What do we mean by "graduation" and what are the implications for financing development?

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6 questions

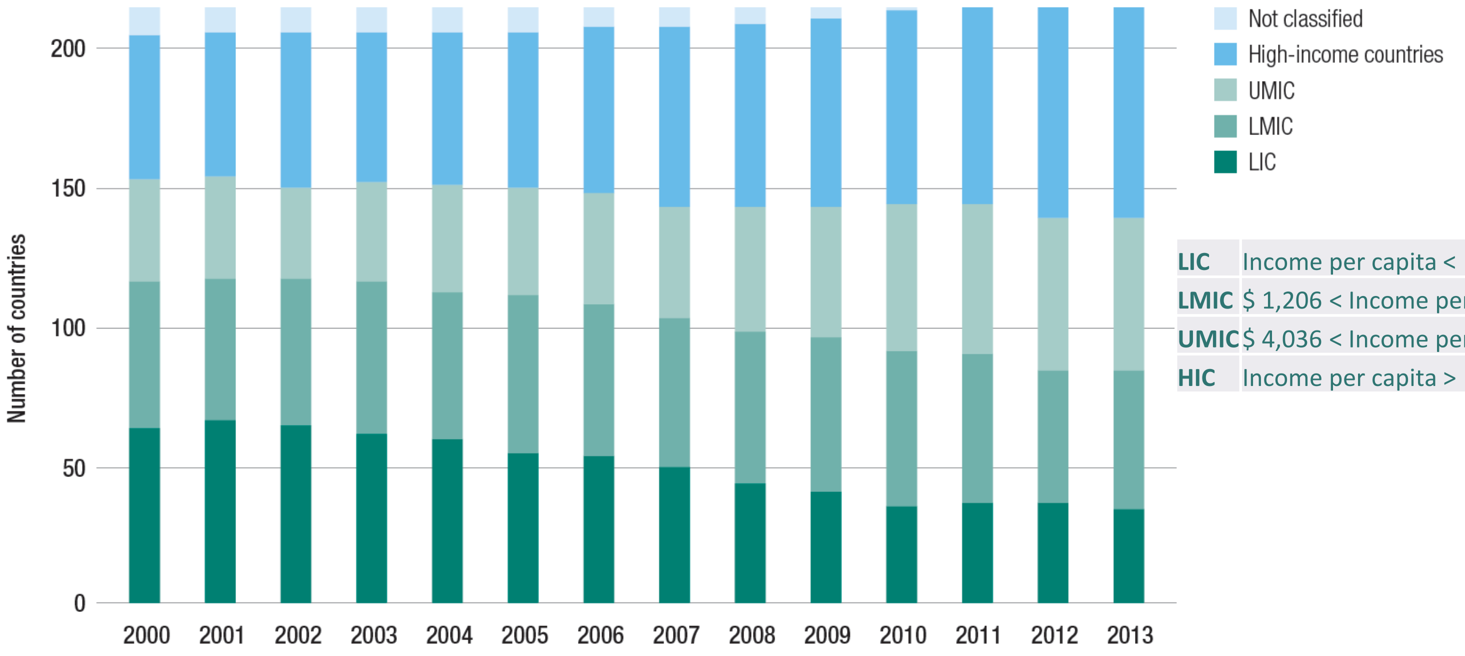
1. What do we mean by “**graduation**”?
2. Why is “graduation” **now** relevant?
3. Which **countries** are expected to “graduate”?
4. What are the **implications** of “graduation” for the volume, type, number of options and conditions of **development finance**?
5. What are the **problems** with the current approaches to “graduation”?
6. What are the **options for reform**?

1. What do we mean by "graduation"?

	Income criteria (trigger)	Other criteria
Graduation from soft windows of MDBs (World Bank, AfDB, AsDB, IADB)	e.g. IDA GNI per capita above IDA operational cut-off (US$1,215 for FY16).	positive **creditworthiness assessments** based on 8 components: • political risk • external debt and liquidity • fiscal policy and public debt burden • balance of payment risks • economic structure and growth prospects • monetary and exchange rate policy • financial sector risks, and • corporate sector debt
Graduation from LDC category	GNI per capita above $ 1,230	• **Human Assets** Index 66 or above • **Economic Vulnerability** Index 32 or below
Graduation from GFATM assistance	Income per capita (above LMIC threshold)	Combination with the **level of disease** burden and **targeting of vulnerable population** e.g. Upper-middle-income countries ($3,956 to $12,235, as of 2017) – who are eligible to receive an allocation and apply for funding if they meet certain disease burden requirements, and must focus this funding exclusively towards maintaining or scaling up interventions for key and vulnerable populations
Graduation from GAVI assistance	Increasing **co-financing costs** based on a) income per capita b) a WHO/UNICEF penta3 coverage estimate of below 90%	
Graduation from ODA eligibility (OECD)	Exceeded the **high-income threshold** for 3 consecutive years at the time of the review (every 3 years)	

