

# **Resource Allocation**

## **Discussion Paper**

ADF-12 Replenishment, Third Meeting  
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**AFRICAN DEVELOPMENT FUND**

## Executive Summary

This paper presents the framework for the allocation of ADF-12 resources across competing demands and in support of the strategic priorities identified during the ADF-12 consultations. Management remains committed to allocating the overall majority of ADF resources through the Performance-Based Allocation (PBA) system, which has proven an effective mechanism for directing more resources to stronger performing countries since its adoption in 1999.

No major changes to the system are proposed for the ADF-12 period. Management rather proposes to further strengthen the link between allocation and performance for the special initiatives continued from ADF-11 that are not directly funded through PBAs. For the Fragile States Facility, Management estimates a resource requirement of UA 824 million, including both the performance-based supplemental allocation (Pillar I) and the expected costs of arrears clearance during the ADF-12 period (Pillar II). Concerning regional operations, Management favors an enlarged envelope at 20 percent of the replenishment size and suggests further reinforcing the link to performance by introducing individual project scorecards as part of the enhanced selection and prioritization process. By limiting the resources used for regional public goods and maintaining a two-times supplemental allocation from Pillar I of the Fragile States Facility, the share of resources allocated directly and indirectly on the basis of performance could reach up to 92 percent. This compares favorably with the 90 percent achieved under ADF-11.

This paper presents various trade-offs in the allocation of resources under different scenarios. For each scenario, Management has prioritized a pipeline of operations that could be funded. The scenarios vary according to several key factors:

- the size of the overall replenishment: scenarios consider a flat increase<sup>1</sup> over ADF-11 as well as increases of 10 percent, 30 percent, 50 percent, and 70 percent;
- the size of the regional operations envelope (17.5 percent, 20.0 percent, and 22.5 percent of the overall ADF-12 replenishment); and
- the modalities of the Fragile States Facility: either a fixed amount or an envelope of 7.5 percent.

The paper also addresses the issues of allocating resources to different categories of ADF recipients and applying differentiated lending terms. In line with the practices of other multilateral development banks, Management proposes to replace the aggregate cap of 5 percent of PBA resources with country-specific caps that better reflect country circumstances. Granting each blend country half of its PBA is a simple measure that maintains the link between performance and allocations and ensures that the bulk of ADF resources continues to benefit ADF-only countries. Also, applying differentiated lending terms to blend and “gap” countries would better match their income levels and creditworthiness, enhance harmonization and alignment with sister institutions, and improve the ADF’s long-term financial capacity to commit new resources for development. Finally, as agreed at the ADF-11 Mid-Term Review, Management will develop a full Bank Group graduation policy to be presented to the Board of Directors for approval. The main elements of this policy as it pertains to ADF countries are presented for Deputies’ guidance.

Deputies are invited to provide their views on these issues.

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<sup>1</sup> The flat scenario corresponds to inflation, i.e., 4.5 percent.

## Table of Contents

<b>Abbreviations .....</b>	<b>iv</b>
<b>1. Introduction .....</b>	<b>1</b>
<b>2. Country Eligibility .....</b>	<b>1</b>
<b>3. Experience with the ADF-11 Resource Allocation Framework .....</b>	<b>1</b>
<i>Overall Resources.....</i>	<i>2</i>
<i>The Performance-Based Allocation System .....</i>	<i>2</i>
<i>Changes Introduced in ADF-11 .....</i>	<i>4</i>
<i>Allocation Results.....</i>	<i>4</i>
<b>4. Proposed ADF-12 Resource Allocation Framework.....</b>	<b>6</b>
<i>Overall Replenishment Levels and the Balance Between Performance-Based Allocations and Set-Asides.....</i>	<i>6</i>
<i>Modalities for the Fragile States Facility .....</i>	<i>7</i>
<i>Modalities for the Regional Operations Set-Aside .....</i>	<i>8</i>
<i>Modalities for the Private Sector Guarantee “top-slice” .....</i>	<i>9</i>
<i>Technical Contingencies .....</i>	<i>9</i>
<i>Allocation Methodology.....</i>	<i>10</i>
<b>5. ADF-12 Resource Allocation Scenarios .....</b>	<b>10</b>
<i>Presentation of the Scenarios.....</i>	<i>10</i>
<i>Operational Focus.....</i>	<i>11</i>
<i>Stronger Link to Performance .....</i>	<i>13</i>
<b>6. Proposals Concerning the Allocation of Resources .....</b>	<b>13</b>
<i>Addressing Allocation Volatility: Country Portfolio Performance Ratings and Multilateral Debt Relief Initiative Netting Out .....</i>	<i>13</i>
<i>Strengthening the Link to Performance for Regional Operations .....</i>	<i>14</i>
<i>Resources for Blend Countries .....</i>	<i>15</i>
<i>Differentiated African Development Fund Lending Terms.....</i>	<i>16</i>
<b>7. Proposed Graduation Policy for African Development Fund Countries.....</b>	<b>18</b>
<b>8. Conclusion and Recommendations .....</b>	<b>19</b>
<b>Annex I: Classification of Regional Member Countries.....</b>	<b>21</b>
<b>Annex II: The Status of African Development Fund Subscriptions and Payments Received as of 22 April 2010, in Units of Account .....</b>	<b>22</b>
<b>Annex III: Resource Allocation for ADF-11 .....</b>	<b>23</b>
<b>Annex IV: The Performance-Based Allocation Framework for ADF-12.....</b>	<b>26</b>
<b>Annex V: Fragile States Facility Phasing-Out Parameters .....</b>	<b>28</b>
<b>Annex VI: Options for determining country-specific caps on African Development Bank resources for blend countries.....</b>	<b>29</b>
<b>Annex VII: Other Multilateral Development Banks’ Country Classifications and Lending Terms...</b>	<b>30</b>
<b>Annex VIII: Resource Allocation Scenarios (technical annex).....</b>	<b>33</b>

## Tables

Table 1: Resources Needed for 2x Supplemental Allocations .....	7
Table 2: Proposed African Development Bank Group Country Classification.....	17
Table 3: Proposal for Phasing Out ADF Resources and Phasing In ADB Resources for Graduating Countries.....	19

## Figures

Figure 1: ADF-11 Resources as of April 22, 2010 .....	2
Figure 2: The Share of Allocations Linked to the Performance-Based Allocation System From ADF-8 to ADF-11 .....	3
Figure 3: Resource Allocations by Performance Quintile: ADF-8 to ADF-11 .....	5
Figure 4: Debt Sustainability Framework Classifications for Performance-Based Allocations, 2005-2010 .....	6
Figure 5: Replenishment Scenarios at a Glance .....	11
Figure 6: Sector Distribution of Resources From ADF-8 to ADF-12.....	12
Figure 7: The Sector Distribution of Resources For Various ADF-12 Replenishment Scenarios .....	12
Figure 8: Distribution of ADF-12 Operations By Sector For Each Funding Window .....	13

## Abbreviations

ADB	African Development Bank
ADF	African Development Fund
ADF-8	Eighth General Replenishment of the African Development Fund
ADF-9	Ninth General Replenishment of the African Development Fund
ADF-10	Tenth General Replenishment of the African Development Fund
ADF-11	Eleventh General Replenishment of the African Development Fund
ADF-12	Twelfth General Replenishment of the African Development Fund
Bp	Basis Points
CPIA	Country Policy and Institutional Assessment
CPPR	Country Portfolio Performance Rating
DSF	Debt Sustainability Framework
FSF	Fragile States Facility
GNI	Gross National Income
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
MDRI	Multilateral Debt Relief Initiative
PBA	Performance-Based Allocation
PBL	Policy-Based Loan
PPF	Project Preparation Facility
RO	Regional Operation
UA	Units of Account

## RESOURCE ALLOCATION

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### 1. Introduction

- 1.1 Following discussions in Cape Town, this paper proposes a comprehensive framework for allocating ADF-12 resources to African Development Fund (ADF or Fund) countries (both ADF-only countries and blend countries). It also sets out the elements of a proposed graduation policy for ADF countries on the basis of comments received on the ADF-11 Mid-Term Review paper “Issues Concerning the Blend Country Regime and the Adoption of a Graduation Policy for ADF Countries.” This paper is complemented by the paper, “ADF-12 Financing Framework 2.”
- 1.2 Section 3 reviews the ADF-11 resource allocation framework, including the results of enhancements to the Performance-Based Allocation (PBA) system introduced in ADF-11. Section 4 of this paper discusses the prospective balance between the resources allocated via the PBA system and the two set-asides for regional operations and fragile states, and the size and modalities of these set-asides. Section 5 presents a number of resource allocation scenarios. Section 6 puts forward proposals concerning the allocation of resources, including to blend countries, and presents differentiated ADF lending terms for these countries. Management’s proposed graduation policy for ADF countries is set out in Section 7, and Section 8 concludes.

### 2. Country Eligibility

- 2.1 According to the Bank Group Credit Policy,<sup>2</sup> eligibility for ADF resources is determined according to the World Bank’s assessment of countries’ creditworthiness, country needs as measured by gross national income per capita below a threshold,<sup>3</sup> and country performance.
- 2.2 The ADF currently counts 37 ADF-only eligible borrowers and three blend countries (Annex I). Operations in ADF-only countries may also be financed by the African Development Bank (ADB or Bank)’s private sector window and non-concessional resources for enclave projects. To qualify for this financing, private sector and enclave projects must meet certain criteria.<sup>4</sup> Countries that, because of sanctions, are not active borrowers, are expected to re-engage during the course of ADF-12, subject to the clearance of their arrears with the Bank Group.

### 3. Experience with the ADF-11 Resource Allocation Framework

- 3.1 During ADF-11, certain changes were introduced to the Bank’s resource allocation framework. Thematic set-asides for regional operations and fragile states were created and the PBA system was modified in line with the modifications of other multilateral development banks. After presenting a snapshot of current ADF-11 resources, this section describes the status of the PBA system and the changes introduced in ADF-11, and details how resources have been allocated.

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<sup>2</sup> Resolution B/BD/94/07/Rev1 adopted on 16 May 1995; ADB/BD/WP/95/79 dated 8 May 1995; *Bank Group Credit Policy*, ADB/BD/WP/98/40, 9 March 1998.

<sup>3</sup> The operational cut-off (threshold) for International Development Association (IDA)/ADF eligibility for FY2010 is gross national income per capita of US\$ 1,135. See World Bank Operations Manual, OP 3.10 – Annex D, updated December 2009. The threshold and ceilings for IDA/ADF eligibility are revised regularly by the IDA.

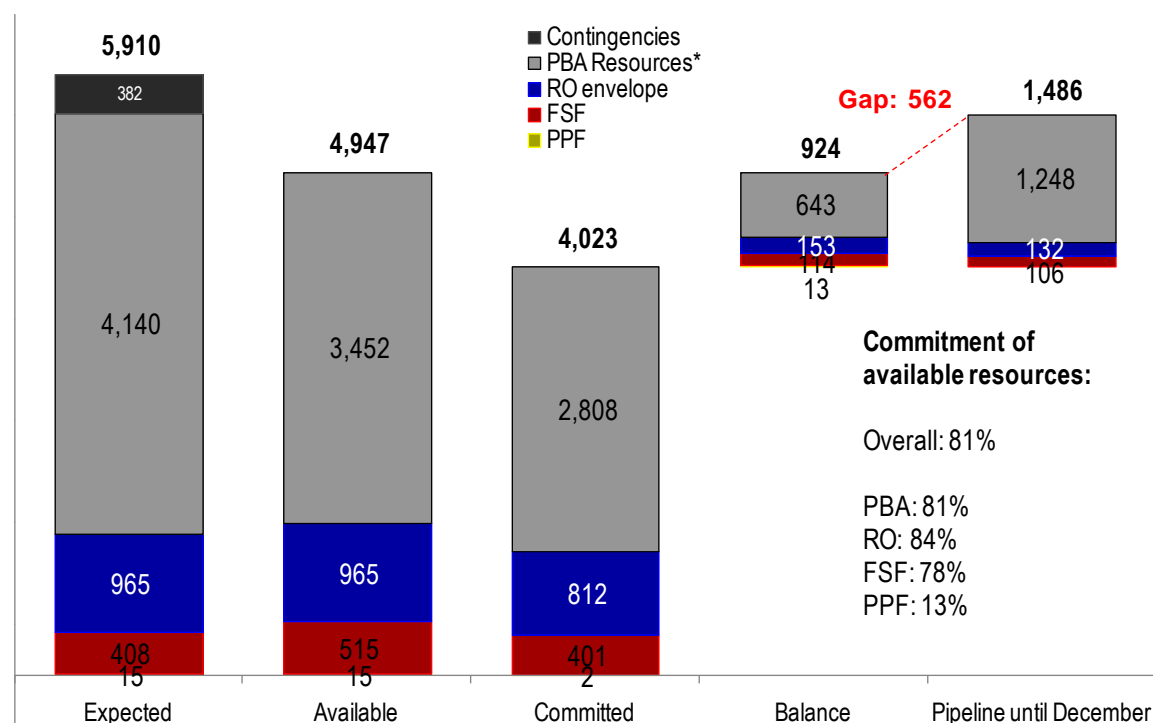
<sup>4</sup> The Bank is discussing the possibility of widening the definition of enclave projects eligible for ADB financing with the International Monetary Fund and the World Bank. See African Development Bank. *Review of the African Development Bank’s Capital Resource Requirements (GCI-VI) - Fourth Working Paper* (ADB/BD/WP/2010/33/FWP/Rev. 2). 26 March 2010.

### Overall Resources

- 3.2 Total expected resources under ADF-11 amount to Units of Account (UA) 5.910 billion, of which UA 4.947 billion had been received as of 22 April 2010. UA 4.023 billion (81 percent) of these resources have been committed; the balance available for commitment for 2010 therefore stands at UA 924 million. The pipeline of ADF operations scheduled for presentation to the Board of Directors before December 2010, in contrast, reaches UA 1.49 billion (Figure 1).

**Figure 1: ADF-11 Resources as of April 22, 2010**

(UA millions)



**Notes:** FSF=Fragile States Facility; PBAs=Performance-Based Allocations; ROs=Regional Operations; UA=Units of Account; PPF=Project Preparation Facility (amounts below the red areas)

(\*) PBA resources have been adjusted for the negative impact of contingencies

**Source:** African Development Bank

- 3.3 The ADF will be unable to authorize commitments corresponding to the full 2010 pipeline unless all subscriptions are paid as due. Deputies are therefore invited to pay the third installment of their subscription in cash or in promissory notes as soon as possible.<sup>5</sup> Annex II provides an overview of payments received as of 22 April 2010.

### The Performance-Based Allocation System

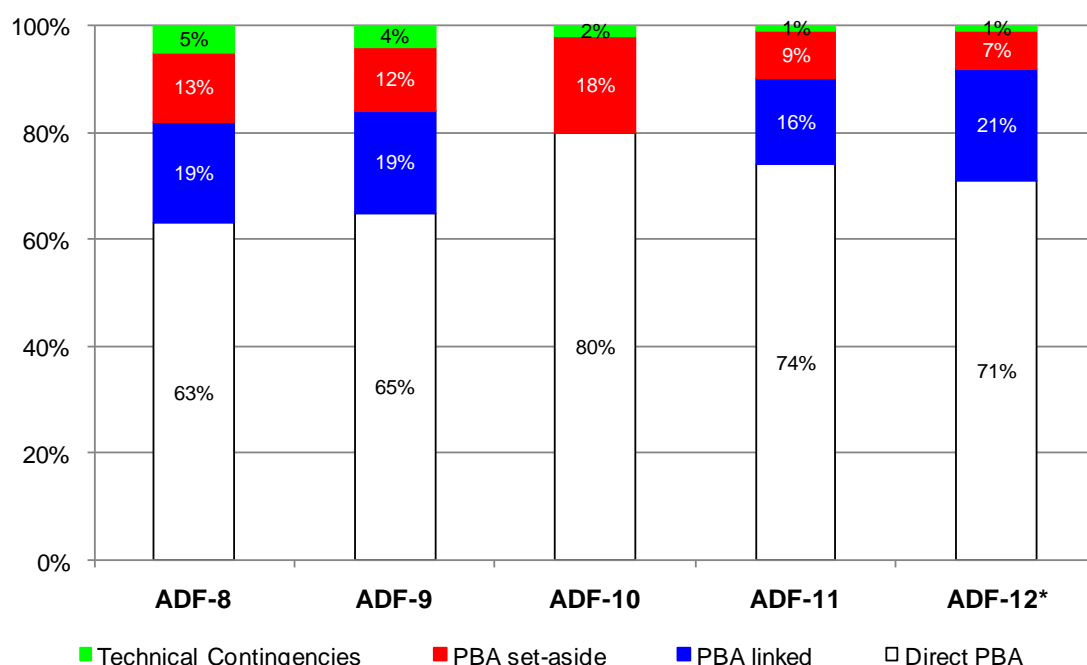
- 3.4 The PBA framework has been used since 1999 to allocate the majority of ADF resources to eligible countries, based on their performance. During ADF-8 and ADF-9, the share of resources allocated through the PBA system was around 80-85 percent (Figure 2): roughly 65 percent of resources were allocated directly through the PBA system, and an additional 19 percent of resources were set aside for policy-based loans (PBLs) and to "top up" resources for high-performing countries.<sup>6</sup> In addition, specific pools of resources were set aside from the PBA framework to finance multinational operations, with no link to performance. Under ADF-

<sup>5</sup> According to the ADF-11 Resolution, the third instalment is scheduled to be paid on or before April 30, 2010.

<sup>6</sup> Under this framework, an additional 50 percent of the standard PBA allocation was made available to high-performing countries to finance PBLs.

10, Deputies agreed to fold the PBL allotment into the standard PBA system and to raise the share of resources earmarked for regional operations to 15 percent. As a result, the share of resources directly allocated through the PBA system increased to 80 percent. Under ADF-11, the share of the resources directly allocated through the PBA system, including PBLs, was 74 percent. Another 25 percent of resources were set aside for regional operations and the Fragile States Facility. Of these, 16 percent were linked to PBAs: Fragile States Facility Pillar I and regional operations with cost-sharing. This brought the proportion of allocations directly or indirectly linked to PBAs to an unprecedented 90 percent (Figure 2 and Annex III).

