INTERNATIONAL MONETARY FUND

Eligibility to Use the Fund's Facilities for Concessional Financing

Prepared by the Strategy, Policy, and Review, the Legal, and the Finance Departments

(In consultation with the Monetary and Capital Markets Department and Area Departments)

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EXECUTIVE SUMMARY

This paper proposes a framework for updating the PRGT eligibility list, based on transparent criteria and a regular review process, including policies for phasing in changes in eligibility. The premise is that access to scarce resources for concessional Fund financing should be preserved for members with a low level of income and related economic and financial vulnerabilities. From this perspective, there are several potential anomalies in the current eligibility list, which has been established primarily on the basis of IDA eligibility, and was last reviewed in 2003.

The proposed framework seeks to ensure uniform treatment of low-income members, in line with the objectives of the PRGT, as well as transparency about the criteria that underlie decisions on PRGT eligibility. The determination of eligibility would remain closely aligned with IDA practices, and the large majority of IDA-eligible countries would remain PRGT-eligible.

The framework comprises differentiated sets of criteria for entry and for graduation. The latter criteria are more demanding, which serves to minimize the risk of untimely graduation decisions and the subsequent need for their reversal. In broad terms, under the proposal, countries would become eligible if their per-capita income is below the IDA cutoff and they do not have durable and substantial access to financial markets. Countries that are on the PRGT eligibility list would be expected to graduate from the list if they have either (i) a persistently high level of income exceeding twice the IDA operational cutoff, or (ii) durable and substantial access to financial markets; and (iii) they do not face serious short-term vulnerabilities. The assessment of these vulnerabilities would focus, in particular, on risks of a sharp decline in income, or loss of market access, and on debt vulnerabilities. This approach seeks to ensure that graduation is permanent and does not pose undue risks to the member's financial sustainability.

The proposal also extends to all small countries the existing exceptional treatment of small islands in determining PRGT eligibility. This approach aims to ensure uniformity of treatment for all members with similar vulnerabilities. For small countries, the criteria for entry and graduation from PRGT eligibility largely mirror the general rules but are less stringent as regards per capita income.

It is proposed that PRGT eligibility be reviewed by the Executive Board every two years, to promote a more continuous alignment of the list with the PRGT's objectives. However, decisions regarding entry onto the PRGT-eligibility list could also be adopted between reviews.

Based on the application of the proposed criteria, staff proposes the following amendments to the list of PRGT-eligible countries:

- ***Entry***. No additions to the list are proposed at this time.

- ***Graduation***. It is proposed that *Albania, Angola*, and *Azerbaijan* graduate based on the income criterion, given that their short-term vulnerabilities appear manageable. Angola also meets the market access criterion. *India, Sri Lanka,* and *Pakistan* are proposed for graduation as they meet the market access graduation criterion and their short-term vulnerabilities appear manageable.

- While the income criterion is also met by *Armenia* and *Georgia*, and the income criterion for small countries is met by *Dominica, Grenada*, *Maldives, St. Lucia*, and *St. Vincent and the Grenadines*, staff proposes maintaining these countries' PRGT-eligibility, based on their short-term vulnerabilities; as with all countries on the list, their eligibility will be reassessed against the graduation criteria at the time of the next PRGT-eligibility review.

It is intended that the changes in the PRGT eligibility list should not interfere with existing PRGT support or ongoing discussions on new financing requests. Accordingly, it is proposed that these changes would become effective three months after the adoption of the Executive Board decision. Moreover, countries that have arrangements in place would remain PRGT-eligible for the full duration of the arrangement. Graduation from the list would also not affect the terms for repayments of outstanding PRGT credit or the subsidization of the rate of charge on otherwise eligible EPCA/ENDA credit.

The proposed changes to the list of PRGT-eligible countries would likely have a limited impact on the demand for the Fund's concessional resources. The six countries identified for graduation were not expected to request concessional resources in the near term; three of these countries have recently requested access to Fund financing from the GRA under Stand-By Arrangements.

I. INTRODUCTION

1. **On several occasions, the Executive Board has indicated that the list of PRGF (throughout this paper, PRGT) [1] eligible countries should be kept under regular review.**[2] The last update of the list was conducted in June 2003. On that occasion, Papua New Guinea, Timor Leste and Uzbekistan were added to the list, while Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia (FYRM) graduated from PRGT eligibility. These decisions were motivated by changes in IDA eligibility, per capita income levels and recent trends, balance of payments and debt situations and projections, reserve adequacy, and the overall economic outlook.

2. **The Board has determined PRGT eligibility primarily on the basis of IDA eligibility.** The latter, in turn, is based on countries' per capita GNI (relative to the IDA operational cutoff), and their creditworthiness for IBRD lending (see Box 1). Accordingly, the IDA and PRGT eligibility lists have always been very similar, and currently they differ with respect to just three countries: Albania, Bosnia and Herzegovina, and Kosovo. While still PRGT-eligible, Albania graduated from the IDA list in July 2008. Bosnia and Herzegovina was removed from the PRGT list in 2003—in light of its high per capita income and sustained increase in gross international reserves—but remains on the IDA list. On July 1, 2009, shortly after joining the Bretton Woods institutions, Kosovo became IDA-eligible.

3. **A clear set of eligibility criteria and regular reviews of their application are warranted to help ensure a closer link of PRGT eligibility to the trust's key objectives.** Access to scarce resources for concessional Fund financing should be preserved for members with a low level of income and related economic and financial vulnerabilities. For these countries, the concessionality of Fund financing to address balance of payments needs can help achieve stable and sustainable macroeconomic positions consistent with strong and durable poverty reduction and growth while limiting risks of debt distress. As countries achieve such positions, they should no longer need access to concessional assistance from the Fund. In this context, many LICs have performed well over the last decade. Timely reviews of PRGT eligibility serve to update the eligibility list in line with these developments.

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[1] The Board's recent decision converting the PRGF-ESF Trust into the Poverty Reduction and Growth Trust (see *A New Architecture of Facilities for Low-Income Countries and Reform of the Fund's Concessional Financing Framework – Decision No.14385*, adopted July 23, 2009 has not yet entered into effect, pending the consent of all lenders and contributors to the Trust, but is expected to become effective shortly.

(Note: Since the paper was written, the consents were received, and the Poverty Reduction and Growth Trust became effective on January 7, 2010.)

[2] This issue was most recently raised at the Board discussion of the new financial architecture for low-income countries (Public Information Notice No. 09/38).

Box 1. IDA Eligibility and Financial Terms

The determination of a country's IDA eligibility is reviewed annually, based on two criteria: its per capita gross national income (GNI), and creditworthiness for International Bank for Reconstruction and Development (IBRD) lending. Per capita GNI is based on the Atlas methodology.

There are three categories of IDA-eligible countries:

- First, "IDA-only" countries are those with per capita income below the operational cutoff (US$1,135 for FY 2010) and no access to IBRD lending.
- Second, IDA extends, temporarily, its eligibility to countries with per capita GNI above the prevailing operational cutoff, that have undertaken major reform, but are not yet creditworthy for IBRD lending ("gap" countries).
- The third category comprises the "blend" countries, which have limited access to IBRD lending. There are two kinds: (a) countries with a per capita GNI below the operational threshold, but with sufficient creditworthiness for IBRD borrowing (e.g., India and Pakistan), and (b) countries with a per capita GNI above the threshold, but only limited creditworthiness for IBRD loans.

Finally, a number of small islands, with a per capita GNI above the prevailing IDA operational cutoff, are allowed to benefit from IDA resources. This exception reflects their vulnerabilities and limited creditworthiness for IBRD lending.

While IDA applies the same financing cost and grace period (10 years) to all borrowers, the loan maturity differs across these categories. For IDA-only countries, the repayment period is 40 years. IDA credit for "blend" countries carries 35 years maturity. Eligible countries with a per capita GNI above the prevailing IDA threshold for more than two consecutive years are subject to hardened borrowing terms, with 20 years maturity.

IDA's Performance Based Allocation (PBA) system allows it to focus scarce concessional resources where they are most needed, in accordance with a country's performance (as measured principally by the country policy and institutional assessment (CPIA). This framework plays a complementary role to the eligibility criteria in aligning IDA resource flows to country circumstances.

