



## Policy Paper

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# Revising the Framework for Asian Development Fund Grants

Asian Development Bank

## ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
DSA	–	debt-sustainability analysis
DSF	–	debt-sustainability framework
GDP	–	gross domestic product
IDA	–	International Development Association
IMF	–	International Monetary Fund
NPV	–	net present value
OCR	–	ordinary capital resources
PBA	–	performance-based allocation
SDR	–	special drawing rights

## NOTES

- (i) The fiscal year (FY) of the International Development Association ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2007 ends on 30 June 2007.
- (ii) In this report, “\$” refers to US dollars.

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## EXECUTIVE SUMMARY

The Asian Development Bank (ADB) introduced grants to the Asian Development Fund (ADF) as part of agreements culminating in the ADF IX replenishment. The grant framework is aligned to the International Development Association (IDA) 13 framework. During the IDA14 replenishment, IDA revised its grant framework with the objective of helping low-income countries restore or maintain external debt sustainability. The approach is based on the debt-sustainability framework of the International Monetary Fund (IMF) and World Bank. The major innovation of the IDA14 framework is the linking of grant eligibility exclusively to the debt-distress status of low-income countries.

This paper proposes a revised ADF grant framework that is substantially aligned with IDA14. With this revision, eligibility to grants is limited to ADF-only countries. The proportion of ADF to be provided on a grant basis is contingent on the country's debt distress. High-risk countries will receive 100% of ADF funding as grants and moderate-risk countries 50%, while low-risk countries will receive only loans. To avoid rewarding poor performance, a 20% volume discount will be applied to the grant portion of a country's performance-based ADF allocation. Projects financed from the subregional ADF pool or using reallocated loan savings and cancellations will also be subject to the same grant shares.

The debt-distress thresholds will be contingent on a country's policy and institutional performance assessment, since better-performing countries can manage higher levels of debt without being under debt distress. ADB's country performance assessments—those used in the performance-based allocation of ADF resources—will be used to determine a country's policy performance, and debt-sustainability analysis will gauge its degree of debt distress.

The resources from the 20% volume discount will be transferred to a new hard-term ADF lending facility. The facility will have a fixed interest rate based on the ordinary capital resources fixed-rate lending terms less 150 basis points or the current ADF rate, whichever is higher. Other terms are similar to those of regular ADF loans. In general, blend countries with per capita income not exceeding the IDA operational cutoff for more than 2 consecutive years and an active ordinary capital resources lending program are eligible to borrow from this new facility. The income generated from this hard-term ADF facility will help defray the cost of interest forgone because of the shift from loan assistance to grants.

Under the revised framework, many countries will experience an increase in the grant shares of their ADF programs, but with the trade-off of a reduced amount of assistance. By front-loading grant-financed projects within admissible performance-based allocations, these changes can be absorbed with minimal impact on the 2007 program.

The incremental cost of the alignment with the IDA14 grant framework will be relatively small during the remainder of ADF IX. The net present value of additional forgone interest will amount to \$27 million, which can be covered without additional donor contributions. In future replenishment periods, lost interest flows will be covered partially by the income from the hard-term ADF loans. Additional donor contributions for forgone reflows could be on a pay-as-you-go basis, which will be discussed in future ADF replenishments.

## I. INTRODUCTION

1. The Asian Development Bank (ADB) introduced Asian Development Fund (ADF) grants as part of the ADF IX replenishment (2005–2008).<sup>1</sup> As agreed with ADF donors, grant eligibility is based on country-specific conditions (such as income, debt stress, and transition from conflict) or the importance of addressing certain sectoral priorities. This approach to grants was in line with the framework of the International Development Association (IDA) at the time of ADF IX negotiations (i.e., the IDA13 grant framework). During its subsequent replenishment (IDA14), IDA revised the framework with a goal of helping low-income countries restore or maintain external debt sustainability. The IDA14 approach to grants directly relates the proportion of grant assistance to a country's degree of debt distress. To address this, the underlying causes of debt distress, not just the outward symptoms, must be considered.

2. The revised IDA framework is grounded in the debt-sustainability framework (DSF) of the International Monetary Fund (IMF) and World Bank, wherein a country's eligibility for grants is based solely on debt-sustainability criteria. This approach provides a stronger analytical basis for grant eligibility and greater flexibility to respond to changing country circumstances. During the ADF IX midterm review meeting, participating donors supported ADB's proposal to align its grant allocation framework with that of IDA14.<sup>2</sup> This report proposes a revised ADF grant framework that is substantially aligned with that of IDA14, and discusses the operational and financial implications of alignment.

## II. SUMMARY OF GRANT FRAMEWORKS

### A. Asian Development Fund IX Grant Framework

3. Similar to the IDA13 approach, the current ADF grant framework determines the amount of grant assistance along several dimensions. For instance, grants are allocated on the basis of country criteria. The grant program helps to ease the debt burden of the poorest countries (those with per capita gross national income of less than \$360) and to support postconflict ADF countries in their transition to peace and stability. Table 1 shows the countries eligible for grant financing. The countries and their grant eligibility are set in the grant framework for the whole ADF IX period. The grant eligibility indicates the upper limit of a country's performance-based allocation (PBA) of ADF resources that can be provided as a grant. Grant financing is also designated to support interventions in specific sectors, e.g., projects to combat HIV/AIDS and other communicable diseases.<sup>3</sup> All eligible countries with access to ADF can request grant financing for projects that meet the sector criteria.

4. The grant program—18% of planned ADF IX operations<sup>4</sup>—was agreed in advance with the donors. Grants based on country-specific criteria are not restricted to specific sectors. Furthermore, the types of goods and services that can be financed with grants are the same as those that can be financed with loans. To address the costs related to the introduction of grants,

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<sup>1</sup> ADB. 2004. *Eighth Replenishment of the Asian Development Fund and Third Regularized Replenishment of the Technical Assistance Special Fund*. Manila (R111-04, Revision 1, 22 July).

<sup>2</sup> ADB. 2006. *Report on ADF IX Grant Framework and Proposal for Alignment with IDA14 Grant Framework*. Manila.

<sup>3</sup> The IDA13 grant framework included a notional amount set aside for reconstruction after natural disasters.

<sup>4</sup> In addition, the replenishment included the transfer of 7% of ADF IX donor contributions—about 3% of planned ADF IX operations—to ADB's technical assistance special fund. Although the transfer was made within the ADF IX grant framework, this paper focuses only on ADF grants that are part of the country allocation of ADF resources. The transfer to the technical assistance special funds is referred to only for the sake of clarity.