**Figure 2: The Share of Allocations Linked to the Performance-Based Allocation System From ADF-8 to ADF-11**



**Notes:** PBA=Performance-Based Allocations; PBA-linked = Fragile States Facility Pillar 1 + regional operations with cost-sharing; Non PBA linked = Fragile States Facility Pillars 2 and 3 + regional public goods  
 (\*) For illustrative purposes, ADF-12 figures are calculated assuming a 50% increase, a regional operation envelope of 20% and an FSF of 7.5%

**Source:** African Development Bank

3.5 The PBA system places country needs and country performance at the center of the allocation process (Annex IV). Countries' needs and absorptive capacity are assessed on the basis of population and gross national income per capita. Country performance is assessed each year according to the following criteria:

- the Country Policy and Institutional Assessment (CPIA), which tracks the performance of the country's policy and institutional framework to promote growth and reduce poverty;
- the Country Portfolio Performance Rating (CPPR), which assesses a country's portfolio implementation performance based on the percentage of projects at risk; and
- a Governance Factor made up of five criteria from the CPIA governance cluster.

3.6 ADF resources are allocated on the basis of an agreed formula using country performance assessments (CPAs), gross national income per capita indicators, and population. As detailed in Annex IV, country performance is the formula's primary driver. An improvement in a country's performance relative to other countries increases its allocation. All other things being equal, an increase in population results in a proportionate increase in allocation, while an increase in gross national income per capita lowers the allocation.



### ***Changes Introduced in ADF-11***

- 3.7 Under ADF-11, changes to the PBA process helped increase the predictability of allocations and simplified the allocation process:
- changes to the timing of the allocation and the Debt Sustainability Framework (DSF) classification cycles to align them to the ADF operational calendar year, thereby eliminating mid-year changes to allocations;
  - the decision to keep country-specific data on population and income levels constant over the entire ADF-11 period to smooth year-to-year changes in these factors;
  - revision of the portfolio performance factor (the CPPR) by including only actual problem projects (not potential problem projects) in project-at-risk measurements, to reduce volatility;
  - revision of the CPIA score to include only the first three clusters of the CPIA, to eliminate double counting governance;
  - revision of the Governance Factor by eliminating the procurement element; and
  - elimination of the Post-Conflict Enhancement Factor upon approval of the proposed Fragile States Facility.

### ***Allocation Results***

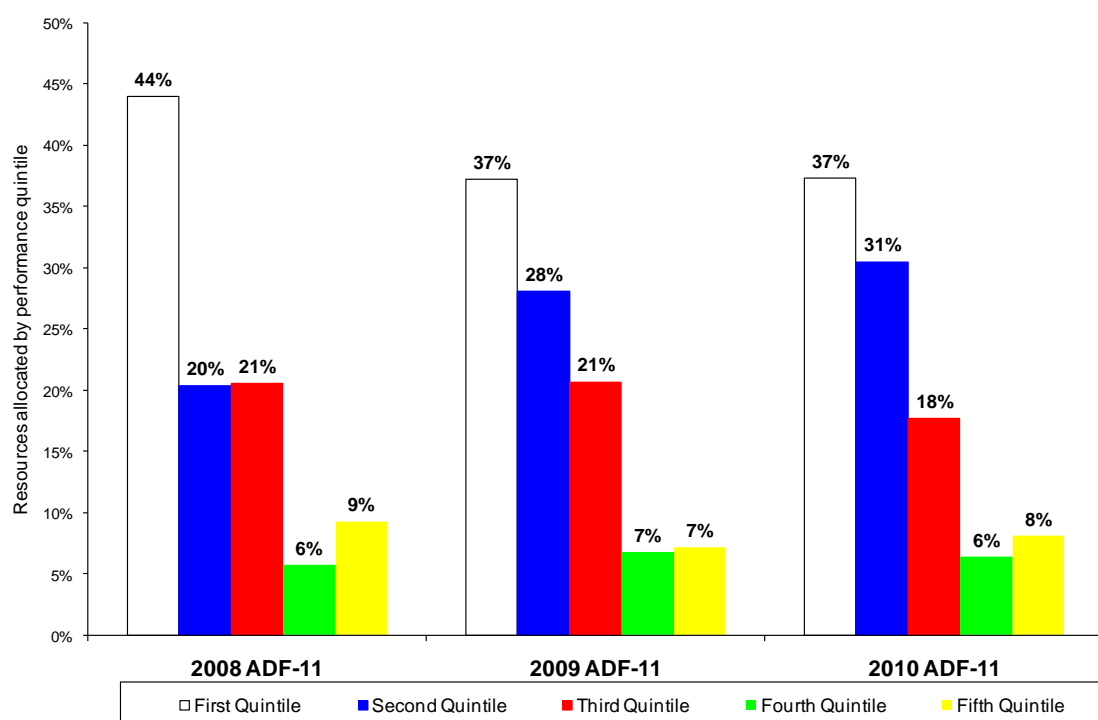
- 3.8 As illustrated in Figure 3,<sup>7</sup> top performers have received an increasingly larger share of successive ADF replenishments. The share of all ADF resources allocated to the best performing quintile increased from 33 percent under ADF-8 to 37 percent under ADF-11.<sup>8</sup> Furthermore, about 68 percent of all ADF resources have been consistently allocated to the two top-performing quintiles. These trends are also evident in each year of the ADF-11 cycle (2008, 2009 and 2010) and for per capita allocations (Figures III-1 and III-2 in Annex III). This demonstrates that the allocation mechanism is effective at directing more resources to stronger performers.

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<sup>7</sup> The graph shows basic allocations under ADF cycles without adjustments for DSF and MDRI impacts under ADF-10 and ADF-11.

<sup>8</sup> The slight decline in the share of resources allocated to the top quintile between ADF-10 and ADF-11 is due to a few large countries changing performance categories.

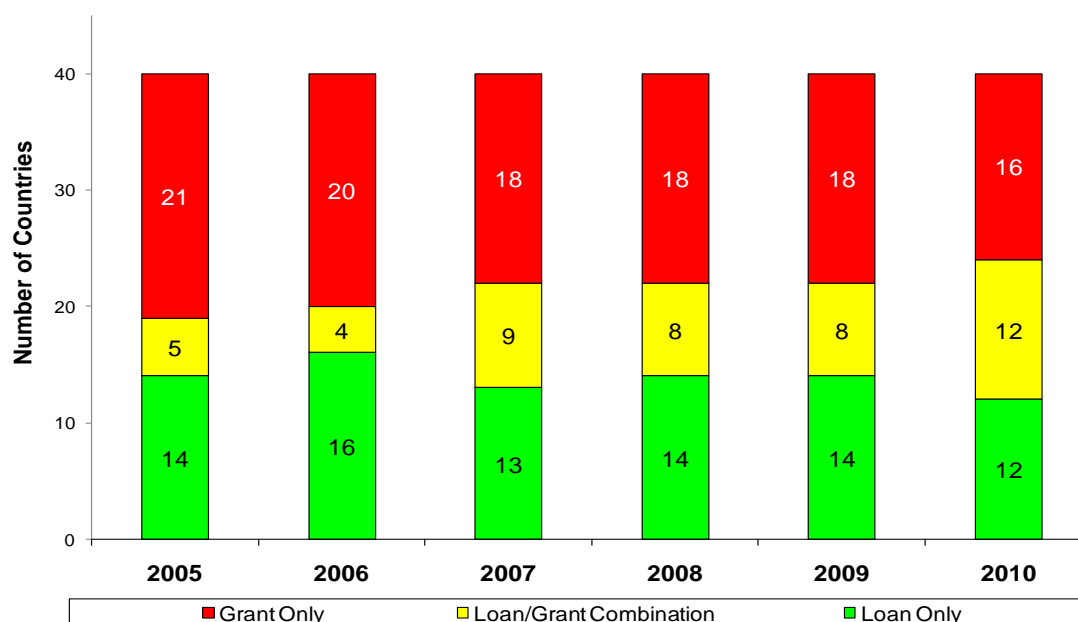
**Figure 3: Resource Allocations by Performance Quintile: ADF-8 to ADF-11**



**Source:** African Development Bank

- 3.9 The introduction of DSF and Multilateral Debt Relief Initiative (MDRI) adjustments in the PBA process has resulted in a partial de-linkage of actual allocations from performance indicators at the country level. During the annual PBA exercise, countries are classified according to their risk of debt distress as determined by the DSF. Their financing terms (whether they are offered only loans, only grants, or a combination of both) are adjusted accordingly. The greater the number of countries at a high or medium risk of debt distress, the higher the overall percentage of grants in the allocations. The share of grants after applying the DSF decreased from 34.3 percent in 2005 to 25.5 percent in 2009, signaling improvements in debt sustainability, but increased to 30.6 percent in 2010 mainly because of the reclassification of Angola (from loan only to loan/grant), Burkina Faso (from loan/grant to grant only), and Ghana (from loan only to loan/grant). DSF classifications over the ADF-11 period are shown in Figure 4.

**Figure 4: Debt Sustainability Framework Classifications for Performance-Based Allocations, 2005-2010**



**Notes:** In the allocation process, five countries changed traffic light status from 2009 to 2010: Ghana and Angola changed from green to yellow; Burkina Faso changed from yellow to red; and Chad and Rwanda changed from red to yellow.

**Source:** African Development Bank

## 4. Proposed ADF-12 Resource Allocation Framework

- 4.1 Following on the issues paper discussed during the Cape Town consultative meeting, this section presents the framework that will be used to allocate resources as per different ADF-12 replenishment scenarios. It summarizes how allocations for the two thematic set-asides (one for fragile states and one for regional operations) vary according to replenishment levels and assesses the set-asides' impact on the ADF's cornerstone PBA system. It then discusses modalities for the two set-asides and presents the methodology used to calculate figures for the replenishment-level scenarios presented in Section 5.

### **Overall Replenishment Levels and the Balance Between Performance-Based Allocations and Set-Asides**

- 4.2 During the second consultative meeting, Management had proposed three replenishment-level scenarios for Deputies' consideration: a flat increase over ADF-11 (i.e., an increase adjusted for inflation of 4.5 percent), a 50 percent increase, and a 70 percent increase. Several Deputies requested that intermediate scenarios be added. This section responds that request by adding two scenarios: a 10 percent increase and a 30 percent increase over the ADF-11 replenishment.
- 4.3 ADF-12 resources will ultimately be allocated across competing demands and in support of the strategic directions and funding priorities identified during the consultation. Management is committed to continuing to allocate the bulk of ADF resources on the basis of performance, as agreed during the ADF-11 Mid-Term Review. For ADF-12, an important challenge will be to balance country allocations (PBAs) and thematic set-asides in such a way that the Fund can (i) channel resources to country operations according to countries' performance; (ii) provide sufficient funding for key priorities such as fragile states and regional operations; and (iii) remain as flexible as possible so as to be in a position to address pressing needs as they arise, notably arrears clearances. As agreed in Cape Town, the Fund will maintain the current number of set-asides in order to prevent fragmentation and to preserve a critical mass for each set-aside. Nonetheless, a balance between the various elements must be found for the

ADF to be able to fund areas that correspond to its core priorities and mandate.

- 4.4 The replenishment level and the size of the set-asides will dictate trade-offs with respect to strategic choices and ambitions for the ADF. For example, a low replenishment level coupled with high prioritization of the PBA will lower the amounts of the two set-asides, thereby reducing the ADF's ability to promote regional integration by completing major links, to undertake new climate change mainstreaming activities, or to quickly re-engage with countries currently under sanctions.

#### **Modalities for the Fragile States Facility**

- 4.5 The resources allocated to the Fragile States Facility will be used for three purposes: (i) topping up regular country allocations with a multiple of the average of the two highest country PBAs under ADF-11 ("high-2"); (ii) clearing the arrears of countries meeting the required criteria; and (iii) providing targeted assistance.
- 4.6 Supplemental support (top-up). One of the keys to the Fund's engagement in fragile states has been its ability to provide supplemental resources roughly twice the size of the performance-based allocation of the previous cycle. Further, a phasing-out strategy (including gradual reduction or discounting of the supplemental allocation) will be proposed for approval by the Board of Directors before the end of 2010, accompanied by an assessment of each country's eligibility. As shown in Table 1, UA 405 million would be required to maintain a 2x top-up factor for potentially eligible countries. See Annex V for an explanation of the proposed discounts, which reflect development of policies and institutions, income level and length of re-engagement. Caps and floors would be maintained at ADF-11 levels, UA 60 and UA 10 million, respectively. Through the use of the previous allocation as the basis, the link to performance is maintained also.

**Table 1: Resources Needed for 2x Supplemental Allocations**

<i>(amounts in UA millions)</i>	<b>"High 2" ADF-11 Basic*</b>	<b>After 2x Multiplication</b>	<b>After Discount</b>	<b>Final After Caps/Floors</b>		<b>Discount</b>
<b>Burundi</b>	44.7	89.5	71.6	<b>60.0</b>		20%
<b>Central African Rep.</b>	20.7	41.3	33.1	<b>33.1</b>		20%
<b>Comoros</b>	6.3	12.5	10.0	<b>10.0</b>		20%
<b>Congo, Dem. Rep.</b>	211.6	423.2	338.5	<b>60.0</b>		20%
<b>Cote d'Ivoire</b>	68.3	136.7	109.4	<b>60.0</b>		20%
<b>Guinea Bissau</b>	12.7	25.4	15.2	<b>15.2</b>		40%
<b>Liberia</b>	36.8	73.5	66.2	<b>60.0</b>		10%
<b>Sierra Leone</b>	34.2	68.5	34.2	<b>34.2</b>		50%
<b>Togo</b>	32.5	64.9	51.9	<b>51.9</b>		20%
<b>Zimbabwe**</b>	10.3	20.5	20.5	<b>20.5</b>		0%
<b>Total</b>	<b>467.7</b>	<b>935.4</b>	<b>730.1</b>	<b>404.9</b>		

**Notes:** The proposed discount varies between 10% and 50%, according to the phase-out parameter(s) met by the country. See Annex V. UA=Units of Account

(\*) "High-2" is the average of the two highest basic allocations of the previous ADF cycle – after step 1 of process detailed in Annex IV

(\*\*) as agreed in Cape Town, a hypothetical entitlement is computed as if Zimbabwe had been classified as ADF only

**Source:** African Development Bank

- 4.7 Arrears Clearance. Two successful arrears clearances, in Togo and Côte d'Ivoire, have nearly exhausted the ADF's resources for this purpose. UA 3.19 million remains available for the clearance of ADB arrears. In addition, UA 49.62 million originally contributed by the ADB are still available and can be used to clear ADF arrears. As part of maximum efforts to improve the level of internally generated resources for ADF-12, Management proposes to transfer

these UA 49.62 million from the FSF (Pillar II) to the ACC.<sup>9</sup> A proposal to this effect is being prepared for the ADB Board of Directors and has already been taken into account in the calculation of the baseline ACC for ADF-12 (see the “Financing Framework II” paper).

- 4.8 Three countries currently in non-accrual status (Somalia, Sudan and Zimbabwe) may require arrears clearance during the ADF-12 period. The ADB arrears of these countries, which must be covered by ADF financing,<sup>10</sup> are expected to amount to UA 474 million by 2013. The final amount to be financed from the Fragile States Facility will depend on (i) the timing of each arrears clearance operation; (ii) the burden-share borne by each country as per the framework approved by the Board of Directors in 2008<sup>11</sup>; and (iii) the amount mobilized through voluntary donor contributions, which the Fragile States Facility framework can accommodate. Given the varying likelihood that these three countries will require arrears clearance during the 2011-2013 period, Management estimates that at least UA 404 million<sup>12</sup> will be required for this purpose. Experience with arrears clearances prior to the establishment of the FSF shows that mobilizing resources from external sources at the time of the arrears clearance can be challenging. It is therefore preferable to have the funds available in Pillar II, as with Togo and Cote d'Ivoire, so that the operation may progress smoothly.
- 4.9 Targeted assistance. The third pillar of the Fragile States Facility has benefited from an exceptional ADB net income allocation of UA 60 million, more than double the UA 25 million allocated during ADF-11. UA 70 million remains available as of end-March 2010, with a number of projects in the process of being approved. Management thus proposes to allocate a fixed amount of UA 15 million from the Fragile States Facility set-aside to Fragile States Facility Pillar 3.
- 4.10 Total resources required for the Fragile States Facility. Management estimates the resource requirements for the Fragile States Facility during ADF-12 at UA 824 million (UA 405 + 404 + 15 million). In Cape Town, Deputies reaffirmed the importance they attach to the supplemental support (2x top-up) for nine fragile states, and also gave guidance that arrears clearance (specifically for Zimbabwe) should take place through Pillar II of the Fragile States Facility rather than ring-fencing funds separately. Taking both these elements into account implies a Fragile States Facility of a fixed size, with the percentage that this represents in overall replenishment terms varying with the replenishment level. In the 50 percent replenishment scenario, for example, UA 824 million represents 10 percent of the replenishment (see Annex VIII). If the Fragile States Facility is to be limited to 7.5 percent of the replenishment as is currently the case, then either the top-up multiplier will be less than two or the resources available for arrears clearance will not be sufficient to cover the costs of arrears.

#### ***Modalities for the Regional Operations Set-Aside***

- 4.11 Regional Operations (ROs) are financed by a dedicated regional envelope and the country PBA allocations of participating countries. As was the case during ADF-11, country allocations will be used to cover one-third of total project costs, with the remaining two-thirds financed from the regional envelope. Financing from the regional envelope will continue to be on the same terms (loans/grants) as the country allocation. The following key points are highlighted:
- The existing cap of 10 percent on the use of country allocations for “small allocation” countries, namely countries whose ADF-12 PBA allocations are less than UA 20 million, is maintained. The cap is cumulative over the replenishment period.<sup>13</sup>

<sup>9</sup> Paragraph 6.15 of the ADF-11 Deputies' Report states that Deputies will decide on the disposition of unused FSF resources in the context of the ADF-12 replenishment discussions.

<sup>10</sup> The financial regulations prohibit using ADB funds to clear ADB arrears and using ADF funds to clear ADF arrears.

<sup>11</sup> African Development Bank. 2008. *Strategy for Enhanced Engagement in Fragile States*, ADB/BD/WP/2008/37 (3 March)

<sup>12</sup> 100% of Zimbabwe's and 50% of Sudan's arrears expected to be outstanding to the ADB by end 2013—arrears to ADF will be covered separately.

<sup>13</sup> For further details, refer to *Strategic and Operational Framework for Regional Operations* presented at the ADF-11 Bamako consultation (September 2007).

