



## ELIGIBILITY TO USE THE FUND'S FACILITIES FOR CONCESSIONAL FINANCING

March 15, 2013

### EXECUTIVE SUMMARY

**Staff has conducted a comprehensive review of the Poverty Reduction and Growth Trust (PRGT)-eligibility framework and related list.** Executive Directors expressed a number of concerns about the framework during the *2012 Review of PRGT Eligibility*. In light of these concerns, the Board decided to bring the next review forward by one year.

**The paper concludes that there is not a strong case for making major changes to the design of the eligibility framework. Specific proposals include:**

- **Special provisions for very small states (microstates) in the PRGT-eligibility framework, on the grounds that these states face special challenges** (as analytical work on small states suggests). Higher income thresholds for PRGT entry and for graduation could be set for these states.
- **Maintenance of the 'absence of serious short-term vulnerabilities' criterion in its current form**, to preserve a degree of flexibility and room for case-by-case evaluation in determining readiness for graduation from the PRGT.
- **A few refinements to the market access criterion**, including differentiation between the entry and the graduation thresholds, to build further safeguards against the risks of 'reverse graduation' (re-entry of recently graduated members).

**Based on the application of the revised PRGT-eligibility framework, three countries are proposed for entry and two for graduation:**

- **Tuvalu, Marshall Islands, and Micronesia** would be added to the PRGT-eligibility list if the proposed new entry criteria for microstates are approved;
- **Armenia and Georgia** are proposed for graduation on the basis of the income criterion; these countries' short-term vulnerabilities appear manageable.
- **Grenada and Maldives** meet the income criterion for graduation, and **Vietnam and Ghana** meet the market access graduation criterion; however, the staff proposes maintaining these countries' PRGT eligibility at this time, based on their serious short-term vulnerabilities.

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## Glossary

ADB	Asian Development Bank
BAICO	British American Insurance Company Limited
CLICO	Colonial Life Insurance Company
CPI	Consumer Price Inflation
DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
EFF	Extended Fund Facility
ESF	Exogenous Shocks Facility
FDI	Foreign Direct Investment
FY	Fiscal Year
GDF	Global Development Finance
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDS	International Debt Statistics
LIC	Low-Income Country
MDRI	Multilateral Debt Relief Initiative
PPG	Public and Publicly-Guaranteed
PRGT	Poverty Reduction and Growth Trust
PSI	Policy Support Instrument
SBA	Stand-By Arrangement
SCF	Standby Credit Facility
SDR	Special Drawing Rights
UCT	Upper-Credit Tranche
US\$	US Dollar
WEO	World Economic Outlook

## INTRODUCTION AND OVERVIEW

1. **During the 2012 Review of Poverty Reduction and Growth Trust (PRGT) Eligibility, Executive Directors expressed a number of concerns about the eligibility framework.** The Board decided to bring forward the next review of eligibility by one year, to early 2013, in light of these concerns. In particular, Directors called for the review to assess:
  - Possible shortcomings of the gross national income (GNI) per capita criterion in the case of small states, and whether additional or alternative variables should be used to better capture members' circumstances, particularly those of small states; as well as further options to enhance the flexibility of the PRGT-eligibility framework to cover small and very small countries;
  - The application of the short-term vulnerabilities criterion for graduation, which can lead to repeated non-graduation of members that meet either the income or the market access criteria for graduation.
2. **To address these concerns, staff has conducted a comprehensive review of the PRGT-eligibility framework and the associated list of eligible countries.** The review examines whether the balance between the various criteria used in the framework—per capita income, market access, vulnerabilities, and size—remains appropriate, and to what extent there is merit in considering additional or alternative indicators.
3. **A key objective of this review is to maintain a transparent, rules-based, and parsimonious framework for PRGT eligibility that ensures uniformity of treatment among members and supports the Trust's key objectives.** In addition, the proposed eligibility framework needs to be consistent with the principle of self sustainability for the Trust's finances, under which modifications to low-income country (LIC) facilities (including eligibility) are expected to ensure that the demand for IMF concessional assistance can be met with resources available under a plausible range of scenarios. The current framework has differentiated criteria for entry and graduation to minimize untimely graduation decisions and the consequential need for their reversal, and the review aimed to strengthen this element of the framework. Frequent reversals in members' PRGT-eligibility status would be undesirable as this would make financial planning difficult, both for the Trust and for its members. 'Reverse graduation' could also have reputational effects for the members.
4. **The remainder of this paper is organized as follows:** the paper first provides an overview of the current framework for determining PRGT eligibility. It then goes on to address, in turn, the various issues Directors raised at the last review regarding the design of the eligibility framework: small states, the adequacy of per capita income as a measure of welfare, and the rationale for taking their exposure to fiscal/external volatility into account; the role played by the 'vulnerabilities' criterion in determining graduation; and the market access criterion. The paper then discusses the operational implications of the proposed modifications to the framework for entry and graduation in this review, policies for phasing in changes in the PRGT-eligibility list, and the potential impact of the proposed modifications on the demand for the Fund's concessional resources. The decisions to

adopt the proposed modifications to the framework for entry and graduation and to make corresponding changes to the PRGT-eligibility list are set forth in the last section, and a redlined text showing the specific modifications to the existing Executive Board decision on PRGT-eligibility criteria is included in Annex III for the convenience of Executive Directors.

## THE CURRENT FRAMEWORK

5. **The criteria established in 2010 aim to link PRGT eligibility closely to the Trust's key objectives.** That is, access to scarce resources for concessional Fund financing should be preserved for members with a low-income level and related economic and financial vulnerabilities. For these countries, the concessionality of Fund financing is considered to be important for providing effective balance of payments support, while limiting risks of debt distress.

6. **The framework comprises differentiated criteria for entry and for graduation.** In broad terms, countries can be added to the PRGT-eligibility list if their annual GNI per capita income is below the International Development Association (IDA) operational cutoff (US\$1,195 in FY 2013) and they do not have capacity to access international financial markets on a durable and substantial basis. Broadly, countries graduate from PRGT eligibility if they have either a higher level of GNI per capita for a defined period of time or the capacity to access international financial markets on a durable and substantial basis, and they do not face serious short-term vulnerabilities. These criteria are presented in more detail in Box 1. The framework also comprises special criteria for entry and graduation of 'small states' as presented in Box 2.

7. **The PRGT-eligibility framework and the related eligibility list are expected to be reviewed every two years.** The 2012 review left both the framework and the list of eligible countries unchanged, except for modifications to the population threshold used to define small states under the framework. The population threshold was raised from 1 to 1.5 million, to align it with the definition used by the World Bank. Directors emphasized the need to maintain a transparent and rules-based framework for PRGT eligibility that ensures uniformity of treatment among members. They also stressed the importance of preserving scarce PRGT resources, and of continuing to closely align PRGT eligibility with the objectives of the PRGT and with IDA practices.