**Table 1: Asian Development Fund IX Grant Allocation Framework**  
(%)

<b>Grant Eligibility Criteria/ Qualifying Country or Sector</b>	<b>Grant Share Ceiling of ADF Allocation</b>	<b>Grant Share of Planned ADF IX Operations</b>
<b>A. Country Eligibility Criteria<sup>a</sup></b>		
1. Poorest and Debt-Stressed		
Cambodia (\$280)	50	
Kyrgyz Republic (\$290)	50	
Lao PDR (\$310)	50	
Nepal (\$230)	50	
<b>Subtotal (1)</b>		<b>8.0</b>
2. Poorest, Postconflict		
Afghanistan (\$186)	50	
Tajikistan (\$180)	40	
Timor-Leste (\$430) <sup>b</sup>	40	
<b>Subtotal (2)</b>		<b>6.7</b>
3. Postconflict		
Solomon Islands (\$620)	30	
Sri Lanka (\$840)	15	
<b>Subtotal (3)</b>		<b>1.3</b>
<b>Subtotal (A)</b>		<b>16.0</b>
<b>B. Sector Eligibility Criteria<sup>c</sup></b>		
Projects addressing HIV/AIDS and other communicable diseases		2.0
<b>Total</b>		<b>18.0</b>

ADF = Asian Development Fund, Lao PDR = Lao People's Democratic Republic.

Note: The calculations assume planned ADF IX operations of \$7.0 billion, based on the Board of Governors' Resolution No. 300. Transfers to the technical assistance special fund equal to 7% of donor contributions to ADF IX, or about 3% of the planned ADF IX operations, are excluded.

<sup>a</sup> The poorest countries are those with per capita gross national income of less than \$360 in 2002. Per capita gross national income figures used at the time the grant framework was prepared are shown in parentheses.

<sup>b</sup> Although its per capita income exceeded the \$360 threshold, Timor-Leste's special circumstances warrant its inclusion in the poorest, postconflict grants category.

<sup>c</sup> Open to all countries with access to ADF. Grants can be up to 100% of ADF financing for projects.

Source: Asian Development Bank.

donors agreed to provide additional financing during ADF IX to cover the forgone interest; the forgone principal is to be financed in future replenishments.

5. During 2005–2006, \$522 million of ADF grants were approved, for an annual average of \$261 million. This is lower than the \$315 million annual grant program envisaged at the time the replenishment was finalized. The shortfall is due to delays in programming and processing grant-financed projects, and lower than expected PBAs to grant-eligible countries. Moreover in 2005, project processing was delayed in Nepal, a major grant recipient, because of political circumstances. In terms of country distribution, Afghanistan has been the largest grant recipient (50% of the dollar value of ADF grant commitments), followed by Nepal (21%) and Cambodia (10%). In terms of sector distribution, the largest grant commitments have been directed to transport and communications (31%); health, nutrition, and social protection (23%); and finance (13%).

**Table 2: Policy Performance-Dependent Debt and Debt-Service Thresholds of the International Development Association**  
(%)

Performance Category	Ratio of NPV of Debt to			Ratio of Debt Service to	
	GDP	Exports	Revenue	Exports	Revenue
Weak (CPIA $\leq$ 3.25)	30	100	200	15	25
Medium (3.25 < CPIA < 3.75)	40	150	250	20	30
Strong (CPIA $\geq$ 3.75)	50	200	300	25	35

CPIA = country policy and institutional assessment, GDP = gross domestic product, NPV = net present value.

Notes: The denominator for the export-based indicators is the 3-year average of exports of goods and services. Revenue excludes grants. The static approach to determining debt distress does not use the revenue-based indicators because of issues with data availability and comparability.

Source: International Monetary Fund and World Bank. 2007. *Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries*. Washington, DC (16 April).

## B. International Development Association 14 Grant Framework

6. The IDA14 framework marks a major departure from IDA13. A review of the IDA13 framework found the various criteria for allocating grants to be overly complex and without a supporting analytical framework. IDA14 grants, in contrast, are allocated according to a single criterion: a country's risk of debt distress. This approach is based on the IMF-World Bank DSF, which was introduced in 2005 (Appendix 1). In the DSF, countries are classified as having high, moderate, or low risk of debt distress. Countries deemed to be at high risk of debt distress qualify to receive 100% of their PBA as grants and those at moderate risk qualify for 50%. Low-risk countries receive all IDA14 allocations on standard IDA terms.<sup>5</sup> The African Development Fund has adopted a similar grant framework. Among the grant-eligible countries that make use of IDA funds for regional projects, high-risk countries receive the funds as grants, while moderate- and low-risk countries receive them as credits.

7. The policy performance-dependent debt and debt-service thresholds currently applied by IDA (Table 2) assume that countries with stronger policies and institutions will be better able to manage their debt. A country's policy performance is its rating in the country policy and institutional assessment, which IDA also uses in its PBA. IMF and the World Bank jointly prepare a forward-looking debt-sustainability analysis (DSA).<sup>6</sup> The DSA includes 20-year projections of key macroeconomic and external debt variables to establish a baseline scenario for the country's debt and debt-service dynamics. Standardized stress tests are used to confirm the robustness of the baseline scenario. Countries with debt indicators that breach the policy performance-dependent thresholds in the baseline scenario are deemed to be at high risk of debt distress. Those with baseline indicators within the thresholds but showing considerable breaches in the stress tests are at moderate risk, while those with all debt indicators well below debt-burden thresholds in the baseline scenario and none significantly breaching the thresholds are at low risk of debt distress. IMF and the World Bank intend to update all DSAs annually.

<sup>5</sup> IDA assigns a "traffic light" to each level of debt distress. Green signifies low risk, yellow moderate risk, and red high risk. The grant allocation is subject to a discount factor (para. 9).

<sup>6</sup> IMF and World Bank. 2007. *Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries*. Washington, DC (16 April).

8. In the absence of a DSA, a country's debt-distress classification is determined by a static comparison of the latest available external debt indicators and the DSF debt thresholds, based on gross domestic product (GDP) and exports. A country is classified according to its solvency (ratio of net present value [NPV] of debt to GDP and of NPV of debt to exports) and liquidity (ratio of debt service to exports) indicators and its policy performance-linked debt thresholds. Countries with solvency or liquidity indicators more than 10% above the threshold are considered to be at high risk of debt distress, those with solvency or liquidity indicators less than 10% below the threshold are at low risk, and those between the two categories are at moderate risk. The debt-distress classification is based on the higher of the two indicators. This approach is an interim measure until forward-looking DSAs are completed for all countries.