- Projects that contribute to the promotion of regional public goods may, on a case-by-case basis, continue to be financed through grants and without contribution from countries' PBAs. To maintain a strong link to performance in the overall allocation framework, regional public goods will be limited to 15 percent of the RO envelope.
- 4.12 As per Deputies' guidance, the link to performance will be strengthened in order to execute Management's vision as presented in the overview paper, "ADF-12 Strategic Directions and Indicative Lending Scenarios," discussed in Cape Town. Specific recommendations are proposed in paragraphs 6.4-6.6.
- 4.13 Guided by the Regional Operations Framework as presented in Cape Town, the pipeline of ROs has been prioritized according to the following criteria: (i) strategic alignment; (ii) expected development outcome; (iii) quality and readiness for implementation; (iv) viability, including impact on climate change; and (v) collaboration with and cofinancing by other development partners. Accordingly, Management proposes three scenarios for Deputies' guidance:
- Option 1: 17.5 percent of ADF-12 resources allocated to the RO envelope. The Fund would focus its activities on completing missing links so as to strengthen connections in major transport, energy and ICT corridors, on building capacity in a selected number of regional economic communities, and on improving the legal and regulatory environment conducive to regional integration. Climate change response would be mainstreamed.
  - Option 2: 20.0 percent of ADF-12 resources allocated to the RO envelope. In addition to the above, the Fund would extend and deepen its activities to further enhance links within each subregion and lay the foundations for stronger economic integration at the regional level.
  - Option 3: 22.5 percent of ADF-12 resources allocated to the RO envelope. In addition to the above, the Fund would play a greater or a lead role with larger interventions and would tackle regional and continental challenges more aggressively, including climate change and the "soft areas" that are important to enhancing regional integration.
- 4.14 Management supports an RO set-aside of at least 20 percent, to enable the Fund to better address weaknesses in Africa's regional integration while building on one of the Fund's recognized comparative advantages.

***Modalities for the Private Sector Guarantee "top-slice"***

- 4.15 As highlighted in the ADF-12 paper "Leveraging ADF Resources for the Private Sector", Management proposes to allocate UA 100 million to a new instrument to be developed under ADF-12: the First Loss Portfolio Guarantee. For the pilot phase, seed capital is needed, which could be complemented by individual donors at a later stage. Since this allocation will not be a recurrent feature of the ADF, it is proposed to allocate these resources upfront, before the distribution to the PBA and set-asides.

***Technical Contingencies***

- 4.16 To be consistent with the ADF-11 resource allocation methodology, technical contingencies of 2 percent of donor contributions will be taken into account.<sup>14</sup> This translates to between 1.4 and 1.6 percent of overall resources, depending on the replenishment size.

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<sup>14</sup> No contingency will be taken into account for internally generated resources.

### ***Allocation Methodology***

- 4.17 In the scenarios that follow, the allocation of ADF-12 resources to various envelopes is calculated using the following formulas:

<b>Total ADF-12 resources</b>	<b>(A) = (1) + (2)</b>
Total donor contributions (subscribed amounts)	(1)
Internally generated resources	(2)
<b>Less upfront deductions</b>	<b>(B) = (3) + (4) + (5)</b>
Exchange rate contingency	(3) = 1%*(1)
Contingency for acceleration	(4) = 1%*(1)
First-Loss Portfolio Guarantee (FLPG)	(5) = UA 100 mn
<b>Total ADF-12 resources available for allocation</b>	<b>(C) = (A) – (B)</b>
Fragile States Facility	(6) = X%*(C) or fixed amount
Regional Operations envelope	(7) = Y%*(C)
Country Performance-Based Allocations	<b>(D) = (C) – (6) – (7)</b>

## **5. ADF-12 Resource Allocation Scenarios**

- 5.1 This section presents various scenarios. As per Deputies' guidance, the scenarios consider a range of values for three key variables:

- the size of the overall replenishment: the scenarios consider no real increase over ADF-11 ("flat")<sup>15</sup> as well as increases of 10 percent, 30 percent, 50 percent, and 70 percent;
- the modalities of the Fragile States Facility: either a fixed amount of UA 824 million or an envelope worth 7.5 percent of the overall ADF-12 replenishment; and
- the size of the RO envelope: the scenarios consider RO envelopes worth 17.5 percent, 20 percent, and 22.5 percent of the overall ADF-12 replenishment.

### ***Presentation of the Scenarios***

- 5.2 Annex VIII contains two summary graphs for each replenishment level. The first graph shows each allocation scenario in nominal terms (millions of UA), while the second graph shows each scenario in percentage terms. In addition, a detailed data sheet is presented.<sup>16</sup>

- 5.3 To illustrate the implications of these scenarios more clearly, this section shows the balance between the PBA envelope and the two set-asides and presents four scenarios for each of the five sample replenishment levels:

- "S 1": 25 percent earmarked for the dedicated set-asides (17.5 percent for ROs and 7.5 percent for the Fragile States Facility), similar to ADF-11;
- "S 2": 27.5 percent earmarked for the dedicated set-asides (20.0 percent for ROs and 7.5 percent for the Fragile States Facility);
- "S 3": a fixed size for the Fragile States Facility (UA 824 million) and an RO envelope of 20.0 percent; and,
- "S 4": a fixed size for the Fragile States Facility (UA 824 million) and an RO envelope of 22.5 percent.

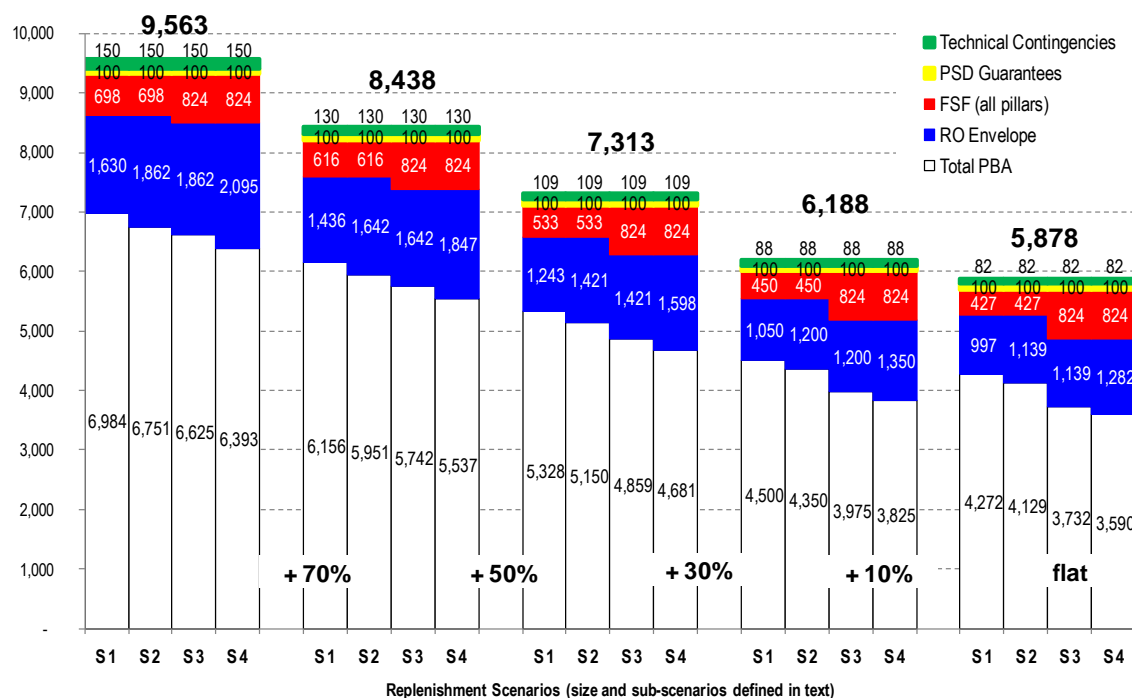
- 5.4 Figure 5 presents the 20 scenarios at a glance. The figure illustrates the trade-offs between the set-asides and the PBA for different replenishment levels and RO envelope proportions. For example, in the 50 percent "S 3" scenario (an RO envelope of 20 percent and a fixed size for the FSF), the amount for country allocations comes to UA 5.742 billion, with UA 1.642 billion for ROs and UA 824 million for the Fragile States Facility. Within this scenario, both the two-times supplemental allocation and the arrears clearance operations could be funded.

<sup>15</sup> The flat scenario corresponds to inflation, i.e., an increase of 4.5 percent.

<sup>16</sup> The file used to generate the graphs includes graphs for all scenarios and is available upon request.

**Figure 5: Replenishment Scenarios at a Glance**

(UA millions)



**Notes:** FSF=Fragile States Facility; PBA=Performance-Based Allocation; RO=regional operations; PSD=Private Sector Development

**Source:** African Development Bank

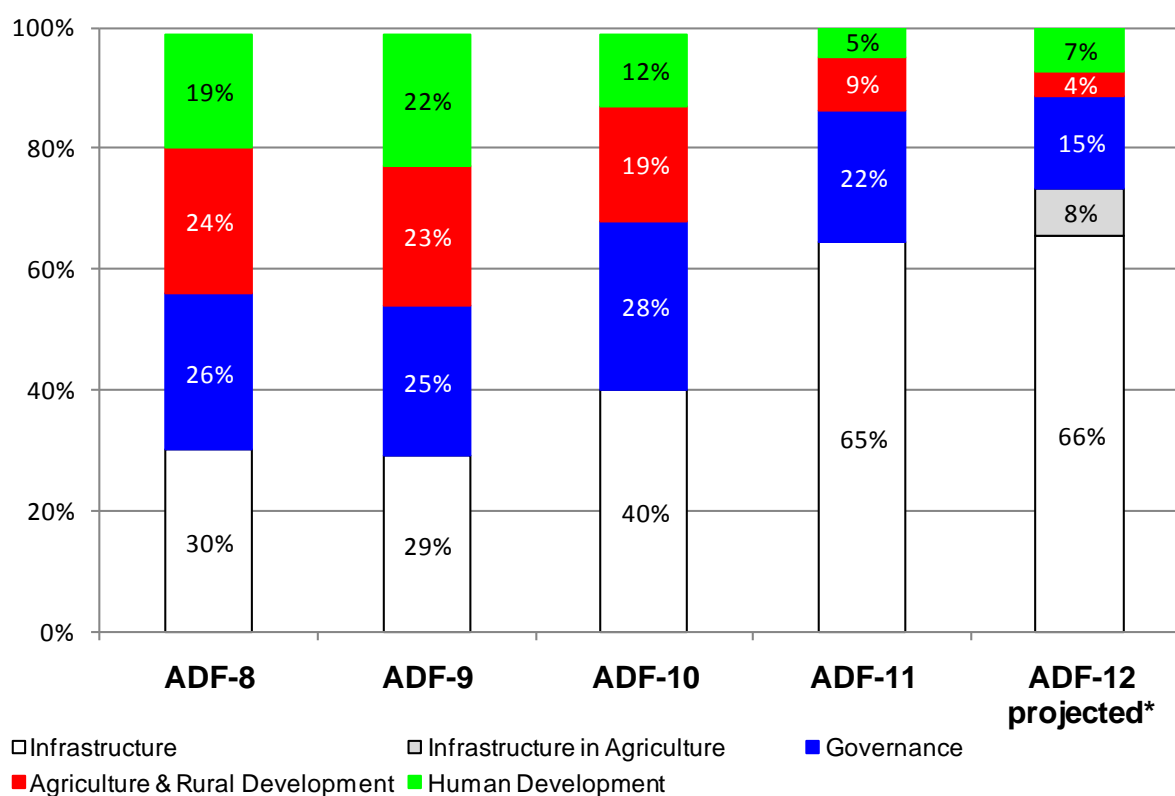
## Operational Focus

- 5.5 ADF-12 operations will build on and deepen the Bank's strategic orientations, reinforcing delivery capacity and the sector expertise the Bank has developed over successive replenishments. In order to focus on areas where the Fund can deliver the strongest results, the ADF will continue to be selective. Figure 6 shows the evolution of this selectivity across replenishments in terms of infrastructure, the Fund's main building block for the ADF-12 cycle.
- 5.6 In response to Deputies' request, country teams prioritized a pipeline of operations for each country and each hypothetical replenishment level. The indicative operational program shown in Figure 7 illustrates the sector orientations proposed for ADF-12 as per those replenishment levels. In line with ADF-11's operational program, a substantial proportion of ADF-12 resources will be devoted to infrastructure (72 to 74 percent, including agricultural infrastructure) and governance (14 to 17 percent). The bulk of the resources devoted to infrastructure will finance both national and regional operations, in particular power supply (20 to 22 percent of total ADF-12 pipeline), transport (31 to 33 percent), and water (sanitation and irrigation, 16 to 18 percent). In governance, the Bank will support the transparent and accountable management of public resources at the country and regional level, primarily through policy-based operations and institutional strengthening projects. In terms of ADF-12 crosscutting issues, 10 to 12 percent of resources will target food security and around 20 percent will be used for climate-sensitive projects.<sup>17</sup> The Fund will also dedicate a growing percentage of its resources to enabling the development of a vibrant private sector, through operations targeting economic infrastructure and dedicated governance programs. Figure 8 illustrates the greater selectivity within each funding window.

<sup>17</sup> The overlap results from operations falling into more than one category.



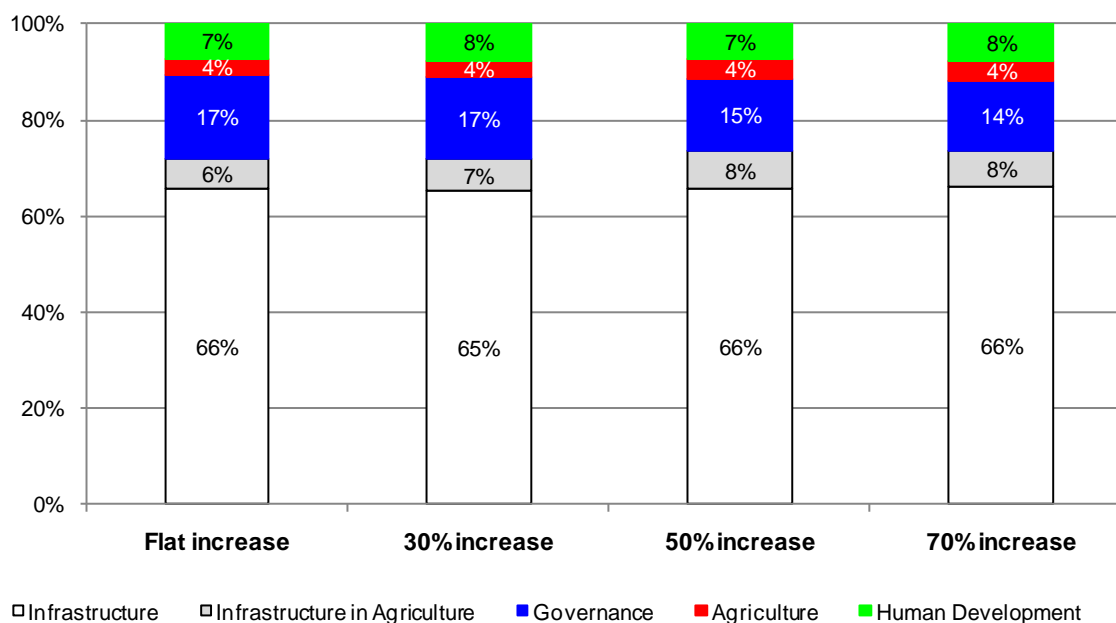
**Figure 6: Sector Distribution of Resources From ADF-8 to ADF-12**



**Notes:** (\*) For illustrative purposes, ADF-12 figures are calculated assuming a 50% increase and a RO envelope of 20% - starting with ADF-12, the infrastructure projects in agriculture are singled out.

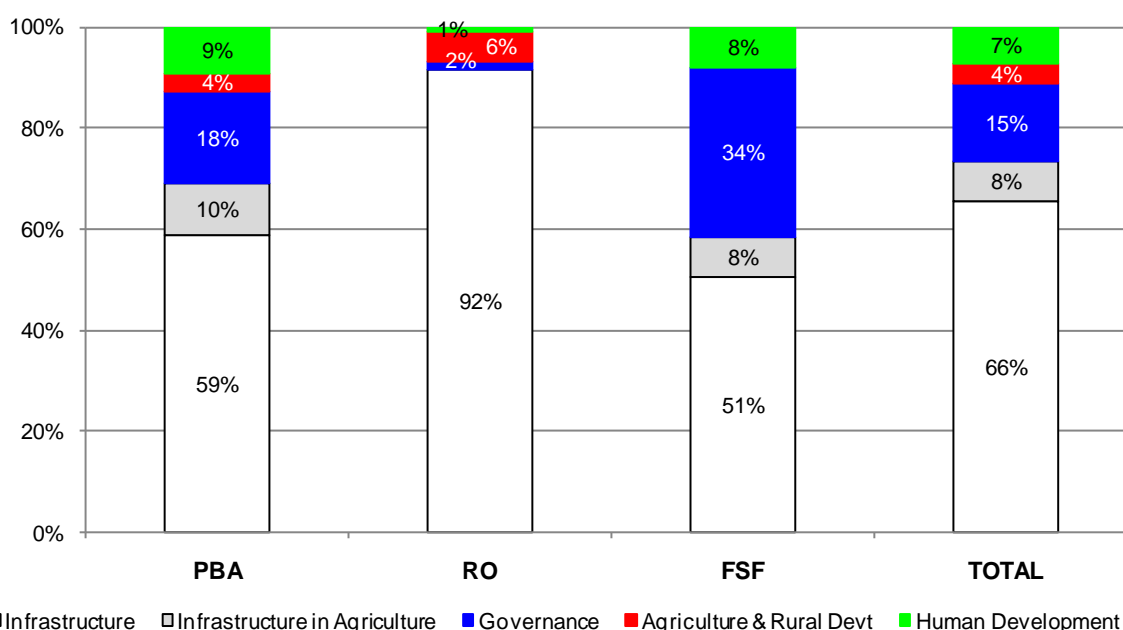
**Source:** African Development Bank

**Figure 7: The Sector Distribution of Resources For Various ADF-12 Replenishment Scenarios**



**Source:** African Development Bank

**Figure 8: Distribution of ADF-12 Operations By Sector For Each Funding Window**



**Notes:** For illustrative purposes, ADF-12 is pictured with the scenario of a 50% increase and a RO envelope of 20%. FSF = Fragile States Facility; PBA = Performance-Based Allocation; RO = regional operations

**Source:** African Development Bank

### **Stronger Link to Performance**

- 5.7 For ADF-12, Management proposes to consolidate the ADF-11 resource allocation framework by further reinforcing the link between allocations and performance. By limiting the resources used for regional public goods (a maximum of 15 percent of the RO envelope) and maintaining a two-times supplemental allocation for Pillar I of the Fragile States Facility, direct PBAs and various PBA-linked allocations could reach 92 percent (Figure 2 and paragraph 3.4). Specific proposals on how to reinforce the link to performance for ROs are made in paragraphs 6.4 to 6.6.

