobilization and Partnership Unit (ORRU) participated in the joint FL_DSA field missions to CAR and Liberia in November 2006. This sets the stage for the ADF to continue to participate, on a selective basis, in future joint FL_DSA field missions..

The 2006 DSF Rankings

4.5 Notwithstanding the challenges involved in ADF staff participating in the joint IMF/IDA FL-DSA exercises, the resulting DSF risk rankings are vital and critical for determining the ADF country allocations under the PBA system. Thus, for the 2006 country PBAs, the IDA FY07 DSF risk rankings (see Annex 3) are adopted and applied. The results of employing this information to determine the ADF country DSF risk rankings are provided in Annex 4. The analysis shows that based on the static mechanistic DSF approach of matching indicative thresholds with actual debt burden ratios, the ADF rankings and the IDA rankings are identical, except for one case, Djibouti, for which ADF's 'traffic light' assessment is *Green* for 100 percent loans,

whereas IDA's assessment is *Red* for 100 percent grants[6]. As no FL-DSA is available for Djibouti, in harmonizing ADF's DSF rankings with IDA's, the final decision is to classify Djibouti as *Red* as well for 100 percent grants.

4.6 Based on the 2006 DSF risk rankings in Annexes 3 and 4, the new ADF-X loan/grant financing terms for the eligible RMCs result in the following:

- 100 percent grants for 20 RMCs;
- Loans/grants in various proportions for 4 RMCs; and
- 100 percent loans for 16 RMCs.

4.7 Table 3 below presents a breakdown of the above results together with the specific ADF-eligible countries.

Table 3. Classification of RMCs based on the 2006 DSF Risk Ranking

Classification	Countries
Loans Only (16)	Benin, Burkina Faso, Cameroon, Cape Verde, Ghana, Kenya, Madagascar, Mali, Mauritania, Mozambique, Nigeria*, Senegal, Tanzania, Uganda, Zambia and Zimbabwe*
Combination of Loans and Grants (4)	Angola, Ethiopia, Lesotho and Malawi
Grants Only (20)	Burundi, CAR, Chad, Comoros, Congo D.R., Congo Rep., Cote d'Ivoire, Djibouti, Eritrea, Gambia, Guinea, Guinea-Bissau, Niger, Liberia, Rwanda, Sao Tome & Principe, Sierra Leone, Somalia, Sudan and Togo

Main Findings

4.8 By comparison with the 2005 DSF rankings, there were shifts of DSF classifications in 8 country cases out of the 38 ADF eligible countries. The 8 cases are: Niger, Djibouti, Angola, Malawi, Cameroon, Benin, Uganda and Zambia. The shifts or changes in DSF classification during the 2006 DSF assessments are highlighted below.

- First, among the 20 RMCs now classified to receive 100 percent grants, 18 of them also received 100 percent grants under the 2005 classification. One exception is **Niger,** which was classified for 100 percent loans in 2005 but is now classified to receive 100 percent grants. The 2006 FL-DSF underscored a drought that had triggered a food crisis in Niger and weakened economic performance in 2004 and 2005, and this reversed the mechanistic DSF assessment from the *Green* 'traffic light' to *Red* (see para 4.2). The other exception is **Djibouti,** classified for 100 percent loans in 2005, but is now classified to receive 100 percent grants, based on policy harmonization with IDA (see para 4.5).

[6] The difference in assessment is due to the fact that IDA's CPIA classifies Djibouti under "Poor Policy" with lower DSF threshold, while ADF classifies the country under "Medium Policy" with a higher indicative threshold.

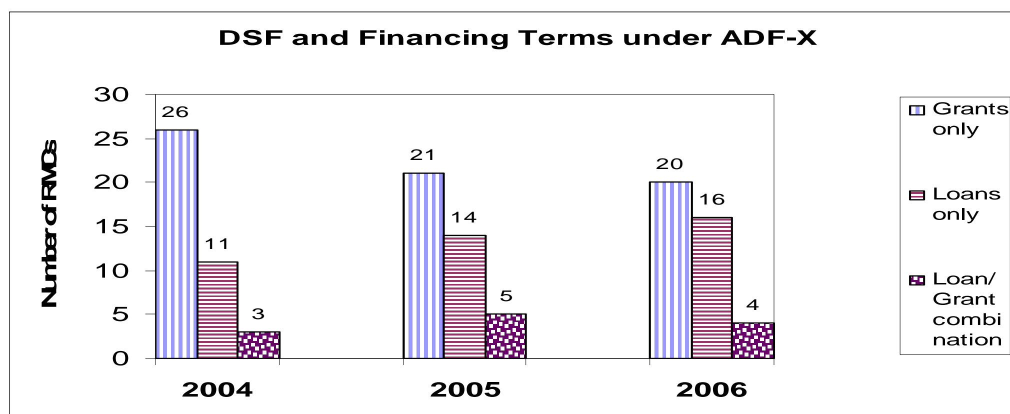
- Second, among the 4 RMCs now classified to receive loan/grant combinations, only two RMCs, Ethiopia and Lesotho, were so classified under the 2005 DSF assessment. The exceptions are **Angola and Malawi**, which now receive loan/grant combinations, while both were classified *Red* under the 2005 DSF classification. Under the static DSF assessment in 2006, both Angola and Malawi were again classified *Red*, but the FL-DSF conducted in both countries reversed the ranking to *Yellow* for loan/grant combinations in 50/50 or other proportions.

- Third, of the 14 RMCs which now receive 100 percent loans only, 10 RMCs also received 100 percent loans under the 2005 DSF assessment. The exceptions are **Cameroon**, which was classified *Red* under the 2005 DSF assessment, and the 3 RMCs, **Benin, Uganda and Zambia** that were formerly classified as *Yellow* under the 2005 DSF rankings. In both Benin and Cameroon, the 2006 static DSF assessment and the FL-DSF assessment both classified the countries *Green* for 100 percent loan. For Uganda, the 2006 static DSF assessment was *Yellow* but the FL-DSA assessment was *Green* for 100 percent loans, which prevailed in the final decision. Similarly, for Zambia, the 2006 DSF assessment was *Red* but the *FL-DSA* ranked the country *Green* for 100 percent loans as well.

Application of the 2006 DSF on the Country PBAs

4.9 Based on the CPIA classifications and the DSF risk rankings, the final ADF-X performance-based country allocations were determined. Annex 5 shows the step by step process as similarly described in Box 2 above. The final allocation envelope is presented per country for the ADF-X period, either as loans only, grants only, or in loan/grant combinations.

Figure 1



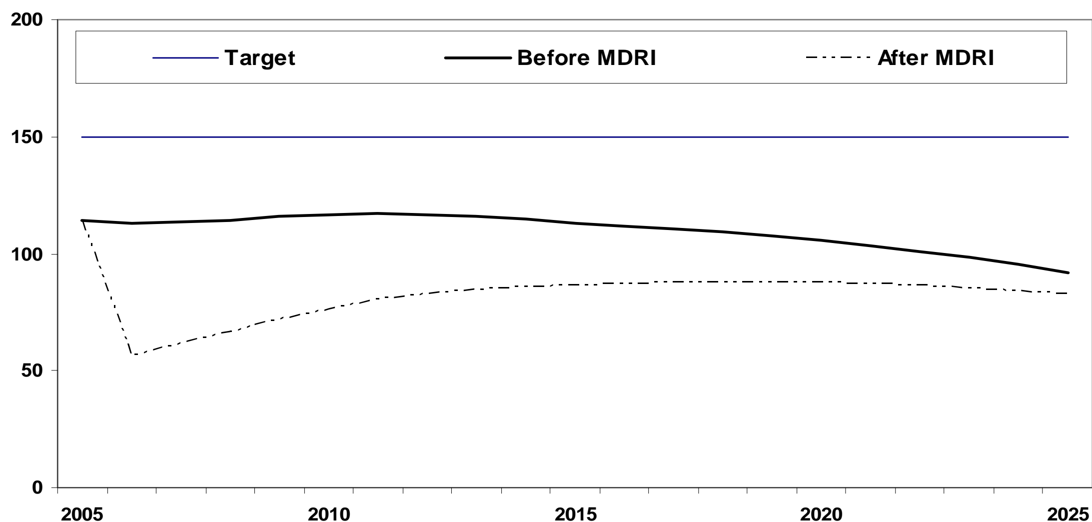
4.10 For the 2006 PBA exercise, the overall share of grants in the total ADF-X replenishment is estimated as **28.35 percent** when 20 RMCs receive grants only, 16 RMCs receive loans only, and 4 RMCs receive loan/grant combinations, by application of the dynamic FL-DSA approach of the DSF. Figure 1 illustrates the loan/grant shares estimated over the 2004-2006 period. By comparison, the overall share of grants based