IDA's eligibility criteria were last re-evaluated and discussed with IDA donors in the context of the IDA13 replenishment discussions in 2001, and subsequently approved by the Bank's Executive Directors in 2002. The existing criteria and exceptions have since been maintained.

4. **From this perspective, there are several potential anomalies in the current eligibility list:**

- The number of PRGT and IDA-eligible countries with a per capita income level above the IDA operational cutoff has increased substantially over time. In 2000, there were 16 countries with income above the threshold, two of which (Bosnia and Herzegovina, and Macedonia) graduated in 2003. Currently, 26 countries exceed the IDA threshold, and most of them have experienced a persistent rise in income above the prevailing IDA cutoff, raising questions on the existing PRGT eligibility classification.

- Second, several IDA- and PRGT-eligible countries have been able to access financial markets on a sustained basis. Since such access implies a shared assessment by lenders and the authorities that borrowing on market terms is both feasible and appropriate, it undercuts the case for continued access to the Fund's scarce concessional resources.

- Third, the small islands exception (see Box 1) has raised questions concerning equality of treatment across the Fund's membership, calling for a reassessment.

5. **The formulation of clear criteria to guide the determination of PRGT eligibility would help enhance transparency and fairness.** While the Fund has deviated from the IDA eligibility list, past reviews of PRGT eligibility were not based on a set of well-articulated criteria. In this context, some important differences between the roles of the IDA and PRGT classifications support the case for the Fund to conduct its own assessment for eligibility.

- All PRGT-eligible countries, as Fund members, have full access to resources in the Fund's General Resources Account (GRA), provided they meet the applicable criteria for such assistance, including capacity to repay the Fund. By contrast, of the IDA-eligible countries, only those classified as IDA-blend countries—on the basis of their (limited) creditworthiness—also have (limited) access to lending by the IBRD. IDA-only countries, on the other hand, may only borrow from IDA with no access to IBRD loans. Accordingly, limited creditworthiness implies that some countries may not have access to any World Bank lending unless they remain IDA-eligible, while graduation from PRGT eligibility does not preclude access to non-concessional financial assistance from the Fund.

- A further distinction is that Fund financing may be considered a closer substitute to market financing than the longer-term World Bank loans, which are often tied to specific uses.

6. **This paper proposes a set of criteria that the Fund would use to update the PRGT eligibility list, based on a regular review process and uniform policies for**

phasing in changes in eligibility. The proposal includes separate criteria for entry onto and graduation from the eligibility list that can be applied in a uniform manner, while preserving close alignment between PRGT eligibility and IDA eligibility. In broad terms, under the proposal, countries would enter the list if their annual per-capita income is below the IDA cutoff and they do not have durable and substantial access to financial markets. Countries that are PRGT-eligible would graduate from PRGT eligibility if they have either a persistently high level of income (exceeding a higher income threshold as defined below) or durable and substantial access to financial markets, and they do not face serious short-term vulnerabilities. The proposal also expands the existing exceptional treatment of small islands in determining PRGT eligibility to all small countries based on a standardized definition, to ensure uniformity of treatment for all members falling within the "small country" category.

7. **PRGT eligibility and IDA eligibility would remain closely aligned.** This reflects, in large part, the continued use of the same per capita GNI cutoff used by IDA for determining eligibility. The market access criterion proposed for PRGT eligibility is also related, although more demanding, than the creditworthiness assessment performed by IDA. In addition, the proposed exception for small countries is, in practice, comparable to the existing small islands exception.

8. **The proposed criteria for graduation from PRGT eligibility seek to ensure that decisions on graduation are permanent and do not pose undue risks to the member's financial sustainability.** Graduation from eligibility for the Fund's concessional resources marks a member's progress in economic development, and has played a signaling role for markets and donors. Graduation is expected to entail a permanent exit from the use of concessional resources, as intermittent access to concessional lending would complicate debt management and economic planning. Against this background, the criteria for graduation should reflect sustained progress, rather than solely the current state of affairs. The assessment of short-term vulnerabilities, taking account of country-specific circumstances, will be conducted to confirm the expected sustainability of this progress, as well as the country's capacity to service GRA debt if it were to receive such financing.

9. The remainder of this paper will address the criteria for inclusion in and graduation from PRGT eligibility, a proposal for the exceptional treatment of small countries, and the move to periodic reviews (Section II). The proposed amendments to the PRGT eligibility list based on the application of the new criteria are summarized in Section III. Arrangements for phasing in changes in eligibility and financing implications are addressed in sections IV and V, respectively. Section VI contains draft decisions that would (i) give effect to the new framework for inclusion and graduation from PRGT eligibility, and (ii) modify the current

eligibility list in light of this new framework. Finally, Annex I presents the relevant economic conditions for each country considered for graduation from the PRGT eligibility list.[3]

II. Proposed Approach

10. **Building on existing practices, the proposed approach aims at establishing a clear framework for entry onto and graduation from the list of PRGT-eligible countries.** The framework seeks to ensure uniform treatment of low-income members over time, in line with the objectives of the PRGT as well as transparency about the criteria that underlie decisions on PRGT eligibility. The determination of eligibility remains closely aligned with IDA practices, and the large majority of IDA-eligible countries would also remain PRGT-eligible.

General Criteria for Entry and Graduation

11. **The framework comprises differentiated sets of criteria for entry and for graduation.** The latter criteria are more demanding. This approach is deliberate and serves to minimize the risk of a reversal of graduation decisions.

- **Entry:** A Fund member would be added to the list of PRGT-eligible countries if: (i) its annual per capita income is below the operational IDA cut-off (based on the latest available qualifying data); and (ii) the sovereign does not have capacity to access international financial markets on a durable and substantial basis as defined in paragraph 12 below.[4]

- **Graduation**: A member would graduate from the list of PRGT-eligible countries only if it: (i) has enjoyed income per capita well above the IDA threshold for a number of years, or (ii) has the capacity for durable and substantial access to international financial markets, and (iii) does not face serious short-term vulnerabilities. These criteria are further described in paragraph 12 below. Graduation from PRGT eligibility should reflect progress toward middle-income emerging market status. Hence, the relevant measure of market access should

[3] Annex II provides the rationale for and additional details on the market access criterion, as well as some country-specific observations on the applicability of this criterion.

[4] These assessments of per capita GNI for purposes of both entry and graduation decisions would normally be based on World Bank data derived using the Atlas methodology, but other data sources could be used in exceptional circumstances (e.g., data estimated by Fund staff, if World Bank data were unavailable). Data will qualify for these purposes only if the most recent observation used in assessing the relevant criterion relates to a calendar year that is not more than 30 months in the past at the time of the assessment. This requirement for recent data would also apply to other data required under the proposed entry and graduation tests. Where more recent data are not available and cannot be estimated, it would be expected that no decisions would be taken in respect of the relevant country.

capture only voluntary access to financial markets by a low-income country (as defined below) rather than any form of directed lending (see Annex II).

12. **It is proposed that the following criteria will guide staff proposals and Executive Board decisions on graduation from PRGT eligibility.** Specifically, a PRGT-eligible country would graduate if it meets the following tests**:**

- **Income Criterion**: The country's annual per capita GNI: (a) has been above the IDA operational cutoff for at least the last five years (for which qualifying data are available); (b) has not been on a declining trend in the same period (comparing the first and the last relevant annual data); and (c) is currently (based on the latest available qualifying data) at least twice the operational IDA cutoff. [5]

Or

- **Market Access Criterion**: The sovereign has the capacity to access international financial markets on a durable and substantial basis, as measured under one of two alternative tests. Under the first test, the existence of such capacity would normally be evidenced by public sector issuance or guaranteeing of external bonds or by disbursements under public and publicly guaranteed external commercial loans in international markets during at least three of the last five years (for which data are available), in a cumulative amount over that period equivalent to at least 100 percent of the country's Fund quota at the time of the assessment As an alternative, a country could also be deemed to meet the market access criterion if there were convincing evidence that the sovereign *could* have tapped international markets on a durable and substantial basis, even though the scale or duration of actual public sector borrowing fell short of the specified thresholds. This would be a case-specific assessment, considering such relevant factors as the volume and terms of recent actual borrowing in international markets and the sovereign credit rating.[6] (See Annex II for further details on the market access criterion.) Finally, as a further safeguard, countries would be considered candidates for graduation under the market access criterion only if: (a)

[5] The proposal to set an income threshold for graduation that is significantly higher than the eligibility threshold could give rise to situations in which a country remains on the eligibility list even though it has per capita income comparable to or higher than some ineligible countries. This can be justified, however, on the grounds that a country not presently on the list (either because it was never deemed eligible, or because it graduated in the past) is, *ipso facto*, likely to be less vulnerable than an eligible country, given that the latter must, by definition, have a recent history of low income and limited creditworthiness.

