

## IDA in the poorer countries' debt crisis

Ishac Diwan, Martin Kessler, and Emanuele Properzi

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### Abstract

**The International Development Association (IDA) is the concessional lending arm of the World Bank and a major financier of the world's poorest countries.** Amid growing demands from its clients, its commitments have almost doubled since 2012 and will continue to grow even further in future as financing adaptation to climate change in most developing countries requires a significant increase in concessional flows, of which IDA is the main provider.

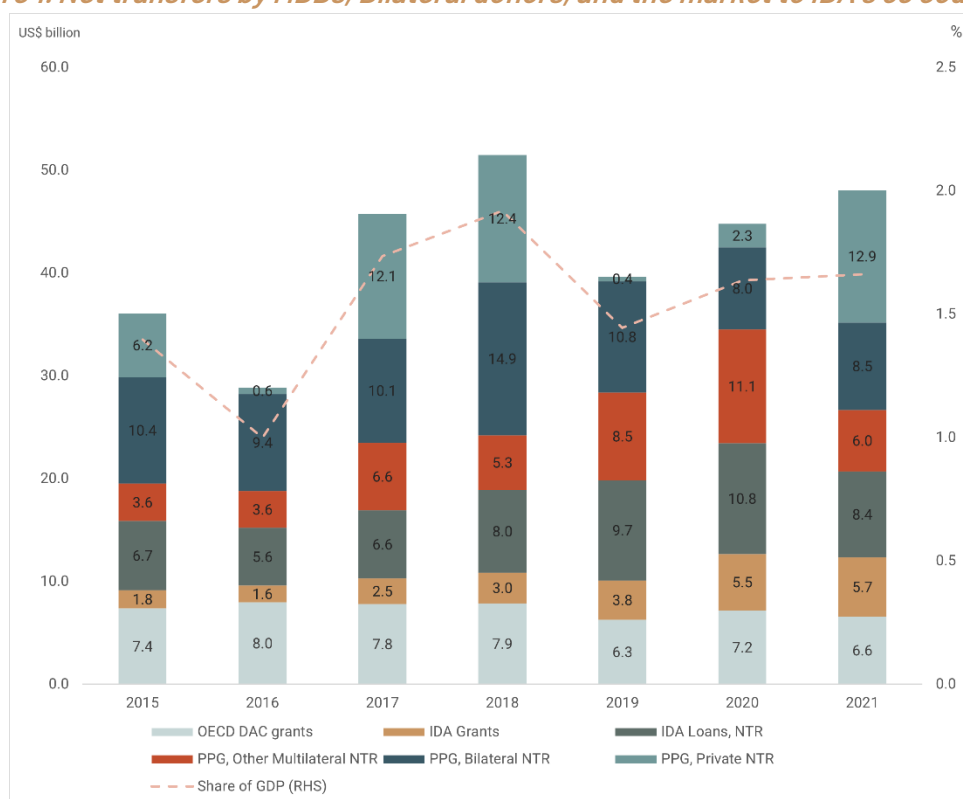
**To fulfil this role, IDA will have to tackle a number of hefty challenges in the foreseeable future, mainly due to the combined effects of growing debt in client countries and its outdated financial model.** In this note, we argue that rising indebtedness has two major consequences: putting IDA's long term sustainability at risk; while providing a "soft bailout" to other lenders. In particular, IDA increasingly had to finance its clients in the form of grants, weakening its own financial sustainability. Strikingly, we also show that its support to highly indebted countries has leaked out in the form of debt service to other creditors, subsidising them over time. While such cross-subsidies in times of crises are part of IDA's countercyclical role, they would clearly undermine its effectiveness in the long run.

**The implication of the analysis is that in order for IDA to consider scaling up, the debt overhang of its clients crucially needs to be resolved.** After reviewing the scope of IDA's support to poor countries, which has been growing at a fast pace, this note shows how IDA's income model has become under threat and how net transfers have evolved over time.

# 1. IDA's contribution to development stems from its long-term support and its countercyclical role

IDA is the largest provider of financing to the world's poorest countries, representing a third of total development assistance to the public sector. As highlighted in Figure 1, multilateral development banks (MDBs) remain the largest providers of net transfers to countries eligible to IDA<sup>1</sup>. The MDB system as a whole provided \$10 billion in net flows in 2015, rising to \$27 billion in the midst of the COVID-19 crisis in 2020. For countries eligible to its loans, IDA plays a predominant role: in aggregate, it represents half of all net transfers for debt. In addition to its magnitude, these flows are countercyclical: they rise when others stop lending, as was the case in 2020.