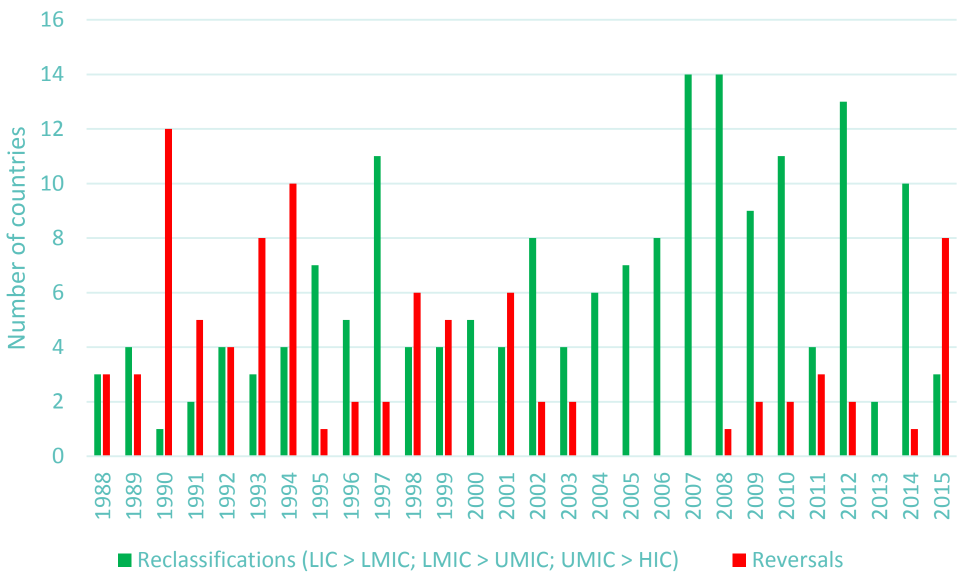
2. Why is "graduation" now relevant?

More and more countries joined the ranks of MICs…



LIC	Income per capita < $ 1,025
LMIC	$ 1,206 < Income per capita < $ 4,035
UMIC	$ 4,036 < Income per capita < $ 12,475
HIC	Income per capita > $ 12,476

…with fewer reversals over time



3. Which countries are expected to "graduate"?

IDA graduation: Moss & Leo (2011)

Table 1 – Projected Graduates by IDA Replenishment Period, Baseline Scenario[11]

IDA-15	IDA-16	IDA-17	IDA-18	IDA-19	IDA-20	IDA-21
Azerb. (H/B)	Angola (H)	Cameroon	Côte d'Ivoire	Cambodia		Bangladesh
	Armenia (H/B)	India (B)	Kenya	Ghana*		Benin
	Bhutan (H)	Nigeria	Kyrgyz Rep.	Lesotho		
	Bolivia (H)	Vietnam (B)	Laos	Nicaragua		
	Bos. & Herz. (H/B)	Yemen Rep.	Mauritania	Pakistan (B)		
	Congo, Rep. of (H)	Zambia	PNG (B)	Senegal		
	Djibouti			Tajikistan		
	Georgia (H/B)					
	Guyana					
	Honduras (H)					
	Moldova (H)					
	Mongolia					
	Sri Lanka (H)					
	Sudan*					
	Uzbekistan (B)					

ODA graduation: OECD (2014)