8. **Application of the current eligibility framework in the 2013 Review would result in reduced coverage of small states (including very small states) under the PRGT.** The income of a few small states that were discussed at some length during the 2012 review remains significantly above the applicable entry threshold (US\$2,390)—notably, Tuvalu, which has GNI per capita at US\$5,010—see Table 1. Moreover, two small states—Dominica and St. Vincent and the Grenadines—would be proposed for graduation, as their incomes are now far above the graduation threshold for small states (US\$3,585), and their short-term vulnerabilities as defined under the framework appear manageable.

**Box 1. Criteria for Entry and Graduation from PRGT Eligibility 1/**

**Entry:** A Fund member would be added to the list of PRGT-eligible countries if: (i) its annual per capita GNI is below the operational IDA cutoff (as defined); and (ii) the sovereign does not have capacity to access international financial markets on a durable and substantial basis (as defined).

**Graduation:**

**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 over the same period (comparing the first and the last relevant annual data); and (c) is currently at least twice the operational IDA cutoff.

**Or:**

**Market Access Criterion:** The sovereign has the capacity to access international financial markets on a durable and substantial basis, as measured by one of the following two alternative tests.

- 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 qualifying data are available), in a cumulative amount over that period equivalent to at least 100 percent of the country's quota at the Fund at the time of the assessment. External bonds and commercial loans issued or contracted in markets that are not integrated with broader international markets do not qualify.
- 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 as specified above 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.

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. As a further safeguard, countries would be considered candidates for graduation under the market access criterion only if: (a) their annual per capita GNI is above 80 percent of the IDA operational cutoff (based on the latest available qualifying data); and (b) their annual per capita GNI has not been on a declining trend over 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 will require, in particular, the absence of risks of a sharp decline in income, or of a loss of market access (where relevant), and limited debt vulnerabilities, as indicated by the latest Debt Sustainability Analysis (DSA), and a confirmation that overall debt vulnerabilities remain limited, taking into account developments and prospects since such analysis. 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 DSA, should be limited. For members with a LIC-DSA, the risk of external debt distress should be moderate or less, and the level of domestic debt should not give rise to 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.

1/ From [Eligibility to Use the Fund's Facilities for Concessional Financing \(2010\)](#) and the Decision on Eligibility to Use the Fund's Facilities for Concessional Financing--PRGT-Eligibility Criteria ([Decision No. 14521-\(10/3\)](#)), January 11, 2010.

**Box 2. Entry and Graduation Criteria for Small States 1/**

**Special criteria apply for entry and graduation for small countries, defined as those with a population below 1.5 million.**

- **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 the Decision on PRGT-Eligibility Criteria); and (ii) per capita GNI is less than *twice* the IDA operational threshold.
- **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); (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; or
  - *market access criterion:* The sovereign has the capacity to access international financial markets on a durable and substantial basis, as defined in the Decision on PRGT-Eligibility Criteria; 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. A small country would generally not be expected to graduate if it faces serious vulnerabilities (as discussed in Box 1 above).

1/ From [Eligibility to Use the Fund's Facilities for Concessional Financing \(2010\)](#) and [Decision No. 14521-\(10/3\)](#); and [Eligibility to Use the Fund's Facilities for Concessional Financing \(2012\)](#).

**Table 1. PRGT-Eligible Countries: Per Capita GNI, Population, and Debt Distress**

Country	2011 GNI Per Capita (US\$)	2011 Population (in millions)	Debt Distress (Oct. 2012)	Country	2011 GNI Per Capita (US\$)	2011 Population (in millions)	Debt Distress (Oct. 2012)
Afghanistan, Rep. of	410 <sup>1/</sup>	31.08	High	Madagascar	430	21.85	Low
Armenia	3,360	3.33	Low	Malawi	340	16.17	Moderate
Bangladesh	770	161.32	Low	Maldives	6,530	0.33	High
Benin	780	9.91	Low	Mali	610	15.85	Moderate
Bhutan	2,070	0.70	Moderate	Mauritania	1,000	3.26	Moderate
Bolivia	2,040	10.63	Low	Moldova	1,980	3.56	Low
Burkina Faso	570	16.97	Moderate	Mongolia	2,320	2.80	Low
Burundi	250	8.57	High	Mozambique	470	22.02	Low
Cambodia	830	15.10	Low	Myanmar	NA <sup>1/</sup>	62.42	In debt distress
Cameroon	1,210	20.93	Low	Nepal	540	30.49	Moderate
Cape Verde	3,540	0.52	Low	Nicaragua	1,170	5.89	Moderate
Central African Rep.	470	4.74	Moderate	Niger	360	15.09	Moderate
Chad	690	10.48	Moderate	Nigeria	1,200	160.34	Low
Comoros	770	0.68	In debt distress	Papua New Guinea	1,480	6.66	Low
Congo, Dem. Rep. of	190	72.57	High	Rwanda	570	10.21	Moderate
Congo, Rep. of	2,270	3.98	Low	Samoa	3,190	0.18	Moderate
Côte d'Ivoire	1,100	22.69	Moderate	São Tomé and Príncipe	1,360	0.17	High
Djibouti	1,270 <sup>1/</sup>	0.84	High	Senegal	1,070	13.44	Low
Dominica	7,090	0.07	Moderate	Sierra Leone	340	6.00	Moderate
Eritrea	430	5.49	In debt distress	Solomon Islands	1,110	0.55	Moderate
Ethiopia	400	86.83	Low	Somalia	<sup>1/</sup>	9.56	NA
Gambia, The	610	1.80	High	South Sudan	984 <sup>1/</sup>	8.40 <sup>1/</sup>	
Georgia	2,860	4.47	Moderate	St. Lucia	6,680	0.17	High
Ghana	1,410	24.30	Moderate	St. Vincent & the Gren.	6,100	0.11	Moderate
Grenada	7,220	0.10	High	Sudan	1,300	32.66	In debt distress
Guinea	440	10.59	Moderate	Tajikistan	870	7.85	High
Guinea-Bissau	600	1.68	Moderate	Tanzania	540	42.18	Low
Guyana	2,900 <sup>1/</sup>	0.77	Moderate	Timor-Leste	2,730 <sup>1/</sup>	1.09	Low
Haiti	700	10.01	High	Togo	560	7.14	Moderate
Honduras	1,970	8.03	Low	Tonga	3,580	0.10	High
Kenya	820	40.91	Low	Uganda	510	35.20	Low
Kiribati	2,110	0.10	High	Uzbekistan	1,510	28.84	NA
Kyrgyz Republic	920	5.53	Moderate	Vanuatu	2,870	0.24	Low
Lao P.D.R.	1,130	6.29	Moderate	Vietnam	1,260	89.32	Low
Lesotho	1,220	1.94	Moderate	Yemen	1,070	25.13	High
Liberia	240	3.88	Low	Zambia	1,160	13.59	Low
<b>Memorandum Item</b>							
Zimbabwe	640 <sup>2/</sup>	12.58	In debt distress				
<b>Non-eligible microstates</b>							
Antigua and Barbuda	12,060	0.09		Seychelles	11,130	0.09	
Marshall Islands	3,910	0.05		St. Kitts and Nevis	12,480	0.06	
Micronesia, Fed. Sts. of	2,900	0.11		Tuvalu	5,010	0.01	
Palau	7,250	0.02					

Sources: Fund WEO, World Bank, World Development Indicators, and OP 3.10, Annex C, of July 2012.