mainly on the static 2005 DSF approach was estimated as **34.29 percent** when there were 21 RMCs for grants only, 14 RMCs for loans only, and 5 RMCs for loan/grant combinations. Similarly, as would be recalled, the overall share of grants as estimated during the final ADF-X replenishment consultations in December 2004 was **44.5 percent** when it was shown that 26 RMCs would receive grants only, 11 RMCs would receive loans only, and 3 RMCs would receive loan/grant combinations. This underscores the principle that the overall grant share is endogenously determined.

V. Impact of MDRI on the DSF

5.1 It has been estimated that for the 18 post-completion point HIPCs worldwide, eligible for debt relief under the Multilateral Debt Relief Initiative (MDRI), the average NPV of debt/exports ratio would fall from about 140 percent after HIPC debt relief to a projected 52 percent when the countries receive MDRI relief[7].

Figure 2: NPV of Debt-to-Exports ratio in MDRI Recipients Before and after MDRI Debt Relief



5.2 In the report on the implementation experience of the DSF[8] based on 23 forward-looking DSAs, the pre- and post-MDRI debt ratios of a sample of 12 countries tend to converge in the long term[9]. The report shows, however, that in the short term there is some impact of MDRI relief on post-MDRI debt ratios. As Figure 2 illustrates, MDRI debt relief reduces the NPV of debt-to-export ratio on average by about 40 percent over

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[7] See IDA: *The G-8 Debt Relief Proposal: Assessments of Costs, Implementation Issues, and Financing Options* (IDA/SecM2005-0414), para 8. Paper presented at the IDA Deputies meeting in Paris, France, 11 September 2005.

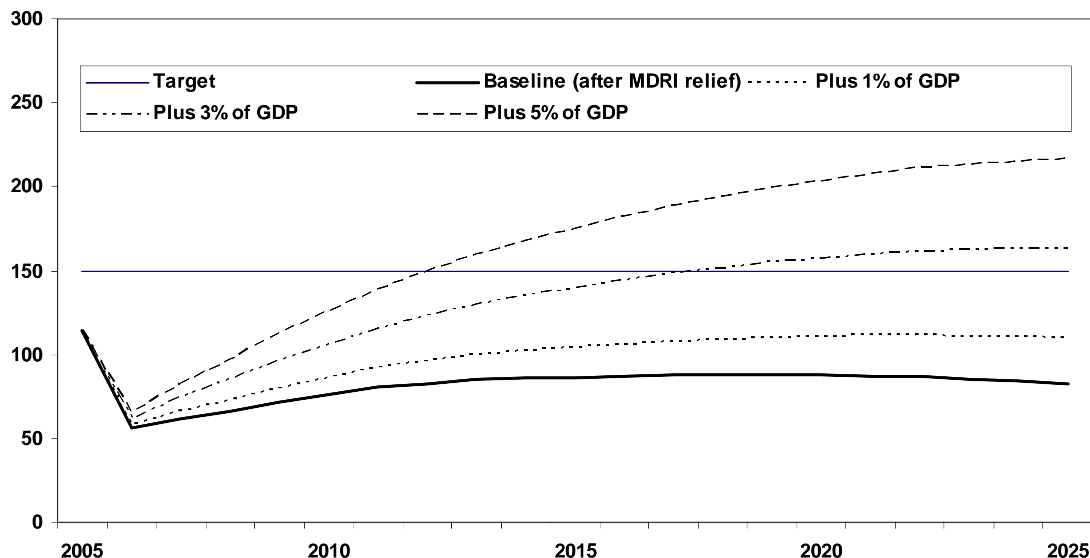
[8] See footnote 5 above. The 12 post-completion point HIPCs in the sample are those for which FL-DSAs are available. They include 3 non-African HIPCs (Guyana, Nikaragua and Tajikistan) and 9 RMCs as follows: Burkina Faso, Ethiopia, Mali, Mozambique, Niger, Rwanda, Tanzania, Uganda, and Zambia.

[9] Ibid. See paras 27-30, and the Appendix on post-MDRI debt scenarios, Figures A1 and A2.

2006-10. But generally, over the long term (2006-25 period), the difference between pre- and post-MDRI debt ratios declines to just about 10 percentage points. In a sub-sample of the 9 African completion point HIPCs, the long-term convergence is similar.

5.3 In all cases, long-term convergence occurs because of the growing importance with time of accumulated debt from new borrowing[10]. The realistic assumption is made that pre- and post-MDRI borrowing remains the same, as MDRI relief is unlikely to lead to a reduction in new borrowing. The unchanged borrowing assumption reflects the idea that borrowing plans made by countries remain the same, as the additional MDRI resources are spent on poverty-reduction projects and programs in line with countries' PRSPs, and the resources are not used to substitute for planned new borrowing. The MDRI debt relief is additional to projected net resource transfers to the RMCs, through additional borrowing, in support of their efforts to reach the MDGs.

Figure 3: NPV of Debt-to-Exports Ratio (2006-2025)
Additional Borrowing Scenarios



5.4 The sensitivity of the debt dynamics, in terms of countries' debt sustainability to increases in new borrowing assumptions, is further explored. The simulations show that small increases in concessional borrowing, say around 1 percent of GDP annually, would tend to have little effect on the debt sustainability outlook. Nevertheless, larger increases in new borrowing, on the order of about 3-5 percent of GDP annually, would lead in most countries to a breach of the indicative thresholds under the DSF (Figure 3)[11]. It is

[10] MDRI relief affects mainly the NPV of existing debt, but long-term debt dynamics are dominated by new borrowing, leading to a diminishing role for MDRI relief. The projected path of the NPV of external debt can be decomposed into two parts: (i) the first part reflects the changes in the NPV of existing debt as of end-2004 and (ii) the second part is attributable to new external borrowing since end-2004. As the NPV of the stock of existing external debt declines relatively rapidly, the long-term effect of MDRI relief through a reduction in the NPV of existing debt is bound to be limited. Ibid., see Appendix para 2.

[11] Ibid., see Appendix paras 4.5.

therefore noted that large increases in resource transfers for these countries will still have to take the form of grants in order to maintain a low or moderate risk of debt distress in these MDRI-eligible countries.

VI. Emerging Issues

6.0 Four emerging issues related to the DSF, and the implications thereof, are examined in this section. These are: (i) predictability of grant resources; (ii) lowering the indicative policy-dependent thresholds; (iii) the free-rider problem; and (iv) implications of domestic public debt.