## **6. Proposals Concerning the Allocation of Resources**

- 6.1 This section presents ways to enhance the system through which ADF-12 resources will be allocated. After discussing volatility in allocations, it proposes ways to strengthen the link to performance for ROs, allocate resources to blend countries, and introduce differentiated lending terms for blend/gap countries.

### **Addressing Allocation Volatility: Country Portfolio Performance Ratings and Multilateral Debt Relief Initiative Netting Out**

- 6.2 As set out in the paper “Issues Concerning the ADF Resource Allocation Framework” discussed in Cape Town, substantial variations in Country Portfolio Performance Ratings (CPPRs) from one year to the next remain a source of volatility in ADF country allocations despite the enhancements introduced in ADF-11. Management has examined options for further adjusting the measurement and application of CPPRs with a view to reducing volatility, including the use of 3-year moving CPPR averages instead of annual averages. None of these options was satisfactory. This, combined with the fact that the use of quarterly data to measure CPPRs was only introduced 2 years ago, leads Management to conclude that further study of the issue is required before additional adjustments can be proposed. More emphasis will be placed on enhancing project supervision and improving the quality of the ratings, and the evolution of the ratings will be closely monitored. In the process of moving towards a more consistent rating and supervision methodology, it can be expected that some volatility will remain in the short term. Management will report on the issue of volatility again,

and if necessary will make proposals, at the ADF-12 Mid-Term Review. The report will also examine other potential sources of volatility, such as the use of three-year rather than annual allocations and changes in the DSF classification.

- 6.3 Similarly, Management recognizes the potential impact of Multilateral Debt Relief Initiative (MDRI) netting out on some country allocations. Given current cost estimates, the largest amount of MDRI netting out (approximately UA 595 million) will take place during the ADF-17 period (2026-2028). Internal estimates of the impact on country allocations made at the time of the ADF-11 Mid-Term Review<sup>18</sup> have been updated and extended through the ADF-19 period, but do not yield substantially different results. Depending on the size of future replenishments, the allocations of around half of all ADF countries would be unaffected or positively affected by netting out and re-allocation, and the allocations of a further one-quarter of countries would decline by up to 10 percent. A minority of countries could experience an allocation decrease of between 10 and 30 percent, and the allocations of only a few countries could decline by more than 30 percent. It should be recalled that all MDRI debt relief netted out from country allocations is re-allocated to other African countries: this ensures that all ADF-only countries benefit from the MDRI. Management does not propose adjusting the netting-out mechanism at this time but will continue to monitor allocations closely and will discuss this issue with other multilateral development banks in the context of the technical working group on PBA.

### ***Strengthening the Link to Performance for Regional Operations***

- 6.4 During ADF-12, the Fund will introduce indicators to measure ROs' effect on regional integration. In Cape Town, Management proposed a two-step, enhanced selection and prioritization process for regional operations. Step One consists of developing Regional Integration Strategy Papers, including a recommended pipeline of operations. Step Two consists of ranking, prioritizing and sequencing operations the basis of four criteria, including quality, cofinancing by other development partners and expected development outcomes.<sup>19</sup> In response to Deputies' requests for further measures to strengthen the link to performance, Management proposes an additional element as part of this process, namely the development of a project scorecard to help compare and rank envisaged operations. The scorecard will be drawn up for each proposed operation and will include the following indicators:
- i. the weighted Country Policy and Institutional Assessment (CPIA) scores of participating countries;
  - ii. project quality at entry measures;
  - iii. measures of the performance of participating countries in ongoing and previous ROs;
  - iv. countries' commitment to regional integration; and
  - v. countries' adoption and implementation of reforms to support regional integration.
- 6.5 The higher the score on each of the indicators and in total, the higher the proposed operation will rank for the purposes of selection and prioritization. Details of the enhanced selection and prioritization process and the scoring system will be jointly developed by the Regional Integration Department, the Research Department (building on lessons and experience from the ex-ante assessment tool for private sector operations), and the Quality and Results Department. Management commits to proposing a framework paper to the Board of Directors by the end of 2010 and launching a pilot version of the scoring tool in early 2011.
- 6.6 The enhanced selection process and scoring system will reinforce ROs' link to performance, especially through the inclusion of CPIA scores and ratings of ongoing and past performance. Priority will be given to quality ROs that involve good performers and/or countries with a solid track record of implementing and committing to regional integration projects.

<sup>18</sup> See the ADF-11 Mid-Term Review Paper *ADF-11 Resource Allocation*, October 2009

<sup>19</sup> ADF-12 Consultation, Cape Town, *Proposed Adjustments to the Regional Operations Framework*, February 2010

### ***Resources for Blend Countries***

- 6.7 The amount of ADF financing available to blend countries is currently capped at 5 percent of resources allocated to countries through the PBA system. Within this amount, resources are allocated to each blend country according to the PBA system. Blend countries receive financing on the same terms as ADF-only countries: 50-year maturity, a 10-year grace period, a service charge of 0.75 percent per annum, and a commitment charge of 0.5 percent per annum on the undisbursed portion.
- 6.8 In the ADF-11 Mid-Term Review paper “Issues Concerning the Blend Country Regime and the Adoption of a Graduation Policy for ADF Countries,” Management made two proposals: (i) to replace the aggregate cap by country-specific caps, and (ii) to apply differentiated financing terms to different country categories. These changes would allow the ADF to better respond to a range of country circumstances and would align the ADF’s policy more closely to the policy of the International Development Association (IDA). Most Deputies responded positively to these proposals, with some emphasizing that country-specific caps should continue to ensure that the bulk of ADF resources be distributed to ADF-only countries.
- 6.9 Since the ADF-11 Mid-Term Review, Cape Verde has achieved blend country status by becoming eligible for ADB lending. Angola may soon follow.

#### Determining country-specific caps on ADF resources for blend countries

- 6.10 There are several ways to determine the caps to apply to blend countries. Insofar as the systems of other multilateral development banks are concerned, IDA applies caps to some blend countries with large populations in cases where granting those countries their full PBA would cause them to absorb a substantial part of the IDA envelope at the expense of other beneficiaries. Thus, for IDA-15, India’s allocation is capped at 11 percent of PBA resources and Pakistan’s at 7 percent. The Asian Development Fund also caps large blend borrowers: any blend country whose PBA allocation exceeds 14 percent of allocable resources receives only half the amount that exceeds this threshold.<sup>20</sup> This policy currently affects Bangladesh, Pakistan and Vietnam.
- 6.11 Management considers that the chosen mechanism should be easy to understand and to apply. It should be free to cater to countries that achieve blend status in coming years, and should ensure that the bulk of ADF resources continue to be allocated to ADF-only countries. Having considered a number of options (Annex VI), Management proposes to grant all blend countries half of their PBA. This simple measure would allocate to each blend country 50 percent of what it would receive if it were an ADF-only country, subject to the minimum allocation of UA 5 million that applies to all ADF-eligible countries. The minimum allocation protects small countries such as Cape Verde and Sao Tomé & Príncipe.
- 6.12 This mechanism has the additional advantage of being performance-based: because it uses PBAs, the link between allocations and performance is preserved. For that reason, the balance between the resources allocated through the PBA system and the resources allocated through set-asides will not change. At the same time, because of the rule that no single ADF country may receive more than 10 percent of allocable resources at the first stage of allocation, no single blend country will receive more than 5 percent at this stage.<sup>21</sup> If this mechanism had been applied during ADF-11, blend countries Cape Verde and Nigeria would have been allocated UA 233.13 million or 5.83 percent of ADF-11 PBA resources, and ADF-only countries would have been allocated 94.17 percent. These allocations are very similar to what actually took place, in that Cape Verde’s and Nigeria’s ADF-11 allocations total UA 219 million (5.48 percent<sup>22</sup>). As the number of blend countries grows, the percentage of ADF PBA resources allocated to blend countries will naturally increase.

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<sup>20</sup> For example, an Asian Development Fund blend country with a regular PBA share of 16 percent receives only 15 percent, and a blend country with a regular PBA share of 20 percent receives 17 percent.

<sup>21</sup> The first stage of allocation means before the reallocation of the performance-related volume discount on grants and the netting out and re-allocation of MDRI debt relief. These subsequent steps may cause the final allocation to exceed 10 percent / 5 percent.

<sup>22</sup> This exceeds the 5 percent cap because Cape Verde was exceptionally allowed to retain its full ADF-11 allocation while awaiting the Bank’s adoption of a graduation policy.

### ***Differentiated African Development Fund Lending Terms<sup>23</sup>***

- 6.13 The ADB's Credit Policy<sup>24</sup> prescribes that the Bank Group use World Bank classification criteria to determine whether countries are ADB-only, ADF-only, or blend. The classification criteria refer to gross national income per capita and the country's creditworthiness for non-concessional financing.<sup>25</sup> As explained in the ADF-11 Mid-Term Review paper "Issues Concerning the Blend Country Regime and the Adoption of a Graduation Policy for ADF Countries," the IDA currently employs the following country categories, each of which has different lending terms (see Annex VII for a more elaborate explanation):
- **IDA-only countries** are countries below the income cut-off and not creditworthy. They are eligible for regular IDA terms: 40 years' maturity, a 10-year grace period, a 75 basis point service charge, and 60 percent concessional.<sup>26</sup>
  - **Blend countries** are countries below the cut-off and creditworthy (e.g., India and Pakistan). They are eligible for International Bank for Reconstruction and Development (IBRD) and IDA resources subject to a cap and blend terms: 35 years' maturity, a 10-year grace period, a 75 basis point service charge, and 57 percent concessional.
  - **Gap countries** are countries above the cut-off but not creditworthy (e.g., Angola and the Republic of Congo). They are not eligible for IBRD resources but are eligible for IDA resources<sup>27</sup> on hardened terms: 20 years' maturity, a 10-year grace period, a 75 basis point service charge, and 40 percent concessional.
  - **IBRD countries** are countries above the cut-off and creditworthy. They are only eligible for IBRD resources. The two exceptions are (i) graduating countries, which are eligible for IDA resources on blend terms during a phasing-out period of 2 to 5 years, and (ii) small island economies, which remain eligible for IDA resources on blend terms even after graduating.
- 6.14 The Asian Development Fund applies the same lending terms to both Asian Development Fund-only and blend countries. Project loans have a maturity of 32 years, a grace period of 8 years, no commitment fee, and an interest charge of 1 percent during the grace period and 1.5 percent during the amortization period. Program loans have nearly the same terms but a maturity of 24 years. Overall, the concessional level of Asian Development Fund loans varies between 43 percent and 49 percent.<sup>28</sup>
- 6.15 Recently, IDA Management proposed to harden its blend terms to a concessional level of 35 percent by shortening loan maturity to 25 years, shortening the grace period to 5 years, and introducing an interest rate of 1.25 percent. These revised blend terms would apply to both blend and gap countries, thereby effectively merging the two categories.<sup>29</sup> The proposal was discussed at the first IDA-16 replenishment meeting in March 2010, where most IDA Deputies expressed their support. Pending further consultations and discussions, the terms finally approved by IDA Deputies will be applied as of the start of the IDA-16 period (1 July 2011).

<sup>23</sup> This subsection only refers to ADF/IDA loans, which are provided to ADF/IDA-only countries with a moderate or low risk of debt distress (yellow or green-light countries), and not to grants.

<sup>24</sup> See footnote 2.

<sup>25</sup> The operational cut-off for IDA eligibility for FY 2010 (July 2009 to June 2010) is a 2008 per capita gross national income of US\$1,135, calculated using Atlas methodology. A country is reclassified when its per capita income exceeds the cut-off for 2 consecutive years. Individual country creditworthiness (risk) ratings are determined by World Bank staff using quantitative and qualitative data.

<sup>26</sup> The IDA calculates concessional levels using the disbursement and repayment profiles of IDA loans, the loan characteristics mentioned, and a constant discount rate of 6 percent. The ADB uses the same methodology for calculating concessional levels, with the current ADF disbursement profile (incorporated in all ADF projections models) and a 6 percent discount.

<sup>27</sup> "Resources" here refers only to IDA loans. IDA gap countries are not eligible for grants, regardless of their risk of debt distress.

<sup>28</sup> *A Review of IDA's Long-Term Financial Capacity and Financial Instruments*, Paper for first IDA-16 replenishment meeting, February 2010, page 19.

<sup>29</sup> *A Review of IDA's Long-Term Financial Capacity and Financial Instruments*, Paper for first IDA-16 replenishment meeting, February 2010

- 6.16 The ADF applies regular ADF terms to all ADF-eligible countries, as set out in paragraph 6.7. At 66 percent, these terms are highly concessional. The only distinction that the ADF makes between country categories is that the overall amount available for blend countries is limited to 5 percent of PBA resources. The ADF thus has undifferentiated financing terms for its borrowers, despite the fact that these countries display a variety of characteristics and circumstances in terms of income and development level, economic prospects and access to financial markets. Adopting the IDA's country classification and differentiated lending terms would mean distinguishing those ADF-only countries whose income is above the operational cut-off (gap countries) and applying less concessional terms to blend and gap countries. This policy would better match these countries' level of development (their income and creditworthiness) than does the current system.<sup>30</sup> It would also improve harmonization and alignment with other multilateral development banks, thereby reducing variation in the treatment of the same or similar recipient countries and strengthening aid effectiveness.
- 6.17 Applying less concessional terms to countries with the required repayment capacity (as confirmed by their income level and/or their access to financial markets) would also improve the ADF's long-term financial capacity to commit new resources to low-income countries for development purposes, because loan reflows would increase. A number of parameters for lending terms can be varied (maturity, grace period, charges, interest rates) to arrive at the desired level of concessionality.
- 6.18 Management proposes to refine the existing three-category country classification by distinguishing the countries within the ADF-only category whose income is above the operational cut-off, as does the World Bank (gap countries). The classification would form the basis for applying differentiated ADF lending terms to blend, gap and graduating countries (Table 2).

**Table 2: Proposed African Development Bank Group Country Classification**

Creditworthiness to Sustain IBRD Financing			
		No	Yes
<b>Per capita income above the IDA's operational cut-off for more than 2 consecutive years</b>	<b>No</b>	Countries below cut-off and not creditworthy: ADF-only countries on <b>regular ADF terms</b>	Countries below cut-off and creditworthy (e.g., Nigeria): Eligible for ADB resources and for ADF resources subject to a cap and <b>blend terms</b>
	<b>Yes</b>	Countries above cut-off but not creditworthy (e.g., Angola and the Republic of Congo): <u>Gap countries</u> not eligible for ADB resources but eligible for ADF resources on <b>blend terms</b>	Countries above cut-off and creditworthy: Only eligible for ADB resources. Exceptionally, <u>graduating countries</u> such as Cape Verde are eligible for ADF resources on <b>blend terms</b> during a 2 to 5-year phasing-out period

**Notes:** The ADB's Credit Policy prescribes that World Bank country classifications be followed: hence the references to IBRD financing and the IDA's operational cut-off. IDA=International Development Association; IBRD=International Bank for Reconstruction and Development

**Source:** African Development Bank.

- 6.19 Management also proposes to consider differentiated lending terms for blend and gap countries to result in a level of concessionality more commensurate to these countries' financial circumstances and environments. These terms would be approved by the ADF Board of Directors as part of the customary document on ADF financing policy drawn up after the conclusion of the replenishment discussions and would be applied to all new loans extended under ADF-12 and beyond. Offering blend credits at a reduced maturity of 30 years and a grace period of 8 years with an interest rate of 1 percent would result in a concessionality level of 41 percent and would be in line with the terms applied by the Asian

<sup>30</sup> There may be tensions if a gap or a blend country is currently at medium or high risk of debt distress, and thus eligible for ADF grants. Debt sustainability considerations would need to be taken into account when developing the loan program.

Development Fund.<sup>31</sup> An alternative would be to adopt terms that are very similar to the revised blend terms recently presented to IDA Deputies for the IDA-16 period: a maturity of 25 years, a grace period of 5 years, and an interest rate of 1 percent<sup>32</sup>. This would result in a concessionality level of 36 percent.<sup>33</sup>

- 6.20 Management requests Deputies' views on the first option: to offer ADF loans to blend and gap countries at a maturity of 30 years, a grace period of 8 years, and an interest rate of 1 percent. These terms would apply as of the entry into force of ADF-12 (2011).
- 6.21 Following the classification proposed in Table 2, during ADF-12, blend terms would apply to blend countries Cape Verde, Nigeria and Zimbabwe, gap countries Angola and the Republic of Congo, and any other country that achieves blend status or whose per capita income exceeds the operational cut-off for 2 consecutive years.<sup>34</sup>
- 6.22 The positive effects on the ADF's commitment capacity would only be felt in the longer term, since the volume of borrowing by these countries is relatively small compared to total reflows and would therefore not significantly impact the Advance Commitment Capacity in the short to medium term. In the long run, however, shorter maturities and grace periods will increase reflows, and the interest rate will bring some income. As the volume of blend country borrowing grows with the number of blend countries, so will the impact on the ACC.

## 7. Proposed Graduation Policy for African Development Fund Countries

- 7.1 Graduation refers to the process by which an ADF-only country transitions to ADB-only status<sup>35</sup> or the process by which an ADB country ceases to be eligible for ADB loans. This paper only addresses the first type of graduation. The ADB Group does not currently have a graduation policy to accompany ADF countries as they transition toward the ADB. Now that Cape Verde has embarked on this process by achieving blend status, and Angola and possibly others are positioned to follow,<sup>36</sup> such a policy should be introduced. Management intends to propose to the Board of Directors a graduation policy with the elements outlined in this section.<sup>37</sup> Deputies' guidance is requested to inform a more detailed proposal.
- 7.2 The first element of the proposed graduation policy will concern the ADB Credit Policy, which should continue to apply. Countries would be determined as eligible for ADF resources only, for a blend of ADF and ADB resources, or for ADB resources only, on the basis of two criteria: (i) per capita income and (ii) creditworthiness for non-concessional financing as determined by the World Bank. Once an ADF country fulfills both the income and creditworthiness criteria, the graduation process could start.
- 7.3 A second element is the length and modalities of the graduation process, which should vary from country to country and should be tailored to each context. Several scenarios could apply:
  - an ADF-only country whose income level and creditworthiness grew hand-in-hand;
  - a gap country (a country that was not sufficiently creditworthy but whose income level was above the operational cut-off) that became creditworthy; or

<sup>31</sup> Assuming principal repayments of 3 percent per annum for years 9-19 and 6.1 percent per annum for years 20-30, 75 bp service charge and 50 bp commitment charge. If no interest were charged, the concessionality level would come to 51 percent.