<sup>1/</sup> 2011 data are not available. 2010 data given for Afghanistan, Guyana, Sudan, Timor-Leste, and 2009 data for Djibouti and South Sudan.

<sup>2/</sup> Zimbabwe is not PRGT-eligible due to its removal from the PRGT-eligibility list by a Board decision in connection with its overdue obligations to the PRGT. It does not meet the graduation criteria for PRGT eligibility and, accordingly, would be expected to become PRGT-eligible if the remedial measure were lifted.

**Table 2. PRGT-Eligible Countries: Public and Publicly-Guaranteed (PPG) Debt, and GNI Per Capita**

	PPG External Bonds and Commercial Loans (Disbursements in millions of US\$)					Cumulative 2007-2011 (in % of Quota 2012)	2011 GNI Per Capita, Atlas Method Percent of IDA Threshold (US\$956)		PPG External Bonds and Commercial Loans (Disbursements in millions of US\$)					Cumulative 2007-2011 (in % of Quota 2012)	2011 GNI Per Capita, Atlas Method Percent of IDA Threshold (US\$956)		
	2007	2008	2009	2010	2011				2007	2008	2009	2010	2011				
Afghanistan, Rep. of	-	-	-	-	-	-	410		Madagascar	-	0.1	-	0.1	-	0.1	430	
Armenia	-	-	-	-	2.4	1.7	3360	✓	Malawi	-	-	-	-	-	-	340	
Bangladesh	-	-	-	-	-	-	770		Maldives	28.6	47.4	4.6	34.0	33.2	963.0	6530	✓
Benin	-	-	-	-	-	-	780		Mali	-	-	2.5	0.0	0.0	1.8	610	
Bhutan	-	-	-	-	-	-	2070	✓	Mauritania	-	0.02	-	-	-	0.0	1000	✓
Bolivia	9.9	66.3	7.0	-	66.4	56.8	2040	✓	Moldova	-	-	-	-	4.0	2.1	1980	✓
Burkina Faso	-	-	-	-	-	-	570		Mongolia	75.0	-	-	-	-	95.5	2320	✓
Burundi	-	-	-	-	-	-	250		Mozambique	-	-	-	50.6	140.1	109.3	470	
Cambodia	-	-	-	-	-	-	830		Myanmar	-	-	-	-	-	-	NA	
Cameroon	-	-	7.8	6.1	4.7	6.5	1210	✓	Nepal	-	-	-	-	-	-	540	
Cape Verde	-	-	-	-	9.8	56.7	3540	✓	Nicaragua	-	-	-	-	-	-	1170	✓
Central African Rep.	-	-	-	-	-	-	470		Niger	-	-	-	-	-	-	360	
Chad	-	-	-	-	-	-	690		Nigeria	18.2	23.6	-	-	500.0	20.1	1200	✓
Comoros	-	-	-	-	-	-	770		Papua New Guinea	-	-	-	-	-	-	1480	✓
Congo, Dem. Rep. of	-	-	-	-	-	-	190		Rwanda	-	-	-	-	-	-	570	
Congo, Rep. of	-	-	-	-	37.7	29.0	2270	✓	Samoa	-	-	-	-	-	-	3190	✓
Côte d'Ivoire	-	-	-	0.2	-	0.0	1100	✓	São Tomé & Príncipe	-	-	-	-	-	-	1360	✓
Djibouti	-	-	-	-	-	-	1270	✓	Senegal	-	-	200.0	-	500.0	281.5	1070	✓
Dominica	-	1.7	-	-	-	13.7	7090	✓	Sierra Leone	-	-	-	-	-	-	340	
Eritrea	-	-	-	-	-	-	430		Solomon Islands	-	-	-	-	-	-	1110	✓
Ethiopia	-	-	-	304.9	473.8	379.0	400		Somalia	-	-	-	-	-	-	NA	
Gambia, The	-	1.5	0.8	6.4	-	18.2	610		South Sudan	-	-	-	-	-	-	984	✓
Georgia	-	500.0	250.5	413.6	500.0	720.4	2860	✓	St. Lucia	-	-	3.4	-	-	14.4	6680	✓
Ghana	828.5	101.4	273.9	297.5	504.3	353.6	1410	✓	St. Vincent & the Gren.	-	16.0	-	-	-	125.4	6100	✓
Grenada	-	-	-	-	-	-	7220	✓	Sudan	-	-	-	-	-	-	1300	✓
Guinea	2.2	-	-	-	-	1.4	440		Tajikistan	-	-	-	-	-	-	870	
Guinea-Bissau	-	-	-	-	-	-	600		Tanzania	3.1	-	-	17.3	303.6	106.0	540	
Guyana	-	-	-	-	-	-	2900	✓	Timor-Leste	-	-	-	-	-	-	2730	✓
Haiti	-	-	-	-	-	-	700		Togo	-	-	-	-	-	-	560	
Honduras	0.1	-	50.0	-	-	25.2	1970	✓	Tonga	-	-	-	0.2	-	2.3	3580	✓
Kenya	-	-	-	1.5	14.1	3.7	820		Uganda	-	-	-	-	-	-	510	
Kiribati	-	-	-	-	-	-	2110	✓	Uzbekistan	19.9	37.3	0.7	14.9	76.1	35.2	1510	✓
Kyrgyz Republic	-	-	-	-	-	-	920		Vanuatu	-	-	-	-	-	-	2870	✓
Lao P.D.R.	-	-	-	-	-	-	1130	✓	Vietnam	433.4	596.8	626.6	1917.6	642.2	595.5	1260	✓
Lesotho	-	-	-	-	-	-	1220	✓	Yemen	-	-	-	-	-	-	1070	✓
Liberia	-	-	-	-	-	-	240		Zambia	-	-	-	-	-	-	1160	✓
<b>Memorandum Item</b>																	
Zimbabwe	-	-	-	0.3	-	0.0	640										
<b>Non-eligible microstates</b>																	
Antigua and Barbuda	-	-	-	-	-	-	12060	✓	Seychelles	139.6	79.9	9.1	15.6	-	1457.9	11130	✓
Marshall Islands	-	-	-	-	-	-	3910	✓	St. Kitts and Nevis	-	-	-	0.1	3.1	23.2	12480	✓
Micronesia, Fed. Sts. of	-	-	-	-	-	-	2900	✓	Tuvalu	-	-	-	-	-	-	5010	✓
Palau	-	-	-	-	-	-	7250	✓									

Sources: World Bank Global Development Finance and IMF staff estimates.

## THE SPECIAL PROVISIONS FOR SMALL STATES

9. In discussing the *2012 Review of PRGT Eligibility*, Executive Directors called for further analysis of the vulnerabilities and economic challenges facing small states. A paper (SM/13/43) on this topic was discussed by the Executive Board on March 11, and this review of PRGT Eligibility builds on its findings.