6.1 *Predictability of Grant Resources*

6.1.1 Application of the DSF has resulted in reclassification of some RMCs in receiving grants in one period, loans in another period, and loan/grant combinations in some other periods[12]. In the light of this, some RMCs have raised the concern regarding predictability of grant resources for beneficiary countries which engage in medium term plans to fund their poverty reduction programs. A country now classified to receive 100 percent loans, but engaged in ongoing negotiations on projects prepared and appraised with grant segments faces the difficulty of the possibility to abruptly cancel such projects midway.

6.1.2 There is also a credibility problem for the Fund in its dialogue with some governments that have insisted that no loans will be contracted for such social sector projects as in education, health, HIV/AIDS, among others. It may be noted that at appraisal, the totality of grant resources for such social sector projects was underscored. Such governments put a high premium on predictability of resources to prepare their medium term budget for implementing their public expenditure programs, but the application of the DSF tends to reduce the predictability of grant resources significantly.

6.1.3 In responding to the above concerns, Management has advised that countries facing the problem of no grant resources, when the DSF reclassifies them as loan-only countries, could transform the project to a loan or scale down considerably. There is also the need for caution in planning and programming resources during the ADF cycle as within the ADF-X allocation envelope, firm allocations are envisaged for only the first year while the portion of the allocation assigned to the outer years is only indicative..

6.2 *Lowering the Indicative Thresholds*

[12] Cameroon which was classified to receive 100 percent grants during the 2005 PBA process, was re-classified to receive 100 percent loans during the 2006 PBA process. Benin, Uganda, and Zambia which were classified to receive a combination of loans and grants in various proportions during the 2005 PBA process, were re-classified to receive 100 percent loans under the 2006 PBA process. On the other hand, Djibouti and Niger which were classified to receive 100 percent loans under the 2005 PBA process, were re-classified to receive 100 percent grants under the 2006 PBA process. See para 4.8 above.

6.2.1 It has been noted earlier that the introduction of the MDRI will lower the NPV of debt/export ratios of MDRI-eligible RMCs from an average of about 140 to 52 percent[13]. The reduction in the risk of debt distress as a result of MDRI relief raises the prospect that ADF and IDA will switch from grants to loans in MDRI countries, leading to a quick re-accumulation of debt. Accordingly, some have argued that in order to maintain the present classification of countries under the DSF traffic light system, there is the need to lower the indicative DSF thresholds.

6.2.2 But based on the evidence (see paras 4.6-4.8 above), there is reason to believe that the MDRI will not lead to an unwarranted switch from grants to loans and an increase in ADF/IDA lending. Having maintained the thresholds at their initial levels for the FL-DSA assessments under the 2006 PBA exercise, the results (20 classified *red*; 16 classified *green*) are comparable with the static DSF assessments under the 2005 PBA exercise (21 classified *red*; 14 classified *green*). Thus the transition from the static DSF to the forward-looking joint DSA assessments has maintained the loan/grant mix. Accordingly, a large shift in the loan/grant mix from grants to loans has not occurred for MDRI countries during the 2006 PBA exercise.

6.2.3 A further observation related to this issue is that if the indicative thresholds were lowered for *all* countries, this could reopen the question of HIPC eligibility. Lowering the thresholds may signal a reduction in tolerance on the part of the international community for debt in low-income countries. Lower thresholds would imply that the HIPC debt sustainability thresholds were too high, suggesting a need to broaden the HIPC initiative, and presumably the MDRI as well, which could substantially increase the cost of the HIPC Initiative. On the other hand, lowering debt thresholds for the MDRI countries *alone* would raise questions of uniformity of treatment. And it would be unacceptable to rationalize treating MDRI recipients differently when they are a subset of the HIPC community. Thus, on these grounds as well, it is prudent to maintain the current MDRI indicative thresholds.

6.3 *The Free-rider Problem*

6.3.1 The "free riding" issue refers to situations in which non-concessional lenders indirectly obtain financial gain from ADF and IDA grants and concessional financing activities, as well as MDRI debt relief, without paying for it. MDRI countries facing sharply reduced debt burdens create for them the potential for new borrowing from commercial and other non-concessional sources. In addition, non-concessional lenders are willing to provide such financing, secure in the knowledge that, with MDRI relief and the prospect of future ADF grants, the country could cover the accumulating debt service.

6.3.2 In the light of the above, it is widely agreed that the free rider problem must be carefully monitored. Accordingly, ADF will continue to liaise closely with IDA and the donor community to address this issue. Proposals for consideration to resolve the issue include: (i) strengthening adherence to reporting requirements, and a new clause in grant

[13] See para 5.1 above

agreements requiring advanced reporting on planned new non-concessional borrowing; (ii) creating incentive mechanisms (further grant discounts, reducing allocations through the PBA system, etc.) aimed at restraining instances of non-concessional borrowing; (iii) broadening acceptance of the DSF as an analytical basis for a common creditor approach to concessionality for eligible borrowers; and (iv) increasing efforts to communicate MDRI debt relief, grant and free riding policies to the creditor community to enhance policy harmonization.

6.3.3 In addition, these mechanisms would need to be complemented by concerted efforts to strengthen debt management capacity in borrowing countries. Actions at the country level needed to help ensure success of the MDRI and restrain "free riding" include: (i) improving debt data quality as well as debt data reporting to the MDBs; and (ii) MDBs support for technical assistance, institutional support and capacity building programs on debt management in borrowing countries.

6.4 *Domestic Debt Issues*

6.4.1 The new DSF approach, the forward-looking debt sustainability analyses (FL-DSA) applies two separate templates, one for external debt, and the other for domestic public sector debt. Both templates generate output tables that display debt and debt-service dynamics under the baseline scenario and summarize the results of standardized alternative scenarios and stress tests. Thus, in some respects, domestic debt is already being accounted for in the evolving new dimensions of the DSF.

6.4.2 During the latest set of DSF assessments as presented in the report[14] on the sample of 23 joint IMF/IDA DSAs completed recently, 14 contained a public debt DSAs. High domestic debt was a factor in the overall risk of debt distress in seven of the countries assessed. However, as public debt indicators generally confirmed the assessment based on the external debt burden, this did not actually change the risk rating.

6.4.3 The major weakness of the template on domestic public debt is the absence of pre-defined indicative policy dependent thresholds similar to the case for external debt DSAs. Domestic obligations are difficult to integrate into a threshold approach that aims to provide signals to donors on the appropriate level of concessionality. Raising concessionality even partially on the basis of domestic borrowing, which is largely under domestic control, would entail moral hazard problems by creating incentives to over-borrow. In the absence of predetermined indicative thresholds, public debt DSAs have therefore typically focused mainly on trends in public debt ratios, vulnerability to shocks, level of debt service payments, and gross financing requirements.

6.4.4 In order to ensure that the DSF distress rating reflects an assessment of all relevant debt, external and domestic, it is important that DSAs should, in future, specifically flag cases in which the rating would be different on the basis of domestic debt only. In addition, future work should focus on the development of an approach that

[14] See para 4.1 and footnote 9 above.

integrates the analysis of domestic and external debt. In parallel, work could be done to define guidelines on how to advise country authorities on domestic debt issues from the perspective of overall debt sustainability.

VII. Conclusion

7.1 This report has reviewed the experience of the African Development Fund in its application of the Debt Sustainability Framework (DSF). The DSF was jointly formulated by the IMF and the World Bank, but with full collaboration of the Bank Group in the development process and in application of the Framework. It is acknowledged that the Framework seeks to ensure that external financing in support of low-income countries' development efforts to achieve the MDGs, does not lead to unsustainable debt burdens.