<sup>32</sup> IDA proposed an interest rate of 1.25 percent.

<sup>33</sup> Assuming principal repayments of 3.3 percent per annum for years 6-15 and 6.7 percent per annum for years 16-25, 75 bp service charge and 50 bp commitment charge. If no interest were charged, the concessionality level would come to 45 percent.

<sup>34</sup> Like Angola, Cape Verde, the Republic of Congo and Nigeria, Cameroon had a 2008 per capita income that exceeded the operational cut-off. Djibouti, Lesotho and Sudan were just below the cut-off.

<sup>35</sup> For some countries, this transition includes time as a blend country.

<sup>36</sup> The Republic of Congo's per capita income has been above the operational cut-off for 2 consecutive years, making it a gap country. If its creditworthiness improves strongly, it can begin graduating to ADB lending. Nigeria is already a blend country and its per capita income has exceeded the operational cut-off for 1 year. If its income level remains above the cut-off and its creditworthiness improves, it too can start the graduation process.

<sup>37</sup> The policy will cover both types of graduation. This paper only refers to elements of the policy that pertain to ADF countries.

- a blend country (a country that was creditworthy but whose income was below the cut-off) whose income level rose to exceed the cut-off.

7.4 Third, the policy should contain proposals to gradually phase out ADF resources and phase in ADB resources. Phasing out should take place over a period of 2 to 5 years or 1 to 2 ADF cycles from the time that the country has met both the income and creditworthiness criteria. Countries' continued eligibility for ADF resources and the allocation of such resources would be determined for each new ADF period. The modalities for phasing out and phasing in could be as follows: determine the number of years of the phase-out, gradually reduce the ADF allocation accordingly, and offer the country ADB resources equivalent to the reduction (Table 3<sup>38</sup>). This system, like IDA's, tries to keep the overall amount of Bank Group resources flowing to the country more or less stable so as to prevent shocks or a rough transition. The actual amount of ADB financing would depend on the country's demand for such resources.

**Table 3: Proposal for Phasing Out ADF Resources and Phasing In ADB Resources for Graduating Countries**

Year	ADF Allocation	ADB Funds Offered
Year 1	100%	-
Year 2	75%	25%
Year 3	50%	50%
Year 4	25%	75%
Year 5 onwards	-	100%

- 7.5 Fourth, a graduation program should be formulated, generally as part of the Country Strategy Paper, and should comprise the above-mentioned phasing out of ADF resources, the phasing in of ADB lending, and special policy dialogue, economic and sector work, advice, expertise, and technical assistance around transition issues. The graduation program should be tailored to countries' needs and circumstances and reflect the context of the graduation. For example, a country whose graduation is induced by sustained good policies and balanced economic growth would have different requirements than a country whose income level and creditworthiness improved rapidly after the discovery and development of natural resources.
- 7.6 Fifth, given graduating countries' improved access to financial markets, the Bank Group's private sector arm would adopt a greater role in leveraging and stimulating private sector capital flows, proffering advice and expertise on the development of (domestic) financial markets, and improving the business environment.

## 8. Conclusion and Recommendations

- 8.1 This paper has presented a proposed allocation framework for the ADF-12 cycle. It has reaffirmed the PBA system as the core allocation mechanism for ADF resources, set out the modalities for the two thematic set-asides, presented a number of replenishment and allocation scenarios, made proposals concerning resources for blend countries and differentiated lending terms, and outlined the elements of a graduation policy for ADF countries.

<sup>38</sup> The table describes a 4-step system; alternatively, the system could also work in three steps of 100 percent, 67 percent, 33 percent, and so forth.



8.2 Management invites Deputies' guidance on the following proposals:

- to endow the FSF with resources sufficient to both ensure a two-times supplemental allocation for eligible countries and allow the Fund to swiftly reengage by securing financing for potential arrears clearance operations; FSF resources would thus be a fixed amount of the ADF replenishment at UA 824 million;
- to mandate an increase in the share of resources for the RO envelope, to 20 percent;
- to strengthen ROs' link to performance by developing a project scorecard as part of the enhanced selection and prioritization process;
- to allocate UA 100m to the First Loss Portfolio Guarantee instrument, before the pro-rata allocation to the PBA and set-asides;
- to limit the ADF resources allocated to blend countries by granting them half of their PBAs;
- to refine the existing three-category country classification by distinguishing the countries within the ADF-only category whose income is above the operational cut-off (gap countries);
- to apply differentiated lending terms to blend/gap and graduating countries; and
- to develop and present the policy to the Board of Directors a graduation policy for ADF countries that contains the elements set out in Section 7.

## **Annex I: Classification of Regional Member Countries**

### **A. Countries Eligible for ADF Resources Only\***

Angola  
Benin  
Burkina Faso  
Burundi  
Cameroon  
Central African Republic  
Chad  
Comoros  
Congo, Democratic Republic of  
Congo, Republic of  
Côte d'Ivoire  
Djibouti  
Eritrea  
Ethiopia  
Gambia  
Ghana  
Guinea  
Guinea-Bissau  
Kenya  
Lesotho  
Liberia  
Madagascar  
Malawi  
Mali  
Mauritania  
Mozambique  
Niger  
Rwanda  
Sao Tome and Principe  
Senegal  
Sierra Leone  
Somalia  
Sudan  
Tanzania  
Togo  
Uganda  
Zambia

### **B. Countries Eligible for a Blend of ADB and ADF Resources**

Cape Verde  
Nigeria  
Zimbabwe

### **C. Countries Eligible for ADB Resources Only**

Algeria  
Botswana  
Egypt  
Equatorial Guinea  
Gabon  
Libya \*\*  
Mauritius  
Morocco  
Namibia  
Seychelles  
South Africa  
Swaziland  
Tunisia

**Note:** ADF = African Development Fund; ADB = African Development Bank; \* Except for limited ADB lending for enclave and private sector projects; \*\* Libya is not a borrowing member country.

**Annex II: The Status of African Development Fund Subscriptions and Payments Received as of 22 April 2010, in Units of Account**

	State Participants	Amounts Subscribed for which Payments are Expected	Payments Received	Payments Due	Qualified Subscriptions
1	Austria	86,545,325	57,994,290	28,551,035	-
2	Belgium	66,863,048	44,610,992	22,252,056	32,119,914
3	Brazil	6,557,936	-	6,557,936	6,557,936
4	Canada	184,878,368	123,252,245	61,626,123	89,098,537
5	China	79,900,950	79,900,950	-	-
6	Denmark	44,333,039	44,333,039	-	-
7	Finland	89,221,984	89,221,984	-	-
8	France	347,115,130	347,115,130	-	-
9	Germany	400,000,000	400,000,000	-	-
10	India	6,434,447	4,289,631	2,144,816	-
11	Italy <sup>1</sup>	-	-	-	-
12	Japan	261,438,952	174,292,635	87,146,317	-
13	Korea	32,474,255	21,649,504	10,824,752	-
14	Kuwait	6,656,705	6,656,705	-	-
15	The Netherlands	201,061,742	201,061,742	-	-
16	Norway	167,029,492	167,029,492	-	-
17	Portugal	29,621,699	29,621,699	-	-
18	Saudi Arabia	16,394,840	16,394,840	-	-
19	South Africa	6,223,941	4,149,294	2,074,647	-
20	Spain	110,938,734	110,938,734	-	-
21	Sweden	160,994,400	107,329,600	53,664,800	-
22	Switzerland	91,186,540	60,791,026	30,395,514	-
23	United Kingdom	547,150,749	364,767,166	182,383,583	-
24	United States Of America	306,944,199	98,369,041	208,575,157	208,575,157
<b>Total</b>		<b>3,249,966,473</b>	<b>2,553,769,738</b>	<b>696,196,735</b>	<b>336,351,545</b>

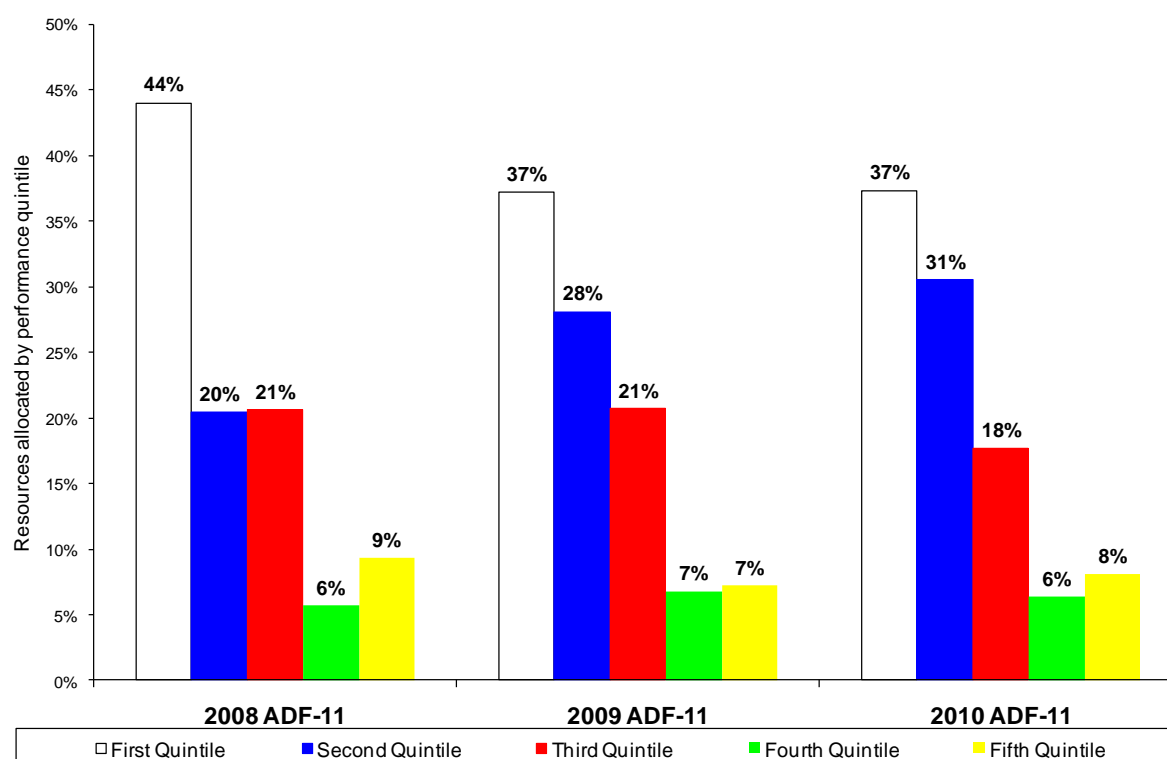
**Note:** <sup>1</sup>: State Participant has not yet deposited its Instrument of Subscription, but pledged UA 194,642,996 during the final replenishment meeting

**Source:** African Development Bank

### Annex III: Resource Allocation for ADF-11

Figure III-1 presents the evolution of resource allocation by performance quintile over the 3 years of the ADF-11 cycle. While some countries have shifted from one quintile to another, the top performance quintile consistently attracts the most resources.

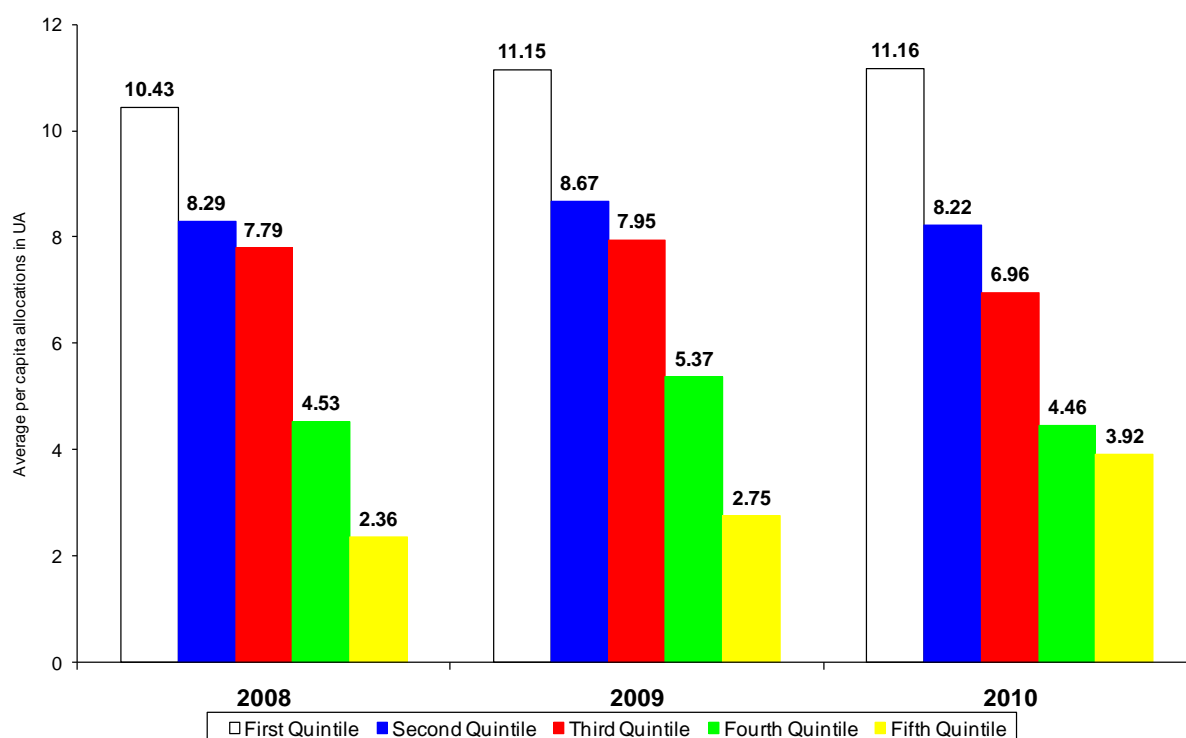
**Figure III-1: ADF-11 Resource Allocations by Performance Quintile, 2008-2010**



**Source:** African Development Bank

Figure III-2 presents average per capita allocations by performance quintile. In general, it shows higher per capita allocations for higher-performing quintiles, and lower per capita allocations for lower-performing quintiles. Average per capita allocation calculations can be vulnerable to the effect of outliers. The large populations of countries like Ethiopia, Nigeria and Tanzania, combined with these countries' allocation caps, can distort results. Minimum ADF allocations for small countries behave similarly. For that reason, the figures presented in Figure III-2 exclude the data from outliers.

**Figure III-2: ADF-11 Average Per Capita Allocations by Performance Quintile (Without Outliers)**



**Notes:** UA = Units of Account

**Source:** African Development Bank

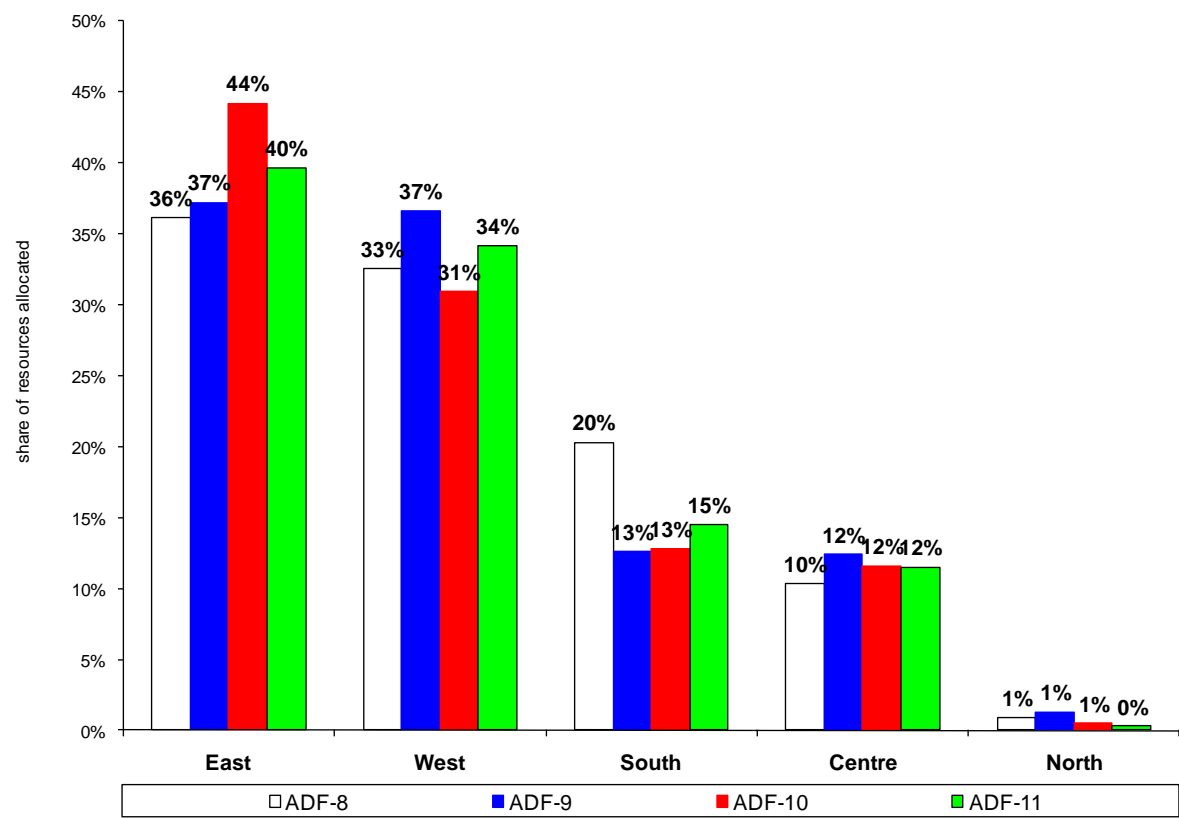
**Table III-3: Top Five ADF-11 Recipients in Aggregate and Per Capita Terms**

Country Allocations in Units of Account		Per Capita Allocations in Units of Account	
1. Tanzania	407.1 million	1. Sao Tome & Principe	31.7
2. Ethiopia	376.1 million	2. Cape Verde	22.7
3. Kenya	355.0 million	3. Ghana	12.6
4. Uganda	309.5 million	4. Mali	12.4
5. Ghana	296.4 million	5. Rwanda	11.2

**Source:** African Development Bank

Figure III-4 shows the consistent distribution of ADF resources by geographical region over the past four ADF cycles. The East and West subregions have been the largest beneficiaries, receiving a combined allocation of between 69 and 75 percent in the past four ADF cycles.