**Box 3. Key Findings of *Macroeconomic Issues in Small States and Implications for Fund Engagement (2013)***

- Small states share intrinsic characteristics that can translate into special challenges for their development. One of these is that diseconomies of scale in providing public goods and services can limit institutional capacity.
- Small states are observed to have higher overall expenditure-to-GDP ratios and higher wage bills, which may reflect these diseconomies of scale in the public sector. A higher dependence on trade taxes may be due to higher trade openness, combined with a limited capacity to implement more broad-based tax systems.
- Unlike earlier studies on small states, emerging evidence suggests that relative growth performance of small states has deteriorated recently, particularly since the late 1990s. The most dramatic relative decline in growth performance was seen in micro states (states with a population of less than 200,000 people).
- Small states' social indicators (such as the Human Development Index) are broadly consistent with levels typically observed in larger countries with similar income levels.
- Small states' fiscal and external accounts have been more volatile and this may have contributed to a build-up of public debt.
- Financial sector development may have a particularly important role to play in helping to manage macroeconomic volatility as well as fostering growth.
- Small states use Upper-Credit Tranche (UCT) Fund facilities infrequently, but are frequent users of Fund emergency assistance in response to natural disasters.

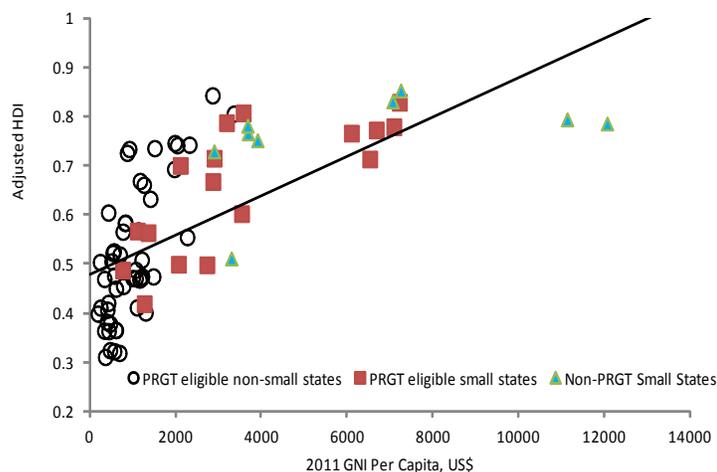
10. **The analytical work on small states confirms the rationale for their exceptional treatment in the PRGT-eligibility framework.** The recent Board paper confirmed the relative volatility of small states' fiscal and external accounts (see Box 3)—this was a key reason for introducing special criteria for small states when the current PRGT-eligibility framework was introduced in 2010 (see [Eligibility to Use the Fund's Facilities for Concessional Financing \(2010\)](#), Box 2). Higher volatility can translate into increased and more frequent financing needs in economic downturns. While in principle macroeconomic policies could aim to build higher policy buffers in anticipation of shocks, in practice this may be more difficult to achieve in low-income small states than in larger LICs, in light of weak institutional capacity, pressing spending needs, and limited scope for additional revenue mobilization. More favorable financing terms for these small states help ensure support for their development goals while maintaining sustainable debt positions, especially when the provision of such financing would be conditioned to the countries' commitment to implement stabilizing macroeconomic policies. The special criteria for small countries mirror the 'small island economies exception' applied by the World Bank in determining eligibility for IDA (see Box 4). A recent (October 2012) review of IDA graduation policies confirmed that the special treatment for these countries under IDA remains appropriate.<sup>1</sup>

<sup>1</sup> See <http://documents.worldbank.org/curated/en/2012/10/16875049/review-idas-graduation-policy>, page 26.

11. **After careful consideration, staff's conclusion is that GNI per capita remains the best indicator of relative poverty for the PRGT-eligibility framework—including for small states.**

Recent analytical work on small states by the staff found that other social development indicators do not convey a significantly different picture than per capita income (see Box 3). The Figure highlights the relationship between GNI per capita and one such social indicator—the Human Development Index (HDI)—and shows that for small states, GNI does not consistently show a higher level of development than the HDI. The recent review of IDA graduation policies likewise examined the feasibility of using alternative measures of relative poverty to complement the per capita-income criterion in some depth, and found that this would be difficult to implement. From an operational perspective, per capita GNI has two advantages over other indicators as a criterion for PRGT eligibility. First, the data are prepared according to a transparent, well-established and well-documented procedure, available for a large group of countries, and published on a predictable annual timetable. Second, given that it continues to be the single most important determinant of IDA eligibility, its use is consistent with the Board's desire to keep PRGT eligibility closely aligned with IDA practices. In sum, staff recommends maintaining the central role for GNI per capita in the PRGT-eligibility framework, including for small states.

**Figure. GNI Per Capita and Adjusted HDI**



Note: The adjusted Human Development Index (HDI) removes the income (GNI per capita) component from the HDI, computed by the Fund staff based on the methodology described in 2011 Report Technical notes, available at <http://hdr.undp.org/en/statistics/hdi/>.

#### Box 4. Eligibility for IDA, the Small Island Exception, and the 2012 Review of IDA's Graduation Policy

Relative poverty (per capita income below an agreed threshold) and the absence of creditworthiness are the main determinants of eligibility for IDA. Currently, there are a total of 81 IDA-eligible countries, of which 65 are IDA-only and 16 are blend countries (those who have limited access to International Bank for Reconstruction and Development or IBRD). With the exception of South Sudan (which is expected to gain IDA eligibility shortly), all currently PRGT-eligible countries are also IDA-eligible.

Graduation from IDA is a flexible process that typically extends over several years and relies on a careful case-by-case analysis, to avoid premature graduation and reversals back to IDA. The current process begins with a positive assessment of creditworthiness and reclassification of a country from IDA-only to blend. The assessment of creditworthiness evaluates eight different components: (i) political risk; (ii) external debt and liquidity; (iii) fiscal policy and public debt burden; (iv) balance of payment risks; (v) economic structure and growth prospects; (vi) monetary and exchange rate policy; (vii) financial sector risks; and (viii) corporate sector debt. The graduation process is normally triggered when a blend country exceeds the IDA operational cutoff for at least two consecutive years—after that the expectation is that countries will transition from blend status to IBRD-only borrower 'within a reasonable timeframe' (which may span several years).

**Small island economy exception:** Since 1985, small island economies with marginal creditworthiness have been granted exceptional access to IDA resources even when their GNI per capita exceeds the IDA threshold and, in some cases, even if they have access to IBRD or to market financing. At present, 13 countries are IDA eligible under the small island exception, five of which are IDA/IBRD blend countries.<sup>2/</sup> The small island exception was introduced to reflect the view that these members face a range of challenges that are typical of LICs, such as export concentration, small domestic markets, high infrastructure costs, limited skill base, weak institutions, geographic isolation, lack of natural resources, lack of access to credit, and vulnerability to natural disasters.

**October 2012 Review of IDA's Graduation Policy.**<sup>1/</sup> Key findings included that:

- Graduation should remain based on case-by-case evaluations—a mechanistic approach needs to be avoided;
- The rationale for the different treatment of small island economies remains valid;
- Using alternative measures of relative poverty to complement the per capita-income criterion would be difficult to implement, owing to design issues (i.e., what dimensions of poverty and social indicators to include), as well as statistical and data problems.