7.2 The DSF has evolved under two main approaches. The first is a static mechanistic methodology of matching indicative thresholds with actual debt burden ratios to determine countries' risk of debt distress. The second approach involves a dynamic process of determining a country's risk of debt distress through application of forward-looking Debt Sustainability Analysis (FL-DSA). The mechanistic DSF approach was applied during the 2005 performance-based allocation exercise while the FL-DSA was the main source for determining the DSF country rankings during the 2006 PBA exercise. It was noted that for all countries where there was a FL-DSA, ADF applied the decision rule that whenever there was a conflict between the mechanistic DSF and FL-DSA outcomes, the FL-DSA "traffic lights" prevailed.

7.3 A major part of the experience with the DSF is the impact of the recent multilateral debt relief initiative (MDRI) on the application of the DSF. The experience revealed that the pre- and post-MDRI debt ratios of a sample of MDRI-eligible countries tend to converge in the long term because of the growing importance with time of accumulated debt from new borrowing. Thus the impact of the MDRI on long term debt dynamics is almost neutral. Accordingly, the case for lowering the indicative debt burden thresholds appear not to be very compelling. This is buttressed by the evidence from the 2006 PBA exercise which shows that by maintaining the initial thresholds, the loan/grant mix is comparable with the results of the 2005 PBA exercise.

7.4 Three other emerging issues the paper examined were: (i) predictability of grant resources; (ii) implications of the free rider issue; and (iii) the need for incorporating domestic debt in the DSF. As the predictability of grant resources is not assured, countries are urged to exercise caution in planning and programming resources during the ADF cycle. It was noted that "free riding" should be restrained and discouraged through increasing efforts to communicate MDRI debt relief, grant and free riding policies to the creditor community to enhance policy harmonization. Finally, it was also noted that future work on the DSF should focus on the development of an approach that integrates the analysis of domestic debt with that of external debt.

Recommendation

7.5 The Deputies are invited to take note of this report and provide guidance and a way forward to the Fund on how to deal with three of the four emerging issues presented for consideration:

(i) In the light of changes in loan/grant financing terms on an annual basis, what are the feasible steps necessary to facilitate predictability of country portfolios on a year to year basis;

(ii) As RMCs in high risk of debt distress make efforts to achieve the MDGs, the free-rider issue limits their ability to seek additional resource flows beyond grants from ADF and IDA. How will such RMCs avert the low growth - low investment vicious circle?

(iii) What are some of the ingredients to be considered in developing a future DSF approach that integrates external and domestic public debt.

Annex I

ADF Ranking of Debt Distress in 2005 by CPIA & DSF Thresholds - Traffic Light System

Countries	2004 CPIA	GNI Per capita (US$)	NPV/GDP	NPV/EXP	DS/EXP	Ranking of debt distress: Average	Ranking of debt distress: DS/EXP	Debt distress country ranking	AfDB Traffic Light Ranking**	IDA Traffic Light Ranking**
Strong Policy: CPIA >= 3.75			**50%**	**200%**	**25%**					
1 Cape Verde	3.98	1440.00	35.4	138.5	10.3	1	1	1	Green	Green
2 Senegal	3.95	540.00	29.5	119.0	15.1	1	1	1	Green	Green
3 Uganda	3.84	250.00	30.6	262.5	11.6	2	1	2	Yellow	Yellow
4 Tanzania	3.80	300.00	21.9	140.0	5.9	1	1	1	Green	Green
5 Burkina Faso	3.79	300.00	15.8	210.8	16.6	1	1	1	Green	Green
Medium Policy : 3.25 < CPIA < 3.75			**40%**	**150%**	**20%**					
1 Ghana	3.74	320.00	30.9	87.6	17.8	1	1	1	Green	Green
2 Mali	3.73	290.00	31.8	134.7	7.5	1	1	1	Green	Green
3 Benin	3.72	440.00	22.8	196.4	14.8	2	1	2	Yellow	Yellow
4 Kenya	3.71	400.00	32.0	133.3	17.3	1	1	1	Green	Green
5 Rwanda	3.68	220.00	59.4	701.2	15.3	3	1	3	Red	Red
6 Mozambique	3.62	210.00	31.3	123.2	8.0	1	1	1	Green	Green
7 Cameroon	3.61	630.00	40.8	177.1	15.6	3	1	3	Red	Red
8 Lesotho	3.61	610.00	44.4	114.5	15.2	2	1	2	Yellow	Yellow
9 Mauritania	3.48	400.00	30.0	54.0	3.0	1	1	1	Green*	Green*
10 Chad	3.43	240.00	33.7	257.0	13.3	3	1	3	Red	Red
11 Ethiopia	3.43	90.00	25.9	175.4	4.5	2	1	2	Yellow*	Yellow*
12 Niger	3.43	200.00	21.2	155.7	9.1	1	1	1	Green	Green
13 Djibouti	3.43	910.00	42.5	94.8	5.6	1	1	1	Green	Green
14 Madagascar	3.41	290.00	26.9	136.8	6.5	1	1	1	Green	Green
15 Gambia, The	3.31	270.00	86.6	201.9	12.0	3	1	3	Red	Red
16 Zambia	3.26	380.00	32.1	117.5	4.0	2	1	2	Yellow*	Yellow*
Poor Policy : CPIA =< 3.25			**30%**	**100%**	**15%**					
1 Malawi	3.21	160.00	107.9	394.8	7.5	3	1	3	Red	Red
2 Congo, Republic of	3.19	650.00	150.4	212.9	2.5	3	1	3	Red	Red
3 Sao Tome and Principe	3.10	300.00	272.9	760.0	34.2	3	3	3	Red	Red
4 Burundi	3.00	90.00	130.0	1829.9	61.4	3	3	3	Red	Red
5 Guinea	2.98	430.00	52.6	238.9	16.4	3	2	3	Red	Red
6 Sierra Leone	2.83	150.00	111.4	552.9	15.8	3	2	3	Red	Red
7 Congo, Democratic Republic of	2.80	100.00	135.0	636.4	12.3	3	1	3	Red	Red
8 Angola	2.79	740.00	70.4	111.5	16.1	3	2	3	Red	Red
9 Central African Republic	2.77	260.00	136.8	1079.6	0.4	3	1	3	Red	Red
10 Togo	2.64	310.00	73.7	241.6	3.0	3	1	3	Red	Red
11 Cote D'Ivoire	2.62	660.00	61.9	154.5	10.4	3	1	3	Red	Red
12 Sudan	2.62	460.00	90.9	767.3	1.6	3	1	3	Red	Red
13 Eritrea	2.50	190.00	49.3	318.4	10.4	3	1	3	Red	Red
14 Comoros	2.26	450.00	64.7	481.2	6.2	3	1	3	Red	Red
15 Guinea-Bissau	2.23	140.00	210.7	799.0	24.5	3	3	3	Red	Red
16 Liberia	2.04	110.00	614.4	1919.1	0.1	3	2	3	Red	Red
17 Somalia	1.00	N/A	..	..	..	..	..	..	N/A	N/A
Blend Countries										
1 Nigeria	**2.85**	350.00	68.6	151.6	7.2	3	1	3	Green	Green
2 Zimbabwe	2.38	480.00	56.2	249.5	3.2	3	1	3	Green	Green

Notes:

(*)	IDA loan/grant rankings determined by evidence from forward-looking DSA field work. Even though ADF-X CPIA classification and ranking by thresholds and debt indicators leads to different loan/grant rankings, in the interest of harmonization, IDA rankings are adopted.
(**)	Ranking of debt distress by the Debt Sustainability Framework (DSF) thresholds against debt burden indicators
NPV/GDP	NPV of external debt over GDP
NPV/EXP	NPV of external debt over exports
DS/EXP	Debt service over exports ratio
Average	Average of NPV of debt over GDP and NPV of debt over exports
Red	Ranking of debt distress by the DSF thresholds against debt indicators resulting in 100% grants and no loans
Yellow	Ranking of debt distress by the DSF thresholds against debt indicators resulting in 50/50 loans and grants proportion
Green	Ranking of debt distress by the DSF thresholds against debt indicators resulting in 100% loans and no grants