9. Countries at high risk of debt distress are also likely to be relatively poor performers. Because the switch from loans to grants increases the NPV of a country's IDA allocation, applying the DSF without adjusting the amount of assistance would amount to rewarding poor performance, contrary to the PBA principle. Consequently, the World Bank applies a volume discount to grant allocations to maintain the link between performance and the NPV of IDA country allocations. Under this "modified volume" approach, the PBA formula-based levels of assistance are discounted by 20% for countries eligible for 100% grants and by 10% for countries eligible for 50% grants. Countries that do not receive grants receive their full PBA.

10. The volume discount has two components: (i) an incentive-related discount aimed at preserving the integrity of the incentive system embedded in the PBA (equivalent to an 11% volume discount); and (ii) a charges-related discount used to offset the forgone charge income on grants (equivalent to a 9% volume discount). The incentive-related discount is reallocated on a PBA basis to IDA-only borrowers, excluding IDA-only gap countries<sup>7</sup> and those that are eligible for exceptional postconflict IDA allocations. The reallocated funds have the same grant proportions corresponding to the countries' risk of debt distress. The charges-related discount is allocated to blend countries (those eligible for assistance on both concessional and nonconcessional terms) with per capita income below the IDA operational cutoff (\$1,025 in FY2007), but on harder terms. About 2% of IDA14 resources will be channeled through this hard-term IDA window, which will generate additional income for IDA.<sup>8</sup> These hard-term IDA country allocations are determined in proportion to a country's PBA and are in addition to regular PBAs.

11. The IDA14 framework does not have a predetermined ceiling on the grant assistance to be provided during the replenishment period. The amount of grants will depend on the countries' debt indicators in relation to the performance-dependent debt-distress thresholds. As such, total grant assistance will be determined endogenously.

### **C. Comparison of the ADF IX and IDA14 Grant Frameworks**

12. The main differences between the ADF IX and IDA14 grant frameworks are as follows.

- (i) ADF IX mandates country-specific grant eligibility levels, based on several country considerations, and a separate share designated for projects addressing HIV/AIDS and other communicable diseases. IDA14 grants are based only on

<sup>7</sup> IDA gap countries are IDA-eligible countries that have limited or no access to nonconcessional World Bank financing and in which per capita incomes are above the IDA operational cutoff for more than 2 consecutive years.

<sup>8</sup> India and Pakistan have access to the hard-term IDA window in FY2007.

risk of debt distress and are not sector-specific; hence, grant eligibility has a clearer analytical basis.

- (ii) Countries with access to both ADF and ordinary capital resources (OCR) funding can receive grants under ADF IX under certain circumstances. IDA14 grants are restricted to IDA-only countries.
- (iii) For identified grant-eligible countries, the share of grant assistance in ADF IX is fixed for the entire replenishment period. In IDA14, the proportion of grant assistance can fluctuate with changes in a country's debt indicators.
- (iv) In ADF IX, grant eligibility does not affect a country's PBA of funds. In IDA14, a discount factor is applied to grants to avoid rewarding poor performance.
- (v) The total amount of grant assistance as a share of planned ADF IX operations was agreed in advance with the donors. The grant assistance in IDA14 is endogenously determined, since the number of countries experiencing debt distress over the replenishment cycle cannot be known in advance.
- (vi) In ADF IX, donors agreed to provide additional funds to cover the forgone interest from grants. In IDA14, a new IDA credit facility with harder lending terms was established to help cover the cost of forgone charges.

13. For most grant-eligible countries, the share of grants under ADF IX is lower than that under IDA14 (Table 3). This difference in grant share is not the best possible situation from the standpoint of debt sustainability, with ADB potentially providing loans to debt-stressed countries. However, differences in country classifications that determine ADF and IDA eligibility cannot be eliminated by aligning the grant frameworks alone. Nevertheless, aligning them will respond to some key concerns of recipient countries and reinforce the overall move toward harmonization among the multilateral development banks.

### III. PROPOSAL FOR ALIGNMENT WITH THE GRANT FRAMEWORK FOR INTERNATIONAL DEVELOPMENT ASSOCIATION 14

14. This report proposes revising the ADF IX grant framework to substantially align it with IDA14, starting with the 2007–2008 biennial allocations.<sup>9</sup> The revised framework will contain the same general features as the IDA14 grant framework, but complete alignment is not possible because of differences in operational conditions between ADB and IDA, such as differences in country membership and classification and lending terms.

15. **Country Eligibility.** In general, eligibility for ADF grant assistance will be limited to ADF-only countries. As with the graduation policy, OCR lending to grant-eligible countries could be considered in exceptional cases for high revenue-earning projects that generate net foreign exchange earnings above the foreign debt-service requirement. Nonsovereign lending is not affected by this policy. Access to grants by Sri Lanka (15% of its PBA) and Timor-Leste (40% of its PBA) will be extended until the end of ADF IX. Under the aligned framework, the grant financing earmarked for projects addressing HIV/AIDS and other communicable diseases will be discontinued.

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<sup>9</sup> The revisions in the grant framework will not affect the agreed transfers to the technical assistance special fund.

**Table 3: Comparison of Grant Shares in the Asian Development Fund IX and International Development Association 14 Grant Frameworks**  
(%)

Country	ADF IX <sup>a</sup>	IDA14	
		FY2006	FY2007
Afghanistan	50	100	100
Bhutan	0	100	100
Cambodia	50	100	100
Kyrgyz Republic	50	100	100
Lao PDR	50	100	100
Mongolia	0	100	50
Nepal	50	50	100
Samoa	0	0	50
Solomon Islands	30	100	100
Sri Lanka <sup>b</sup>	15	50	0
Tajikistan	40	100	50
Timor-Leste <sup>c</sup>	40	100	60
Tonga <sup>d</sup>	0	100	100

ADB = Asian Development Bank, ADF = Asian Development Fund, FY = fiscal year, IDA = International Development Association, Lao PDR = Lao People's Democratic Republic.

<sup>a</sup> Grant shares based on country-eligibility criteria only.

<sup>b</sup> Country is eligible for loans from both ADF and ordinary capital resources.

<sup>c</sup> IDA14 grant eligibility is based on the country's postconflict status rather than its debt-distress classification. Grant eligibility is to be phased out with the share dropping to 30% in FY2008.

<sup>d</sup> Tonga is currently an ADB blend country, but is being considered for reclassification as an ADF-only country under the proposed revision of the graduation policy.

Source: Asian Development Bank and International Development Association.