<sup>1/</sup> See <http://documents.worldbank.org/curated/en/2012/10/16875049/review-idas-graduation-policy>.

<sup>2/</sup> Kiribati, Maldives, Marshall Islands, Micronesia, Samoa, Tonga, Tuvalu, Vanuatu, Dominica, Grenada, Cape Verde, St. Lucia, and St. Vincent and the Grenadines. The last five are blend countries.

12. **Staff's recent analytical work on small states suggests that microstates face particularly severe challenges.** [Macroeconomic Issues in Small States and Implications for Fund Engagement \(2013\)](#) defines microstates as those with a population below 200,000 people—a threshold that has been used in the literature. These countries were found to be prone to even greater volatility than other small states in their fiscal and external accounts. Moreover, the various diseconomies of small scale that are characteristic of small states in general are inevitably more pronounced in microstates—which means that the capacity of these countries to cope with external shocks (whether economic or natural) is particularly constrained.

13. **In light of their special challenges, staff proposes to set higher income-related thresholds for microstates than for other small states, both for PRGT entry and graduation.** In particular, a graduation threshold for income for microstates could be set at double that of small states (i.e., at least six times the IDA threshold, or US\$7,170 in this review), with an entry threshold just below that (i.e., less than five times the IDA threshold, or US\$5,975) (paragraphs 1(B)(1) (c) and 1(A)(i)(c) of the decision on the PRGT-eligibility criteria with the proposed modifications). With these thresholds, Marshall Islands, Micronesia, and Tuvalu would meet the entry criteria for PRGT eligibility. Moreover, Dominica and St. Vincent and the Grenadines would no longer meet the income criterion for graduation. With the new graduation threshold, only one currently eligible microstate (Grenada) would still have a per capita GNI above the graduation threshold—but it would not graduate as it is currently assessed at high risk of debt distress. The proposed higher income thresholds for microstates would align PRGT eligibility with IDA eligibility, as all three entrants are currently IDA eligible (as are the two microstates for which the graduation threshold would no longer be met). The impact on the demand for the Fund's concessional resources is expected to be minimal, in light of the very small quota of the microstates (see below).

## THE 'VULNERABILITIES' CRITERION

14. **Under the current framework, members can only graduate from PRGT eligibility in the absence of serious short-term vulnerabilities.** The definition of these vulnerabilities is broad, which has prevented the graduation of members that met the income criterion for graduation but not the “absence of vulnerabilities” criterion.<sup>2</sup> Under the current framework, a country that meets the income criterion would not be expected to graduate if there is a serious risk of a sharp decline in a member's income, to a level below the applicable graduation threshold. 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. Furthermore, debt vulnerabilities, as indicated by the most recent DSA, should be limited. At the time of the *2012 Review of PRGT Eligibility*, Directors called for a careful assessment of the ‘vulnerabilities’ criterion in the context of the 2013 Eligibility Review. Options that could be considered to limit the scope of the ‘absence of vulnerabilities’ criterion include (i) introducing income ceilings beyond which members graduate irrespective of their vulnerabilities, or (ii) focusing on debt vulnerabilities only, since this measure would relate directly to members' ability to use GRA resources without jeopardizing their debt sustainability.

15. **In the view of the staff, it is critical to maintain a degree of flexibility and room for country-specific evaluation in determining readiness for graduation from the PRGT.** The current broad definition of absence of serious short-term vulnerabilities leaves some room for judgment by the Executive Board based on relevant considerations in graduating members from the PRGT-eligibility list, and in the view of the staff, it is important to keep this element of the

<sup>2</sup> Six members (Armenia, Dominica, Georgia, Grenada, Maldives, and St. Vincent and the Grenadines) met the income criteria in both the 2010 and the 2012 eligibility review but still could not graduate owing to serious short-term vulnerabilities.

framework. Without it, in future reviews, members that meet the income or market access criterion for graduation by a narrow margin could 'automatically' graduate, even when relevant considerations seem to indicate that such graduation would be premature. The recent review of IDA graduation policies also concluded that a mechanistic approach needs to be avoided, and that graduation should remain based on case-by-case evaluations. Hence, maintaining the 'absence of vulnerabilities' criterion in its current form will also help keep the PRGT-eligibility framework aligned with IDA practices.

16. **Staff therefore proposes to maintain the 'absence of serious short-term vulnerabilities' criterion in its current form.** To modify it with the introduction of an income ceiling beyond which members would graduate irrespective of their short-term vulnerabilities would have two main drawbacks: (i) it would reduce or eliminate the scope for country-specific evaluations and judgment; and (ii) such a ceiling would likely become a new focal point in the discussion on PRGT eligibility, making it more difficult to graduate members that meet the income criterion (but are not yet at the level of the new ceiling). Similarly, focusing solely on debt vulnerabilities would reduce both the scope for judgment and safeguards against the risk of reverse graduation. For example, if debt vulnerability were the only criterion, Vietnam would now be proposed for graduation in this review of eligibility, despite current signs of weakening prospects for future access of international financial markets.

17. **The application of the 'absence of vulnerabilities' criterion in its current form is conducive to the graduation of two members in this review of PRGT eligibility.** As will be discussed below, under the current definition of the 'absence of vulnerabilities' criterion, Armenia and Georgia are ready to graduate in the 2013 round. This illustrates that the broad definition of vulnerabilities under the framework does not preclude graduation when members are ready for it.

## MARKET ACCESS

18. **Staff proposes to introduce differentiation between the entry and the graduation thresholds for market access.** The motivation is to better align the market access criterion with the income criterion under the framework, and build further safeguards against the risks of 'reverse graduation.' As in the case of the income thresholds used under the framework (for non-small states), the market access graduation level could be set at double the entry level. The minimum level of actual market access required for graduation could remain at 100 percent of quota cumulatively (where "access" is measured over the last five years for which qualifying data (as presently defined) are available, and access must be present during at least three of those five years), or convincing evidence must exist that the sovereign could have tapped the international markets as set forth the decision on the PRGT-eligibility criteria. On the entry side of the framework, countries with access of at least 50 percent cumulatively (with access required during at least two of these five years) would be considered as having market access (paragraph 1(C)(1) of the revised PRGT-eligibility framework

decision).<sup>3</sup> Thus, members that are not currently PRGT eligible could not become so if they meet or exceed the newly proposed (lower) level of market access.

19. **Furthermore, under the market access criterion, staff proposes to increase the income threshold for graduation, again to enhance safeguards against reverse graduation.** Under the current framework, countries are considered for graduation under the market access criterion if their annual per capita GNI based on the latest qualifying annual data is above 80 percent of the IDA operational cutoff. Staff proposes to increase this threshold to 100 percent of the IDA operational cutoff, also to help further align PRGT eligibility with IDA practices (paragraph 1(B)(2) of the revised PRGT-eligibility framework decision).