Annex 2

2005 ADF-X Performance-based Allocation & DSF Debt Distress Rankings - Loan/Grant Shares

	Country Classification	2004 CPA adj. *	GNIpc (US$)	2004 CPIA for country ranking	Debt distress country ranking (Traffic Light)		% Grants	Initial ADF-X Res. Alloc. (Pure Volume Approach)			20% & 12% discount on grants	Revised ADF-X allocation (after Grants discounts)			Break-down of 20 percent Grants***			Reallocated 8% Grants by PBA	Final ADF-X Res. Alloc. (Volume Disc. Approach)			Grants% in ADF-X Final Alloc.	Revised Alloc. Shares	
								Loans	Grants	Total		Loans	Grants	Total	8%	12%	Total	Grants	Total Loans	Total Grants	Total Alloc.		Loans (%)	Grants (%)
Strong Policy: CPIA >= 3.75					**AfDB**	**IDA**																		
1	Cape Verde	3.96	1440	3.98	Green	Green	0%	9.8	-	9.8	-	9.8	-	9.8	-	-	-	0.08	9.8	-	9.8	-	100.0	-
2	Senegal	4.34	540	3.95	Green	Green	0%	117.6	-	117.6	-	117.6	-	117.6	-	-	-	2.46	120.0	-	120.0	-	100.0	-
3	Uganda	3.67	250	3.84	Yellow	Yellow	50%	111.6	111.6	223.1	22.3	111.6	89.2	200.8	8.9	13.4	22.3	4.78	113.9	91.6	205.6	3.2	55.4	44.6
4	Tanzania	3.49	300	3.80	Green	Green	0%	278.0	-	278.0	-	278.0	-	278.0	-	-	-	5.99	283.9	-	283.9	-	100.0	-
5	Burkina Faso	3.73	300	3.79	Green	Green	0%	110.7	-	110.7	-	110.7	-	110.7	-	-	-	2.30	113.0	-	113.0	-	100.0	-
Medium Policy : 3.25 < CPIA < 3.75																								
1	Ghana	3.77	320	3.74	Green	Green	0%	187.2	-	187.2	-	187.2	-	187.2	-	-	-	3.99	191.2	-	191.2	-	100.0	-
2	Mali	3.99	290	3.73	Green	Green	0%	121.8	-	121.8	-	121.8	-	121.8	-	-		2.55	124.3	-	124.3	-	100.0	-
3	Benin	3.58	440	3.72	Yellow	Yellow	50%	28.6	28.6	57.1	5.7	28.6	22.8	51.4	2.3	3.4	5.7	1.13	29.1	23.4	52.5	0.8	55.4	44.6
4	Kenya	2.97	400	3.71	Green	Green	0%	174.6	-	174.6	-	174.6	-	174.6	-	-	-	3.71	178.3	-	178.3	-	100.0	-
5	Rwanda	3.41	220	3.68	Red	Red	100%	-	69.0	69.0	13.8	-	55.2	55.2	5.5	8.3	13.8	1.39	-	56.6	56.6	2.0	-	100.0
6	Mozambique	3.73	210	3.62	Green	Green	0%	176.1	-	176.1	-	176.1	-	176.1	-	-	-	3.75	179.8	-	179.8	-	100.0	-
7	Cameroon	3.55	630	3.61	Red	Red	100%	-	120.9	120.9	24.2	-	96.7	96.7	9.7	14.5	24.2	2.53	-	99.3	99.3	3.5	-	100.0
8	Lesotho	3.43	610	3.61	Yellow	Yellow	50%	9.0	9.0	18.0	1.8	9.0	7.2	16.2	0.7	1.1	1.8	0.26	9.1	7.3	16.4	0.3	55.5	44.5
9	**Mauritania**	2.88	400	3.48	**Green***	**Green***	0%	20.2	-	20.2	-	20.2	-	20.2	-	-	-	0.31	20.5	-	20.5	-	100.0	-
10	Niger	2.85	200	3.43	Green	Green	0%	68.4	-	68.4	-	68.4	-	68.4	-	-	-	1.37	69.8	-	69.8	-	100.0	-
11	**Ethiopia**	3.51	90	3.43	**Yellow***	**Yellow***	50%	150.6	150.6	301.1	30.1	150.6	120.5	271.0	12.0	18.1	30.1	13.47	157.3	127.2	284.5	4.4	55.3	44.7
12	Chad	3.06	240	3.43	Red	Red	100%	-	57.4	57.4	11.5	-	46.0	46.0	4.6	6.9	11.5	1.13	-	47.1	47.1	1.6	-	100.0
13	Djibouti	2.71	910	3.43	Green	Green	0%	8.8	-	8.8	-	8.8	-	8.8	-	-	-	0.06	8.9	-	8.9	-	100.0	-
14	Madagascar	2.99	290	3.41	Green	Green	0%	100.1	-	100.1	-	100.1	-	100.1	-	-	-	2.07	102.2	-	102.2	-	100.0	-
15	Gambia	2.85	270	3.31	Red	Red	100%	-	13.3	13.3	2.7	-	10.6	10.6	1.1	1.6	2.7	0.16	-	10.8	10.8	0.4	-	100.0
16	**Zambia**	2.67	380	3.26	**Yellow***	**Yellow***	50%	25.4	25.4	50.8	5.1	25.4	20.3	45.7	2.0	3.0	5.1	0.99	25.4	21.3	46.7	0.7	54.4	45.6
Poor Policy : CPIA =< 3.25																								
1	Malawi	2.64	160	3.21	Red	Red	100%	-	57.4	57.4	11.5	-	45.9	45.9	4.6	6.9	11.5	1.13	-	47.0	47.0	1.6	-	100.0
2	Congo, Rep. of	2.66	650	3.19	Red	Red	100%	-	21.0	21.0	2.5	-	18.4	18.4	-	2.5	2.5	0.33	-	18.8	18.8	0.7	-	100.0
3	Sao Tome & Principe	2.57	300	3.10	Red	Red	100%	-	6.6	6.6	1.3	-	5.3	5.3	0.5	0.8	1.3	0.01	-	5.3	5.3	0.2	-	100.0
4	Burundi	2.21	90	3.00	Red	Red	100%	-	31.5	31.5	3.8	-	27.7	27.7	-	3.8	3.8	0.56	-	28.3	28.3	1.0	-	100.0
5	Guinea	2.70	430	2.98	Red	Red	100%	-	40.2	40.2	8.0	-	32.2	32.2	3.2	4.8	8.0	0.75	-	32.9	32.9	1.1	-	100.0
6	Sierra Leone	2.73	150	2.83	Red	Red	100%	-	33.1	33.1	4.0	-	29.1	29.1	-	4.0	4.0	0.60	-	29.7	29.7	1.0	-	100.0
7	Congo DRC	2.28	100	2.80	Red	Red	100%	-	202.3	202.3	24.3	-	178.0	178.0	-	24.3	24.3	4.32	-	182.3	182.3	6.3	-	100.0
8	Angola	2.15	740	2.79	Red	Red	100%	-	40.7	40.7	4.9	-	35.8	35.8	-	4.9	4.9	0.76	-	36.6	36.6	1.3	-	100.0
9	Central African Republic	1.63	260	2.77	Red	Red	100%	-	12.5	12.5	2.5	-	10.0	10.0	1.0	1.5	2.5	0.14	-	10.2	10.2	0.4	-	100.0
10	Togo	1.59	310	2.64	Red	Red	100%	-	13.6	13.6	2.7	-	10.9	10.9	1.1	1.6	2.7	0.17	-	11.0	11.0	0.4	-	100.0
11	Cote D'Ivoire	1.37	660	2.62	Red	Red	100%	-	23.8	23.8	4.8	-	19.0	19.0	1.9	2.9	4.8	0.39	-	19.4	19.4	0.7	-	100.0
12	Sudan	1.37	460	2.62	Red	Red	100%	-	43.1	43.1	8.6	-	34.5	34.5	3.5	5.2	8.6	0.82	-	35.3	35.3	1.2	-	100.0
13	Eritrea	2.38	190	2.50	Red	Red	100%	-	22.4	22.4	2.7	-	19.7	19.7	-	2.7	2.7	0.36	-	20.1	20.1	0.7	-	100.0
14	Comoros	1.07	450	2.26	Red	Red	100%	-	6.4	6.4	1.3	-	5.1	5.1	0.5	0.8	1.3	0.01	-	5.1	5.1	0.2	-	100.0
15	Guinea-Bissau	1.09	140	2.23	Red	Red	100%	-	7.2	7.2	1.4	-	5.8	5.8	0.6	0.9	1.4	0.03	-	5.8	5.8	0.2	-	100.0
16	Liberia	1.05	110	2.04	Red	Red	100%	-	8.6	8.6	1.7	-	6.9	6.9	0.7	1.0	1.7	0.06	-	7.0	7.0	0.2	-	100.0
17	Somalia	0.29	90	1.00	Red	Red	100%	-	6.6	6.6	1.3	-	5.3	5.3	0.5	0.8	1.3	0.01	-	5.3	5.3	0.2	-	100.0
1	Nigeria	1.86	350	2.85	Red	Red	0%	138.0	-	138.0	-	138.0	-	138.0	-	-	-	-	138.0	-	138.0	-	100.0	-
2	Zimbabwe	1.36	480	2.38	Red	Red	0%	12.5	-	12.5	-	12.5	-	12.5	-	-	-	-	12.5	-	12.5	-	100.0	-
								1,848.6	**1,162.7**	**3,011.3**	**204.5**	**1,848.6**	**958.2**	**2,806.8**	**64.9**	**139.5**	**204.5**	**64.9**	**1,887.1**	**984.7**	**2,871.8**	**34.29**	**65.71**	**34.29**
									38.6%				**34.1%**							**34.29%**				

