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Concessional financing windows: reforming the magic triangle

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The Millennium Development Goals agenda is coming to an end. The post-2015 agenda is taking up the baton to define what the next development objectives and milestones should be. To achieve them, the financing agenda must be reconsidered in parallel. The reform of concessional financing, particularly the multilateral bank concessional financing windows, occupies a special place in this context.

The organizational framework for the concessional financing offered by multilateral development banks (MDBs) has until now been based on mobilizing donor contributions to generate funds which are allocated, in the form of grants or highly subsidized loans and based on performance, to recipient governments while meeting their debt sustainability level.

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•••/••• This system was put in place around fifteen years ago, and has since undergone a succession of only minor adjustments. Special waivers have also stacked up, producing an excessively complicated system. Reform of this system must be comprehensive and based on the magic triangle in which resource mobilization, allocation of resources and debt sustainability management are closely linked and achieve an overall balance.

Resources from traditional donors appear to have reached a climax. After the significant increase in official development assistance during the 2000s, reaching US$ 135 billion in 2014, and a highly focused political agenda, political mobilisation became more diffuse and was made more difficult by the budgetary constraints experienced by the main donors. Moreover, the development agenda was primarily driven by the traditional actors in the aid field (Europe, North America and Japan). It can therefore be reasonably expected that the level of concessional financing will face a float growth during the next replenishment cycles, with the notable exception of multilateral organisations focusing on an item which is an international political priority with leadership at the highest level. This was the case with the Green Climate Fund, which was able to raise more than US$ 10 billion pledges in Lima in December 2014 for its first fundraising initiative, thanks in particular to decisive commitment from the G20 heads of state and government.

In parallel, the performance-based allocation formula, the objective of which is to reward successful countries, has become increasingly complicated. Reality (health and food crises, climate disruption, support for endemically fragile and vulnerable regions) has introduced, over the course of various replenishment cycles, a number of a posteriori adjustments – whether to allocate funding based on exceptional circumstances (the Crisis Response Window provided by the World Bank (WB) and the Asian Development Bank (ADB) and the Fragile States Facility operated by the African Development Bank (AfDB)) or to target priorities such as the AfDB's regional integration projects. Since then, the stacking up of waivers and set asides has only made the allocation framework more cumbersome, rendering the whole system opaque and complex. There is a large volume of literature on this subject, demonstrating the need to take greater account of countries' structural vulnerability in a bid to make the system intrinsically fairer and more effective. The current performance-based system allocates little more than 50% of resources distributed and more than half of recipient countries – whether IDA or AfDF – are fragile countries. This trend will grow over the next ten years.

Debt sustainability remains a constant concern. Concessional loan maturities mean that it will be in 2020–2025 that the significant rise in loans granted between 2005 and 2015, as a result of the increased resources made available to concessional financing windows, will have a particular impact on the public finances of borrowing countries. This situation may leave countries vulnerable to external shocks, all the more so in the case of those countries which also borrowed from capital markets but on much more expensive terms – these loans will mature at the same time. A substantial increase in domestic resources is a necessity if countries are to be able to absorb these costs and maintain a sustainable level of debt.

The acceleration of countries completing the debt cancellation processes (HIPC and MDRI) combined with the acceleration of global economic changes is generating a multitude of paradoxical situations where countries currently eligible for concessional financing windows can, at the same time, gain access to capital markets. The recent revision of credit policies allowing countries in receipt of concessional financing to access non-concessional funds requires a comprehensive revision of classification and graduation procedures.

While the arguments in favour of maintaining concessional financing are strong – according

to WB estimates, extreme poverty will still affect 504 million people in 2025, 58 % of whom will be in Sub-Saharan Africa (80.7 % if India, the major source of poverty outside Africa, is excluded) – it is the way in which it is mobilised and allocated that needs to be fundamentally rethought.
Four main avenues of reform could be explored:

(i) the mobilisation of concessional financing should be based on high-level political consensus

With this in mind, there would appear to be a need for political re-appropriation of WB and regional development bank replenishment. Consequently, it would be desirable to hold the last replenishment meeting during the annual Governors' meetings, in other words at the ministerial level.