Figure 1. Net transfers by MDBs, Bilateral donors, and the market to IDA's 69 countries



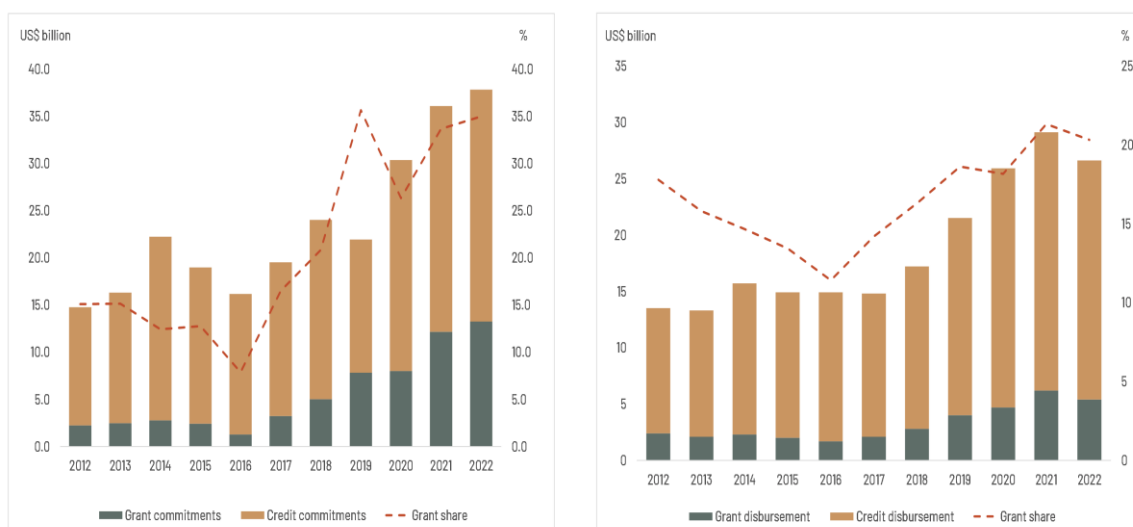
Source: World Bank (IDS), OECD Creditor Reporting System

Note: OECD DAC grants selected are only the ones flowing through the public sector

Second, IDA's lending is very concessional, and increasingly so. Interest rates are low (about 0.8% of interest rate in general) and maturities are long (30 to 40 years), implying a grant equivalent of 50% of the face value of the loan. It also delivers large amounts of funding through grants. In 2022, IDA committed a historical record \$38 billion, from \$24 billion in 2018. This surge sought to offset the series of negative shocks hitting poor countries, a third in grants, and the rest in highly concessional loans. It also disbursed a historical record of \$21.2b of which around \$6b were in the form of grants.

<sup>1</sup> This is the group we focus on in this note. It includes 75 countries, but the analysis relies on 69 countries for which the data is available.

Figure 2. IDA commitments and disbursements in the form of debt and grants



Source: World Bank Open Finances, IDA Financial Statements  
 Note: See Annex for more details

## 2. IDA’s financial model has expanded

From an income point of view, IDA finances have evolved since the HIPC-era. It has managed to grow its loan portfolio and started to borrow from the market. Its operations are now mainly financed through three channels of similar magnitude:

- **It receives regular contributions from donors, generally over 3-year cycles.** Since 2009, they have remained constant at about \$25 billion, or \$8 billion per year.<sup>2</sup> This has pushed IDA to seek other sources of financing to meet growing commitments. In reaction to the COVID-19 surge, the last cycle only lasted two years, which de facto increased the role of donors.
- **It also receives debt service on loans provided in the past, for a total of about \$7 billion.** For countries which are still IDA clients, those reflows are generally smaller than new loans. IDA also receives \$4b from countries which have “graduated”, thus providing a net income. The HIPC/MDRI initiatives have eliminated a lot of IDA’s old debts (\$48b of face value) but with \$174b of debt outstanding in 2022, reflows are projected to rise in future (see Table 1).
- **IDA has been borrowing from the market since 2018, with a triple-A rating:** \$26b of outstanding IDA bonds (Table 1). Those have steadily increased, from \$20 billion in 2020 to \$28 billion in 2021 and \$35 billion in 2022.

A fourth source of income is the transfers from World Bank sister windows, i.e., the IBRD and the IFC, but those have steadily decreased since the 2010s and only represented \$300 million last year.

<sup>2</sup> Most of the data used can be found in: <https://thedocs.worldbank.org/en/doc/95f18d0acf6cf1aee22f82a82d963da9-0040012022/original/IDA-Financial-Statements-June-2022.pdf>

*Table 1. IDA's Balance sheet June 30, 2022 (\$ billions)*

Assets		Liabilities & Equity	
Investments & Cash	41	Market debt	26
Net Loans Outstanding	174	Shareholder Loans & Other Liabilities	15
Other Assets	5	Equity	179
<b>Total</b>	<b>220</b>	<b>Total</b>	<b>220</b>

Source: IDA

### 3. IDA and the increasing number of highly indebted clients

Over the last decade, the indebtedness of poorer countries has risen fast, and close to 60% are now classified at high risk or in debt distress. During the past 15 years, the debt structure of these countries has also experienced significant change. Debt owed to private creditors has more than decupled- IDA countries owed \$133b to private creditors in 2021 up from \$13b in 2010. At the same time, the share of debt owed to multilateral and bilateral creditors slightly shrunk. By now, MDBs are by far the largest group of creditors to poor countries, holding 43% of total external public debt to IDA countries. They are followed by private lenders at more than 22% of total debt, China as an official lender and all other bilateral donors at approximately 17% (see Table 2).