**16. Debt-Distress Classification.** For countries eligible for grant assistance, the proportion of grants in the country program will follow the same debt-distress classification now used by IDA, i.e., (i) no grants for low risk of debt distress, (ii) 50% grants for moderate risk of debt distress, and (iii) 100% grants for high risk of debt distress. Debt-distress risk is determined by the outcome of the forward-looking DSA when available, or by a comparison of the country's latest available external debt indicators with the policy performance-dependent debt-burden thresholds.<sup>10</sup> Debt distress classifications will be reviewed annually, around the same time as the country performance assessment exercise. The ratings from ADB's country performance assessment will be used to classify countries as having strong, medium, or weak policy performance. For the purpose of debt-distress classification, the performance score will be the unweighted average of the following four performance indicator clusters: economic management, structural policies, policies for social inclusion/equity, and governance.<sup>11</sup> A debt-

<sup>10</sup> Given ADB's fiduciary responsibility, joint preparation of the DSAs by ADB, IMF, and the World Bank is desirable. ADB's participation is now being discussed with the two institutions. In countries where an IMF-World Bank DSA is not available, ADB will conduct its own assessment.

<sup>11</sup> The debt-distress classification is based on the DSA as well as the country performance assessment. Hence, in principle, in some cases where ADB and IDA use the same DSA, the actual distress classification will differ because of differences in country performance ratings between ADB and the World Bank. For ADF IX, only Tonga's debt-distress classification has been affected by this difference ("high risk" in IDA's classification, "moderate risk" in ADB's).

**Table 4: Comparison of Grant Shares under the Original and Revised Asian Development Fund Grant Frameworks**  
(%)

Country	Original Framework <sup>a</sup> (2005–2006)	Revised Framework (2007)
Afghanistan	50	100
Bhutan	0	100
Cambodia	50	50
Kyrgyz Republic	50	100
Lao PDR	50	100
Mongolia	0	100
Nepal	50	100
Samoa	0	50
Solomon Islands	30	100
Sri Lanka <sup>b</sup>	15	15
Tajikistan	40	50
Timor-Leste <sup>c</sup>	40	40
Tonga <sup>d</sup>	0	50
Tuvalu	0	100

ADF = Asian Development Fund, Lao PDR = Lao People's Democratic Republic.

<sup>a</sup> Grant shares based on country-eligibility criteria only.

<sup>b</sup> Sri Lanka has access to loans from both ADF and ordinary capital resources. Its grant eligibility is based on its postconflict status, and this will be extended through 2007–2008.

<sup>c</sup> Timor-Leste's grant eligibility is based on its postconflict status rather than its debt-distress classification, and this will be extended through 2007–2008.

<sup>d</sup> Tonga, currently an ADB blend country, is being considered for reclassification as an ADF-only country under the proposed revision of the graduation policy. Grant eligibility is contingent on the country's reclassification.

distress classification of countries for 2007 is in Appendix 2.<sup>12</sup> Table 4 compares the grant shares by country under the original and revised grant frameworks.

17. **Grant Allocations and PBA.** ADF grants under the revised framework will be allocated as follows. First, ADF resources will be distributed according to the current PBA formula. Next, the proportion of grant assistance will be set on the basis of the debt-distress classification. Finally, a 20% volume discount will be applied to the grant portion of the PBA to offset the risk of perverse incentives and moral hazard in replacing loans with grants for countries with poor debt management. The volume discount will be transferred to a new hard-term ADF facility, the reflows from which will help offset the NPV of charge income forgone in switching from loans to grants.<sup>13</sup> Because the volume discount is 20% of the grant share, moderate-risk countries with access to 50% of their PBA as grants will have a discount equivalent to 10% of the PBA. The

<sup>12</sup> The list of countries includes Tonga, an IDA-only country that is being considered for reclassification as an ADF-only country under the proposed revision of the graduation policy. Georgia, a new ADB member that does not yet have access to ADF, is not included. Note that the IDA and IMF debt-sustainability analysis classifies Georgia as being at low risk of debt distress. For the 2007 debt-distress classification, a cutoff date of 31 December 2006 for published DSAs is used. DSAs published after this date will be used to determine 2008 debt-distress classifications.

<sup>13</sup> In the IDA framework, only a portion of the 20% volume discount (9%) is transferred to a hard-term IDA window, while the remaining amount is reallocated to countries not eligible for grants. However, IDA regular lending terms are much lower (0.75% service charge, no interest) than those of ADF (no service charge, 1.0% interest rate during the grace period and 1.5% thereafter), which leads to a higher NPV of forgone charges for ADF than for IDA. Note that even transferring the full 20% to the hard-term ADF window will not recover all of the forgone charges.

grant allocations of postconflict countries, which receive an agreed set-aside allocation rather than PBA, will not be subject to the volume discount.<sup>14</sup>

18. **Subregional Pool and Loan Savings and Cancellations.** As the grant eligibility system is rooted in a country's borrowing capacity, the same grant shares will be applied to projects financed from the ADF subregional pool. The same principle will apply to the reallocation of loan savings and cancellations if sufficient grant commitment authority is available.<sup>15</sup> High-risk countries will receive these funds fully as grants, while financing for moderate-risk countries will be half grant and half loan. No volume discount will be applied for project financing from the subregional pool or reallocated loan savings and cancellations.

19. **Hard-Term ADF Facility.** To help cover the forgone interest income from ADF grants, a separate ADF facility with harder lending terms will be established. Resources from the volume discount will be retained within each operations group and made available for allocation through the hard-term ADF facility at the discretion of the operations group vice president. This allocation will be in addition to regular PBAs. Blend countries with active OCR lending programs and gross national income per capita that has not exceeded the IDA operational cutoff for more than 2 consecutive years will be eligible for this facility.<sup>16</sup> In addition, access by ADF-only countries could be considered in individual cases for high revenue-earning projects that generate net foreign exchange beyond the foreign debt-service requirement. Unused funds under this window will be invested as part of the ADF liquidity pool, and the income from the investment will help cover the cost of forgone interest from grants.

20. Hard-term ADF loans, similar to the hard-term window of IDA, will have terms that provide a higher degree of concessionality than OCR loans, through a lower interest rate and a longer grace period. The interest rate will be 150 basis points below the weighted average of the 10-year fixed swap rates of the special drawing rights component currencies plus the OCR lending spread, or the applicable ADF interest rates (i.e., currently at 1% during the grace period and 1.5% thereafter), whichever is higher. The interest rate will be reset every January through a Board information paper, together with the OCR rebate revision. The rate will apply to all hard-term loans approved that year and will be fixed for the life of the loan. For hard-term ADF loans approved in 2007, the interest rate is set at 3.85%.<sup>17</sup> The rest of the loan terms will be the same as the current ADF terms, i.e., equal amortization, 8-year grace period, 32-year maturity for project loans and 24-year maturity for program loans, no commitment fees, and no service charges. Appendix 3 compares the terms of the ADF hard-term loan with those of IDA.