* Refers to adjusted 2004 CPA representing the standard CPA adjusted by the GF and PCEF

** Twelve (12) and Twenty (20) percent discounts on grants are applied respectively to the 6 post-conflict countries (PCCs) and to the rest of the ADF-only RMCs.

*** The total 20 percent discount on grants is made up of the incentive-related 8 percent portion and the 12 percent surcharge portion representing payback for forgone net income from reflows.

Annex 3

Preliminary Policy-Dependent Debt Distress Risk Rating (Traffic light) for IDA-only Countries, FY07 1/

IDA-only country	Debt indicator (percent)			Traffic light		**Preliminary Traffic Light for FY07 incorporating DSA-based risk rating 5/**
	NPV of debt-to-GDP 2/	NPV of debt-to-Exports 3/	Debt-service-to-Exports 3/	Debt indicator-based	DSA-based 4/	
Strong performance (CPIA>=3.75) 6/	***50***	***200***	***25***			
Burkina Faso	19	234	15	Green	Green	**Green** 7/
Cape Verde	33	127	10	Green		**Green**
Ghana	28	78	7	Green		**Green**
Senegal	19	79	17	Green		**Green**
Tanzania	21	132	6	Green	Green	**Green**
Uganda	30	250	12	Yellow	Green	**Green**
Medium performance (3.75<CPIA<3.25)	***40***	***150***	***20***			
Benin	20	171	13	Green	Green	**Green**
Cameroon	16	72	17	Green	Green	**Green**
Ethiopia	26	171	8	Green	Yellow	**Yellow**
Kenya	28	119	9	Green		**Green**
Lesotho	41	106	10	Green	Yellow	**Yellow**
Madagascar	41	162	7	Yellow	Green	**Green**
Malawi	60	213	12	Red	Yellow	**Yellow**
Mali	27	108	8	Green	Green	**Green**
Mozambique	15	56	4	Green		**Green**
Niger	22	157	10	Green	Red	**Red**
Rwanda	14	168	16	Green	Red	**Red**
Zambia	28	110	27	Red	Green	**Green**
Weak performance (CPIA<=3.25)	***30***	***100***	***15***			
Angola	43	81	19	Red	Yellow	**Yellow**
Burundi	14	184	176	Red	Red	**Red**
Central African Republic	66	588	12	Red	Red	**Red**
Chad	18	75	4	Green	Red	**Red**
Comoros	59	422	6	Red		**Red**
Congo DRC	31	130	8	Red		**Red**
Congo, Rep. Of	205	295	11	Red		**Red**
Cote d'Ivoire	76	180	6	Red		**Red**
Djibouti	44	102	6	Red		**Red**
Eritrea	44	422	20	Red		**Red**
Gambia	94	221	19	Red		**Red**
Guinea	45	198	21	Red	Red	**Red**
Guinea-Bissau	269	1001	60	Red		**Red**
Liberia	681	2887	1	Red		**Red**
Mauritania	60	215	14	Red	Green	**Green**
Sao Tome & Principe	162	452	43	Red		**Red**
Sierra Leone	33	182	14	Red		**Red**
SM Somalia	…	…	…	Red		**Red**
Sudan	129	899	11	Red		**Red**
Togo	69	191	3	Red		**Red**

Notes:

1/ As of 10/05/06 for grant-eligible IDA/ADFcountries only
2/ In ratios, both the numerator and the denominator refer to 2004 data.
3/ In ratios, the numerator refers to 2004 data and the denominator refers to the backward 3-year average of 2002-4.
4/ Based on available DSF-style DSAs.
5/ DSA-based traffic lights prevail in case of conflict with debt indicator-based traffic light.
6/ Based on 2005 CPIA ratings
7/ Rating is based on additional debt sustainability analysis in the context of DSF-style DSA
.. Not available
* Highlights with italicised figures show indicative policy-dependent thresholds by performance category; Gray highlights indicate debt indicators above the indicative thresholds.

Data source:

a. NPV of debt (2004) and debt service (2004): Preliminary GDF 2006. The scope of debt and debt service is public and publicly guaranteed external debt and IMF credits. Debt figures do not reflect the effects of MDRI.
b. GDP (2004):World Development Indicators (WDI) 2005.
c. Exports (2002-4): World Economic Outlook (WEO) 2005.
d. CPIA, the World Bank (2006).