*Table 2: External debt stocks, Public and Publicly Guaranteed (PPG) of IDA countries, end 2021*

	Face value		Present Value
	2010	2021	
PPG external debt stock (USD bns)	221	592	423
IDA (%)	28%	23%	17%
Multilateral ex-IDA (%)	27%	21%	19%
Bilateral ex-China (%)	31%	17%	16%
China (%)	7%	17%	18%
Private creditors (%)	6%	22%	30%

Source: IDS, WB, 2022

Those face value figures are misleading, however. IDA credits have a 50% level of concessionality, which implies that in present value, it represents around 17% of the total. This is also evident in debt service flows. In other words, because market debt, and to a lesser extent Chinese debt, are at higher rates and shorter maturities, those flows are contributing the most to liquidity pressures.

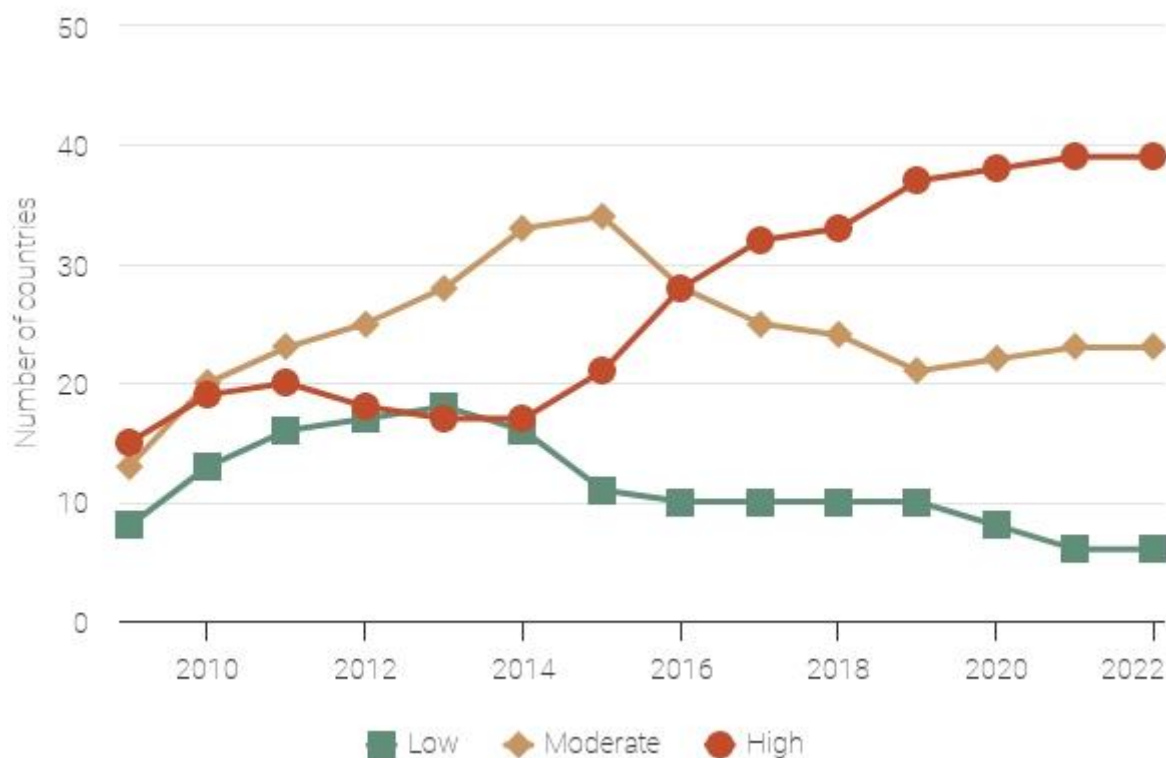
### 4. An untenable status-quo

The debt crisis is costly to IDA. This is due to two main factors: IDA is forced to switch from loans to grants, reducing the debt service reflows in the future; and more dramatically, the support from IDA becomes less effective, as it leaks more into debt service.

### a. IDA grants are growing and weakening the institution

IDA’s country allocation rule was changed in 2009 to ensure that it does not contribute to a debt overhang. For countries below the eligibility threshold (countries which grow above IDA’s threshold, but are not deemed “creditworthy” by the IBRD, still receive preferential conditions, but are not eligible to grants), this is done by switching the disbursement of IDA allocations to grant terms for countries at high risk of debt distress.<sup>3</sup> Following the increase in debt risks, the provision of grants has grown and now makes up around a third of IDA’s net disbursements – around \$6b.

*Figure 3. Traffic lights in IDA countries*



Source: LIC-DSF

Since the inception of this rule, over \$80b of grants have been provided, which would have grown IDA’s balance sheet otherwise. This would keep worsening if debts rose further. Although donors had promised to repay the capital displaced by grant-making, it is doubtful that this has worked in practice. The delivery on this promise is not apparent as contributions have been flat since 2010. It should also be noted that there is no separate accounting for these “losses”, unlike the specific pledging done to replenish equity after HIPC and MDRI.

As a result, IDA is becoming increasingly dependent on contributions from donors, as opposed to reflows from clients, as it strategically aspires to. In a way, IDA is already providing debt relief, but it is doing so in an ineffective way. It can also be unfair: all things equal, the grant system allocates more IDA “capital” to countries that have high debts – as opposed to poorer, or better performing countries. The recently adopted “Sustainable Development Finance Policy” (SDFP) has developed tools to mitigate

<sup>3</sup> Countries at moderate risk get a mix of 50% credit/50% grant, and country at low risk receive all their allocation in loans. Until recently, grants were provided with a 20% discount relative to loans, a rule now eliminated.