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<sup>14</sup> As Sri Lanka's grant allocation was justified by its status as a postconflict country, its allocation will also not be subject to volume discount.

<sup>15</sup> Article V of the Regulations of the Asian Development Fund provides donors with specific rights to their contributions if they withdraw from ADF or if ADF is terminated. To allow for grants in ADF IX, Board of Governors' Resolution No. 300, section 3(d), notes: "Article V of the ADF Regulations shall not be applicable to grants used pursuant to this Resolution to provide financing for projects and programs of high developmental priority." As this waiver of the rights under the ADF regulations refers only to contributions made during ADF IX, total grant commitments (through PBA, from the subregional pool, or from reallocated loan savings and cancellations) cannot exceed total ADF IX donor contributions. The use of grants beyond this limit would first need to be agreed with all past ADF donors and approved by the Board of Governors, as may be discussed in future replenishment negotiations depending on the need.

<sup>16</sup> For 2006 (the latest year available), the IDA operational cutoff was gross national income per capita of \$1,065. According to the criteria, the eligible countries are Azerbaijan, Bangladesh, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam.

<sup>17</sup> The hard-term interest rate for loans approved in 2007 is based on the weighted average of the 10-year fixed swap rates of the component currencies of the special drawing rights as of 31 July 2007.

21. **Processing and Fiduciary Requirements.** No sector restrictions will be placed on the use of ADF grants or hard-term ADF loans. The processing and fiduciary guidelines for both facilities will be the same as those for regular ADF loans.

#### IV. IMPLICATIONS OF THE ALIGNMENT PROPOSAL

##### A. Operational Implications

##### 1. Issues in Programming Asian Development Fund Resources

22. The alignment with IDA14 may increase the grant shares for most ADF grant-eligible countries. However, PBAs for 2007–2008 will have to be revised to allow for the volume discount applied to grants; the revision is expected to lead to a decrease in the assistance available for grant-eligible countries. Furthermore, to preserve consistency with the DSF principles, grant-eligible countries generally will be restricted from public or publicly-guaranteed OCR borrowing until their debt indicators improve.<sup>18</sup> On the other hand, some blend countries will be eligible for additional concessional funds through the hard-term ADF facility. These changes are likely to have some programming effects on the size and composition of projects. However, by using the front-loading option allowed by the PBA policy, these effects could be absorbed with minimal impact on the 2007 program. The 2008 ADF program may have to be adjusted, but the adjustments could be moderated at the discretion of the operations group vice presidents by using the resources released from loan savings and cancellations.

23. Under the current ADF IX grant framework, up to 2% of planned ADF operations is earmarked for projects addressing HIV/AIDS and communicable diseases. This amount was almost fully committed in 2005–2006. Eliminating these sector-based grants will therefore have minimal impact on operations.

24. Country classifications within ADB and IDA have important differences. Bangladesh and Viet Nam are IDA-only countries for the World Bank, but blend countries for ADB.<sup>19</sup> These blend countries, which are borrowing OCR, could be classified as eligible only for IDA grants (or 50% IDA grants). However, this is not currently an issue since both countries are classified as low risk, and therefore not eligible for IDA grants.

##### 2. Debt-Sustainability Analysis

25. The adoption of the DSF as the framework for determining the debt-carrying capacity of poor countries and directly linking the ADF grant allocation scheme to the countries' debt-sustainability analyses will have significant operational and financial implications for ADF countries as well as ADB itself. IMF and the World Bank developed the DSF; they also prepare the DSAs. However, after alignment with the IDA14 grant framework, ADB's fiduciary responsibilities will require ADB staff to confirm the results of the DSAs. ADB has therefore been discussing the issue of its participation in the DSA with IMF and the World Bank. To

<sup>18</sup> As previously noted, exceptions to this restriction could be considered in individual cases for high revenue-earning projects that generate more net foreign exchange than the foreign debt-service requirement. This is consistent with the approach in the graduation policy for OCR borrowing by ADF-only countries.

<sup>19</sup> Armenia and Sri Lanka, which are also blend countries for ADB, are being classified by IDA as "gap" countries from FY2007 and are no longer eligible for IDA grants. Tuvalu (ADF-only) is not an IDA member. Tonga, an IDA-only country and a blend country in ADB, is being considered for reclassification as an ADF-only country in the proposed revision of the graduation policy.

contribute fully to the analytical work, ADB will ensure that staff assigned for DSA tasks are sufficiently trained in the techniques.

### **3. Nonconcessional Borrowing by Grant Recipients**

26. The purpose of providing grants to a country is to help improve the external debt situation and to ensure its future sustainability. However, a country may use the borrowing headroom freed up by the switch from concessional loans to grants to contract debt on commercial terms. In effect, the ADF grant would be subsidizing such nonconcessional lenders by reducing the likelihood of the country's default. IDA has introduced mechanisms to deter grant-eligible countries from acquiring or expanding their commercial debt.<sup>20</sup> Under these mechanisms, IDA allocations will either be reduced or their terms hardened. ADB will adopt a similar approach should an ADF grant-recipient begin accumulating nonconcessional debt.

### **4. International Development Association Grant Framework under Review**

27. IDA continues to review and report on its experience in implementing the new framework. During the IDA14 midterm review, IDA reported that the newly introduced grant mechanism seems to be succeeding in preserving the strength of the PBA incentive system, while avoiding excessive volume cuts that could jeopardize the countries' progress toward the Millennium Development Goals. This result seems to confirm the new system's robustness. However, IDA continues to monitor the implications of the provision of debt relief for the grant framework, to avoid the reaccumulation of unsustainable debt by the countries benefiting from these initiatives. Steps to extend the framework to accommodate a country's projected debt dynamics and measures to mitigate shocks are also likely to be considered. Thus, the IDA grant framework may evolve further. Keeping the grant systems of IDA and ADF closely aligned will continue to require close institutional coordination.

## **B. Financial Implications**

28. Under the existing ADF IX financing arrangements, forgone interest from grants has been financed through additional donor contributions computed on the basis of a total ADF IX grant envelope of \$1.26 billion (18% of the \$7.0 billion in planned operations). Assuming that the planned ADF operations are achieved, the total grant utilization in ADF IX—comprising grant commitments for 2005–2006 made under the existing grant framework and projected commitments for 2007–2008 under the revised grant framework—is likely to exceed this envelope by \$240 million. The estimates of the incremental forgone reflows resulting from the alignment are indicated in Table 5.<sup>21</sup> The associated incremental forgone interest resulting from the increase in grants due to the revision of the grant framework is estimated to be \$51 million in nominal terms and \$27 million in NPV terms. This incremental amount of forgone interest is not covered by the additional donor contributions agreed at the conclusion of the ADF IX negotiations. The introduction of the hard-term ADF window will cover the incremental forgone interest; no additional contributions will be required for the remainder of ADF IX.