[6] As noted in Annex II, both tests of the market access criterion would take into account bonds/loans issued/contracted or guaranteed by *non-sovereign* public sector debtors, where such a debtor's ability to access international markets is assessed to be an indicator of the sovereign's creditworthiness.

their annual per capita GNI is above 80 percent of the IDA operational cutoff (based on the latest available qualifying data);[7] and (b) their annual per capita GNI has not been on a declining trend during the last five years for which data is available (comparing the first and last relevant annual data).

And

- **Absence of serious short-term vulnerabilities**: In addition to meeting at least one of the above two criteria, the country should not face serious short-term vulnerabilities. The assessment of these vulnerabilities would focus, in particular, on risks of a sharp decline in income, or loss of market access, and on debt vulnerabilities. Thus, for example, a country that meets the income criterion would not be expected to graduate if there is a serious risk that its income might decline to less than twice the operational IDA cutoff. Similarly, a country that meets the market access criterion would not be expected to graduate if there is reason to believe that market access might be lost. In this context, large spreads on recent external borrowing could provide an indication of risks to prospective market access. Furthermore, debt vulnerabilities, as indicated by the most recent Debt Sustainability Analysis (DSA) should be limited. For members with a LIC-DSA, the risk of external debt distress should be moderate or less, and additional risks related to domestic debt should not raise serious concerns regarding debt sustainability. Finally, developments and prospects since the most recent DSA was prepared should be taken into account and should confirm that overall debt vulnerabilities remain limited.

13. **The graduation framework builds on the recently approved new blending rules for the PRGT**, and together these rules provide a consistent framework for the progressive graduation from concessional Fund financing. In the context of the new architecture for the Fund's concessional lending, there is a presumption that PRGT resources are to be blended with GRA resources for PRGT-eligible members that have durable market access or a per-capita income level exceeding the IDA operational cutoff. These criteria are closely related to the graduation criteria, but the latter are more stringent. The income criterion for graduation involves a higher threshold and a longer evaluation period, while the market access criterion for graduation contains specific thresholds for the magnitude and duration of such access (Table 1). To ensure consistency, it is proposed that the income threshold applicable to the

[7] This condition ensures that countries with a very low level of income do not graduate, consistent with the PRGT's core objectives.

market access graduation criterion (i.e., 80 percent of the IDA operational cutoff) be added to the blending rules.[8]

Table 1. A Comparison of the Proposed Criteria for Graduation and the Proposed Criteria for Blending

Graduation Criteria	Blending Criteria
Income Criterion: i) Per capita GNI above the IDA operational cutoff in the last five years; ii) Per capita GNI in the last year at least twice the IDA operational cutoff, or at least three times the cutoff for small countries; and iii) Per capita GNI not declining in the last five years.	***Income Criterion:*** Per capita GNI above the prevailing IDA operational cut-off.
Market Access Criterion: i) Per capita GNI above 80 percent of the IDA operational cutoff; and ii) Durable and substantial access to foreign bond markets and external commercial loans of at least 100 percent of quota in the last five years.	***Market Access Criterion:*** i) Per capita GNI above 80 percent of the IDA operational cutoff; and ii) Sustained past and prospective access to non-concessional lending from capital markets and official lenders.
Vulnerability Criterion Short-term vulnerabilities with regard to income, market access, and debt must be limited. In this context, where there is a LIC -DSA, risks of debt distress should be moderate or less.	***Vulnerability Criterion*** Normally, blending is not used for countries at a high risk of debt distress or in debt distress.

Special Criteria for Entry and Graduation for Small Countries

14. **Following IDA, the Fund has granted PRGT eligibility to a number of small islands with a relatively high level of income**. In determining IDA eligibility, these islands have been exempted from the standard income criterion (see Box 1) in light of their greater vulnerabilities and generally limited creditworthiness for IBRD lending.

15. **To strengthen uniformity of treatment, staff proposes to move from a small islands exception to a small countries exception**, based on a clear threshold for country size and standardized criteria for entry and graduation. Small countries—including but not limited to small islands—are more vulnerable to shocks than large countries given their less diversified economies and exceptionally high degree of openness (see Box 2). They also have smaller economies of scale, particularly in providing public services. To take into account the higher vulnerabilities facing small countries, the proposed entry and graduation criteria include higher income thresholds.

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[8] Specifically, this income threshold is proposed to be added to the existing criteria used to establish a presumption of blending in cases of market access under the current blending rules. See *A New Architecture of Facilities For Low-Income Countries,* July 2009, and Public Information Notice No. 09/94.

16. **For small countries, the criteria for entry and graduation from PRGT eligibility largely mirror the general rules but are less stringent as regards per capita income.** Drawing on the literature (cited in Box 2), small countries can be defined as those with a population below 1 million. The exceptional treatment of small countries would be made operational as follows:

- **Entry:** Small countries that are not currently PRGT-eligible would be considered for entry to the PRGT eligibility list if: (i) the sovereign does not have capacity to access international financial markets on a durable and substantial basis (as defined in paragraph 12 above); and (ii) per capita GNI is less than *twice* the IDA operational threshold (based on the latest available annual qualifying data).
- **Graduation:** Small countries would graduate on the basis of three criteria:

➢ *income criterion*: Their annual per capita GNI: (i) has been above the IDA operational threshold for at least the last five years (for which qualifying data are available);[9] (ii) has not been on a declining trend in the same period (comparing the first and the last relevant annual data); and (iii) is currently at least three times the IDA threshold (based on the latest available qualifying data); or

➢ *market access criterion:* The sovereign has the capacity to access international financial markets on a durable and substantial basis, as defined in paragraph 12 above; and

➢ *absence of serious short-term vulnerabilities*: Small countries that meet either of the above two criteria would graduate if they do not face serious short-term vulnerabilities as described in paragraph 12 above.[10]

The Periodicity of Reviews

17. **It is proposed that PRGT eligibility be reviewed by the Executive Board every two years.*** So far, the reviews of PRGT eligibility have been conducted on an ad-hoc basis, generally to address specific cases, and often in response to changes in IDA eligibility.[11] During the past five years, during which the IDA eligibility list remained virtually

[9] As noted in footnote 4, it would be expected that no decisions would be taken in respect of a country where the most recent data that is available or can be estimated relates to a calendar year more than 30 months in the past.

[10] With respect to the risk of a sharp decline of income, a small country would generally not be expected to graduate if there is a serious risk of a decline in income to less than *three* times the operational IDA cutoff.

*The Executive Board decided that the criteria for entry and graduation should be reviewed also every two years.

[11] IDA has updated its eligibility list at the beginning of every fiscal year. See Operational Policies 3.10, Annex D–The World Bank, July 2009.

unchanged, no review of PRGT eligibility was carried out. The proposal for bi-annual reviews responds to concerns expressed by the Executive Board, and should promote a more continuous alignment of the list with the PRGT's objectives.

18. **Notwithstanding the regular review cycle, decisions on entry onto the PRGT-eligibility list could also be adopted in the interim period between reviews.*** It would be expected that entry decisions would be adopted on a stand-alone basis where a member that is not on the list meets the entry criteria in the period between reviews, and where a delay until the next scheduled review of the PRGT eligibility list would disadvantage the member (in particular, if the member wishes to request support under the PRGT facilities). Re-entry on the list in the interim period between reviews would also be possible (assuming the graduation criteria were not met) for any country that had been removed in the context of sanctions imposed for overdue obligations to the PRGT. [12]

III. Proposed Amendments to the PRGT Eligibility List

19. **Based on the application of the proposed criteria, including country-specific assessments to determine short-term vulnerabilities (see Annex I), staff proposes the following amendments to the list of PRGT-eligible countries (Table 2)**:

Entry

- No additions to the list are proposed at this time. In particular, *Kosovo*, though IDA-eligible, would not qualify for entry onto the PRGT eligibility list, as its 2008 per capita income level exceeds two times the IDA operational cutoff.