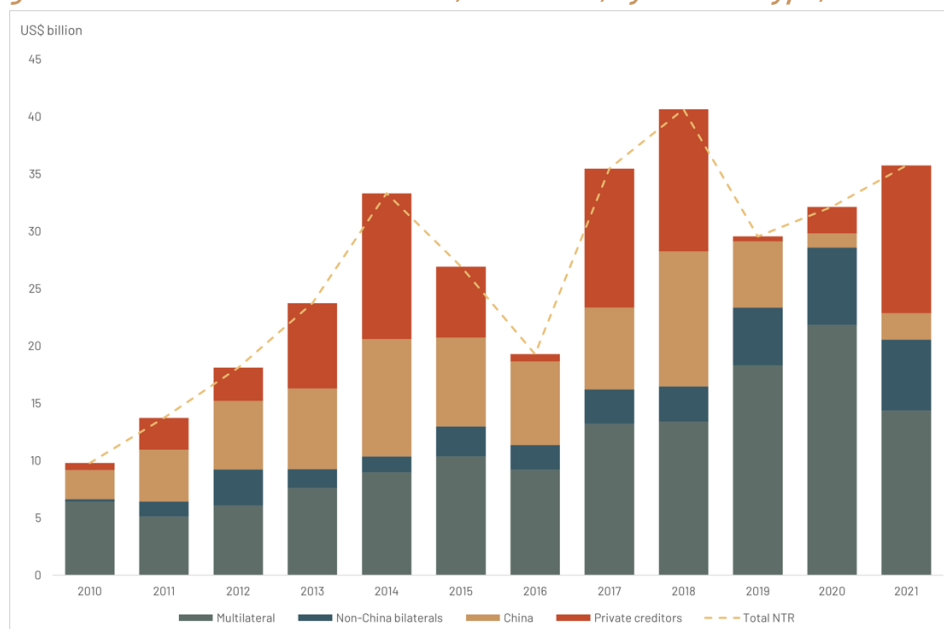
such risks, setting aside 10-20% of IDA country allocations which are only accessed conditional to the completion of a set of Performance and Policy Actions (PPA).

### b. With leakages to other creditors

The series of shocks which have been affecting developing countries since 2019 in addition to the growth slowdown which started a couple of years earlier, reduced the supply of external financing for developing countries, especially lower income ones. As financial conditions tightened after 2019, IDA and other MDBs have surged, while other creditors have slowed their provision of new loans, starting instead to become negative in net-flows for more than 20 IDA countries in 2020 and 15 in 2021 (Cohen and Harnoy-Vannier, 2023). As a cyclical force, this is a core function of the multilateral system: IFIs maintain countries’ credit in times of crises. If this change becomes a trend, however, and the liquidity drought extends to the medium term, this means that a soft bailout of developing countries is ongoing, which would be an inefficient use of public monies.

In aggregate, net transfers have remained positive for IDA countries for major creditors groups until 2021. Bond issuance rebounded due to eased monetary policy, and the Debt Service Suspension Initiative (DSSI) froze a large share of debt service. Data is not yet available for 2022, but there are good reasons to believe that the situation worsened considerably, with a clear trend emerging. Bond issuance by IDA countries have slowed to a trickle after Russia’s invasion of Ukraine, and barely rebounded in 2023, while debt service is increasing. Trends in debt service beyond 2024 are clearly increasing as well. On the bilateral side, the end of the DSSI and stagnant new loans by China also lead to think that the main source of net transfers will be multilateral.