29. Starting with ADF X, the allocation of grants will result in a compounded loss of reflows and interest income to ADF. A simulation developed to illustrate the future financial implications of the grant framework assumes that grant shares are maintained at 25% of total ADF funding,

<sup>20</sup> IDA. 2006. *IDA Countries and Non-Concessional Debt: Dealing with the Free-Rider Problem in IDA14 Grant-Recipient and Post-MDRI Countries*. Washington, DC (23 June).

<sup>21</sup> These estimates are based on the 2006 country performance assessment results, the policy performance-dependent debt-distress classification in Appendix 2, and ADF's revised disbursement scheme.

**Table 5: Incremental Reflows Forgone during ADF IX  
from the Grant Framework Alignment**  
(\$ million)

Item	Incremental Reflows Forgone	
	NPV	Nominal
Interest	27	51
Principal	94	240
<b>Total</b>	<b>121</b>	<b>292</b>

ADF = Asian Development Fund, NPV = net present value.

Note: Figures might not sum to totals because of rounding.

Source: Asian Development Bank estimates.

as is currently observed. The amount of grant approvals depends on the overall level of funding, which in turn depends on the quantity of donor contributions in each replenishment. The simulation uses a constant \$3.5 billion in nominal terms for donor contributions from ADF X onward. This is equal to the amount contributed by donors for ADF IX evaluated at current exchange rates. However, this is only an assumption for an illustrative exercise to give a broad indication of the financial implications of grant alignment. Actual funding will, of course, depend on the outcome of each replenishment negotiation.

30. Table 6 shows the possible financial impact of future grants on ADF under the assumed scenario.<sup>22</sup> The grant approval amount ranges from \$1.5 billion during ADF IX to \$3.0 billion at the end of the simulation period, representing 25% of the funding. Total forgone reflows of interest and principal from grants are projected to reach \$3.3 billion in the final period, for a cumulative loss of \$14.7 billion in nominal terms. The cumulative loss of interest and principal repayments in 2005 NPV terms is \$4.0 billion. The incremental loss from the alignment of the grant policy comes from the assumed increase from 18% in the current ADF IX framework to 25%. This leads to a cumulative loss of \$2.9 billion in principal (\$756 million in NPV terms) and nearly \$1.0 billion in interest (\$273 million in NPV terms) for the whole simulation period.

31. With the grant share constant at 25% and ADF operations projected to increase, maintaining the expanded advance commitment authority will require significant additional donor contributions. Over the projection period, the overall expanded advance commitment authority is estimated to be 20%–29% lower than without any ADF grants. Although the hard-term ADF facility will help cover some of the forgone interest, some interest will be lost, which will reduce future ADF operations in the absence of additional contributions. As part of the ADF IX financing arrangements, donors agreed to finance the lost principal reflows on a pay-as-you-go basis. The same approach will be suggested in future replenishments.

<sup>22</sup> The results are sensitive to the sets of assumptions used. The expanded advance commitment authority calculation method is now under review.

**Table 6: Projection of Possible Financial Implications of Grant Alignment**  
(\$ million)

**A. Forgone Reflows from All Asian Development Fund Grants**

Period	Grant Approvals	Nominal Value			Net Present Value		
		Principal	Interest	Total	Principal	Interest	Total
2005–2008 (ADF IX)	1,500	0	1	1	0	1	1
2009–2012 (ADF X)	2,275	0	24	24	0	19	19
2013–2016 (ADF XI)	2,613	33	85	118	21	55	76
2017–2020 (ADF XII)	2,665	346	216	561	184	116	300
2021–2024 (ADF XIII)	2,771	763	340	1,103	339	152	490
2025–2028 (ADF XIV)	2,892	1,215	443	1,658	445	163	608
2029–2032 (ADF XV)	3,043	1,677	525	2,202	506	159	665
2033–2036 (ADF XVI)	3,043	2,072	587	2,659	515	146	661
2037–2040 (ADF XVII)	3,043	2,446	633	3,079	501	130	630
2021–2044 (ADF XVIII)	3,043	2,646	663	3,309	446	112	558
Total	26,891	11,197	3,517	14,714	2,957	1,052	4,008

**B. Incremental Forgone Reflows from Alignment**

Period	Incremental Grant Approvals	Nominal Value			Net Present Value		
		Principal	Interest	Total	Principal	Interest	Total
2005–2008 (ADF IX)	240	0	0	0	0	0	0
2009–2012 (ADF X)	637	0	3	3	0	2	2
2013–2016 (ADF XI)	732	0	16	16	0	11	11
2017–2020 (ADF XII)	746	65	51	116	34	28	62
2021–2024 (ADF XIII)	776	181	88	268	80	39	119
2025–2028 (ADF XIV)	810	307	119	426	112	44	156
2029–2032 (ADF XV)	852	438	143	581	132	43	175
2033–2036 (ADF XVI)	852	555	162	717	138	40	178
2037–2040 (ADF XVII)	852	666	173	840	136	36	172
2021–2044 (ADF XVIII)	852	728	179	907	123	30	153
Total	7,350	2,940	935	3,876	756	273	1,029

ADF = Asian Development Fund.

Notes: Figures may not sum to totals because of rounding. Net present value calculations assume a 5.0% discount rate. Incremental forgone reflows are the additional amounts forgone after alignment compared with those under the current framework.

Source: Asian Development Bank.

**V. RECOMMENDATION**

32. The President recommends that the Board approve the revision of the ADF grant framework, as described in paras. 14–21. The provisions of this new grant framework will supersede the grant framework of the revised PBA policy.<sup>23</sup> If approved, the revised grant framework will be applied to the 2007–2008 ADF allocations.

<sup>23</sup> ADB. 2004. *Review of the Asian Development Bank's Policy on the Performance-Based Allocation of Asian Development Fund Resources*. Manila.