**Figure III-4: The Geographical Allocation of ADF Resources from ADF-8 to ADF-11**



**Source:** African Development Bank

## Annex IV: The Performance-Based Allocation Framework for ADF-12

The allocation of available African Development Fund (ADF) resources to ADF-eligible regional member countries (RMCs) for projects, programs and technical assistance during ADF-12 will be a three-step process. First, resources will be allocated to eligible countries using the Performance-Based Allocation (PBA) formula. Second, country-specific financing terms (loan, grant, or loan/grant combination) will be determined using the Debt Sustainability Framework (DSF). Third, Multilateral Debt Relief Initiative (MDRI) debt relief to eligible RMCs will be netted out of those countries' allocations and donor replacement funds will be re-allocated to all ADF-only RMCs.

### First Step: Applying the PBA Formula

Available resources will be allocated using the PBA formula:

$$A_i = (CPA_i)^4 \times \left(\frac{GNI}{P}\right)_i^{-0.125} \times P_i^1$$
$$CPA_i = 0.26 CPIA_{(A-C)_i} + 0.58 GR_i + 0.16 CPPR_{(REV)_i}$$

where:

$A_i$	is the allocation for country $i$
$CPA_i$	is the country performance assessment for country $i$
$(GNI/P)_i$	is the gross national income per capita for country $i$
$CPIA_{(A-C)_i}$	is the Country Policy and Institutional Assessment for country $i$
$GR_i$	is the governance rating for country $i$
$CPPR_{(REV)_i}$	is the revised Country Portfolio Performance Rating for country $i$
$P_i$	is the population for country $i$

The PBA formula has two main determinants:

- country need as indicated by gross national income per capita (GNI/P) and country population (P);
- country performance as per the country performance assessment score (CPA).

An increase in GNI/P will decrease the per capita allocation, while an increase in the CPA caused by the net positive impact of CPIA, GR and CPPR will increase the per capita allocation. The population variable (P) converts per capita country allocations to total country allocations. Countries with relatively high populations will be allocated more resources in absolute terms.

In addition, the following procedures will be applied:

- Single country allocations will not be permitted to exceed 10 percent of all resources available to ADF-only countries. The cap will be applied at the basic allocation stage, i.e., on the initial results of the PBA process. Any excess over capped amounts will be re-allocated to the rest of the ADF-only countries using the PBA formula.
- A minimum allocation of UA 5 million will be applied to all countries.
- Allocations for blend countries will follow Deputies' guidance regarding the proposals made in this document.

### Second Step: Using the Debt Sustainability Framework and the Modified Volume Approach

The DSF is used to determine each country's risk of debt distress. It is based on two criteria: the institutional strength and quality of a country's policies to withstand debt distress, and country-specific debt burden indicators (namely, the net present value of debt/gross domestic product ratio, the net present value of debt/exports ratio, and the debt service/exports ratio). Countries are classified by three "traffic lights," where red indicates a high risk of debt distress, yellow indicates a moderate risk, and green indicates a low risk. Countries in the red category qualify for 100 percent grants, countries in the green category qualify for 100 percent loans, and countries in the yellow category qualify for a 50/50 loan/grant combination.

A modified volume approach will be applied under ADF-12. The primary purpose of the approach is to cover administrative charges for grant allocations up front and to strengthen the incentive structure of the PBA system. The approach will apply a 20 percent volume discount to all grants. This discount will be sub-divided into a 14.57 percent charges-related portion and a 5.43 percent incentives-related portion. The incentives-related portion will then be re-allocated to all ADF-only countries, using the

PBA method, to help reinforce the PBA system's incentive structure. The PBA-related country allocations of fragile states eligible<sup>39</sup> for grants will be subject to the charges-related discount of 14.57 percent. These countries will be excluded from the allocation of the incentives-related portion of the volume discount. The discount on grants will not apply to top-up allocations under Pillar I of the Fragile States Facility.

***Third Step: Multilateral Debt Relief Initiative Netting Out***

The foregone debt service payments of countries qualifying for debt relief under the MDRI are deducted from these countries' allocations through the MDRI netting-out mechanism. Resources provided by donors to compensate the ADF for the MDRI are re-allocated to all ADF-only countries using the PBA system.

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<sup>39</sup> For allocation planning purposes, this document understands fragile states to mean the nine countries potentially eligible for Pillar I of the Fragile States Facility. Should these countries fail to become eligible, adjustments will be made.



## Annex V: Fragile States Facility Phasing-Out Parameters

As discussed in Cape Town, Management proposes to gradually phase out Pillar I support on the basis of a country-by-country evaluation of three simple parameters. Following Deputies' guidance, Management has reviewed the thresholds of the parameters and the modalities of phasing out. In Management's revised proposal, average Country Performance and Institutional Assessment (CPIA) scores carry lesser weight. Fragile States Facility allocations that decrease as a result of a higher CPIA score are compensated by higher Performance-Based Allocation (PBA) entitlements.

Management makes the following revised proposal (Table V-1):

**Table V-1: Parameters and Thresholds for Phasing Countries Out of Fragile States Facility Pillar I**

Parameter	Objective	Threshold	Discount before applying caps and floors
Average World Bank/African Development Bank Country Policy and Institutional Assessment score	To measure performance against the agreed fragility benchmark	Greater than 3.30	10%
Gross National Income Per Capita on a Purchasing Power Parity basis	To measure internal capacity to generate resources for economic development	Greater than US\$ 500	20%
Length of Re-engagement (including pre-Fragile States Facility engagement, i.e., engagement under the Post-Conflict Country Facility)	To distinguish between countries according to the length of support provided by the international community and to favor those recently re-engaging	Greater than 6 years	20%

**Source:** African Development Bank

These reductions will be cumulative. For example, if both the country's Country Policy and Institutional Assessment score and its gross national income per capita are above the threshold, the reduction will be 30 percent. In this way, the maximum reduction for countries meeting all three criteria will be 50 percent. Phasing out will be introduced during the second cycle of assistance, based on a country-by-country evaluation that applies the parameters outlined above. The evaluations will take place during the second semester of 2010 and will use the most recent data available.

**Table V-2: Preliminary Estimate of the Impact of Phasing Out During ADF-12**

Country	Average Country Policy and Institutional Assessment Score Threshold: greater than 3.30	Per Capita Gross National Income Threshold: greater than US\$ 500	Length of Re-engagement in 2011 Threshold: greater than 6 years (year of reengagement)	Magnitude of Deduction
Burundi	3.15	380	7 years (2004)	20 %
Central African Republic	2.73	730	5 years (2006)	20 %
Comoros	2.42	1,170	4 years (2007)	20 %
Congo, Dem. Rep.	2.88	290	7 years (2004)	20 %
Côte d'Ivoire	2.72	1,580	2 years (2009)	20 %
Guinea Bissau	2.80	530	7 years (2004)	40 %
Liberia	3.60	300	4 years (2007)	10 %
Sierra Leone	3.32	750	7 years (2004)	50 %
Togo	2.90	820	3 years (2008)	20 %
Zimbabwe	1.50	n.a.	n.a.	0 %

**Note:** n.a. = not available

**Source:** African Development Bank

## **Annex VI: Options for determining country-specific caps on African Development Bank resources for blend countries**

Management has considered various options for determining country-specific caps for blend countries. This annex summarizes those options. In each option, unless stated otherwise, the African Development Fund (ADF) allocations of blend countries are determined at the beginning of the Performance-Based Allocation (PBA) process. The sum of blend countries' allocations is then subtracted from the total amount of ADF PBA resources and the balance is allocated to ADF-only countries as per the PBA system.

Option 1: Using criteria to determine the caps. Under this option, selected criteria such as country creditworthiness, country performance, gross national income per capita and population enter into a formula that yields an amount for each blend country. The advantages of this option are that the criteria can be tailored to blend countries' characteristics and circumstances, and that the weights or exponents for the variables in the formula can be adjusted to ensure that the overall amount for blend countries does not become too large. The main disadvantage of this option is its complexity: determining the criteria and the indicators by which they are measured, determining the formula with weights and/or exponents, running successive reiterations until an acceptable result is achieved, and so forth.

Option 2: Granting all blend countries half of their PBA. This simple measure allocates to each blend country 50 percent of what it would receive if it were an ADF-only country, subject to the minimum allocation of UA 5 million for all ADF-eligible countries. The minimum allocation protects small countries like Cape Verde and Sao Tomé. This option has the advantage of being performance-based, but leaves less discretion to determine how many ADF resources should be allocated to blend countries. However, because of the rule that no single ADF country may receive more than 10 percent of available resources at the first stage of allocation, no blend country would receive more than 5 percent at this stage.

Option 3: Granting most blend countries their full PBA but capping the allocations of blend countries whose population exceeds a certain threshold. This system is applied by the International Development Association. Management would determine the caps for populous countries taking into consideration the amounts allocated to uncapped blend countries. This option is advantageous for the latter group, since they would receive a higher allocation than under the other options, but it may raise the question of equity between blend countries.

Option 4: Determining a per capita allocation and multiplying it by blend countries' populations to arrive at allocations for these countries. In order to take account of blend countries' higher income levels and access to other resources, the per capita allocation should be lower than the average per capita allocation of ADF-only countries. This introduces a constraint into the application of the allocation model, but one which should not pose problems in practice. Actually, under final ADF-11 allocations,<sup>40</sup> the 37 ADF-only countries were allocated an average of UA 7 per capita, while the 3 blend countries were allocated an average of UA 1.4 per capita.<sup>41</sup>

Option 5: Determining individual caps for blend countries on a discretionary basis. In addition to the criteria named in Option 1, this option could take more country-specific elements into account. These elements could include a country's political situation/outlook, macroeconomic factors (e.g., diversification of the economy, sources of revenue including remittances), and potential vulnerabilities. This option offers the most flexibility to respond to individual country circumstances, but may raise questions of equity and transparency.

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<sup>40</sup> African Development Bank. 2010. *2010 Country Allocations Under ADF-11*. ADF/BD/IF/2010/54 (24 February)

<sup>41</sup> The blend country allocation average only reflects the allocations of Cape Verde and Nigeria, as Zimbabwe was excluded from the final ADF-11 allocation process.

## Annex VII: Other Multilateral Development Banks' Country Classifications and Lending Terms

**Table VII-1: The International Development Association's Current Country Classification System**

	Creditworthiness to sustain IBRD financing	
	No	Yes
Per capita income above IDA's operational cut-off for more than 2 consecutive years	No	Countries below cut-off and not creditworthy: IDA-only countries on regular IDA terms
	Yes	Countries above cut-off but not creditworthy (e.g. Angola, Congo Rep.): <u>Gap countries</u> not eligible for IBRD resources and eligible for IDA resources on hardened terms
		Countries below cut-off and creditworthy (e.g. India and Pakistan): Eligible for IBRD resources and for IDA resources subject to a cap and blend terms
		Countries above cut-off and creditworthy: Eligible for IBRD resources. Exceptions: <u>Graduating countries</u> are eligible for IDA resources during a phasing-out period (2-5 years) on blend terms <u>Small island economies</u> are eligible for IDA resources on blend terms despite being above cut-off and creditworthy

**Notes:** IBRD = International Bank for Reconstruction and Development; IDA = International Development Association

**Source:** African Development Bank

**Table VII-2: The International Development Association's Current Financial Instruments**

(Terms applicable for FY2010)

Instrument Type	Recipient Countries	Maturity / Grace Period	Principal Repayment (years)	Charges	Interest Rate	Concessionality (Grant element)
IDA Grant	Red-light IDA-only countries	NA	None	None	None	100%
Regular IDA Credit	Yellow or green-light IDA-only countries	40 / 10 years	2%/annum for years 11-20, 4%/annum for years 21-40	75 bp service charge + 0-50 bp commitment charge	None	60%
Blend Credit	IDA/IBRD blend countries	35 / 10 years	2.5%/annum for years 11-20, 5%/annum for years 21-35	75 bp service charge + 0-50 bp commitment charge	None	57%
Hardened Term Credit	Gap countries with per capita GNI above IDA cut-off (US\$ 1,135) for 2 years	20 / 10 years	10%/annum for years 11-20	75 bp service charge + 0-50bp commitment charge	None	40%

**Source:** International Development Association. February 2010. A Review of IDA's Long Term Financial Capacity and Financial Instruments. Paper for the first IDA-16 replenishment meeting.

**Notes:** The IDA's commitment charge is determined annually in the range of 0 to 0.5 percent. For FY2009 and FY2010, the commitment charge is 0. The grant element is calculated using a constant discount rate of 6% (based on IBRD's lending rate converted into fixed-rate equivalents over 40 years). Using alternative discount rates such as 10% or the Commercial Interest Reference Rate or other methodologies yields different concessionality levels.

bp = basis points; GNI = gross national income; IBRD = International Bank for Reconstruction and Development; IDA = International Development Association

**Table VII-3: Asian Development Fund Lending Terms**

Instrument Type	Recipient Countries	Maturity / Grace Period	Principal Repayment	Commitment Fee	Interest	Concessional (Grant element)
Project Loans	All AsDF-eligible countries, including blend countries	32 / 8 years	Equal amortization	None	1% during grace period, 1.5% during amortization period	49%
Program Loans	All AsDF-eligible countries, including blend countries	24 / 8 years	Equal amortization	None	1% during grace period, 1.5% during amortization period	43%

**Notes:** AsDF = Asian Development Fund

**Source:** <http://www.adb.org/ADF/about.asp>, 23 April 2010. Concessional levels from A Review of IDA's Long Term Financial Capacity and Financial Instruments, Paper for first IDA-16 replenishment meeting, February 2010

**Table VII-4: Proposed Country Classification System for IDA-16 (changes marked in gray)**

Creditworthiness to Sustain IBRD Financing			
Per Capita Income above IDA's Operational Cut-off for more than 2 Consecutive Years		No	Yes
	No	Countries below cut-off and not creditworthy: IDA-only countries on regular IDA terms	Countries below cut-off and creditworthy (e.g. India and Pakistan): Eligible for IBRD resources and for IDA resources subject to a cap and revised blend terms
	Yes	Countries above cut-off but not creditworthy (e.g. Angola, Congo Rep.): <u>Gap countries</u> not eligible for IBRD resources and eligible for IDA resources on revised blend terms	Countries above cut-off and creditworthy: Eligible for IBRD resources. Exceptions: <u>Graduating countries</u> are eligible for IDA resources during a phasing-out period (2-5 years) on revised blend terms <u>Small island economies</u> are eligible for IDA resources on regular IDA terms despite being above cut-off and creditworthy

**Notes:** IBRD = International Bank for Reconstruction and Development; IDA = International Development Association

**Source:** International Development Association. February 2010. A Review of IDA's Long Term Financial Capacity and Financial Instruments. Paper for the first IDA-16 replenishment meeting.

**Table VII-5: Proposed Instruments for IDA-16 (changes marked in gray)**

Instrument Type	Recipient Countries	Maturity / Grace Period	Principal repayment (years)	Charges	Interest Rate	Concessional-ity (Grant element)
IDA Grant	Red-light IDA-only countries	NA	None	None	None	100%
Regular IDA Credit	Yellow and green-light IDA-only countries	40 / 10 years	2%/annum for years 11-20, 4%/annum for years 21-40	75 bp service charge + 0-50 bp commitment charge	None	60%
Revised Blend Credit	IDA/IBRD blend countries and gap countries	25 / 5 years	3.3%/annum for years 6-15, 6.7%/annum for years 16-25	75 bp service charge + 0-50 bp commitment charge	1.25%	35%

**Notes:** bp = basis points; IBRD = International Bank for Reconstruction and Development; IDA = International Development Association; NA = not applicable

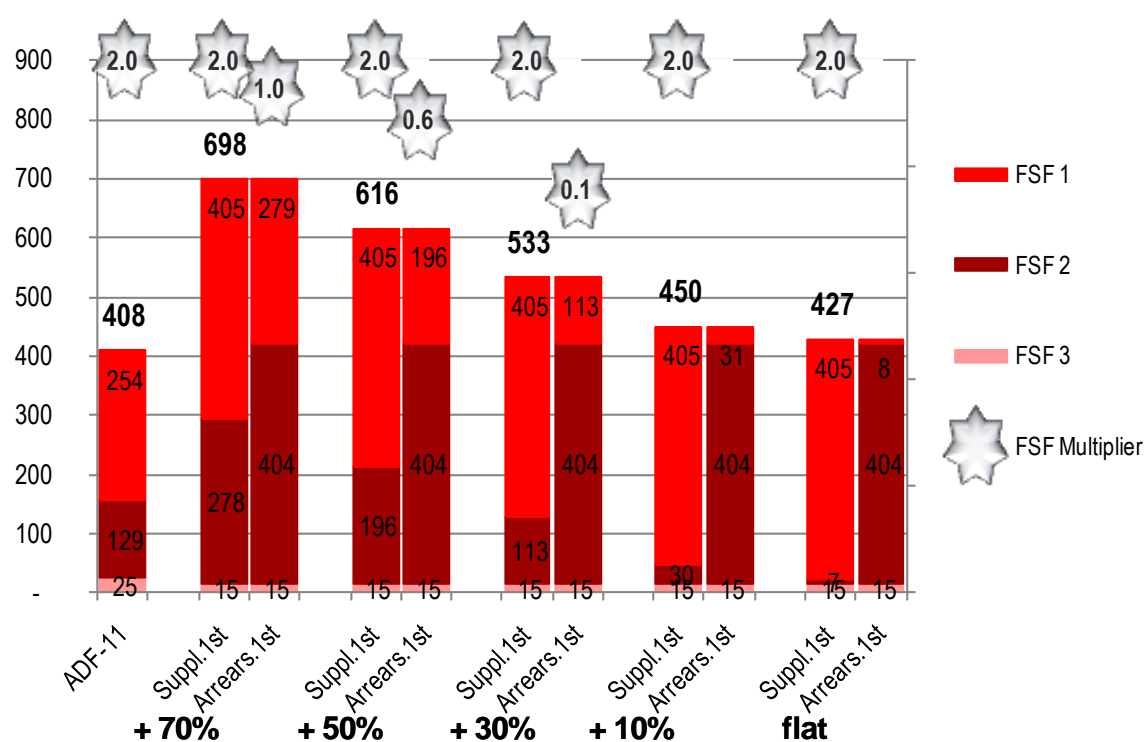
**Source:** International Development Association. February 2010. *A Review of IDA's Long Term Financial Capacity and Financial Instruments. Paper for the first IDA-16 replenishment meeting.*

## Annex VIII: Resource Allocation Scenarios (technical annex)

The two figures below provide detail on the sub-components of the two thematic set-asides. Figure VIII-1 shows the Fragile States Facility, assuming a set-aside of 7.5 percent of the replenishment, and includes the top-up multiplier (top-up envelope as a multiple of the “high-2” allocations for eligible countries) for the 10 possible Fragile States Facility scenarios (two allocation methodologies - prioritizing supplemental allocations or prioritizing arrears clearance within the envelope - and five replenishment levels). Figure VIII-2 shows regional operations and provides detail on the regional envelope, including PBA-linked and non-PBA-linked sub-components as well as the use of country allocations to finance ROs for the 15 possible RO scenarios (three RO envelope sizes and five replenishment levels).