Graduation

- *Albania, Angola*, and *Azerbaijan* would graduate based on the income criterion (their per capita GNI exceeds twice the IDA operational cutoff and the two other elements of the income criterion are also met), in the absence of serious short-term vulnerabilities. Angola also meets the market access criterion. While the income criterion is also met by *Armenia* and *Georgia*, staff proposes maintaining these countries' PRGT eligibility, based on their debt vulnerabilities and the potential for a substantial drop in GNI per capita in 2009; the eligibility of these countries will be reassessed at the time of the next PRGT eligibility review.

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*A revised staff proposal was approved by the Executive Board: decisions on graduation can be adopted also in the interim period between reviews for a member that meets the criteria for graduation, at the request of such a member.

[12] Zimbabwe is not PRGT eligible due to its removal from the PRGT-eligibility list by Executive Board decision in connection with its overdue obligations to the PRGT. Zimbabwe's per capita GNI is estimated to be well below the IDA operational cutoff and the country does not have market access. Accordingly, it does not meet the graduation criteria for PRGT eligibility, and would be expected to become PRGT eligible if the remedial measure were lifted.

- While the income criterion for small countries is met by *Dominica, Grenada*, *Maldives, St. Lucia*, and *St. Vincent and the Grenadines* (their per capita GNI exceeds three times IDA's operational cutoff and the two other elements of the criterion are also met), staff proposes maintaining their PRGT eligibility, based on their short-term vulnerabilities (especially on debt). The eligibility of these countries will be reassessed at the time of the next PRGT-eligibility review.

- *India, Sri Lanka,* and *Pakistan* would graduate as they meet the market access graduation criterion, and short-term vulnerabilities appear manageable.

IV. Policies for Phasing in Changes in Eligibility

20. **It is intended that the proposed and future changes in the PRGT eligibility list should not interfere with existing PRGT support or ongoing discussions on new financing requests.** Accordingly, it is proposed that these changes would become effective three months after the adoption of the related decision by Executive Board. This would allow the Board to approve, during the transitional period, new requests for PRGT support (i.e., arrangements and outright disbursements) based on past or ongoing discussions with the authorities. Moreover, countries that meet the criteria for graduation, but have concessional arrangements in place when the new decision (or decisions for future eligibility reviews) becomes effective would remain PRGT-eligible for the full duration of the arrangement. The graduation decision in respect of such countries would specify that their removal from the list would become effective only upon termination of the relevant arrangement.[13]

21. **Repayments of outstanding PRGT credit would remain subject to PRGT terms after graduation of the member from the PRGT eligibility list.** This would include repayments linked to ongoing or past arrangements or outright disbursements, as well as disbursements that may be approved during the transitional period. Similarly, subsidization of the rate of charge on otherwise eligible EPCA/ENDA credit would remain available (subject to the terms of the administered account for EPCA/ENDA subsidies) for all EPCA or ENDA purchases made while a member was PRGT-eligible.

[13] A similar deferral of the effectiveness of a graduation decision would apply with respect to the PSI.

Table 2. PRGT-Eligible Countries - 2008 Per Capita GNI (US dollars)

Afghanistan	na	Liberia	170
Armenia**	3350	Madagascar	410
Bangladesh	520	Malawi	290
Benin	690	Maldives**	3630
Bhutan	1900	Mali	580
Bolivia	1460	Mauritania	na
Burkina Faso	480	Moldova	1470
Burundi	140	Mongolia	1680
Cambodia	600	Mozambique	370
Cameroon	1150	Myanmar	na
Cape Verde *	3130	Nepal	400
Central African Rep.	410	Nicaragua	1080
Chad	530	Niger	330
Comoros	750	Nigeria	1160
Congo, Dem. Rep. of	150	Papua New Guinea	1010
Congo, Republic of	1970	Rwanda	410
Côte d'Ivoire	980	Samoa*	2780
Djibouti	1130	São Tomé & Príncipe	1020
Dominica**	4770	Senegal	970
Eritrea	300	Sierra Leone	320
Ethiopia	280	Solomon Islands	1180
Gambia, The	390	Somalia	na
Georgia**	2480	St. Lucia**	5530
Ghana	670	St. Vincent & Grenadines**	5140
Guinea	n.a.	Sudan	1130
Grenada**	5710	Tajikistan	600
Guinea-Bissau	250	Tanzania	440
Guyana	1420	Timor-Leste	2460
Haiti	660	Togo	400
Honduras	1800	Tonga*	2560
Kenya	770	Uganda	420
Kiribati	2000	Vanuatu*	2330
Kyrgyz Republic	740	Vietnam	890
Lao People's Dem. Rep	740	Uzbekistan	910
Lesotho	1080	Yemen	950
		Zambia	950
Proposed Graduation:			
Albania	3840	India	1070
Angola	3450	Pakistan	980
Azerbaijan, Rep. of	3830	Sri Lanka	1780

* Maintained on the list due to small country exception

** Maintained on the list due to short-term vulnerability

Source: The World Bank, World Development Indicators, September 2009

V. Financing Implications

22. **The proposed changes to the list of PRGT-eligible countries would likely have a limited impact on the demand for the Fund's concessional resources.** The most recent financing projections, presented in SM/09/254, did not assume any change in the list of PRGT-eligible countries and were based in part on country-by-country information provided by area departments. [14] The projections did not envisage in the near term requests for concessional resources from the six countries identified for graduation beyond existing commitments. In addition, three of these countries—Angola, Pakistan and Sri Lanka—have recently requested access to Fund financing from the GRA under Stand-By Arrangements (SBAs) and were judged unlikely to request concessional resources in the medium term. At the inception of the ESAF in 1987, India indicated that it did not intend to use the Fund's concessional resources and has therefore been excluded from the financing projections, while Albania was unlikely to consider concessional resources in light of its relatively strong economic position. Moreover, none of the countries proposed for graduation from PRGT-eligibility are among the "ring-fenced" countries that could benefit from the HIPC Initiative.[15] The proposed changes, therefore, would have no implications on the resources needed by the Fund to provide HIPC Initiative and MDRI debt relief.

[14] See *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries* , September 2009. The demand projections did not take into account the three protracted arrears cases (Somalia, Sudan, and Zimbabwe), and no changes are being proposed for these countries.

[15] See *Heavily Indebted Poor Countries Initiative—List of Ring-Fenced Countries That Meet the Income and Indebtedness Criteria at end-2004,* April 2006.

Box 2. Economic Vulnerability in Small Countries

There is no generally accepted definition of a small country. The literature often uses a definition based on the number of inhabitants, and in practice a threshold of 1 million or less has been the criterion to define a small country. Other criteria, such as territory size or GDP have been also used. On average, compared with other countries at the same stage of development, GDP growth and per capita income are higher in small countries. At the same time, they are exposed to significantly higher economic volatility (Kose and Prasad, 2002; Easterly and Kraay, 1999). The literature identifies several common characteristics of small countries that contribute to better define their greater vulnerability, including exceptionally high degree of openness, high concentration of export bases, and small domestic markets (Armstrong and Read, 2002). Large public sector (Alesina and Spolaore, 2002; Kose and Prasad, 2002) and a high degree of aid dependency (Kose and Prasad, 2002) are additional features of small countries.

Empirical analysis (Easterly and Kraay, 1999; Kose and Prasard, 2002) has shown that openness to trade and a small economic size are keys to vulnerability. Small economies are less diversified and, thus, more susceptible to external shocks and natural disasters, while the larger size of a government reflects the high average cost of producing public goods on a small scale. Kose and Prasard (2002) noted that GDP may not be a good measure of income (or wealth) for economies that are highly open to trade, given the strong volatility of their terms of trade, which tend to be sharp and persistent, also reflecting the volatility of international prices. Small countries have a ratio of trade to GDP that is 54 percentages points higher than the average economy (Easterly and Kraay, 1999), while developing countries' terms of trade volatility was estimated to be 30 percent higher on average for small states as opposed to other developing countries (Kose and Prasad, 2002).

Small countries are also characterized by greater output and consumption volatility. The volatility of per capita real GDP growth is almost twice higher in small countries than in other countries, while the volatility of consumption growth was over 50 percent higher in small countries (Easterly and Kraay, 1999). This study also shows that there is significant 'residual' volatility of output in small countries that is unrelated to their exposure to international trade.