(ii) the division of effort between development institutions should be rethought in order to identify obvious comparative advantages

The first challenge for generalist institutions is to establish the best position between genuine selectivity and organising the work among themselves. Simple coordination – the leaders of the main MDBs meet on a regular basis – is not sufficient; there would need to be a return to the spirit of the founding fathers that Romeo Horton (former Governor of the Central Bank of Liberia and one of the founding fathers of the AfDB) described so well in his memoirs, where the mandate of the African bank, for example, was to target regional integration projects, while the WB would focus on national projects. This separation of tasks appears to be even more crucial for these two institutions in particular, as the majority of IDA countries are set to become AfDF countries within the next ten years, but it is clearly not limited to the WB and the AfDB. In the same vein, it is possible to take the view that national projects should primarily be the prerogative of bilateral development agencies, allowing MDBs to focus on global, cross-cutting and regional challenges.
Moreover, while the dialogue between development institutions is critical, it cannot replace the mandate granted by their shareholders. It would be useful to improve the coordination between ministerial agencies in capitals. This is why it would seem relevant – insofar as IDA and AFDF countries will converge over the next ten years – to organise in the margins of the WB's spring meetings and the AfDB's annual meetings, on an alternate basis, a joint meeting bringing together representatives from both institutions with the authority to discuss objectives and priorities that can then be taken to their respective boards.

(iii) country classification needs to be improved and there should be more granularity in the sectorial approach

Country allocation has demonstrated its limits, particularly due to the threshold effects that it produces, and it is now recognized that the existence of a single threshold (GNI per capita with an operational cut off of US$ 1,215 for the 2015 fiscal year) and creditworthiness indicator used to qualify all countries eligible for concessional financing is not relevant (IDA-only or AFDF-only) due to the heterogeneous nature of IDA and AFDF countries. The level of the current threshold (operational cut off of GNI per inhabitant of US$ 1,215 for the 2015 fiscal year) can be questioned. Across all IDA-only (excluding Latin America and the Caribbean), ADF-only and AFDF-only countries, 46% have a GNI of less than US$ 800 per inhabitant, and 91% of them are in Africa. In addition, 77% have a GNI per capita of less than US$ 1,500; this increases to 95% if only African countries are taken into account. Projections for graduation show that by 2022, the operational cut off – according to trajectories based on the IMF World Economic Outlook's 2013–2022 assumptions – will be around US$ 1,415 per capita. Among African countries alone, five countries could end up with gap status, just surpassing this cut off. These aspects are hardly satisfactory for at least three reasons: the first, as already mentioned, stems from the relative statistical reliability of the data, which has already been subject to variation and correction in the past, making it possible to use mechanisms with less definitive threshold effects; the second relates to the very small gap which exists between countries liable to reach gap status and the others, while their economic and budgetary strength does not necessarily match these gaps; finally, the question of overall consistency remains, particularly with regard to debt sustainability and the recent exceptions introduced in the implementation of institutions' credit policies. The idea of creating an IDA+ window is a step toward better classification. To limit the perverse effects of such thresholds as far as possible, it would probably be worth exploring a further refined classification, with IDA-only, IDA+ and IDA++ windows.

(iv) the framework for allocating resources should be adjusted to take account of these changes

The first measure would be to start to move progressively away from the CPIA (Country Policy and Institutional Assessment) as a rating used to calculate allocations, and instead to employ it primarily as a tool for political dialogue. Rating inflation combined with the fact that more than half of countries eligible for concessional financing are fragile states or countries in crisis renders the current system obsolete as well as excessively complicated. The trend over the next ten years will be even more pronounced. In such conditions, the inclusion of a vulnerability indicator makes perfect sense. On the other hand, it would seem desirable to retain the principle of the governance indicator while simplifying it, and the portfolio review, without which it would be impossible to assess project quality.

The proposed reforms of the magic triangle (mobilisation, allocation and debt) take account of the profound economic changes countries are experiencing, and the constraints faced by multilateral development institutions. But no reform is possible without the political will to lead it. It is therefore first and foremost for capitals and for shareholders to demonstrate the courage to lead an ambitious and strategic reform agenda for the next decade.

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