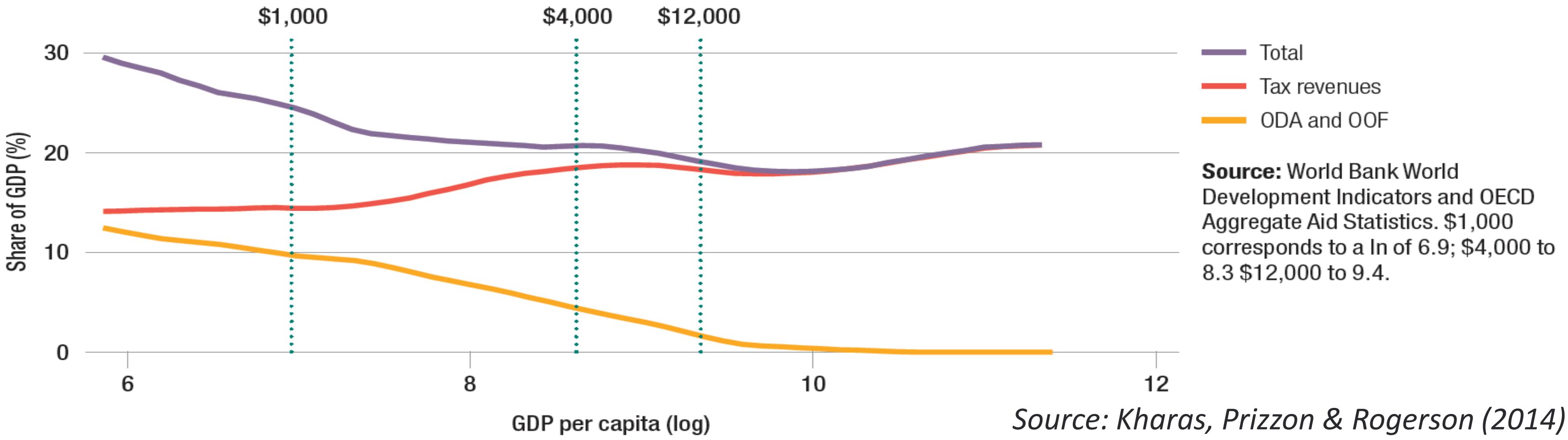
The DAC list in 2030 using current and adjusted thresholds

a) ODA eligible countries under IBRD threshold		b) Additional eligible countries if high income threshold retained	c) Countries which will leave the list under either threshold
Afghanistan	Mali	Algeria	Anguilla
Albania	Marshall Islands	Angola	Antigua and Barbuda
Bangladesh	Mauritania	Armenia	Argentina
Belize	Micronesia, Fed. States	Azerbaijan	Botswana
Benin	Moldova	Belarus	Brazil
Bolivia	Morocco	Bhutan	Chile
Bosnia-Herzegovina	Mozambique	Colombia	China
Burkina Faso	Myanmar	Dominica	Cook Islands
Burundi	Nauru	Dominican Republic	Costa Rica
Cambodia	Nepal	Ecuador	Gabon
Cameroon	Nicaragua	Equatorial Guinea	Iraq
Cape Verde	Niger	Former Yugoslav Republic of Macedonia	Kazakhstan
Central African Rep.	Nigeria		Lebanon
Chad	Niue	Grenada	Libya
Comoros	Pakistan	Indonesia	Malaysia
Congo, Dem. Rep.	Papua New Guinea	Jordan	Mauritius
Congo, Rep.	Philippines	Maldives	Mexico
Cote d'Ivoire	Rwanda	Mongolia	Montserrat
Cuba	Samoa	Montenegro	Palau
Djibouti	Sao Tome & Principe	Namibia	Panama
Egypt	Senegal	Paraguay	Peru
El Salvador	Sierra Leone	Serbia	Seychelles
Eritrea	Solomon Islands	South Africa	St. Kitts-Nevis
Ethiopia	Somalia	St. Lucia	Suriname
Fiji	South Sudan	St. Vincent & Grenadines	Turkey
Gambia	Sri Lanka	Thailand	Turkmenistan
Georgia	St. Helena	Timor-Leste	Uruguay
Ghana	Sudan		Venezuela
Guatemala	Swaziland		Wallis & Futuna
Guinea	Syria		
Guinea-Bissau	Tajikistan		
Guyana	Tanzania		
Haiti	Togo		
Honduras	Tokelau		
India	Tonga		
Iran	Tunisia		
Jamaica	Tuvalu		
Kenya	Uganda		
Kiribati	Ukraine		
Korea, Dem. Rep.	Uzbekistan		
Kosovo[1]	Vanuatu		
Kyrgyz Republic	Vietnam		
Laos	West Bank & Gaza Strip		
Lesotho	Yemen		
Liberia	Zambia		
Madagascar	Zimbabwe		
Malawi			

4. What are the implications of "graduation" for the volume, type, number of options and conditions of development finance?