20. **Staff will continue to use the *Global Development Finance (GDF)*, recently renamed *International Debt Statistics (IDS)*, database to assess actual market access.** This will ensure continuity with the approach followed under the previous PRGT-eligibility reviews. A comparison of this source with other data sources confirmed that the GDF/IDS data set is more comprehensive in terms of country coverage, which is crucial for the review of PRGT eligibility. GDF/IDS data through end-2011 were published in December 2012 and are used for this review of PRGT eligibility (see Table 2). To compensate for the lag in GDF/IDS data availability, and as envisaged by the framework (see Box 1), staff will continue to assess potential market access using relevant data available through other data providers (for example Bloomberg, Dealogic, and others, as available).

21. **Potential market access can continue to be assessed using the volume and terms of recent actual borrowing and the sovereign credit rating.** In the past, an investment grade credit rating has been used to support a proposal for graduation ([Eligibility to Use the Fund's Facilities for Concessional Financing \(2010\)](#), page 34), and in the view of the staff, a credit rating at this level can continue to be used as evidence of potential market access (as Table 3 shows, at present, there are no PRGT-eligible countries that are rated 'investment grade'). Introducing differentiation between the entry and the graduation threshold used to gauge potential market access by using a lower credit rating at the entry side of the framework would be difficult to implement in practice, since market access at ratings below investment grade depends on global market sentiment. Countries with ratings higher than single B (but below investment grade) tend to have market access, but not on a consistent basis. The assessment of potential market access will therefore have to remain case-specific.

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<sup>3</sup> So as to avoid unwarranted discontinuities in the application of the policy, paragraph 5 of the proposed decision A provides that these ratios of market access will be automatically reduced, *pari passu*, once a member's quota increase under the Fourteenth General Review becomes effective. In these circumstances, the level of market access required for graduation from PRGT-eligibility would be reduced to the equivalent of at least 50 percent of quota, and the level of market access for entry onto the PRGT-eligibility list would be reduced to less than 25 percent of quota. For members that do not increase their quotas under the Fourteenth General Review the applicable market access thresholds for graduation and for entry would remain at the equivalent of at least 100 percent of quota and of less than 50 percent of quota, respectively.

**Table 3. PRGT-Eligible Countries: Latest Sovereign Ratings**<sup>1/ 2/</sup>

Country	Fitch	Standard & Poor's	Moody's	Country	Fitch	Standard & Poor's	Moody's
Afghanistan, Rep. of				Madagascar			
Armenia	BB-		Ba2	Malawi	-		
Bangladesh		BB-	Ba3	Maldives			
Benin	-	B		Mali	-		
Bhutan				Mauritania			
Bolivia	BB-	BB-	Ba3	Moldova	-		B3
Burkina Faso		B		Mongolia	B+	BB-	B1
Burundi				Mozambique	B	B+	
Cambodia		B	B2	Myanmar			
Cameroon	B	B		Nepal			
Cape Verde	B+	B+		Nicaragua			B3
Central African Rep.				Niger			
Chad				Nigeria	BB-	BB-	Ba3
Comoros				Papua New Guinea	-	B+	B1
Congo, Dem. Rep. of				Rwanda	B	B	
Congo, Rep. of				Samoa			
Côte d'Ivoire				São Tomé and Príncipe			
Djibouti				Senegal		B+	B1
Dominica				Sierra Leone			
Eritrea				Solomon Islands			
Ethiopia				Somalia			
Gambia, The	-			South Sudan			
Georgia	BB-	BB-	Ba3	St. Lucia			
Ghana	B+	B		St. Vincent & the Gren.			B2
Grenada		CCC+		Sudan			
Guinea				Tajikistan			
Guinea-Bissau				Tanzania			
Guyana				Timor-Leste			
Haiti				Togo			
Honduras		B+	B2	Tonga			
Kenya	B+	B+	B1	Tonga	B	B+	
Kiribati				Uganda			
Kyrgyz Republic				Uzbekistan			
Lao P.D.R.				Vanuatu			
Lesotho	BB-			Vietnam	B+	BB-	B2
Liberia				Yemen			
				Zambia	B+	B+	B1
<b>Memorandum Item</b>							
Zimbabwe							
<b>Non-eligible microstates</b>							
Antigua and Barbuda				Seychelles	B		
Marshall Islands				St. Kitts and Nevis			
Micronesia, Fed. Sts. of				Tuvalu			
Palau							

Sources: Rating agencies' websites.

1/ Bonds are considered investment grade (speculative or junk grade) if their credit rating is, respectively (a) for Fitch, BBB- or higher (BB+ and below); (b) for S&P, BBB- or higher (BB+ and below); (c) for Moody's, Baa3 or higher (Ba1 and below).

2/ Downloaded December 17, 2012.

## IMPLICATIONS FOR THE PRGT-ELIGIBILITY LIST

22. **On the basis of the proposed amendments to the PRGT-eligibility framework, staff proposes the following amendments to the list of PRGT-eligible countries:**<sup>4</sup>

- **Tuvalu, Marshall Islands, and Micronesia** are proposed to be added to the list of PRGT-eligible members as their per capita GNI meets the entry threshold for microstates (i.e., is less than five times the IDA operational cutoff) and they do not have capacity to access international financial markets on a durable and substantial basis (as defined under the newly proposed market access threshold for entry).
- **Armenia and Georgia** are proposed to 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. Georgia also meets the market access criterion.
- Staff proposes maintaining PRGT eligibility for **Grenada and Maldives** based on their debt vulnerabilities; the eligibility of these countries will be reassessed at the time of the next PRGT-eligibility review (both countries currently meet the income criterion for graduation, while Maldives also meets the market access criterion).
- While the market access criterion is also met by **Ghana and Vietnam**, staff proposes maintaining their PRGT eligibility based on serious short-term vulnerabilities that could result in a loss of market access.
- **Pakistan** meets the income criterion for entry, but not the market access criterion, and is, hence, not proposed for entry, since both criteria need to be met.

## POLICIES FOR PHASING IN CHANGES IN ELIGIBILITY

23. **It is intended that the proposed graduations from PRGT eligibility will not interfere with existing PRGT support or ongoing discussions on new financing requests.** Consistent with the current PRGT-eligibility framework decision, these graduations would become effective three months after the adoption of the related decision by the 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 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

<sup>4</sup> Detailed assessments of countries that meet the graduation criteria are provided in Annex I, while Annex II provides background information on the new entrants.

from the list would become effective only upon termination of the relevant arrangement.<sup>5</sup> By contrast, decisions regarding entry to the list of PRGT-eligible countries, once adopted by the Executive Board, become effective immediately.

24. **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.

## FINANCING IMPLICATIONS

25. **Taken together, staff's proposals for modifications to the PRGT-eligibility framework and related list would be expected to leave the projected range of demand for the Fund's concessional resources broadly unchanged (i.e., between SDR 1.2 and 2.1 billion)** (Table 4). While the combined quota size of the candidates for graduation in the 2013 eligibility review is larger than the combined quota of the three candidates for entry, the net impact is well within the margins of error of the aggregate long-term demand projections. Staff projections indicate that over the next decade, a further 15–20 countries could be ready to graduate from PRGT eligibility. When the proposed revisions to the PRGT-eligibility framework and list are combined with the proposals contained in the paper on the LIC facilities review (forthcoming), the overall average demand projections for 2013–35 would be in the range of SDR1.1–1.7 billion, implying that the Trust should have the capacity to meet the demand for IMF concessional lending under a range of plausible scenarios.