Annex 4

ADF Ranking of Debt Distress in 2006 by CPIA & DSF Thresholds with FL-DSA - Traffic Light System

	Country Classification	2005 CPIA	GNI Per capita (US$)	NPV/GDP	NPV/EXP	DS/EXP	Ranking of debt distress		Debt distress country ranking	Debt distress country ranking (Traffic Light)			Final Traffic light
							Avge of NPV	DS/EXP					
Strong policy: CPIA >= 3.75				**50**	**200**	**25**				**AfDB***	**IDA***	**FL-DSA****	
1	Cape Verde	4.21	1770	33	127	10	1	1	1	Green	Green		Green
2	Senegal	4.01	670	19	79	17	1	1	1	Green	Green		Green
3	Tanzania	3.93	330	21	132	6	1	1	1	Green	Green	Green	Green
4	Uganda	3.88	270	30	250	12	2	1	2	Yellow	Yellow	Green	Green
5	Ghana	3.83	380	28	78	7	1	1	1	Green	Green		Green
6	Burkina Faso	3.77	360	19	234	15	1	1	1	Green	Green	Green	Green
Medium policy : 3.25 < CPIA < 3.75				**40**	**150**	**20**							
1	Mali	3.74	360	27	108	8	1	1	1	Green	Green	Green	Green
2	Kenya	3.73	460	28	119	9	1	1	1	Green	Green		Green
3	Benin	3.72	530	20	171	13	1	1	1	Green	Green	Green	Green
4	Lesotho	3.66	740	41	106	10	1	1	1	Green	Green	Yellow	Yellow
5	Rwanda	3.58	220	14	168	16	1	1	1	Green	Green	Red	Red
6	Mozambique	3.58	250	15	56	4	1	1	1	Green	Green		Green
7	Niger	3.48	230	22	157	10	1	1	1	Green	Green	Red	Red
8	Zambia	3.48	450	28	110	27	3	3	3	Red	Red	Green	Green
9	Ethiopia	3.46	110	26	171	8	1	1	1	Green	Green	Yellow	Yellow
10	Madagascar	3.46	300	41	162	7	2	1	2	Yellow	Yellow	Green	Green
11	Cameroon	3.45	800	16	72	17	1	1	1	Green	Green	Green	Green
12	Mauritania	3.40	420	60	215	14	3	1	3	Red	Red	Green	Green
13	Djibouti	3.32	1030	44	102	6	1	1	1	Green	Red		Red
14	Gambia	3.29	290	94	221	19	3	2	3	Red	Red		Red
15	Malawi	3.26	170	60	213	12	3	1	3	Red	Red	Yellow	Yellow
Poor Policy : CPIA < 3.25				**30**	**100**	**15**							
1	Guinea	3.13	460	45	198	21	3	3	3	Red	Red	Red	Red
2	Burundi	3.11	90	14	184	176	3	3	3	Red	Red	Red	Red
3	Sao Tome & Principe	3.05	370	162	452	43	3	3	3	Red	Red		Red
4	Sierra Leone	3.03	200	33	182	14	3	2	3	Red	Red		Red
5	Chad	3.01	260	18	75	4	1	1	1	Green	Green	Red	Red
6	Congo, Rep. Of	2.88	770	205	295	11	3	1	3	Red	Red		Red
7	Congo DRC	2.83	120	31	130	8	3	1	3	Red	Red		Red
8	Guinea-Bissau	2.83	160	269	1001	60	3	3	3	Red	Red		Red
9	Angola	2.73	1030	43	81	19	3	3	3	Red	Red	Yellow	Yellow
10	Sudan	2.62	530	129	899	11	3	1	3	Red	Red		Red
11	Togo	2.59	380	69	191	3	3	1	3	Red	Red		Red
12	Cote d'Ivoire	2.58	770	76	180	6	3	1	3	Red	Red		Red
13	Eritrea	2.54	180	44	422	20	3	2	3	Red	Red		Red
14	Liberia	2.54	110	681	2887	1	3	1	3	Red	Red		Red
15	Central African Republic	2.47	310	66	588	12	3	1	3	Red	Red	Red	Red
16	Comoros	2.42	530	59	422	6	3	1	3	Red	Red		Red
17	Somalia	1.00	90	..	..	..	..	..	..	Red	Red		Red
Blend Countries													
1	Nigeria	3.18	350	69	152	7	3	1	3	Red			Green
2	Zimbabwe	1.90	480	56	250	3	2	1	2	Yellow			Green

Notes:

(*)	Ranking of debt distress by mechanical Debt Sustainability Framework (DSF) thresholds against debt burden indicators
(**)	IDA loan/grant rankings determined by evidence from forward-looking IMF/IDA DSA field work.
FL-DSA	Forward-looking debt sustainability analysis
NPV/GDP	NPV of external debt over GDP
NPV/EXP	NPV of external debt over exports
DS/EXP	Debt service over exports ratio
Average	Average of NPV of debt over GDP and NPV of debt over exports
Red	Ranking of debt distress by the DSF resulting in 100% grants and no loans
Yellow	Ranking of debt distress by the DSF resulting in 50/50 loans and grants proportion
Green	Ranking of debt distress by the DSF resulting in 100% loans and no grants