Figure 4. Debt flows to IDA countries, 2010-2021, by creditor type, USD billions

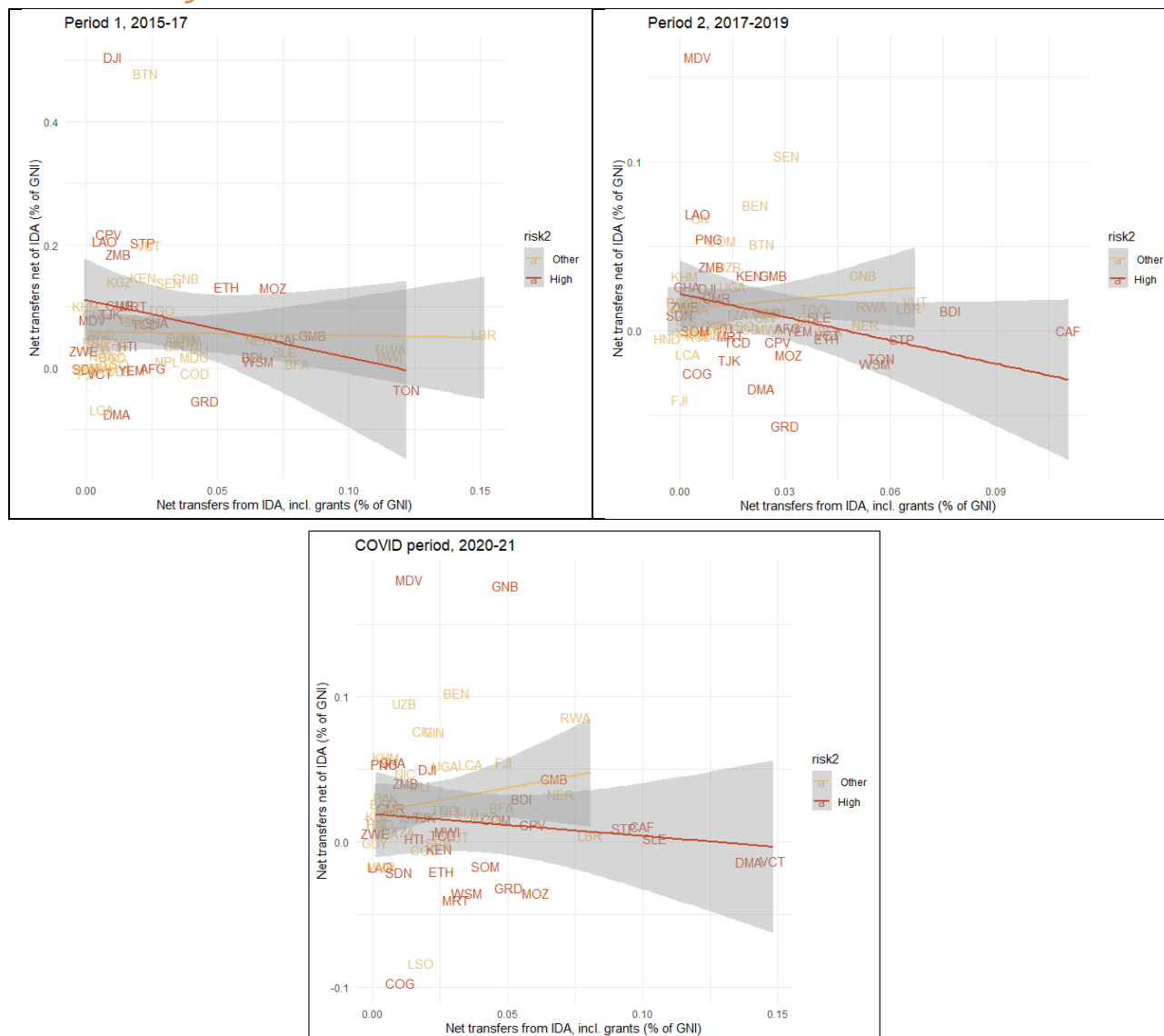


Source: World Bank, IDS 22

To verify the “leakage hypothesis” in more detail, we look at how the relationship between IDA net transfers (“NT”, defined as the difference between disbursements and debt service, including interest and principal repayments), and NT to non-IDA creditors (all bilateral and private creditors) evolves over time. We group them over 3 periods: 2014-2016, 2017-2019 and the COVID period, 2020-21. In the first

period, the relationship is weak, with negative correlation, close to zero. In the second period, IDA and other flows are positively correlated, but the weight of debt clearly increases, whilst for countries at high risk of debt distress, the correlation is negative: IDA disbursements leak towards other creditors. For the COVID period, the relationship is not significant, as the DSSI and higher private loans in 2021 mitigate the risks.

**Figure 5. Correlation between net transfers from IDA and all other sources**



Source: World Bank, IDS 2022

**However, this is not true for countries at high risk of debt distress: the correlation becomes negative, meaning that MDBs, and IDA in particular, provides net transfers to other creditors.** As more countries shift to a high risk of debt distress, our prediction is that this trend will generalise. A simple regression framework further illustrates this correlation (see Annex), including when controlling for variables which could co-determine the direction of both flows. There is a limited number of data points, and a number of outliers, which explain that the statistical results are relatively weak, but we believe they are indicative of future trends. In the most recent periods, an additional transfer from IDA by 1% of GNI crowds in 0.4% of GNI (0.7% when adding controls), but for high-risk countries, the effect is reversed

and becomes negative (0.4%-1% = -0.6%). In the COVID period, coefficients weakened, and the effect went back to zero, likely due to DSSI and the rebound in liquidity in 2021, both of which disappeared.

*Table 3: IDA and non-IDA transfers*

	Net transfers, net of IDA					
	2014-16 (1)	2017-19 (2)	2020-21 (3)	2014-16 (+ controls) (4)	2017-19 (+ controls) (5)	2020-21 (+ controls) (6)
Net Transfers from IDA	-0.063 (0.448)	0.443 (0.344)	0.340 (0.389)	-0.453 (0.534)	0.737* (0.436)	0.581 (0.473)
High risk dummy	0.052 (0.034)	0.011 (0.014)	-0.001 (0.018)	0.014 (0.036)	0.013 (0.016)	0.007 (0.021)
Population (log)				-0.005 (0.008)	0.006 (0.003)	0.002 (0.004)
GDP per capita (log)				-0.029 (0.025)	0.013 (0.011)	0.013 (0.012)
Debt to GDP				0.001** (0.001)	0.00003 (0.0002)	-0.00005 (0.0002)
High risk x NT from IDA	-0.873 (0.764)	-1.010** (0.446)	-0.491 (0.446)	-0.791 (0.767)	-1.040** (0.471)	-0.687 (0.492)
Constant	0.059*** (0.020)	0.017* (0.010)	0.020 (0.013)	0.269 (0.217)	-0.106 (0.096)	-0.096 (0.105)
Observations	68	67	63	65	65	61
R <sup>2</sup>	0.049	0.107	0.049	0.141	0.152	0.072
Adjusted R <sup>2</sup>	0.005	0.065	0.001	0.052	0.064	-0.031
Residual Std. Error	0.098 (df = 64)	0.039 (df = 63)	0.047 (df = 59)	0.097 (df = 58)	0.040 (df = 58)	0.048 (df = 54)
F Statistic	1.106 (df = 3; 64)	2.521* (df = 3; 63)	1.015 (df = 3; 59)	1.584 (df = 6; 58)	1.734 (df = 6; 58)	0.696 (df = 6; 54)

