

**OPERATIONS MANUAL
BANK POLICIES (BP)**

These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

CLASSIFICATION AND GRADUATION OF DEVELOPING MEMBER COUNTRIES

A. Introduction

1. Article 14 (v) and (vi) of the *Agreement Establishing the Asian Development Bank* (the Charter) provide that, in financing the development of its developing member countries (DMCs), the Asian Development Bank (ADB) will pay due regard to the ability of the borrower to obtain financing elsewhere on terms and conditions that ADB considers reasonable for the recipient, and that ADB will pay due regard to the borrower's capacity to service ADB loans. Article 2 (ii) of the Charter provides that ADB should have special regard to the needs of smaller or less developed member countries in Asia and the Pacific.

B. The Graduation Policy¹

2. ADB employs a classification system for its DMCs that meet the requirements of the Charter (para. 1) by establishing criteria to determine their eligibility to borrow from the Asian Development Fund (ADF) and their access to ordinary capital resources (OCR). As economic conditions in a DMC change over time, its classification may also change. Once a DMC has reduced its dependence on official assistance and has reliable access to commercial capital, it may graduate from regular ADB assistance.

C. Scope of the Policy

1. Classification

3. The two main criteria adopted to classify DMCs are (i) gross national income (GNI) per capita, and (ii) creditworthiness. Under the graduation policy, regarding GNI per capita, ADB uses the World Bank's GNI per capita estimates based on the Atlas method. Creditworthiness of DMCs is assessed by a creditworthiness assessment committee in accordance with the graduation policy.² The creditworthiness assessment committee consists of representatives of the Risk Management Unit, the Treasury Department, the Economics and Research Department, and the Strategy and Policy Department; it is chaired by the Strategy and Policy Department.

4. A review of country classification would normally take place at the same time as the ADF replenishment exercise. ADB may undertake country classification of a new DMC, or a review of individual country classification if economic conditions in that country warrant it. Country classifications of DMCs based on the proposed framework will be submitted to the Board for

¹ ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila; and ADB. 1998. *A Graduation Policy for ADB's DMCs. Corrigendum 1*. Manila.

² ADB's *Public Communications Policy* (2005) presumes the disclosure of information, but provides for specific exceptions. Para. 126 (6) of the policy provides that the analysis of country creditworthiness and credit ratings shall not be made publicly available.

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approval, generally on a no-objection basis. Country classification papers submitted to the Board would normally contain modified or condensed information on the assessment of creditworthiness, which would not be made publicly available (footnote 2). However, country classification of DMCs will be made publicly available upon approval by the Board (see Section E below).

2. Graduation from ADF

5. ADB adopts the International Development Association's (IDA) operational cutoff for eligibility as the income threshold. IDA's current GNI per capita operational cutoff is \$1,065 in 2006 US dollars, which is updated periodically (usually annually). Graduation from ADF resources is normally triggered when a country exceeds the per capita GNI operational cutoff (\$1,065 in 2006 US dollars) and achieves adequate creditworthiness for OCR or market-based resources. Graduation from ADF resources involves close consultation with the borrower. The process of graduation normally takes about 4 years to complete, after crossing the income threshold.

3. Graduation from Regular ADB Assistance

6. The criteria for graduation from regular ADB assistance are (i) GNI per capita, (ii) availability of commercial capital flows on reasonable terms, and (iii) attainment of a certain level of development by key economic and social institutions. ADB uses the International Bank for Reconstruction and Development's (IBRD) benchmark of \$6,275 in 2006 US dollars to trigger the graduation process. The benchmark is updated periodically (usually annually).

7. When a country reaches the GNI per capita benchmark, ADB will then analyze a country's readiness for graduation, applying the criteria set out in para. 6. Recognizing that countries reaching the graduation threshold may differ in the extent of their progress toward developing key institutions for economic and social development, ADB will take a flexible approach to determining the pace of graduation. Graduation from regular ADB assistance will also involve close consultation with the borrower. Graduation from new OCR lending normally occurs within 5 years after a country crosses the graduation benchmark, with variations according to country-specific conditions. Direct private sector investment by ADB in graduated DMCs would cease.

8. A developing member country graduating from either ADF or OCR resources may be eligible for these resources again if its economic conditions deteriorate.

D. Application of the Policy

9. Reliable macroeconomic information is a prerequisite for classifying a DMC. Normally, ADB prepares an economic report before classifying a new DMC. A Board paper on the classification of the new DMC is prepared only after the economic report has been completed. In some cases, however, it is sufficient to rely on reports prepared by the World Bank, the International Monetary Fund, or United Nations agencies.

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E. Classification of DMCs

Group A (ADF-only):	Afghanistan, Bhutan, Cambodia, Kiribati, Kyrgyz Republic, Lao People's Democratic Republic, Maldives, Mongolia, Myanmar, ³ Nauru, ³ Nepal, Samoa, Solomon Islands, Tajikistan, Timor-Leste, Tonga, Tuvalu, Vanuatu
Group B (Blend):	Armenia, Azerbaijan, Bangladesh, Georgia, India, ³ Marshall Islands, Federated States of Micronesia, Pakistan, Palau, ³ Papua New Guinea, Sri Lanka, Uzbekistan, Viet Nam
Group C (OCR-only):	Cook Islands, ⁴ People's Republic of China, Fiji Islands, Indonesia, ⁴ Kazakhstan, Malaysia, Philippines, Thailand, Turkmenistan

10. ADB lending on OCR terms and ADB guarantees with counter-guarantees from a government can be considered on an exceptional basis for Group A DMCs for projects that are foreign exchange earning and are able to fully service their foreign debt from their net foreign exchange earnings.

F. Relationship between Graduated DMCs and ADB

11. Currently, four DMCs—Hong Kong, China; the Republic of Korea; Singapore; and Taipei, China—have graduated from regular ADB assistance.

12. Graduation from regular assistance is not linked to the DMC status of the country, nor does it signify termination of a DMC's relationship with ADB. In the context of an economic crisis, emergency assistance is available to graduated DMCs; ADB may provide expert services and technical assistance (on a reimbursable basis) as requested and if available; ADB may contribute to the development of capital markets of its graduated DMCs through its borrowing activities; transfer of technology may be arranged between graduated DMCs and other DMCs; cofinancing opportunities with ADB may arise; ADB may promote private-to-private flows from graduated DMCs to other DMCs; and graduated DMCs may become involved in subregional projects.

³ Currently with no access to ADF. However, Nauru and Palau will have access to ADF effective on 1 January 2009.

⁴ Effective on 1 January 2009, until then a Group B borrower in ADB.

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- Basis:** This OM section is based on
- ADB. 2008. Doc. R71-08. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila.
- ADB. 1998. Doc. R204-98. *A Graduation Policy for ADB's DMCs. Corrigendum 1*. Manila.
- Compliance:** This OM section is subject to compliance review.
- For inquiries:** Questions may be directed to the Senior Director of the Strategic Planning, Policy, and Interagency Relations Division, Strategy and Policy Department.

**OPERATIONS MANUAL
OPERATIONAL PROCEDURES (OP)**

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This OM section does not contain operational procedures.