VI. Proposed Decisions

The following decisions, which may be adopted by a majority of the votes cast, are proposed for adoption by the Executive Board:

Decision A

1. The following criteria for entry and graduation shall, respectively, guide Executive Board decisions to add members to, and remove members from, the list annexed to Decision No. 8240-(86/56) SAF, as amended (the "PRGT-eligibility list"):

(A) Criteria for entry: A member will be added to the PRGT-eligibility list if (i) its annual per capita gross national income ("GNI"), based on the latest available qualifying data, is below the International Development Association ("IDA") operational cut-off or, for a member qualifying as a "small country" under the definition set forth in subparagraph (D), is less than twice the IDA operational cut-off; and (ii) the sovereign does not have capacity to access international financial markets on a durable and substantial basis as defined in subparagraph (C).

(B) Criteria for graduation: A member will be removed from the PRGT-eligibility list if it meets either or both the income and market access criteria specified in (1) and (2) below, and does not face serious short-term vulnerabilities as specified in (3) below:

(1) Income Criterion: the member’s annual per capita GNI (i) has been above the IDA operational cut-off for at least the last five years for which qualifying data are available; (ii) has not been on a declining trend over the same period, comparing the first and last relevant annual data; and (iii) based on the latest qualifying annual data, is at least twice the IDA operational cut-off or, for a member qualifying as a “small country” under the definition set forth in subparagraph (D), is at least three times the IDA operational cut-off.

(2) Market Access Criterion: (i) the sovereign has the capacity to access international financial markets on a durable and substantial basis as defined in subparagraph (C); (ii) the member’s annual per capita GNI is above 80 percent of the IDA operational cut-off based on the latest qualifying annual data; and (iii) the member’s annual per capital GNI has not been on a declining trend over the last five years for which qualifying data are available, comparing the first and last relevant annual data.

(3) Absence of serious short-term vulnerabilities: the member does not face serious short-term vulnerabilities, which shall require in particular (i) the absence of risks of a sharp decline in the member’s income, or of a loss of its market access (where relevant); (ii) limited debt vulnerabilities as indicated by the most recent debt sustainability analysis, including, for members whose debt has been assessed under the Debt Sustainability Framework for Low-Income Countries, an external debt distress classification of moderate or less and a level of domestic debt that does not give rise to serious concerns about the member’s debt sustainability; and

(iii) confirmation that overall debt vulnerabilities remain limited, taking into account developments and prospects since the most recent debt sustainability analysis.

(C) For the purposes of subparagraphs (A) and (B)(2), the sovereign's capacity to access international financial markets on a durable and substantial basis shall be evidenced by either of the following:

(1) The issuance or guarantee by a public debtor of external bonds in international markets, or disbursements under external commercial loans contracted or guaranteed by a public debtor in international markets, if such issuance, guarantee or disbursement has occurred during at least three of the last five years for which qualifying data are available, and has been in a cumulative amount equivalent to at least one hundred percent of the member's quota in the Fund at the time of the assessment; or

(2) The existence of convincing evidence that the sovereign could have tapped international markets as specified under (1) above, even though the actual issuance or guarantee by a public debtor of external bonds in international markets, or actual disbursements under external commercial loans contracted or guaranteed by a public debtor in international markets, fell short of the duration and scale thresholds specified under (1) above. Determinations under this paragraph shall be a case-specific assessment that takes into account relevant factors, including the volume and

terms of recent external borrowing or guaranteeing of external borrowing in international markets, and the sovereign credit rating where one exists.

For purposes of this subparagraph (C): (i) a "public debtor" shall include the sovereign (national government) as well as other public borrowers (including political subdivisions, agencies of the national government or of political subdivisions, autonomous public bodies and public corporations) whose ability to borrow in international markets is assessed to be an indicator of the sovereign's creditworthiness; (ii) "external bonds" are those issued in international capital markets and "external commercial loans" are commercial loans contracted in international markets by residents of a member with nonresidents, provided that bonds issued and loans contracted in markets that are not integrated with broader international markets shall not qualify; and (iii) bonds and commercial loans guaranteed by a public debtor shall be obligations of a private debtor whose repayment is guaranteed by a public debtor.

(D) For the purposes of the criteria set forth in this paragraph 1, a member will be considered a "small country" if it has a population below 1 million.

(E) For the purposes of the criteria set forth in this paragraph 1, assessments of per capita GNI will normally be based on World Bank data using the ATLAS methodology, but other data sources may be used in exceptional circumstances, including data estimated by Fund staff in the absence of World Bank data. Qualifying data for the purposes of the criteria set forth in this paragraph 1 shall be data in respect of which the most recent observation relates to a calendar year that is not more than 30 months in the past at the time of the assessment.

2. Executive Board decisions to remove a member from the PRGT-eligibility list pursuant to the graduation criteria set forth in paragraph 1 of this decision shall become effective three months after their adoption, provided that such decisions in respect of members that have an existing arrangement under the Poverty Reduction and Growth Trust established pursuant to Decision No. 8759-(87/176) ESAF, adopted December 18, 1987, as amended ("PRGT"), or that have a program subject to assessment and endorsement by the Fund under an existing policy support instrument, shall become effective upon the expiration or other termination of such arrangement or policy support instrument, respectively.

3. Notwithstanding the entry into effect of a decision to remove a member from the PRGT-eligibility list in accordance with this decision, any outstanding PRGT resources disbursed to such member prior to the effectiveness of the decision shall remain subject to the terms of the PRGT. In Section II, paragraph 4(c) of the PRGT, the reference to "as such list may be amended from time to time," shall be deleted.

4. The term "eligible recipients" under paragraph 7(a) of Decision No. 12481-(01/45) governing subsidies for postconflict and natural disaster purchases of PRGT-eligible members shall be understood to include members that, at the time of their removal from the PRGT-eligibility list pursuant to this decision, have outstanding postconflict or natural disaster purchases in respect of which subsidies may be provided under Decision No. 12481-

(01/45), for as long as such purchases remain outstanding. In subparagraph 7(d) of Decision No. 12481-(01/45), as amended, the references to "qualifying PRGT-eligible members" shall be replaced with references to "PRGT-eligible members", and the second sentence shall be deleted.

5. It is expected that the criteria for entry and graduation set forth in this decision shall be reviewed every two years.* It is also expected that the PRGT-eligibility list shall be reviewed and updated every two years on the basis of the then applicable criteria for entry and graduation; provided however that (i) decisions on entry onto the PRGT-eligibility list of members that meet the entry criteria specified in paragraph 1 above may also be adopted in the interim period between reviews, (ii) notwithstanding paragraph 1 above, decisions may be adopted in the interim period between reviews in respect of the re-entry onto the PRGT-eligibility list of members that had previously been removed from such list as a sanction for overdue obligations, so long as such a member at the time of re-entry does not meet the criteria for graduation specified in subparagraph 1(B) above, and (iii) decisions may be adopted in the interim period between reviews in respect of the graduation from the PRGT-eligibility list of members that meet the criteria for graduation specified in subparagraph 1(B) above, at the request of such a member.**

Decision B

1. In light of the criteria set forth in Decision No. ---------- [Decision A above], the list annexed to Decision No. 8240-(86/56) SAF shall be amended by removing from such list Albania, Angola, the Azerbaijan Republic, India, Pakistan and Sri Lanka.

2. This decision shall become effective on April 10, 2010.

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* This sentence was introduced by the Executive Board, and was not included in the original staff proposal.

** Clause (iii) was approved by the Executive Board on the basis of a revised staff proposal.

Annex I. Assessments of Countries that Meet the Income or

Market Access Criteria

Albania

In July 2008, Albania was removed from the IDA eligibility list. Its per-capita GNI reached US$3,840 in 2008, has been above the prevailing IDA threshold since 2000 and has not been on a declining trend for at least the last 5 years. The Board paper for the 2003 PRGT review noted an expectation that Albania would be removed from the list after its existing PRGF-EFF arrangement had expired. Under three consecutive PRGF-EFF arrangements, the last one completed on January 2009, Albania has made significant progress with GDP growth averaging almost 6 percent in the last 5 years (2002-2008), stable inflation and sustainable debt.