## DEBT-SUSTAINABILITY FRAMEWORK

1. The International Development Association (IDA) revised its grant framework with the IDA14 replenishment and introduced the revised framework on 1 July 2005.<sup>1</sup> The new framework differs significantly from the IDA13 and Asian Development Fund (ADF) IX grant frameworks as it limits eligibility for grants to IDA-only countries and its allocation system is anchored in the new International Monetary Fund (IMF)-World Bank debt-sustainability framework (DSF).<sup>2</sup>

2. The DSF seeks to minimize the possibility that low-income countries will incur unsustainable debts in view of the large financing needs implied by the Millennium Development Goals. An evaluation of prospective debt dynamics and judgments about the risk of debt distress lie at the core of the new framework. The analytical basis for this system rests on three pillars: (i) policy-dependent external debt thresholds, (ii) debt-sustainability analyses and associated stress tests, and (iii) an appropriate borrowing (and lending) strategy that contains the risk of debt distress. Initially, IDA14 grant eligibility rests on the first pillar, supplemented by debt-sustainability analyses (second pillar) as these become available. Under the first pillar, projected solvency (ratio of the net present value of external debt to gross domestic product and exports) and liquidity (debt-service ratios) indicators are compared with threshold levels that demarcate acceptable levels of risk of default.<sup>3</sup> If projected indicator values breach the relevant acceptable levels, this is taken as a preliminary signal of a high risk of default. Where projected indicator values are below the thresholds, this is taken as a preliminary signal that the risks of default are low (footnote 2). Before a final judgment is made about the risks of debt distress, the impact of plausible shocks on the signals generated by the threshold analysis is considered and the individual country circumstances are examined in detail.

3. The implementation of the DSF requires country debt-sustainability analyses using new debt templates for each low-income country. Although IMF and the World Bank will lead the debt-sustainability analysis work, close coordination with other donors is envisaged at the country level. At the operational level, decisions on the financing mix that draw on the debt-sustainability analysis will also require close donor coordination. The DSF is expected to be fully operational in 2–3 years. Until the DSF is fully implemented, IDA adopts a partial approach to determining eligibility and allocation of grants. Where a full debt-sustainability analysis is unavailable, a threshold analysis that provides a snapshot of the likelihood of debt distress is applied.

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<sup>1</sup> IDA. 2005. *Addition to IDA Resources: Fourteenth Replenishment. Working Together to Achieve Millennium Development Goals*. Washington, DC (10 March).

<sup>2</sup> IMF and World Bank. 2004. *Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications*. Washington, DC (3 February); IMF and World Bank. 2005. *Operational Framework for Debt Sustainability Assessments in Low-Income Countries*. Washington, DC (28 May); and IMF and World Bank. 2006. *Review of Low-Income Country Debt Sustainability Framework and Implications of MDRI*. Washington, DC (26 March).

<sup>3</sup> The precise tolerance selected for the probability of default is ultimately subjective and reflects preferences about different types of prediction error. By setting thresholds that give a lower probability of default, more countries will be considered at risk of distress and fewer cases of defaults will occur that were not predicted. However, a lower probability of default will also generate more cases where the risks of debt distress are considered unacceptably high, but defaults do not occur.

## DEBT-DISTRESS CLASSIFICATION FOR 2007

Quality of Policies and Institutions/ Debt Threshold <sup>a</sup>	Country	Basis for Assessment <sup>b</sup>	Narrative Summary of Assessment	Debt-Distress Classification
<b>Strong</b> <b>(Score ≥ 3.75)</b>  NPV of Debt as Percentage of GDP        50 Exports    200 Revenue    300  Debt Service as Percentage of: Exports    25 Revenue    35	Bhutan	Static approach (2005)	<ul style="list-style-type: none"> <li>• NPV debt/GDP = 80%</li> <li>• NPV debt/exports = 341%</li> <li>• Debt service/exports = 3%</li> </ul>	High risk
	Maldives	Static approach (2005)	<ul style="list-style-type: none"> <li>• NPV debt/GDP = 40%</li> <li>• NPV debt/exports = 51%</li> <li>• Debt service/exports = 6%</li> </ul>	Low risk
	Samoa	DSA (May 2005)	<ul style="list-style-type: none"> <li>• NPV debt/GDP and NPV debt/revenue ratios well below thresholds in the baseline scenario</li> <li>• Stress testing shows some minor breaches in NPV debt/GDP ratio</li> </ul>	Moderate risk
<b>Medium</b> <b>(3.25 &lt; Score &lt; 3.75)</b>  NPV of Debt as Percentage of GDP        40 Exports    150 Revenue    250  Debt Service as Percentage of Exports    20 Revenue    30	Cambodia	DSA (July 2006)	<ul style="list-style-type: none"> <li>• All debt indicators are below the thresholds in the baseline scenario, which assumes agreement on the restructuring of debt from the United States and the Russian Federation, including up-front 70% discount of the Russian debt; this assumption is needed to contain the projected debt indicators below the policy performance-dependent thresholds</li> <li>• Stress testing shows some minor breaches in NPV debt/revenue ratio</li> </ul>	Moderate risk
	Kyrgyz Republic	Static approach (2005)	<ul style="list-style-type: none"> <li>• NPV debt/GDP = 60%</li> <li>• NPV debt/exports = 168%</li> <li>• Debt service/exports = 14%</li> </ul>	High risk
	Mongolia	DSA (November 2005)	<ul style="list-style-type: none"> <li>• NPV debt/GDP above the thresholds in most years of the baseline scenario</li> <li>• Stress testing shows breaches in NPV debt/GDP and NPV debt/exports ratios</li> </ul>	High risk
	Nepal	DSA (February 2006)	<ul style="list-style-type: none"> <li>• NPV debt/exports and NPV debt/revenue ratios above the thresholds in the baseline scenario</li> <li>• Stress testing shows significant breaches in the thresholds of these indicators and in NPV debt/GDP ratio</li> </ul>	High risk
	Tajikistan	DSA (February 2006)	<ul style="list-style-type: none"> <li>• All debt indicators are below the thresholds in the baseline scenario</li> <li>• Stress testing shows breaches in NPV debt/GDP, NPV debt/exports, and NPV debt/revenue ratios</li> </ul>	Moderate risk