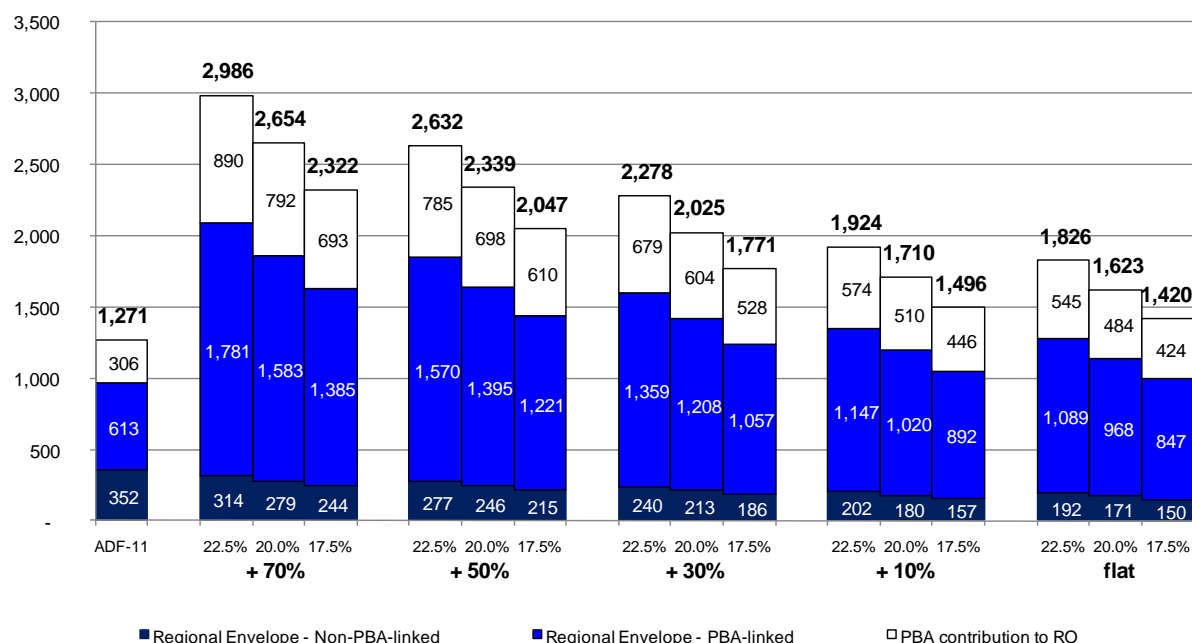
**Figure VIII-1: Fragile States Facility scenarios**

(UA million)



**Figure VIII-2: RO scenarios**

(UA million)



For each replenishment level, two summary graphs are provided for the associated allocation scenarios. The first graph shows the scenarios in nominal terms (millions of UA), while the second graph shows them in percentage terms. Each graph presents two columns for each allocation scenario:

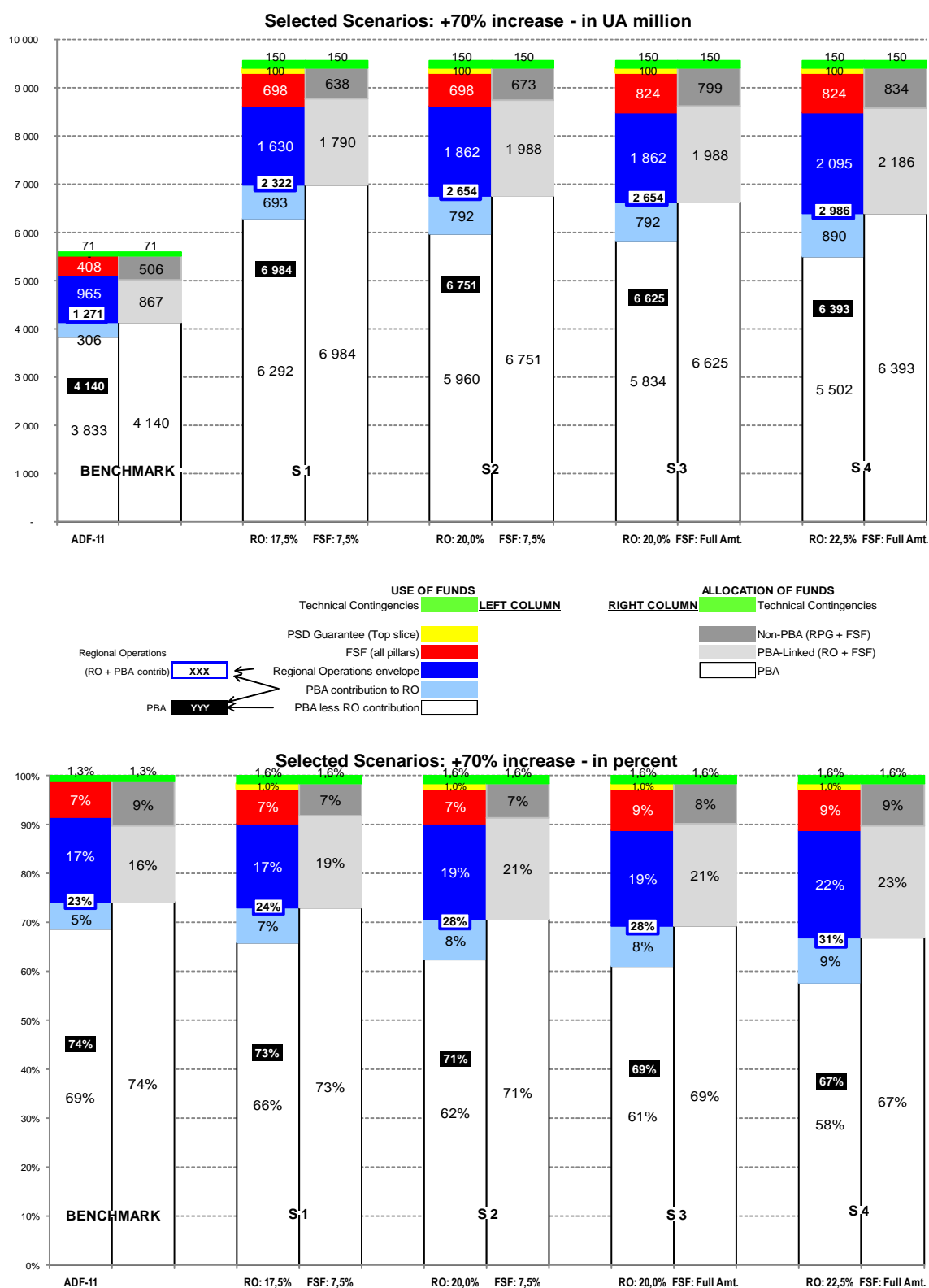
**Use of Funds.** The stacked bars on the left show the scenario in terms of end-use of resources:

- in white, performance based allocations (PBAs) for national projects;
- in light blue, PBAs used to finance ROs;
- in blue, the RO envelope covering the remaining two-thirds;
- in red, the Fragile States Facility.

The amount of PBA used for ROs is estimated by deducting 15% utilization for regional public goods and assuming a regular one third-two third split for the remainder of the RO envelope. The black box on the bar provides the total amount of resources for PBAs (the sum of 1 and 2 above). The blue box provides the total amount of resources used for ROs (the sum of 2 and 3 above).

**Allocation Mechanism.** The bars on the right show the scenario in terms of how the resources are allocated: direct PBA (white), PBA-linked mechanisms (light grey) and non-PBA linked (dark grey). All resources for country allocations are allocated directly through the PBA. PBA-linked resources include the Fragile States Facility “high-2” top-up and the RO envelope used to complement the use of PBAs to finance ROs. For the purpose of calculation, in the “sub-1” and “sub-2” scenarios, it has been assumed that the 2x top-up is preserved within the envelope of 7.5 percent. Non-PBA linked resources include the use of the RO envelope to finance regional public goods, arrears clearance operations and targeted assistance under the Fragile States Facility.

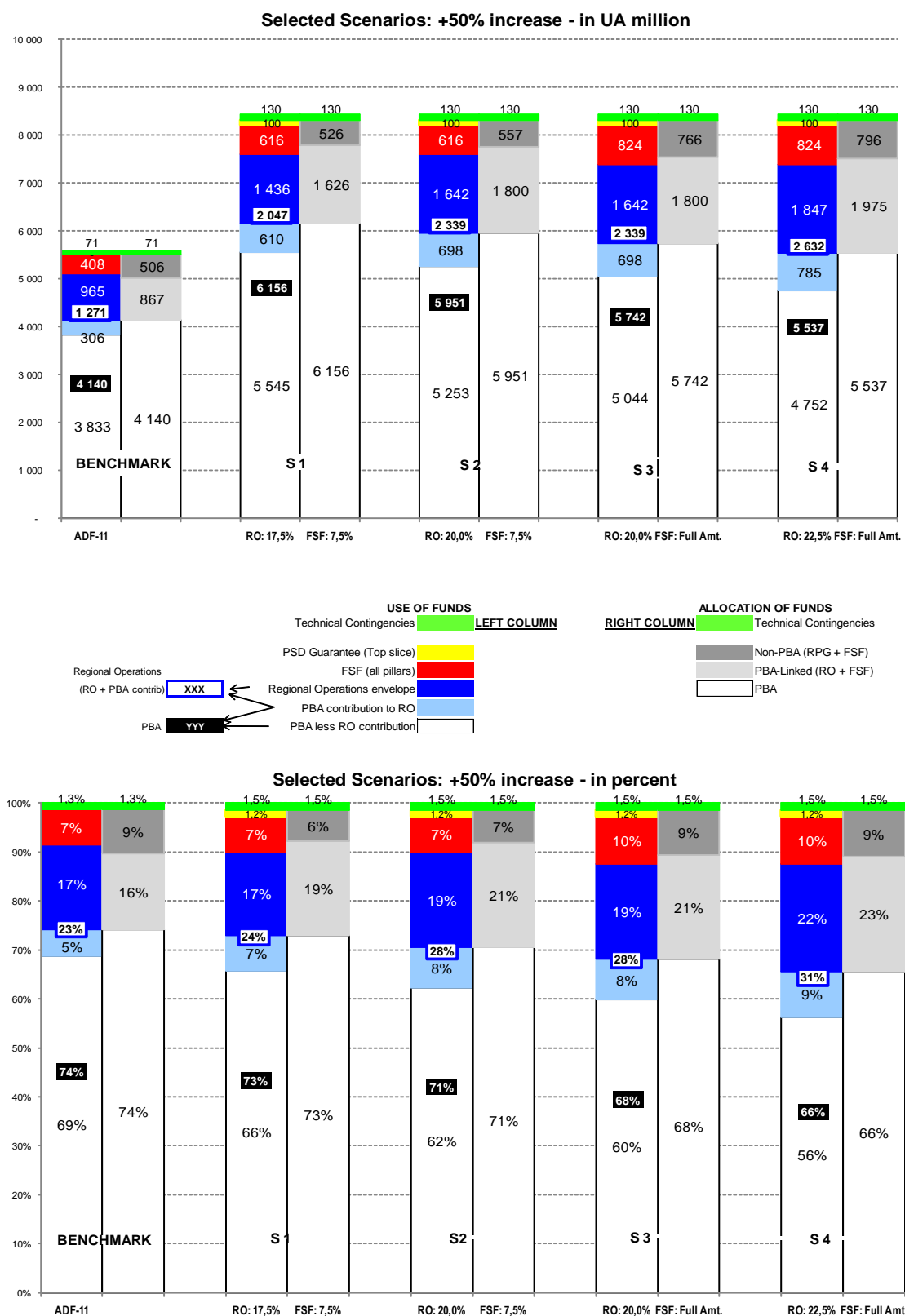
**Figure VIII-3: The 70% Increase Scenario**



**Note:** percentages are defined with respect to resources available for allocation but displayed with respect to overall replenishment size.  
**Source:** African Development Bank



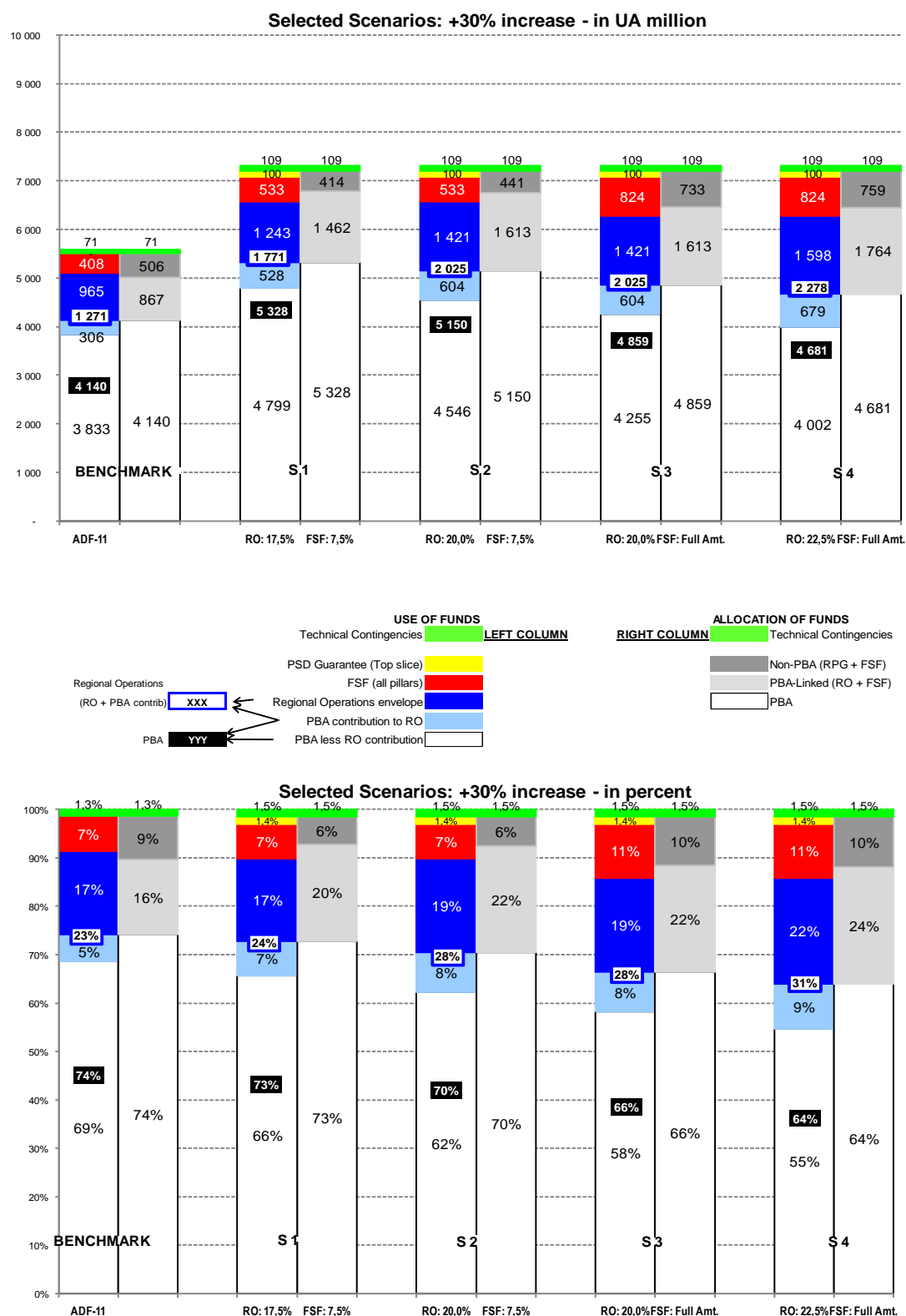
**Figure VIII-4: The 50% Increase Scenario**



**Note:** percentages are defined with respect to resources available for allocation but displayed with respect to overall replenishment size.