Note:

\* \*\* \*\*\* p < 0.01

Source: World Bank, IDR 2022, IMF WEO 2023

**The effects hold when excluding blend countries, which also receive loans from the IBRD, as well as when excluding all multilaterals from the left-hand side.** However, it is difficult to disentangle to which creditor group those IDA allocations “leak”: coefficients go in the same direction but are weaker and not significant. On average, the trend towards subsidisation of more expensive creditors by concessional lenders seems to be increasing for high-debt countries. This is concerning, especially as the share of countries with risks of debt distress is rising and is likely to continue.



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## Conclusion

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**The risk of an “IDA cliff” in 2024 is increasingly debated and featured high on the agenda of the 2023 Spring Meetings.** The challenges, however, are not only in the short run, but would continue in the medium run as long as the debt crisis is not resolved. IDA receives significant income from reflows on past credits, and those will continue to weaken if IDA continues to switch to grants. Worse, its grants are at least in part subsidizing other creditors. While this is a normal feature of countercyclical finance, there are signs that such negative correlation is entrenching, and becomes a “soft bailout” in the medium term, especially for 2024–2025, in a context of high debt service due and little liquidity. A larger recourse to donors is unlikely to be successful as long as its effectiveness continues to be weakened by debt service leakages to bilateral and private creditors. A larger recourse to the capital market would not be possible either if donor’s contribution and debt reflows are weaker.

**With its three sources of finance at risk, the association will remain in a fragile situation until there are credible plans to resolve debt crises when they arise in the poorer countries.** How to connect improvements in IDA’s finances, and the construction of an effective debt resolution mechanism will be the subject of further work.

# ANNEXES

## • IDA Flows and Transfers

*Annex table 1: IDA flows and transfers, billions of current dollars*

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>IDA gross flows</b>	11.1	11.2	13.4	12.9	13.2	12.7	14.4	17.5	21.2	22.9	21.2
<b>IDA Net Flows*</b>	6.9	7.4	9.9	8.8	8.8	8.1	9.3	12.2	15.1	16.5	14.4
<b>O/W grants</b>	2.4	2.1	2.3	2.0	1.7	2.1	2.8	4.0	4.7	6.2	5.4
<b>IDA Net Transfer*</b>	6.0	6.4	8.9	7.8	7.6	6.9	7.9	10.7	13.4	14.4	12.5
<b>Memo items</b>											
<b>Total Reflows to IDA **</b>	5.1	4.9	4.6	5.1	5.6	5.8	6.5	6.8	7.8	8.5	8.7
<b>o/w from graduates</b>	2.0	1.3	1.1	2.9	3.1	3.2	4.0	4.1	4.2	3.7	4.3

Note: \*Net flows are defined as the balance between gross disbursements and repayments. Net transfers equal net flows minus interest and service fees.

\*\* Reflows includes principal repayment as well as interest and service fees.

## • IDA Financing Conditions

The eligibility to IDA's resources is determined by the relative poverty of a country, which is defined through the Gross National Income per capita thresholds. As of June 2022, IDA eligibility is based on a GNI per capita threshold of \$1205 for fiscal year 2022 and of \$1255 or less for fiscal year 2023. Within these countries, 3 groups can be identified as follows:

- **IDA-only:** countries that have 1) not exceeded the income cut-off of GNI per capita for more than two consecutive years and 2) are not creditworthy for International Bank for Reconstruction and Development (IBRD) loans.
- **Gap:** countries that are 1) deemed by IDA to be eligible for financing, 2) have a GNI per capita that has exceeded the cut-off for more than two consecutive years and 3) are not creditworthy for IBRD loans.
- **Blend:** countries that are both 1) eligible for IDA financing and 2) creditworthy to borrow from IBRD.

IDA provides financial assistance to eligible countries in the form of loans, grants, and guarantees. In IDA<sup>20</sup> resources are allocated either through Country Allocations, or through five specific IDA windows, regional or for specific purposes.

IDA also provides funding through non-concessional windows:

- **Non-Concessional Scale-Up Window:** a window of resources established to enhance support for high-quality, transformational, country-specific and/or regional operations with strong development impact.

- **Private Sector Window (PSW):** to mobilise private sector investment in IDA-only countries and IDA-eligible Fragile and Conflict-affected Situations.

IDA provides concessional resources in the form of grants, loans, and guarantees. In previous versions of IDA, a traffic light system was implemented, which determined the share of grants and concessionality for each country, based on the level of debt distress (from the LIC-DSF): high risk or in debt distress countries ("red" light) received 100% of the financing in the form of grants, medium risk countries ("yellow" light) received 50-year credits, while low risk countries ("green" light) received 100% of their resources in the form credits and no grants.

IDA<sup>20</sup> has introduced new financing terms. Countries with high risk of debt distress still receive IDA assistance in the form of grants, but Gap and Blend countries are only eligible for grant financing for specific windows. For countries that are not "red", and thus obtain IDA credits, the terms vary according to specific characteristics (Annex chart 1).