Quality of Policies and Institutions/ Debt Threshold <sup>a</sup>	Country	Basis for Assessment <sup>b</sup>	Narrative Summary of Assessment	Debt-Distress Classification
	Tonga <sup>c</sup>	DSA (June 2006)	<ul style="list-style-type: none"> <li>All debt indicators are below the thresholds in the baseline scenario</li> <li>Stress testing shows breaches in the NPV debt/GDP, NPV debt/exports, and NPV debt/revenue ratios</li> </ul>	Moderate risk
<b>Weak (Score ≤ 3.25)</b>  NPV of Debt as Percentage of GDP 30 Exports 100 Revenue 200  Debt Service as Percentage of Exports 15 Revenue 25	Afghanistan	HIPC preliminary document (March 2007)	<ul style="list-style-type: none"> <li>NPV debt/Exports ratio is 585% (306% after traditional debt relief), well in excess of the threshold; threshold on NPV debt/revenue ratio also breached in the baseline even after traditional debt relief</li> </ul>	High risk
	Kiribati	—	<ul style="list-style-type: none"> <li>Data not available; IDA classification used</li> </ul>	Low risk
	Lao PDR	DSA (November 2006)	<ul style="list-style-type: none"> <li>NPV debt/GDP, NPV debt/exports, and NPV debt/revenue ratios breach their policy-dependent thresholds under the baseline scenario</li> <li>Stress testing shows significant breaches in these debt-indicator thresholds</li> </ul>	High risk
	Solomon Islands	DSA (October 2006)	<ul style="list-style-type: none"> <li>NPV debt/GDP above the threshold in the baseline scenario</li> <li>Stress testing shows significant breaches in NPV debt/GDP and NPV debt/exports thresholds</li> </ul>	High risk
	Timor-Leste <sup>d</sup>	IMF, Article IV (February 2007)	<ul style="list-style-type: none"> <li>IMF Article IV consultation noted that the country has no public sector debt, as the authorities have a policy of avoiding domestic or external borrowing</li> </ul>	Low risk
	Tuvalu <sup>e</sup>	—	<ul style="list-style-type: none"> <li>From available data, NPV debt/GDP ratio is roughly 36%, well above the policy performance-dependent threshold</li> <li>Exports are negligible</li> </ul>	High risk
	Vanuatu	Static approach (2005)	<ul style="list-style-type: none"> <li>NPV debt/GDP = 18%</li> <li>NPV debt/exports = 45%</li> <li>Debt service/exports = 2%</li> </ul>	Low risk

ADB = Asian Development Bank, ADF = Asian Development Fund, DSA = debt-sustainability analysis, GDP = gross domestic product, HIPC = heavily indebted poor countries, IDA = International Development Association, IMF = International Monetary Fund, Lao PDR = Lao People's Democratic Republic, NPV = net present value.

<sup>a</sup> The performance category is based on ADB's 2006 country performance assessment ratings, except for Bhutan, Maldives, Samoa, Tonga, and Tuvalu, where the 2005 ratings are used. The performance score is the unweighted average of the following four performance indicator clusters: economic management, structural policies, policies for social inclusion/equity, and governance.

<sup>b</sup> The DSA approach to debt-distress classification uses a forward-looking analysis of the evolution of a country's debt indicators to determine the potential for debt distress. For the 2007 classification, a cutoff date of 31 December 2006 for published DSAs was used. The debt-distress categories are

(i) High risk: the DSA baseline scenario indicates a breach of policy performance-dependent debt or debt-service thresholds over the projection period; this is worsened by stress testing.

- (ii) Moderate risk: although policy performance-dependent debt or debt-service thresholds are not breached in the DSA baseline scenario, stress testing shows a significant rise in debt-service ratios over the projection period or a breach of debt thresholds.
- (iii) Low risk: all debt indicators are well below policy performance-dependent debt-burden thresholds in the DSA baseline scenario, and stress testing does not result in indicators significantly breaching thresholds.

The static approach to assessing a country's external debt situation is an interim measure used until a forward-looking DSA is completed. Using debt and GDP data for 2005 and average exports for 2003–2005, the debt-distress classification is determined as follows:

- (i) Percentage differences between actual debt-burden indicators for the NPV debt/GDP, NPV debt/exports, and debt service/exports ratios and their respective policy performance-dependent thresholds are calculated.
  - (ii) The percentage differences for the two NPV debt ratios are averaged, and the average is compared with the percentage difference for the debt-service ratio.
  - (iii) The risk rating is determined to be high-risk if the higher percentage difference is more than 10% above the threshold, low-risk if it is less than 10% below the threshold, or moderate-risk if it is somewhere between the two.
- <sup>c</sup> Tonga's debt distress classification is for information only. The country is currently a blend borrower in ADB, but is being considered for reclassification as an ADF-only country under the proposed revision of the graduation policy. Grant eligibility is contingent on the country reclassification.
- <sup>d</sup> Timor-Leste's access to grants on a postconflict basis (40% of its performance-based allocation) will be extended until the end of ADF IX, after which its grant eligibility will be based on debt-sustainability criteria.
- <sup>e</sup> Tuvalu is not a World Bank member and so does not have an IDA debt-distress classification. Establishing the level of debt distress is hampered by data limitations. The NPV debt/GDP ratio is based on the NPV of debt from 2005 and GDP for 2002 from government sources.
- Sources: IMF and World Bank documents, as indicated; and ADB staff assessments.

### COMPARATIVE LOAN TERMS FOR HARD-TERM LOAN FACILITIES

Item	Asian Development Fund	International Development Association
Currency	SDR	SDR
Maturity	32 years for project loans 24 years for program loans	35 years
Grace Period	8 years	10 years
Commitment Fee	None	Variable: 0.0%–0.5% of the undisbursed balance <sup>a</sup>
Service Charge	None	0.75% of the disbursed and outstanding balance
Interest Rate	OCR rate minus 150 basis points <sup>b</sup>	IBRD rate minus 200 basis points <sup>c</sup>
Fixed/Floating Rate	Fixed	Fixed
Repayment Rate	Equal installments (4.17% p.a. for project loans and 6.25% p.a. for program loans)	2.5% p.a. for years 11–20 and 5% p.a. for years 21–35
Eligible Borrowers	Blend countries with (i) per capita income not exceeding the IDA operational cutoff for more than 2 consecutive years, and (ii) an active OCR lending program <sup>d</sup>	Blend countries with (i) per capita income below the IDA operational cutoff, and (ii) an active IBRD lending program

ADF = Asian Development Fund, IBRD = International Bank for Reconstruction and Development, IDA = International Development Association, OCR = ordinary capital resources, p.a. = per annum, SDR = special drawing rights.

<sup>a</sup> The IDA commitment fee is a variable charge set annually within a range of 0.0% to 0.5%. For FY2007 (ending 30 June 2007), the commitment charge is 0.2%.

<sup>b</sup> Calculated as the weighted average of the 10-year fixed swap rates of the SDR component currencies plus the OCR lending spread. The rate will be announced annually in January (except in 2007) and applied for the term of all loans approved that calendar year. The minimum interest rate is the standard ADF rate: 1% on the disbursed and outstanding balance during the grace period, and 1.5% thereafter. For loans approved in 2007, the interest rate is 3.85%, based on the prevailing interest rates on 31 July 2007. For loans approved after 2007, the interest rate will be determined based on the rates of the last working day of the preceding year.

<sup>c</sup> For loans approved during IDA's 2008 fiscal year, the interest rate is 4.2%, fixed for the term of the loan.

<sup>d</sup> Access by ADF-only countries could be considered in individual cases for revenue-earning projects that generate net foreign exchange above the foreign debt-service requirement.

Sources: Asian Development Bank and World Bank.