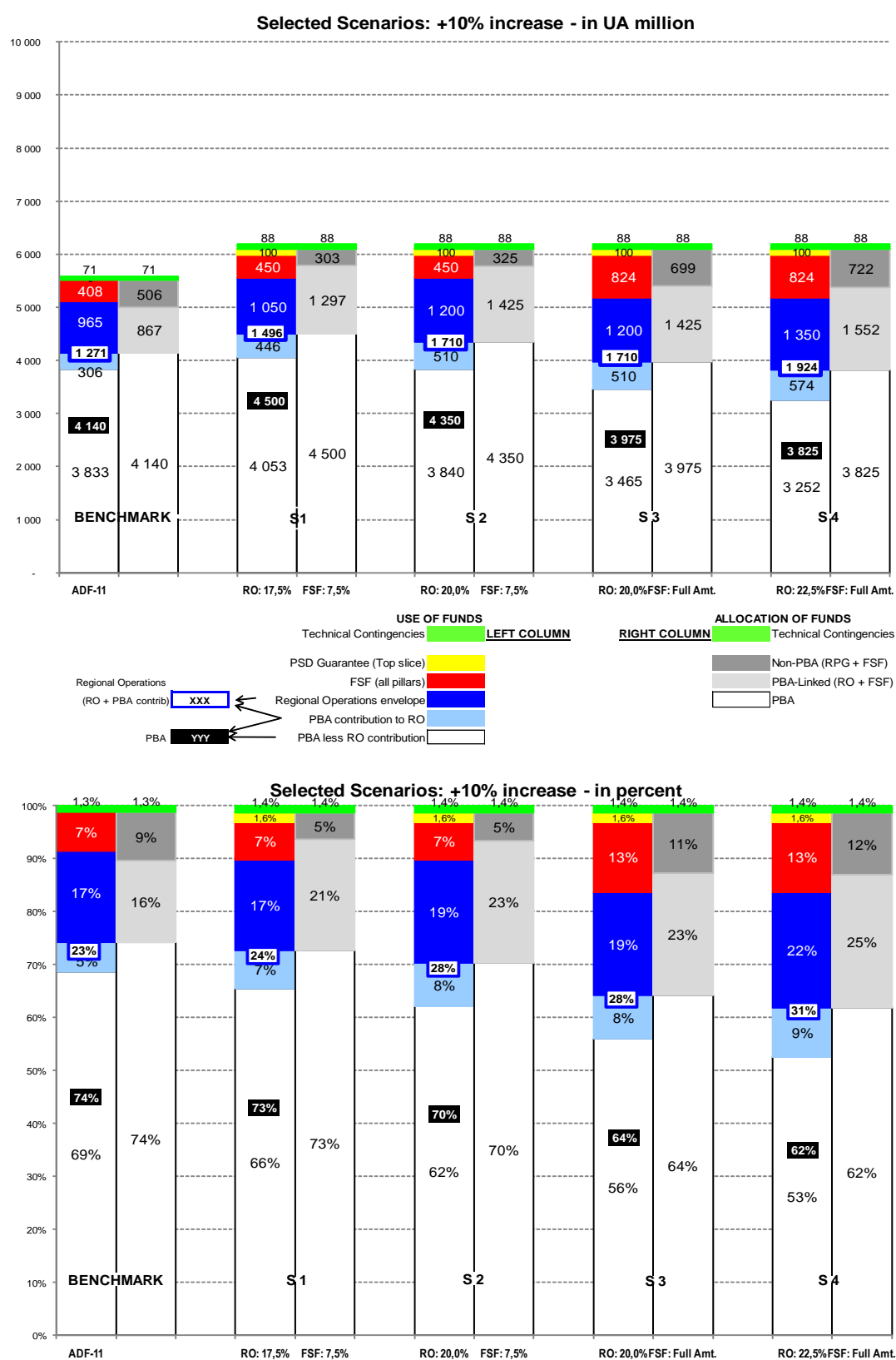
**Source:** African Development Bank

**Figure VIII-5: The 30% Increase Scenario**



**Note:** percentages are defined with respect to resources available for allocation but displayed with respect to overall replenishment size.  
**Source:** African Development Bank

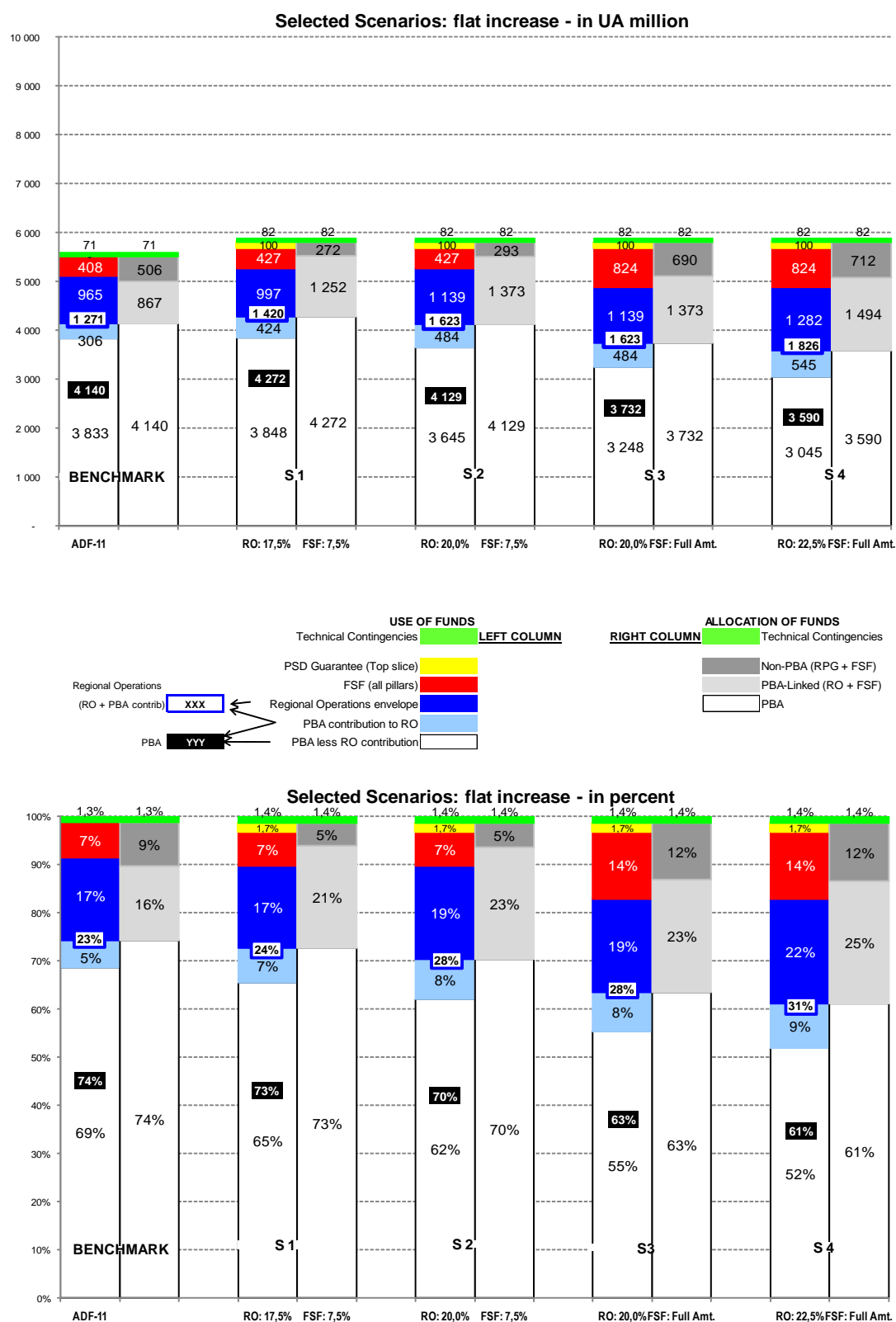
**Figure VIII-6: The 10% Increase Scenario**



**Note:** percentages are defined with respect to resources available for allocation but displayed with respect to overall replenishment size.

**Source:** African Development Bank

**Figure VIII-7: The Flat Increase Scenario**



**Note:** percentages are defined with respect to resources available for allocation but displayed with respect to overall replenishment size.

**Source:** African Development Bank

**Table VIII-8.a: Data table with Fragile States Facility sized at 7.5% of replenishment (priority within FSF given to supplemental allocation)**

<b>Replenishment Scenario</b>	<b>ADF-11</b>	<b>70.0%</b>	<b>70.0%</b>	<b>70.0%</b>	<b>50.0%</b>	<b>50.0%</b>	<b>50.0%</b>	<b>30.0%</b>	<b>30.0%</b>	<b>30.0%</b>	<b>10.0%</b>	<b>10.0%</b>	<b>10.0%</b>	<b>4.5%</b>	<b>4.5%</b>	<b>4.5%</b>
<b>Regional Operations</b>	<b>ADF-11</b>	<b>22.5%</b>	<b>20.0%</b>	<b>17.5%</b>	<b>22.5%</b>	<b>20.0%</b>	<b>17.5%</b>	<b>22.5%</b>	<b>20.0%</b>	<b>17.5%</b>	<b>22.5%</b>	<b>20.0%</b>	<b>17.5%</b>	<b>22.5%</b>	<b>20.0%</b>	<b>17.5%</b>
<b>FSF label</b>		<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.5%</b>
<i>assumes priority to the supplemental allocation within the FSF</i>																
	<b>ADF-11</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>
Country Allocations	4,140	6,518	6,751	6,984	5,746	5,951	6,156	4,973	5,150	5,328	4,200	4,350	4,500	3,987	4,129	4,272
RO Envelope	965	2,095	1,862	1,630	1,847	1,642	1,436	1,598	1,421	1,243	1,350	1,200	1,050	1,282	1,139	997
FSF 1	254	405	405	405	405	405	405	405	405	405	405	405	405	405	405	405
FSF 2	129	278	278	278	196	196	196	113	113	113	30	30	30	7	7	7
FSF 3	25	15	15	15	15	15	15	15	15	15	15	15	15	15	15	15
PSD - Portfolio Guarantee		100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Technical Contingencies	71	150	150	150	130	130	130	109	109	109	88	88	88	82	82	82
<b>Total</b>	<b>5,583</b>	<b>9,563</b>	<b>9,563</b>	<b>9,563</b>	<b>8,438</b>	<b>8,438</b>	<b>8,438</b>	<b>7,313</b>	<b>7,313</b>	<b>7,313</b>	<b>6,188</b>	<b>6,188</b>	<b>6,188</b>	<b>5,878</b>	<b>5,878</b>	<b>5,878</b>
<i>of which FSF</i>	<i>408</i>	<i>698</i>	<i>698</i>	<i>698</i>	<i>616</i>	<i>616</i>	<i>616</i>	<i>533</i>	<i>533</i>	<i>533</i>	<i>450</i>	<i>450</i>	<i>450</i>	<i>427</i>	<i>427</i>	<i>427</i>
<i>of which: ROs</i>	<i>965</i>	<i>2,095</i>	<i>1,862</i>	<i>1,630</i>	<i>1,847</i>	<i>1,642</i>	<i>1,436</i>	<i>1,598</i>	<i>1,421</i>	<i>1,243</i>	<i>1,350</i>	<i>1,200</i>	<i>1,050</i>	<i>1,282</i>	<i>1,139</i>	<i>997</i>
<i>of which PSD Guarantees</i>		<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>
<i>of which Country Allocations</i>	<i>4,140</i>	<i>6,518</i>	<i>6,751</i>	<i>6,984</i>	<i>5,746</i>	<i>5,951</i>	<i>6,156</i>	<i>4,973</i>	<i>5,150</i>	<i>5,328</i>	<i>4,200</i>	<i>4,350</i>	<i>4,500</i>	<i>3,987</i>	<i>4,129</i>	<i>4,272</i>
PBA	4,140	6,518	6,751	6,984	5,746	5,951	6,156	4,973	5,150	5,328	4,200	4,350	4,500	3,987	4,129	4,272
RO - PBA-linked	613	1,781	1,583	1,385	1,570	1,395	1,221	1,359	1,208	1,057	1,147	1,020	892	1,089	968	847
FSF - PBA-linked (FSF1)	254	405	405	405	405	405	405	405	405	405	405	405	405	405	405	405
RO - RPG (15% of RO)	352	314	279	244	277	246	215	240	213	186	202	180	157	192	171	150
FSF - Non-PBA (FSF2+FSF3)	154	293	293	293	211	211	211	128	128	128	45	45	45	22	22	22
PSD - Portfolio Guarantee		100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Technical Contingencies	71	150	150	150	130	130	130	109	109	109	88	88	88	82	82	82
<b>Total</b>	<b>5,583</b>	<b>9,563</b>	<b>9,563</b>	<b>9,563</b>	<b>8,438</b>	<b>8,438</b>	<b>8,438</b>	<b>7,313</b>	<b>7,313</b>	<b>7,313</b>	<b>6,188</b>	<b>6,188</b>	<b>6,188</b>	<b>5,878</b>	<b>5,878</b>	<b>5,878</b>
FSF Multiplier	1.97	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Arrears Clearance coverage		69%	69%	69%	48%	48%	48%	28%	28%	28%	7%	7%	7%	2%	2%	2%
<b>FSF</b>	<b>ADF-11</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>	<b>RO:22.5%</b> <b>FSF:7.5%</b>	<b>RO:20.0%</b> <b>FSF:7.5%</b>	<b>RO:17.5%</b> <b>FSF:7.5%</b>
FSF Top Up - FSF1	254	405	405	405	405	405	405	405	405	405	405	405	405	405	405	405
Targeted Assistance - FSF3	25	15	15	15	15	15	15	15	15	15	15	15	15	15	15	15
Arrears Clearance - FSF2	129	278	278	278	196	196	196	113	113	113	30	30	30	7	7	7
<b>RO</b>																
Regional Envelope - Non-PBA-linked	352	314	279	244	277	246	215	240	213	186	202	180	157	192	171	150
Regional Envelope - PBA-linked	613	1,781	1,583	1,385	1,570	1,395	1,221	1,359	1,208	1,057	1,147	1,020	892	1,089	968	847
PBA contribution to RO	306	890	792	693	785	698	610	679	604	528	574	510	446	545	484	424
<b>National Projects</b>																
PBA less RO contribution	3,833	5,628	5,960	6,292	4,961	5,253	5,545	4,293	4,546	4,799	3,626	3,840	4,053	3,442	3,645	3,848

**Table VIII-8.b: Data table with Fragile States Facility sized to fully cover 2x supplemental allocation and arrears clearance**

<b>Percent Increase</b>	ADF-11	70.0%	70.0%	70.0%	50.0%	50.0%	50.0%	30.0%	30.0%	30.0%	10.0%	10.0%	10.0%	4.5%	4.5%	4.5%
<b>Regional Operations</b>	ADF-11	22.5%	20.0%	17.5%	22.5%	20.0%	17.5%	22.5%	20.0%	17.5%	22.5%	20.0%	17.5%	22.5%	20.0%	17.5%
<b>FSF label</b>		Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.	Full Amt.
	ADF-11	RO:22.5% FSF:Full Amt.	RO:20.0% FSF:Full Amt.	RO:17.5% FSF:Full Amt.	RO:22.5% FSF:Full Amt.	RO:20.0% FSF:Full Amt.	RO:17.5% FSF:Full Amt.	RO:22.5% FSF:Full Amt.	RO:20.0% FSF:Full Amt.	RO:17.5% FSF:Full Amt.	RO:22.5% FSF:Full Amt.	RO:20.0% FSF:Full Amt.	RO:17.5% FSF:Full Amt.	RO:22.5% FSF:Full Amt.	RO:20.0% FSF:Full Amt.	RO:17.5% FSF:Full Amt.
Country Allocations	4,140	6,393	6,625	6,858	5,537	5,742	5,947	4,681	4,859	5,036	3,825	3,975	4,125	3,590	3,732	3,875
RO Envelope	965	2,095	1,862	1,630	1,847	1,642	1,436	1,598	1,421	1,243	1,350	1,200	1,050	1,282	1,139	997
FSF 1	254	405	405	405	405	405	405	405	405	405	405	405	405	405	405	405
FSF 2	129	404	404	404	404	404	404	404	404	404	404	404	404	404	404	404
FSF 3	25	15	15	15	15	15	15	15	15	15	15	15	15	15	15	15
PSD - Portfolio Guarantee		100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Technical Contingencies	71	150	150	150	130	130	130	109	109	109	88	88	88	82	82	82
Total	<b>5,583</b>	<b>9,563</b>	<b>9,563</b>	<b>9,563</b>	<b>8,438</b>	<b>8,438</b>	<b>8,438</b>	<b>7,313</b>	<b>7,313</b>	<b>7,313</b>	<b>6,188</b>	<b>6,188</b>	<b>6,188</b>	<b>5,878</b>	<b>5,878</b>	<b>5,878</b>
of which FSF	408	824	824	824	824	824	824	824	824	824	824	824	824	824	824	824
of which: ROs	965	2,095	1,862	1,630	1,847	1,642	1,436	1,598	1,421	1,243	1,350	1,200	1,050	1,282	1,139	997
of which PSD Guarantees		100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
of which Country Allocations	4,140	6,393	6,625	6,858	5,537	5,742	5,947	4,681	4,859	5,036	3,825	3,975	4,125	3,590	3,732	3,875
PBA	4,140	6,393	6,625	6,858	5,537	5,742	5,947	4,681	4,859	5,036	3,825	3,975	4,125	3,590	3,732	3,875
RO - PBA-linked	613	1,781	1,583	1,385	1,570	1,395	1,221	1,359	1,208	1,057	1,147	1,020	892	1,089	968	847
FSF - PBA-linked (FSF1)	254	405	405	405	405	405	405	405	405	405	405	405	405	405	405	405
RO - RPG (15% of RO)	352	314	279	244	277	246	215	240	213	186	202	180	157	192	171	150
FSF - Non-PBA (FSF2+FSF3)	154	419	419	419	419	419	419	419	419	419	419	419	419	419	419	419
PSD - Portfolio Guarantee		100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Technical Contingencies	71	150	150	150	130	130	130	109	109	109	88	88	88	82	82	82
Total	<b>5,583</b>	<b>9,563</b>	<b>9,563</b>	<b>9,563</b>	<b>8,438</b>	<b>8,438</b>	<b>8,438</b>	<b>7,313</b>	<b>7,313</b>	<b>7,313</b>	<b>6,188</b>	<b>6,188</b>	<b>6,188</b>	<b>5,878</b>	<b>5,878</b>	<b>5,878</b>
FSF Multiplier	1.97	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Arrears Clearance coverage		100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
<b>FSF</b>	<b>ADF-11</b>	<b>RO:22.5% FSF:Full Amt.</b>	<b>RO:20.0% FSF:Full Amt.</b>	<b>RO:17.5% FSF:Full Amt.</b>	<b>RO:22.5% FSF:Full Amt.</b>	<b>RO:20.0% FSF:Full Amt.</b>	<b>RO:17.5% FSF:Full Amt.</b>	<b>RO:22.5% FSF:Full Amt.</b>	<b>RO:20.0% FSF:Full Amt.</b>	<b>RO:17.5% FSF:Full Amt.</b>	<b>RO:22.5% FSF:Full Amt.</b>	<b>RO:20.0% FSF:Full Amt.</b>	<b>RO:17.5% FSF:Full Amt.</b>	<b>RO:22.5% FSF:Full Amt.</b>	<b>RO:20.0% FSF:Full Amt.</b>	<b>RO:17.5% FSF:Full Amt.</b>
FSF Top Up - FSF1	254	405	405	405	405	405	405	405	405	405	405	405	405	405	405	405
Targeted Assistance - FSF2	25	15	15	15	15	15	15	15	15	15	15	15	15	15	15	15
Arrears Clearance - FSF2	129	404	404	404	404	404	404	404	404	404	404	404	404	404	404	404
<b>RO</b>																
Regional Envelope - Non-F	352	314	279	244	277	246	215	240	213	186	202	180	157	192	171	150
Regional Envelope - PBA-linked	613	1,781	1,583	1,385	1,570	1,395	1,221	1,359	1,208	1,057	1,147	1,020	892	1,089	968	847
PBA contribution to RO	306	890	792	693	785	698	610	679	604	528	574	510	446	545	484	424
<b>National Projects</b>																
PBA less RO contribution	3,833	5,502	5,834	6,166	4,752	5,044	5,337	4,002	4,255	4,508	3,252	3,465	3,679	3,045	3,248	3,451