1. **Volume of resources**:

- “Missing middle” of development finance for LMICs/lower dependency on aid



Source: Kharas, Prizzon & Rogerson (2014)

- Lower assistance from bilateral donors (triggered at LIC-LMIC reclassification)
- Greater borrowing from international financial markets

2. Terms and conditions

- More loans, fewer grants
- More expensive terms and conditions for sovereign loans from MDBs

Typical terms and conditions of lending instruments

MDB	Instrument	Maturity	Grace period	Interest and other features
IDA	Regular credit	38 years	6 years	No interest. 0.75 % service charge (Special Drawing Rights (SDR)).
	Blend	25 years	5 years	1.25% interest. 0.75 % service charge (SDR).
	Hard-term lending	25 years	5 years	1.08% interest. 0.75 % service charge (SDR).
IBRD	Flexible loan, variable and fixed spread and development policy loans	8 to 15/20 years	N/A	6-month Libor, plus contractual spread of 0.5%. Front-end and commitment fee of 0.25% each.
	Special Development Policy Loan	5 to 10 years	3 to 5 years	6-month Libor plus a minimum of 2%. Front-end fee of 1% of the principal loan.

3. Sectoral allocation

- Increasing borrowing for infrastructure development, less so for the social sectors

5. What are the problems with the current approaches to graduation (from MDB soft loans and analytical reclassification)?

A. Limitations of income per capita determining graduation

1. **GNI per capita reflects the economic dimension only**, not development (analytical vs operational classification)
2. **GNI per capita can rapidly change** because of
   - **GDP rebasing** – updates in inflation rates (Ghana in 2010 – rise by 62.8%; Kenya in 2014 by 25.3% – shifting both countries from LIC to LMIC status!)
   - **Economic performance lower than population growth** – especially between LIC and LMIC group – e.g. Senegal and South Sudan

B. Bilateral donors can reinforce other donors' exit/transition and inform allocation based on analytical classification (LIC, LMIC)

C. "Cliff-edge" following MDB graduation – the "missing-middle" of development finance to be addressed

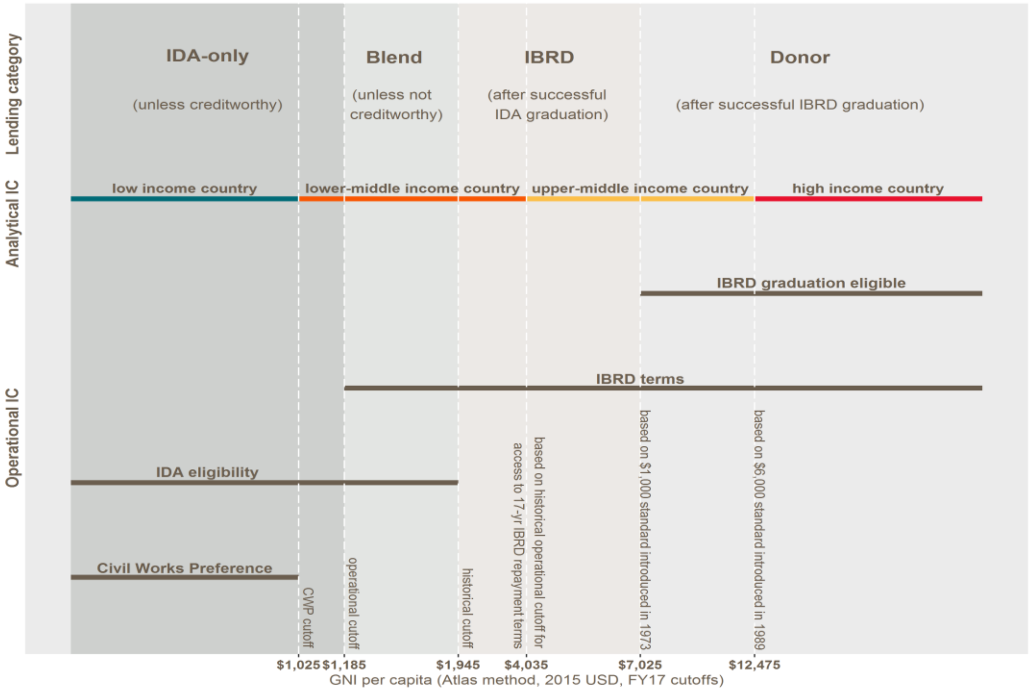
D. "One-size-fits-all" approach does not take exceptions into account (SIDSs)

E. Implications for the allocation of external assistance by sectors

5. *What are the* ***options for reform****?*

- Include non-income based criteria (graduation and allocation)
- Move from “graduation” to “gradation”
- Apply differentiated pricing
- Consider specific evidence-based exceptions e.g. for
  - Small Island Developing States (see exception for IDA)
  - Specific GPGs (climate change mitigation, regional integration)
  - Non-sovereign operations in MDBs (if no separate institution exists)
- Earmark resources for certain sectors

Being reclassified as a MIC does not mean a country graduates from IDA!



GAVI graduation process: increasing share of co-financing