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<sup>5</sup> A similar deferral of the effectiveness of a graduation decision would apply with respect to the Policy Support Instrument (PSI).

**Table 4. Access to PRGT Resources: Impact of New PRGT-Eligible Members and Alternative Blending Rules**  
(in billions of SDRs)

	2013–23		2013–35	
	Low-case scenario	High-case scenario	Low-case scenario	High-case scenario
<b>Average annual demand for access to PRGT resources 1/</b>				
Baseline at time of gold windfall distribution decision 2/	1.1	1.8	1.1	1.9
Updated baseline				
Without entry of new PRGT-eligible members 3/	1.1	1.7	1.2	2.1
With entry of new PRGT-eligible members 3/ 4/	1.1	1.7	1.2	2.1
Moderate expansion of blending rules 5/	1.0	1.5	1.1	1.7
More aggressive expansion of blending rules 6/	0.9	1.4	1.0	1.6
<b>Average annual savings (+) or dissavings (-)</b>				
Updated baseline				
Without entry of new PRGT-eligible members	0.0	0.0	0.0	-0.2
With entry of new PRGT-eligible members	0.0	0.0	0.0	-0.2
Moderate expansion of blending rules	0.1	0.3	0.1	0.2
More aggressive expansion of blending rules	0.1	0.3	0.1	0.3

1/ The low-case scenario assumes that about 30 percent of PRGT-eligible countries would resort to Fund financing in any given year, while the high-case scenario assumes that some 50 percent of LICs request some form of Fund financial support in any given year.

2/ See SM/12/244 (September 17, 2012); detailed calculations are reported in SM/12/203 (July 26, 2012).

3/ Based on 50 percent reduction in access norms and limits (in percent of quota) when the quota increase under the Fourteenth General Review of Quotas goes into effect in 2013, followed by increases in access in nominal SDR terms of 24.2 percent at three-year intervals, starting in 2016. The update to the baseline also reflects other methodological refinements, such as (i) applying the vulnerability criterion to the graduation and blending assumptions; and (ii) aligning the graduation assumptions with the two-year PRGT-eligibility review cycle.

4/ Includes entry into PRGT eligibility of Marshall Islands, Micronesia, and Tuvalu.

5/ Assumes that, for PRGT-eligible countries that are presumed to blend, half of access to Fund resources is from the PRGT.

6/ Assumes that PRGT-eligible countries are presumed to blend when their GNI per capita exceeds 80 percent of the prevailing IDA operational threshold and that, for those countries, half of access to Fund resources is from the PRGT.

## 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 Pursuant to paragraph 5 of [Decision No. 14521-\(10/3\)](#), adopted January 11, 2010, as amended, the Fund has reviewed the criteria for entry onto and graduation from, the list annexed to [Decision No. 8240-\(86/56\)](#) SAF, as amended.

2. Subparagraph (A) of paragraph 1 of Decision No. 14521-(10/3), shall be amended to read as follows:

“(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 (a) below the International Development Association (“IDA”) operational cut-off; or (b) less than twice the IDA operational cut-off if the member qualifies as a “small country” under the definition set forth in subparagraph (D); or (c) less than five times the IDA operational cut-off if the member qualifies as a “microstate” under the definition set forth in subparagraph (D) ; and (ii) the sovereign does not have capacity to access international financial markets on a durable and substantial basis as defined in subparagraph (C).”

3. Subparagraph (B) (1) of paragraph 1 of Decision No. 14521-(10/3) shall be amended to read as follows:

“(B)(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 (a) at least twice the IDA operational cut-off; or (b) at least three times the IDA operational cut-off if the member qualifies as a “small country” under the definition set forth in subparagraph (D); or (c) at least six times the IDA operational cut-off if the member qualifies as a “microstate” under the definition set forth in subparagraph (D)”

4. In subparagraph (B)(2) of paragraph 1 of Decision No. 14521-(10/3), the reference to "80 percent" shall be replaced with "100 percent"

5. Subparagraph (C)(1) of paragraph 1 of Decision No. 14521-(10/3) shall be amended to read as follows:

"(C)(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 that (i) for the purposes of subparagraph (A) occurred during at least two of the last five years for which qualifying data are available, and has been in a cumulative amount equivalent to at least fifty percent of the member's quota in the Fund at the time of the assessment, provided that if the member's quota increase under the Fourteenth General Review of Quotas has become effective, the cumulative amount shall be equivalent to at least 25 percent of the member's quota or (ii) for the purposes of paragraph (B)(2), 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, provided that if the member's quota increase under the Fourteenth General Review of Quotas has become effective, the cumulative amount shall be equivalent to at least 50 percent of the member's quota , or

6. Subparagraph (D) of paragraph 1 of Decision No. 14521-(10/3) shall be amended to read as follows:

"(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 1.5 million, and a "microstate" if it has a population below 200,000"

## **Decision B**

1. In light of the criteria set forth in Decision No. 14521-(10/3), as amended, the list annexed to Decision No. 8240-(86/56) SAF shall be amended by adding Federated States of Micronesia,

Republic of the Marshall Islands, and Tuvalu to that list and by removing Georgia and Republic of Armenia from such list.

2. The removal of Georgia from the list shall become effective on July 8, 2013, or on the date of the termination of any arrangement under the PRGT that may be in existence for Georgia, whichever is later.

3. The removal of Republic of Armenia from the list shall become effective on July 8, 2013, or on the date of the termination of any arrangement under the PRGT that may be in existence for the Republic of Armenia, whichever is later.

## Annex I. Assessments of Countries that Meet the Income or Market Access Criteria for Graduation

### Armenia

Armenia's GNI per capita reached US\$3,360 in 2011, more than 40 percent above its graduation threshold (US\$2,390). Income has been consistently above the IDA operational cutoff since 2004 and has not been on a declining trend for at least the last five years. Armenia has not established durable and sustainable market access.

Performance has strengthened in 2012. Growth has accelerated to over 6 percent, led by agriculture, agro-processing, mining, and services. Construction, a key driver of growth prior to the 2008–09 crisis, is stabilizing. Credit has continued to expand at a healthy pace, and the financial sector remains well capitalized. There have been no significant spillovers from the euro area crisis.

The impact of the 2008–09 global crisis was severe, with a substantial fall in GDP, sharply higher debt ratios, and an elevated poverty incidence. Following a countercyclical response, the authorities are now implementing a fiscal adjustment path to stabilize debt, supported under the 2010–13 Extended Fund Facility (EFF)/Extended Credit Facility (ECF) arrangement. As in 2011, consolidation will again be larger than expected in 2012, reflecting both spending restraint and revenue gains. External consolidation has also continued, supported by the fiscal adjustment, and reserves are adequate. Although the country faces vulnerabilities stemming from high dependence on remittances and a weak export base, the 2012 LIC-DSA maintained Armenia's low risk of debt distress rating.