Annex 5

2006 ADF-X Performance-based Allocation & DSF Debt Distress Rankings - Loan/Grant Shares

Country Classification		2005 CPA adj. *	2005 CPIA for country ranking	Debt distress country ranking (Traffic Light)			Final Traffic light	% Grants	Initial ADF-X Res. Alloc. (Pure Volume Approach)			20% & 12% discount on grants	Revised ADF-X allocation (after Grants discounts)			Break-down of 20 percent Grants***			Reallocated 8% Grants by PBA			Final ADF-X Res. Alloc. (Volume Disc. Approach)			Grants% in ADF-X Final Alloc.	Revised Alloc. Shares	
				AfDB	IDA	DSA-FL			Loans	Grants	Total		Loans	Grants	Total	8%	12%	Total	Loans	Grants	Total	Total Loans	Total Grants	Total Alloc.		Loans (%)	Grants (%)
Strong Policy: CPIA >= 3.75																											
1	Cape Verde	4.22	4.21	Green	Green		Green	0%	10.1	-	10.1	-	10.1	-	10.1	-	-	-	0.05	-	0.05	10.1	-	10.1	-	100.0	-
2	Senegal	4.39	4.01	Green	Green		Green	0%	114.4	-	114.4	-	114.4	-	114.4	-	-	-	1.38	-	1.38	115.8	-	115.8	-	100.0	-
3	Tanzania	3.65	3.93	Green	Green	Green	Green	0%	288.2	-	288.2	-	288.2	-	288.2	-	-	-	3.59	-	3.59	291.8	-	291.8	-	100.0	-
4	Uganda	3.62	3.88	Yellow	Yellow	Green	Green	0%	206.2	-	206.2	-	206.2	-	206.2	-	-	-	2.55	-	2.55	208.8	-	208.8	-	100.0	-
5	Ghana	3.58	3.83	Green	Green		Green	0%	161.3	-	161.3	-	161.3	-	161.3	-	-	-	1.98	-	1.98	163.3	-	163.3	-	100.0	-
6	Burkina Faso	3.47	3.77	Green	Green	Green	Green	0%	92.1	-	92.1	-	92.1	-	92.1	-	-	-	1.10	-	1.10	93.2	-	93.2	-	100.0	-
Medium Policy : 3.25 < CPIA < 3.75																											
1	Mali	3.91	3.74	Green	Green	Green	Green	0%	111.9	-	111.9	-	111.9	-	111.9	-	-		1.35	-	1.35	113.2	-	113.2	-	100.0	-
2	Kenya	3.28	3.73	Green	Green		Green	0%	202.5	-	202.5	-	202.5	-	202.5	-	-	-	2.50	-	2.50	205.0	-	205.0	-	100.0	-
3	Benin	3.51	3.72	Green	Green	Green	Green	0%	52.6	-	52.6	-	52.6	-	52.6	-	-	-	0.59	-	0.59	53.2	-	53.2	-	100.0	-
4	Lesotho	3.30	3.66	Green	Green	Yellow	Yellow	50%	8.3	8.3	16.5	1.7	8.3	6.6	14.9	0.7	1.0	1.7	0.07	0.07	0.13	8.3	6.7	15.0	0.2	55.5	44.5
5	Rwanda	3.56	3.58	Green	Green	Red	Red	100%	-	71.5	71.5	14.3	-	57.2	57.2	5.7	8.6	14.3	-	0.83	0.83	-	58.1	58.1	2.0	-	100.0
6	Mozambique	3.62	3.58	Green	Green		Green	0%	158.4	-	158.4	-	158.4	-	158.4	-	-	-	1.94	-	1.94	160.3	-	160.3	-	100.0	-
7	Niger	3.04	3.48	Green	Green	Red	Red	100%	-	73.5	73.5	14.7	-	58.8	58.8	5.9	8.8	14.7	-	0.86	0.86	-	59.7	59.7	2.1	-	100.0
8	Zambia	3.26	3.48	Red	Red	Green	Green	0%	69.7	-	69.7	-	69.7	-	69.7	-	-	-	0.81	-	0.81	70.5	-	70.5	-	100.0	-
9	Ethiopia	3.88	3.46	Green	Green	Yellow	Yellow	50%	150.6	150.6	301.1	30.1	150.6	120.5	271.0	12.0	18.1	30.1	1.65	1.65	3.31	152.2	122.1	274.3	4.2	55.5	44.5
10	Madagascar	3.02	3.46	Yellow	Yellow	Green	Green	0%	97.6	-	97.6	-	97.6	-	97.6	-	-	-	1.17	-	1.17	98.7	-	98.7	-	100.0	-
11	Cameroon	3.36	3.45	Green	Green	Green	Green	0%	103.8	-	103.8	-	103.8	-	103.8	-	-	-	1.25	-	1.25	105.0	-	105.0	-	100.0	-
12	Mauritania	2.68	3.40	Red	Red	Green	Green	0%	17.7	-	17.7	-	17.7	-	17.7	-	-	-	0.15	-	0.15	17.9	-	17.9	-	100.0	-
13	Djibouti	2.85	3.32	Green	Red		Red	100%	-	9.0	9.0	1.8	-	7.2	7.2	0.7	1.1	1.8	-	0.04	0.04	-	7.2	7.2	0.2	-	100.0
14	Gambia	2.76	3.29	Red	Red		Red	100%	-	12.5	12.5	2.5	-	10.0	10.0	1.0	1.5	2.5	-	0.08	0.08	-	10.1	10.1	0.3	-	100.0
15	Malawi	2.96	3.26	Red	Red	Yellow	Yellow	50%	33.7	33.7	67.4	6.7	33.7	27.0	60.7	2.7	4.0	6.7	0.39	0.39	0.78	34.1	27.4	61.5	0.9	55.5	44.5
Poor Policy : CPIA =< 3.25																											
1	Guinea	2.65	3.13	Red	Red	Red	Red	100%	-	37.3	37.3	7.5	-	29.9	29.9	-	7.5	7.5	-	0.40	0.40	-	30.3	30.3	1.0	-	100.0
2	Burundi	2.58	3.11	Red	Red	Red	Red	100%	-	39.0	39.0	4.7	-	34.3	34.3	-	4.7	4.7	-	0.42	0.42	-	34.7	34.7	1.2	-	100.0
3	Sao Tome & Principe	2.54	3.05	Red	Red		Red	100%	-	6.6	6.6	1.3	-	5.3	5.3	-	1.3	1.3	-	0.01	0.01	-	5.3	5.3	0.2	-	100.0
4	Sierra Leone	3.16	3.03	Red	Red		Red	100%	-	40.3	40.3	4.8	-	35.5	35.5	-	4.8	4.8	-	0.44	0.44	-	35.9	35.9	1.2	-	100.0
5	Chad	2.36	3.01	Green	Green	Red	Red	100%	-	35.1	35.1	7.0	-	28.1	28.1	-	7.0	7.0	-	0.37	0.37	-	28.5	28.5	1.0	-	100.0
6	Congo, Rep. Of	2.54	2.88	Red	Red		Red	100%	-	19.0	19.0	2.3	-	16.8	16.8	-	2.3	2.3	-	0.17	0.17	-	16.9	16.9	0.6	-	100.0
7	Congo DRC	2.64	2.83	Red	Red		Red	100%	-	258.3	258.3	31.0	-	227.3	227.3	-	31.0	31.0	-	3.21	3.21	-	230.5	230.5	8.0	-	100.0
8	Guinea-Bissau	1.69	2.83	Red	Red		Red	100%	-	8.8	8.8	1.8	-	7.0	7.0	0.7	1.1	1.8	-	0.04	0.04	-	7.0	7.0	0.2	-	100.0
9	Angola	2.05	2.73	Red	Red	Yellow	Yellow	50%	17.9	17.9	35.9	2.2	17.9	15.8	33.7	-	2.2	2.2	0.19	0.19	0.38	18.1	16.0	34.1	0.6	53.2	46.8
10	Sudan	1.57	2.62	Red	Red		Red	100%	-	52.2	52.2	6.3	-	46.0	46.0	-	6.3	6.3	-	0.59	0.59	-	46.5	46.5	1.6	-	100.0
11	Togo	1.51	2.59	Red	Red		Red	100%	-	12.5	12.5	2.5	-	10.0	10.0	1.0	1.5	2.5	-	0.08	0.08	-	10.1	10.1	0.3	-	100.0
12	Cote d'Ivoire	1.25	2.58	Red	Red		Red	100%	-	20.1	20.1	4.0	-	16.1	16.1	1.6	2.4	4.0	-	0.18	0.18	-	16.3	16.3	0.6	-	100.0
13	Eritrea	2.50	2.54	Red	Red		Red	100%	-	23.2	23.2	2.8	-	20.4	20.4	-	2.8	2.8	-	0.22	0.22	-	20.7	20.7	0.7	-	100.0
14	Liberia	1.41	2.54	Red	Red		Red	100%	-	10.5	10.5	1.3	-	9.2	9.2	-	1.3	1.3	-	0.06	0.06	-	9.3	9.3	0.3	-	100.0
15	Central African Republic	1.44	2.47	Red	Red	Red	Red	100%	-	10.9	10.9	1.3	-	9.6	9.6	-	1.3	1.3	-	0.06	0.06	-	9.6	9.6	0.3	-	100.0
16	Comoros	1.28	2.42	Red	Red		Red	100%	-	6.6	6.6	1.3	-	5.2	5.2	0.5	0.8	1.3	-	0.01	0.01	-	5.2	5.2	0.2	-	100.0
17	Somalia	0.29	1.00	Red	Red		Red	100%	-	6.5	6.5	1.3	-	5.2	5.2	0.5	0.8	1.3	-	0.01	0.01	-	5.2	5.2	0.2	1.0	100.0
Blend Countries																											
1	Nigeria	2.04	3.18				Green	0%	142.0	-	142.0	-	142.0	-	142.0	-	-	-	-	-	-	142.0	-	142.0	-	100.0	-
2	Zimbabwe	0.93	1.90				Green	0%	8.6	-	8.6	-	8.6	-	8.6	-	-	-	-	-	-	8.6	-	8.6	-	100.0	-
									2,047.3	**964.0**	**3,011.3**	**155.1**	**2,047.3**	**808.9**	**2,856.2**	**33.09**	**122.00**	**155.1**	**22.7**	**10.4**	**33.1**	**2,070.1**	**819.3**	**2,889.3**	**28.35**	**71.6**	**28.35**
										32.01%				**28.32%**									**28.35%**				

* Refers to adjusted 2005 CPA representing the standard CPA adjusted by the GF and PCEF

** Twelve (12) and Twenty (20) percent discounts on grants are applied respectively to the 9post-conflict countries (PCCs) and to the rest of the ADF-only RMCs.

*** The total 20 percent discount on grants is made up of the incentive-related 8 percent portion and the 12 percent surcharge portion representing payback for forgone net income from reflows.