*Annex chart 1: IDA financing terms*

Lending Group		Financing Terms	
Risk of External Debt Distress		Non-Small States	Small States
IDA-only Countries	High Risk or in Debt Distress	Grants	Grants
	Moderate Risk	<ul style="list-style-type: none"> <li>• 50-year loans</li> <li>• 12-year Concessional SMLs</li> </ul>	<ul style="list-style-type: none"> <li>• Half grants and half 40-year loans (small economy)</li> <li>• 12-year Concessional SMLs</li> </ul>
	Low Risk	<ul style="list-style-type: none"> <li>• 38-year loans (regular)</li> <li>• 12-year Concessional SMLs</li> </ul>	<ul style="list-style-type: none"> <li>• 40-year loans (small economy)</li> <li>• 12-year Concessional SMLs</li> </ul>
Gap Countries		<ul style="list-style-type: none"> <li>• 30-year loans (blend)</li> <li>• 12-year Concessional SMLs</li> </ul>	<ul style="list-style-type: none"> <li>• 40-year loans (small economy)</li> <li>• 12-year Concessional SMLs</li> </ul>
Blend Countries			

Source: IDA Financial Statement, June 2022

### • IDA Eligible countries

As of 2023, 75 countries are eligible to receive IDA resources. In particular, 59 countries are defined as IDA-only, whereas the remaining 16 countries are blend countries.

Afghanistan	Djibouti <sup>3</sup>	Kosovo <sup>4</sup>	Nicaragua <sup>4</sup>	St. Vincent <sup>2&amp;3</sup>
Bangladesh <sup>4</sup>	Dominica <sup>2&amp;3</sup>	Kyrgyz Republic	Niger	Sudan
Benin	Eritrea <sup>1</sup>	Lao People's Democratic Republic <sup>4</sup>	Nigeria <sup>2&amp;4</sup>	Syrian Arab Republic <sup>1</sup>
Bhutan <sup>3</sup>	Ethiopia	Lesotho <sup>4</sup>	Pakistan <sup>2&amp;4</sup>	Tajikistan
Burkina Faso	Fiji <sup>2&amp;3</sup>	Liberia	Papua New Guinea <sup>2&amp;4</sup>	Tanzania
Burundi	Gambia, The	Madagascar	Rwanda	Timor-Leste <sup>2&amp;3</sup>
Cabo Verde <sup>2&amp;3</sup>	Ghana <sup>4</sup>	Malawi	Samoa <sup>3</sup>	Togo
Cambodia <sup>4</sup>	Grenada <sup>2&amp;3</sup>	Maldives <sup>3</sup>	Sao Tome and Principe <sup>3</sup>	Tonga <sup>3</sup>
Cameroon <sup>2&amp;4</sup>	Guinea	Mali	Senegal <sup>4</sup>	Tuvalu <sup>3</sup>

Central African Republic	Guinea-Bissau	Marshall Islands <sup>3</sup>	Sierra Leone	Uganda
Chad	Guyana <sup>3</sup>	Mauritania <sup>4</sup>	Solomon Islands <sup>3</sup>	Uzbekistan <sup>2 &amp; 4</sup>
Comoros <sup>3</sup>	Haiti	Micronesia, Federated States of <sup>3</sup>	Somalia	Vanuatu <sup>3</sup>
Congo, Democratic Republic of	Honduras <sup>4</sup>	Mozambique	South Sudan	Yemen, Republic of
Congo, Republic of <sup>2 &amp; 4</sup>	Kenya <sup>2 &amp; 4</sup>	Myanmar <sup>4</sup>	Sri Lanka <sup>4</sup>	Zambia <sup>4</sup>
Cote d'Ivoire <sup>4</sup>	Kiribati <sup>3</sup>	Nepal	St. Lucia <sup>2 &amp; 3</sup>	Zimbabwe <sup>1 &amp; 2</sup>