External debt has remained low, below 20 percent of GDP, and is expected to decline further. Over the past five years, debt sustainability has continued to improve, with lengthened maturities and a declining public debt-to-GDP ratio. The most recent (non-LIC) DSA confirmed that debt was set to remain on a sustainable path, provided an adequate fiscal anchor remains in place. Per capita income is expected to continue to grow and the projected strong external position would provide Albania with the capacity to service possible future lending on non-concessional terms.

Staff proposes the immediate graduation of Albania.

Angola

Angola is the third largest economy in Sub-Saharan Africa. Since 2004, the country has experienced double digit growth, underpinned by a stable macroeconomic environment. Its GNI per capita has consistently exceeded the IDA threshold for the last five years, has not been on a declining trend during such period, and in 2008, per capita income reached US$ 3,450, about 3 times the IDA threshold. Growth in Angola has been boosted by a strong expansion of oil production and rapid growth in the non-oil sector.

Notwithstanding Angola's strong macroeconomic performance, the global economic crisis and the drop in oil prices has had a negative impact on the fiscal and external positions. The sharp decline in oil revenues in 2009 has shifted both the fiscal and current account surpluses into negative territory, while undermining the country's external reserve position, which is projected to drop to 2.9 months of imports by the end of 2009. In response to the crisis, a 27-month stand-by arrangement (SBA) was approved in November 2009 to help restore macroeconomic stability and reverse the decline in reserves. Key elements of the program include addressing fiscal weaknesses to insulate the budget from oil price volatility by expanding the economic base, and improving public financial management and fiscal transparency. After a minor contraction in 2009 (by 0.4 percent), GDP growth is expected to reach 7.1 percent in 2010.

Angola's external debt position appears sustainable, with the stock of external debt projected to remain below 30 percent of GDP in the medium-term. The SBA includes a non-zero ceiling of 2.4 percent of GDP on non-concessional debt. The LIC-DSA indicated a moderate risk of debt distress due to vulnerability to oil prices and high non-concessional indebtedness.

As the impact of the crisis dissipates and oil prices recover, pressures on Angola's external position will subside and strong growth should be restored.

Staff proposes the immediate graduation of Angola.

Armenia

In 2008, per capita GNI reached US$3,350, it has been above the IDA threshold since 2004 and has not been on a declining trend for at least the last 5 years . Under the 2005-08 PRGF-supported program, Armenia experienced double-digit growth rates while keeping inflation relatively low. This strong performance reflected sound macroeconomic policies, supported by structural reforms. The external position remained sustainable, and was underpinned by FDI and remittances flows, fostering a steady accumulation of reserves, to almost five months of imports by end-2008.

The global economic crisis has exacted a heavy toll on the Armenian economy. The exchange rate has depreciated by over 25 percent since early 2009, and GDP is expected to contract by 15 percent in 2009 and would only recover to 1.2 percent in 2010. Similarly, transfers dropped by about 30 percent in 2009 and are projected to rise slightly in 2010. To cushion the severe impact of the global economic downturn on the fiscal and external positions, an SBA with exceptional access was approved in March 2009. The SBA aims to support the authorities' efforts to restore external stability, ensure fiscal discipline and strengthen confidence in the domestic currency and the banking sector.

The most recent LIC-DSA indicated that the risk of debt distress remains low. However, the recent rise in external borrowing, particularly from the international financial institutions, will cause a rapid increase in external debt, which is expected to reach 40 percent of GDP in 2011 before falling to under 30 percent in the medium-term. Debt dynamics, while remaining sustainable, are vulnerable to several shocks, particularly to growth and depreciation. Successful implementation of the SBA, along with the expected economic recovery, will provide the conditions to restore prospects of access to private capital markets within the next two or three years.

Considering the country's short-term vulnerabilities, especially debt vulnerabilities and the potential for a substantial drop in GNI per capita in 2009, staff proposes maintaining Armenia's PRGT-eligibility with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.[16]

[16] Based on current projections, Armenia's per capita GNI in dollar terms could fall below twice the IDA operational cutoff once the full impact of the devaluation has been incorporated (which would take three years, in the World Bank's Atlas methodology).

Azerbaijan

Annual real GDP growth has been above 20 percent since 2005 due to a major expansion in oil and gas production, resulting in higher living standards, lower unemployment, and rapidly declining poverty. Per capita GNI, which reached US$3,830 in 2008, has been above the IDA operational cut-off since 2004, and has not been on a declining trend for at least the last 5 years. A PRGF arrangement expired in 2005.

The outlook for Azerbaijan's external position remains favorable over the medium term, as oil revenues will continue to provide abundant financing for large increases in government spending in the pursuit of a fast-track development strategy. The challenges facing the country are to deepen structural reforms and broaden the economic base. Oil exports have substantially strengthened the balance of payments and boosted international reserves, which reached 7.2 months of imports in 2008, representing almost three times total external debt.

Despite the global downturn, the external position has remained robust and reserve accumulation is expected to continue, though at a slower pace. With public and external debt below 20 percent of GDP in 2008, the most recent DSA indicated that the debt position will remain sustainable under a number of possible shocks, including lower oil prices.

Staff proposes the immediate graduation of Azerbaijan.

Eastern Caribbean Currency Union Member Countries

The four Eastern Caribbean Currency Union (ECCU) member countries that are PRGF eligible–Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines—share exposure to system-wide risks in addition to their country-specific vulnerabilities (see below). There is continued stress on the financial sector resulting from the economic downturn. While the banking system has only modest direct cross-country exposure, there are risks of regional spillovers, particularly in light f the ECCB's limited capacity to act as lender-of-last-resort. Moreover, the collapse of the Trinidad and Tobago-based CL Financial group in January 2009 represents a major challenge to financial stability.[17] Resolution of these problems could add significantly to the already high public debt burden of these countries.

Dominica

In 2008, per capita GNI reached US$4,931 and has remained well above the prevailing IDA threshold since 2004 and has not been on a declining trend for at least the last 5 years. Dominica made substantial progress under the last PRGF arrangement that ended in 2006, though additional steps are necessary to increase the country's resilience to shocks. Efforts to

[17] Two of the group's two insurance subsidiaries, British American Insurance Company (BAICO) and the Colonial Life Insurance Company (CLICO), with extensive branch networks in the ECCU countries, had been offering deposit-like products. Judicial managers for BAICO have reported that the company is insolvent. BAICO accounts for just over half of the exposure of the two subsidiaries to policy and deposit holders in the ECCU (EC$2 billion, 15 percent of GDP). At the regional level, BAICO is estimated to have a negative net worth of some EC$0.8 billion (6 percent of GDP).

modernize the economy have continued despite the damage inflicted by Hurricane Dean, which struck the island in August 2007 and Hurricane Omar, which struck in October 2008.

Recent natural disasters and the global downturn have resulted in lower tourism receipts, FDI, and remittances, leading to an increase in the current account deficit, which is expected to remain elevated. Fund support was approved under the Rapid Access Component of the Exogenous Shocks Facility in July 2009 to help overcome the adverse effects of external shocks on the balance of payments. Real GDP growth is expected to remain slightly positive in 2009/10 and to gradually recover over the medium term.

Since the debt restructuring in 2004-05, external debt sustainability has improved further. The LIC-DSA confirms a progressive improvement in debt sustainability, resulting in a continued decline in the public debt-to-GDP ratio. However, Dominica's public debt still remains high, at 84 percent of GDP at end-June 2009, it is projected to decline only gradually in coming years to 75 percent of GDP by 2014. External debt, currently at 60 percent of GDP is projected to decline gradually to about 56 percent of GDP by 2014. Sensitivity analysis highlights that economic growth and grants inflows are the main driver of debt dynamics, while natural disasters are a significant source of debt-related vulnerabilities. Although Dominica's external debt indicators are generally below the relevant threshold for debt distress in the medium term, they have breached them occasionally when buffeted by extreme shocks.

As noted earlier, Dominica's financial system remains vulnerable following the collapse of the Trinidad and Tobago-based CL Financial group.

Considering the country's short-term vulnerabilities, especially serious debt vulnerabilities related to total public debt, and including emerging risks related to the current financial system problems, staff proposes maintaining Dominica's PRGT-eligibility, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.

Grenada

Grenada's per capita GNI reached US$5,730 in 2008 and has been above the threshold during the current decade and has not been on a declining trend for at least the last 5 years. After a series of devastating hurricanes in 2004-5, economic activity rebounded in 2007.