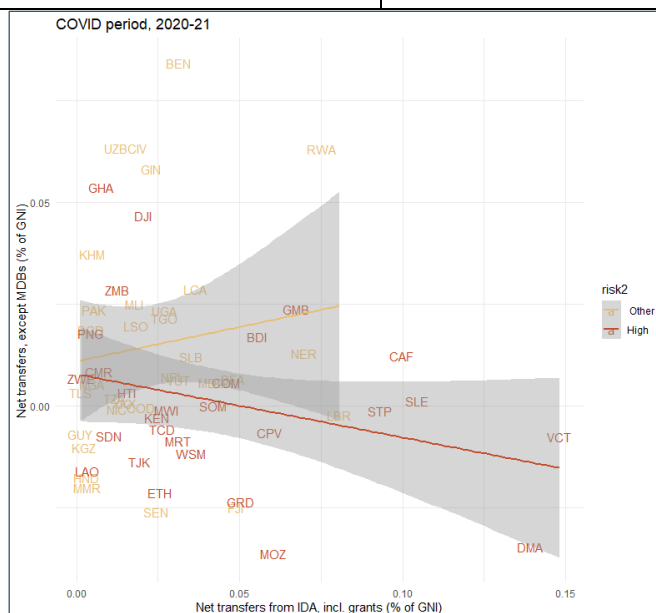
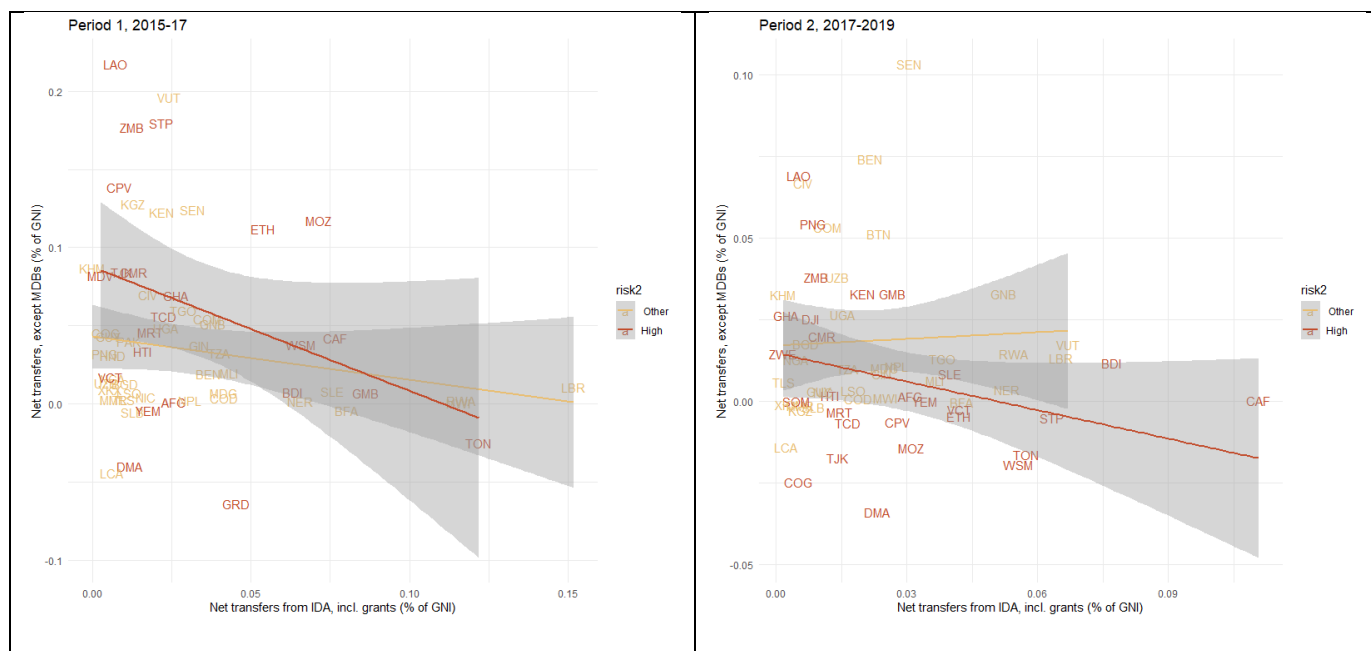
<sup>1</sup> Inactive countries: no active IDA financing due to protracted non-accrual status.

<sup>2</sup> Blend Countries: IDA-eligible but also creditworthy for some IBRD borrowing.

<sup>3</sup> Borrowing on small economy terms, when applicable.

<sup>4</sup> Borrowing on blend credit terms.

• **Regressions with net transfers to non-multilateral sources**



*Dependent variable:*

	Net transfers, except multilateral sources					
	2014-16	2017-19	2020-21	2014-16 (+ controls)	2017-19 (+ controls)	2020-21 (+ controls)
	(1)	(2)	(3)	(4)	(5)	(6)
Net Transfers from IDA	-0.242 (0.412)	0.199 (0.278)	0.169 (0.314)	-0.512 (0.500)	0.488 (0.354)	0.241 (0.387)
High risk dummy	0.053* (0.031)	0.010 (0.011)	0.003 (0.014)	0.024 (0.034)	0.013 (0.013)	0.005 (0.017)
Population (log)				-0.005 (0.007)	0.004 (0.003)	-0.0003 (0.004)
GDP per capita (log)				-0.020 (0.023)	0.012 (0.009)	0.005 (0.009)
Debt to GDP				0.001* (0.001)	-0.00003 (0.0002)	-0.00001 (0.0002)
High risk x NT from IDA	-0.690 (0.702)	-0.659* (0.360)	-0.340 (0.360)	-0.648 (0.718)	-0.728* (0.382)	-0.421 (0.402)
Constant	0.048** (0.019)	0.012 (0.008)	0.011 (0.010)	0.196 (0.203)	-0.102 (0.078)	-0.034 (0.086)
Observations	68	67	63	65	65	61
R <sup>2</sup>	0.072	0.077	0.032	0.138	0.121	0.043
Adjusted R <sup>2</sup>	0.028	0.033	-0.017	0.048	0.030	-0.063
F Statistic	1.649 (df = 3; 64)	1.755 (df = 3; 63)	0.655 (df = 3; 59)	1.543 (df = 6; 58)	1.335 (df = 6; 58)	0.405 (df = 6; 54)
<i>Note:</i>						* ** *** p<0.01

Sources: IDS 2022, IMF WEO 2023



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Communications@findevlab.org  
[www.findevlab.org](http://www.findevlab.org)