However, the global slowdown and financial turmoil have hit the economy hard; tourism, FDI and remittances flows have been severely affected. Under the current PRGF-supported program, progress has been made, particularly in the area of fiscal adjustment and improving the business environment. To cope with the external shock, the authorities have reprioritized spending through accelerating the implementation of high impact capital outlays, albeit within a tight budget.

Notwithstanding the progress made, Grenada still faces important short-term vulnerabilities, including a high risk of debt distress. The last LIC-DSA showed a deterioration of debt sustainability owing to lower economic growth, lower FDI, and higher-than-expected debt growth. The public debt is very high (almost 114 percent of GDP in 2009) and is projected to remain above the ECCU target threshold of 60 percent well beyond the 2020 target date. External debt is expected to reach about 84 percent of GDP in 2010 and it remains sensitive to shocks and policy slippages, particularly borrowing at nonconcessional terms.

As noted earlier, Grenada's financial system remains vulnerable following the collapse of the Trinidad and Tobago-based CL Financial group.

Considering the country's short-term vulnerabilities, especially the high risk of external debt distress as well as the further debt vulnerabilities related to total public debt, and including emerging risks related to the current financial system problems, staff proposes maintaining Grenada's PRGT-eligibility, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.

St. Lucia

Per capita GNI has been well above the IDA threshold for more than a decade, has not been on a declining trend for at least the last 5 years, and reached US$5,530 in 2008, almost five times the current IDA threshold. St. Lucia is a small tourism-based economy, which has made significant progress in expanding the tourism sector (three-fourths of exports). However, the global slowdown and financial turmoil has impacted severely St. Lucia's economy as tourism, FDI, and remittances flows have fallen sharply.

In response to the adverse impact of the global downturn on St. Lucia, the Executive Board approved a Fund-supported program under the Rapid Access Component of the Exogenous Shocks Facility in July 2009. Real GDP is expected to decline in 2009 and the overall fiscal deficit is expected to narrow by ½ percent of GDP this fiscal year due to financing constraints. Rebalancing of global demand is also likely to have a permanent adverse impact on tourism arrivals and FDI, the two main drivers of growth. The key challenge facing St. Lucia is to address fiscal imbalances decisively to ensure medium-term sustainability.

St. Lucia's public debt still remains high, at 67 percent of GDP at end-2008, and is projected to rise to 71 percent before declining in coming years to 52 percent of GDP by 2020. External debt will reach 41 percent of GDP in 2010 before gradually declining to about 29 percent by 2029. Sensitivity analysis highlights that economic growth is the main driver of debt dynamics. Accordingly, St. Lucia is expected to remain at a moderate risk of debt distress.

As noted earlier, St. Lucia's financial system remains vulnerable following the collapse of the Trinidad and Tobago-based CL Financial group.

Considering the country's short-term vulnerabilities, especially serious debt vulnerabilities related to total public debt, and including emerging risks related to the current financial system problems, staff proposes maintaining St. Lucia's PRGT-eligibility, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.

St. Vincent and the Grenadines

Per capita GNI has remained above the IDA threshold over the past decade, has not been on a declining trend for at least the last 5 years, and in 2008 reached US$5,437. In 2006 and 2007, the economy grew above potential, sustained by tourism-related construction.

However, the global slowdown and financial turmoil have severely impacted St. Vincent and the Grenadines. In 2009, real GDP is expected to decline, the fiscal deficit is projected to widen and tourism, FDI, and remittances flows have fallen sharply. Recent Fund support, approved in May 2009 under the Rapid Access Component of the Exogenous Shock Facility, will contribute to meeting the balance of payments need.

St. Vincent and the Grenadines' rising public debt poses the main risk to macroeconomic stability. With a weakening fiscal performance, public debt is projected to increase sharply—from 69.7 percent of GDP in 2008 to 89 percent in 2010, with the upward trend continuing in the coming years. A rise in external debt-to-GDP ratio is also expected, though it will remain below 50 percent of GDP. Various stress tests underscore the country's vulnerabilities to shocks in GDP growth, exports, and FDI.

As noted earlier, St. Vincent and the Grenadine's financial system remains vulnerable following the collapse of the Trinidad and Tobago-based CL Financial group.

Considering the country's short-term vulnerabilities, especially serious debt vulnerabilities related to total public debt, and including emerging risks related to the current financial system problems, staff proposes maintaining St. Vincent and the Grenadines' PRGT-eligibility, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.

Georgia

In 2008, per capita GNI reached US$2,480 and income has been above the IDA threshold and not on a declining trend for the past five years. In recent years, Georgia achieved high economic growth supported by large capital inflows in the context of sound macroeconomic policies and structural reforms. Foreign direct investments responded to an improved business environment and large privatization.

Following the 2008 political tensions, an exceptional access SBA was approved to support the balance of payments after the sudden and large capital account pressures. The global economic crisis has exacerbated the pressures on the Georgian economy, where the exchange rate has depreciated by almost 20 percent since November 2008, remittances dropped by about 20 percent in 2009, and real GDP is expected to contract by 4 percent in 2009. In the current environment, Georgia faces challenging external conditions in the short-term, but the macroeconomic outlook is expected to improve over the medium term. The recovery of real GDP growth, to 5 percent in the medium term, is expected to be supported by the restoration of market access and continued structural reform.

The economic and political crisis and the fiscal response have led to a sharp increase in public sector indebtedness. Despite a high concentration of debt repayments in 2013-14, staff assesses the risk of debt distress as moderate. While remaining sustainable, debt is sensitive to adverse shocks, particularly a worsening of borrowing terms and currency depreciation. Both public and external debt will peak in 2011 (at 47 percent of GDP and 65 percent, respectively), but are expected to gradually decline over the medium term, with the full and timely implementation of the Fund-supported program. Assuming a normalization of international credit conditions by 2010, the private sector should regain capital market access within the next two–three years.

Considering the country's short-term vulnerabilities, especially debt vulnerabilities and the potential for a substantial drop in GNI per capita in 2009, staff proposes maintaining Georgia's PRGT-eligibility, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review. [18]

India

Notwithstanding its PRGT eligibility, India has indicated that it does not intend to make use of PRGT resources.[19] Since 2000, its per capita income has been growing at sustained pace, reaching US$1,070 in 2008, slightly below the IDA threshold. GDP growth averaged 9 percent from 2004-2008, supporting a substantial reduction in poverty.

Economic activity has been resilient during the current global crisis. GDP growth is projected at about 6-6 ½ percent in 2009/10, strengthening to around 8 percent in subsequent years. Fiscal policy has been supportive of economic activity and the general government deficit is projected at 11.2 percent of GDP in 2009/10, nearly unchanged from 2008/09.

External debt has remained modest at around 20 percent of GDP and the (non-LIC) DSA projects a gradual decline in debt over the medium term. Gross international reserves reached US$280 billion in September 2009, covering more than 10 months of imports.

India's improving macroeconomic fundamentals and its continued integration with the global economy have led to a sustained surge in investor interest in public sector financial instruments over the past decade. India meets the market access criterion (see Annex II).

Staff proposes the immediate graduation of India.

Maldives

Maldives' per capita GNI stood at US$3,630 in 2008 and has been above the threshold during the current decade, and not on a declining trend for at least the last 5 years. However,

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[18] Based on current projections, Georgia's per capita GNI in dollar terms could fall below twice the IDA operational cutoff once the full impact of the devaluation has been incorporated (which would take three years, in the World Bank's Atlas methodology).

[19] See Decision No. 8240-(86/56) SAF, March 26, 1986, as amended.

the Maldivian economy is facing serious and unsustainable fiscal and external imbalances that have been compounded by the global financial crisis. Real GDP is expected to contract by almost 4 percent in 2009, while international reserves are expected to decline to 2.3 months of imports and return to 3 months of imports in 2010. To help address these problems, the Executive Board approved blended Stand-By/Exogenous Shocks Facility financing with a combined access of 700 percent of quota in December 2009. The 36-month Fund-supported program is based on ambitious fiscal adjustment, as well as structural and banking sector reforms. In the medium-term, the economy is expected to stabilize, along a gradual growth recovery path of around 4 percent.

Under the adjustment scenario, the LIC-DSA for external public and publicly-guaranteed (PPG) debt suggests that Maldives is at a moderate risk of debt distress. At end 2008, the stock of external debt stood at 37 percent of GDP, and domestic debt was 31 percent of GDP. All external public debt indicators remain below their respective policy-dependent thresholds and the present value of external debt is projected to remain below 25 percent in the medium-term in the baseline scenario which envisages major fiscal adjustment. Nevertheless, total public debt vulnerabilities remain high, as public debt, especially domestic debt, has increased very rapidly since 2004, especially in 2009, driven by highly expansionary fiscal policy. Debt dynamics would become unsustainable under the historical (no-reform) scenario.

The sustainability of the fiscal and external position, including debt dynamics, hinges on the successful implementation of a strong adjustment program, which faces considerable risks, including uncertainty about the global economic conditions, the growth path, and availability of external financing.

Considering the country's short-term vulnerabilities, staff proposes maintaining Maldives' PRGT-eligibility, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.

Pakistan

Since 2001, Pakistan's economy has experienced high growth with real GDP expanding annually at 6–7 percent, moderate inflation, a declining debt burden, and lower poverty rates. In 2008, per capita GNI reached US$980, almost 90 percent of the prevailing IDA threshold and its per capita GNI has not been on a declining trend for at least the last 5 years. While the accelerated privatization of state-owned entities has facilitated FDI inflows, greenfield investments also represent a large part of FDI. Improved regulation and progress in structural reforms, particularly in liberalizing financial markets and reducing trade protection, have played a crucial role.

The global recession and volatile political and security situation led to the deterioration of macroeconomic conditions. However, real GDP growth is expected to remain positive in 2009/10, while remittances have increased by 20 percent from mid-2008 to May 2009 despite the global crisis. In November 2008, a two-year SBA was approved to support the authorities' efforts to restore financial stability through tightening the policy mix and strengthening social safety nets. Despite political and security uncertainties, the macroeconomic imbalances have shrunk and inflation has fallen, although the external position remains subject to considerable downside risks. Timely implementation of structural measures will remain a challenge.

Total public debt is expected to remain stable at around 56 percent of GDP, partly reflecting debt from the electricity sector. The DSA shows that the debt stock would remain moderate and external debt manageable. External debt would remain broadly stable at 32 percent of GDP in the medium-term. Debt dynamics are vulnerable to a number of shocks, particularly fiscal deterioration and exchange rate depreciation.

Through 2007, Pakistan had access to international financial markets by issuing Eurobonds, Global Depository Receipts, and exchangeable bonds. Since then, it has maintained a good record in servicing its external debt despite volatile economic conditions, and the country meets the market access criterion (see Annex II). With the normalization of financial markets and successful implementation of the current SBA, the country should regain full access to international capital markets.

Staff proposes the immediate graduation of Pakistan.

Sri Lanka

Strong economic performance in recent years has lifted Sri Lanka's per capita income substantially, reaching US$1790 by 2008, well above the prevailing IDA threshold and its per capita GNI has not been on a declining trend for at least the last 5 years. The strong growth performance signaled substantial resilience to shocks, including to oil prices, and to the expiration of the Multi-Fiber Agreement.

To cushion the impact of the global crisis, an SBA was approved in July 2009. Economic developments under the program have so far been somewhat stronger than expected, with GDP growth expected to return almost to pre-crisis levels already in 2010 and exports showing signs of recovery.

The recent LIC-DSA indicates a moderate risk of external debt distress, though this assessment hinges on the satisfactory implementation of the Fund-supported program. Despite a recent decline, total public debt is expected to remain at high levels for a number of years. Public external debt is projected to decline gradually over the medium term, after reaching 50 percent of GDP in 2010. While debt dynamics remain sensitive to currency depreciation and export shocks, a timely implementation of fiscal consolidation, as envisaged in the program, is crucial to ensure that the debt remains on a sustainable path.

Sri Lanka has benefited from access to capital markets in the past years and meets the market access criterion (see Annex II). A recent oversubscribed five-year Euro bond reflected the progress made under the Fund-supported program, and signaled good prospect for continued access to capital markets.

Staff proposes the immediate graduation of Sri Lanka.

Annex II. Market Access by Low-Income Countries

This note provides broad guidance on key considerations in assessing sovereign market access for low-income countries (LICs), that inform the proposed market access criterion. The challenges in measuring LIC market access relate to both domestic and external factors. In particular, domestic financial markets in most LICs are underdeveloped and illiquid while external market access is often sporadic.

This note explains the rationale for the proposed definition of market access, considers its operational features, and then applies the definition to available and comparable cross-country data.

A Definition of Market Access:

The proposed definition of LIC market access is based on the following pillars:

- **Voluntary**: A market access measure should capture only voluntary access to financial markets by a low-income sovereign. This is important since many LICs frequently rely on their domestic banks for funding their financial needs. If such bank borrowing is directed, then it often does not reflect the voluntary aspect of market access.[20] Domestic bond issuance may suffer from similar limitations.[21] The proposed definition of LIC market access therefore focuses on public and publicly guaranteed external bond issuance and disbursements under external commercial loans. Public bonds and commercial loans refer to obligations of a public debtor, which includes the sovereign (national government), as well as other public borrowers (including political subdivisions, agencies of the national government or of political subdivisions, autonomous public bodies, as well as public corporations) whose ability to borrow is assessed to be an indicator of the sovereign's creditworthiness. Publicly guaranteed bonds and commercial loans refer to obligations of a private debtor that is guaranteed for repayment by a public debtor. "External bonds" are those issued in international capital markets. External commercial loans refers to commercial loans contracted with nonresidents by residents of an economy. External bonds and commercial loans issued or contracted in markets that are not integrated with broader international markets do not qualify.

- **Durability and Size**: The sustainability of market access over a short period can be limited even for mature emerging market economies. Therefore, to ensure that the

[20] See Gelos, Sahay, and Sandleris (IMF Working Paper/04/221).

[21] Furthermore, domestic borrowing by the government can also have the adverse impact of crowding out the private sector.

measure gives some sense of the durability of market access, it is important that it take into consideration bond issuance over the medium term (e.g., over a time horizon of five years) and that countries have established some record of continued market access (i.e., accessed markets more than once in recent periods). The measure also needs to capture whether market access is sufficiently large, on some comparable cross-country measure. Accordingly, it is proposed to measure market access relative to Fund quota, which provides an indicator of a country's economic size.

Estimated Statistic of Market Access:

Based on the proposed definition of market access, and using available data for the 2003-2007, the following observations can be made:[22]

- A few LICs have tapped external bond markets since 2003, but only a small subset have issued bonds multiple times (Grenada, India, and Pakistan). Two countries have issued only one external bond (Vietnam in 2005 and Sri Lanka in 2007).

- Angola, Maldives, Sri Lanka, Vietnam, and a number of ECCU member countries have obtained external commercial loans over this period.

- For many of these countries, market access is fairly small (e.g., below 10 percent of the Fund quota on average during 2003–07).

- Angola, Sri Lanka and Pakistan have accessed the international financial markets in four or five of the recent (pre-crisis) years (2003-2007), with cumulative market access exceeding their present quota in the Fund.

- While India has had significant access to international capital markets, actual access over 2003-07 remained below 100 percent of quota.[23] India's market access is confirmed, however, by its investment grade sovereign credit rating.

- The evidence shows that Angola, India, Sri Lanka, and Pakistan have maintained regular market access in recent years in line with the proposed conditions for duration and magnitude, while also meeting the income threshold under the market access criterion.

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[22] For cross-country comparison, the disbursement data (1990-2007) of external bond and commercial loans are drawn from the Global Development Finance (GDF) database. The results concerning countries that meet the market access criterion have been confirmed based on additional available information.

[23] Comparable data on India are not available in the GDF database.

Market Access, Public and Publicly Guaranteed External Bond and Commercial Loan Disbursements
(In percent of IMF quota)

	2000	2001	2002	2003	2004	2005	2006	2007	Average (2003-07)	Credit Rating
Angola	272.6	289.2	299.8	407.4	446.5	789.7	132.7	1064.1	568.1	-
Sri Lanka	8.2	2.2	16.1	17.9	9.2	22.6	20.5	117	37.4	B+
Pakistan	-	21.5	6.9	-	31.4	40.6	51.3	47.4	42.7	B-/B3

Source: GDF Database

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