In the view of the staff, vulnerabilities are being reduced, with fiscal and external consolidation efforts well on track. Per capita income is now so far above the graduation threshold that it seems very unlikely that, under a downside scenario, it would drop back below that threshold—i.e., there are no serious short-term vulnerabilities as defined under the framework.

*Staff proposes the graduation of Armenia.*

### Georgia

Per capita GNI reached US\$2,860 in 2011, about 20 percent above its graduation threshold (US\$2,390). Income has been above the IDA operational cutoff over the last eight years and has not been on a declining trend for at least the last five years.

Georgia's market access, measured by public sector issuance or guaranteeing of external bonds or by disbursements under public and publicly-guaranteed external commercial loans in international markets, amounted to more than 700 percent of its IMF quota cumulatively over 2007–2011, with access in four of these years—hence, the market access criterion was also met. A US\$500 million

Eurobond was issued in 2008 and a second one in 2011, and Georgia's sovereign credit rating has been stable for more than a year.

The economy has been growing strongly after a setback at the time of the 2008–09 global crisis. Real GDP growth is projected at 7 percent in 2012, the same as the 2011 outturn. Inflation is expected to moderate sharply to zero in 2012, from 8.5 percent in the previous year. The banking sector remains sound. Banks have sufficient levels of capital and liquidity while NPLs remain low.

Following a countercyclical response to the global crisis, fiscal consolidation is well on track, supported under the 2012–14 Stand-By Arrangement (SBA)/Standby Credit Facility (SCF). The deficit is projected to narrow to 3.6 percent of GDP in 2012 and 2.8 percent in 2013, with public debt falling to 32 percent of GDP in 2013. While the current account deficit remains high at 12½ percent of GDP in both 2011 and 2012, the bulk of its financing consists of foreign direct investment (FDI) and official inflows (though FDI has weakened recently, and part of the financing now relies on nonresident deposits). In the 2012 DSA, both external debt (around 80 percent of GDP including intercompany loans) and public debt are projected to decline over the medium term, and converge toward moderate levels even when subjected to standard shocks.

In the view of the staff, vulnerabilities are being contained, with fiscal consolidation efforts well on track. Per capita income is now so far above the graduation threshold that it seems very unlikely that, under a downside scenario, it would drop back below that threshold—i.e., there are no serious short-term vulnerabilities as defined under the framework.

*Staff proposes the graduation of Georgia.*

## **Ghana**

Ghana meets the market access criterion for graduation: market access as measured under the framework amounted to 354 percent of its IMF quota cumulatively over 2007–2011 (relative to a graduation threshold of 100 percent of quota). The minimum income level for graduation under the market access criterion is also met, with 2011 GNI per capita at US\$1,410. Income has been on an increasing trend over the past five years.

GDP growth amounted to 14 percent in 2011, reflecting the start of oil production, and is estimated at 7 percent in 2012. The inflation rate (about 9 percent year on year) does not fully reflect underlying pressures, with dynamics in food prices and energy subsidies that keep prices temporarily below normal market levels. Non-food CPI inflation was 11.5 percent in January 2013, while a February fuel price increase of 20 percent is not yet reflected in the inflation data.

Serious short-term vulnerabilities persist and have recently increased in a pre-election environment. Significant fiscal policy slippages, including high public wage payments and energy subsidies, have pushed the cash deficit to an estimated 13.3 percent of non-oil GDP in 2012, up from 6.7 percent anticipated at the completion of the 2009–12 ECF-supported program. The cedi depreciated by about 20 percent in the first half of 2012 in an environment of loose monetary policy and election-

related spending pressures. The slide was only halted by a significant monetary policy tightening at the cost of high (double-digit) real interest rates. The current account deficit has risen to an estimated 13 percent of GDP, with Ghana's economy remaining vulnerable to a protracted slowdown in external demand, a weakening of terms of trade, and a reversal of portfolio inflows. Official reserves of less than three months of imports are insufficient to provide a robust buffer against shocks. The financial sector remains underdeveloped, with many firms and individuals lacking access to financial markets. Non-performing loans, while declining, are still at 13 percent of total loans in 2012.

The most recent LIC-DSA confirmed Ghana's moderate risk of debt distress. The external debt stock has risen substantially since the Multilateral Debt Relief Initiative (MDRI) debt relief in 2005 to around 22 percent of GDP at end-2012. The large 2012 deficit was primarily financed by domestic debt, with net domestic financing exceeding an estimated 10 percent of non-oil GDP in 2012. As a result, domestic debt—which has more than doubled in percent of non-oil GDP since 2005—has continued to increase to about 28 percent of GDP at end-2012.

In the view of the staff, Ghana's market access is not sufficiently assured to qualify the country for graduation from PRGT eligibility given its serious short-term vulnerabilities, which, until they are addressed, may put at risk the country's ability to maintain market access.

*Staff proposes maintaining Ghana's PRGT eligibility given the presence of serious short-term vulnerabilities, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.*

## **Grenada**

Per capita GNI reached US\$7,220 in 2011, which is just over six times the IDA operational cutoff (US\$7,170), and it has not been on a declining trend over the last five years.

Grenada was severely impacted by the global financial crisis. Following two years of contraction in 2009–10, a fragile recovery seems to be underway. Real GDP growth is projected at 1.5 percent in 2012 following a 1 percent expansion in 2011, with the recovery driven mainly by agriculture and tourism. Inflation is projected at about 3 percent in 2012, as in 2011.

The fiscal balance deteriorated significantly in 2011, reflecting expansionary fiscal policies. The authorities extended temporary tax breaks for the business sector, resulting in significant revenue shortfalls. Expenditures were also higher, reflecting acceleration of domestically financed capital projects as well as new schemes to provide temporary jobs to the unemployed. As a result, public and publicly-guaranteed debt increased to 103 percent of GDP by end-2011. Since mid-2011, no review has been completed under the three-year ECF arrangement approved in April 2010.

The economy remains vulnerable across several dimensions. The 2012 DSA concluded that the risk of debt distress remains high, and any significant shocks or fiscal slippages could put debt on an unsustainable path. Additional risks arise from the increase in debt service payments projected in

the next several years. The current account deficit remains high, at 25 percent of GDP in 2011, raising concerns about its medium-term sustainability. The financial sector also remains vulnerable, with rising non-performing loans, and declining profitability. Region-wide financial sector issues (the insolvency of the two CL Financial Group-related insurance companies, British American Insurance Company Limited (BAICO) and Colonial Life Insurance Company (CLICO)) could add pressures to the already high public debt burden.

Grenada's short-term vulnerabilities remain significant, especially given very high public debt.

*Staff proposes maintaining Grenada's PRGT eligibility given the presence of serious short-term vulnerabilities, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.*

## **Maldives**

Maldives' GNI per capita reached US\$6,530 in 2011, more than five times the IDA operational cutoff, and it has been on an increasing trend over the past five years. Market access, measured by public sector issuance or guaranteeing of external bonds or by disbursements under public and publicly-guaranteed external commercial loans in international markets, amounted to more than 900 percent of its IMF quota cumulatively over 2007–2011, with access in at least three of these years—hence, Maldives met both the income and the market access criteria.

However, the 'vulnerabilities' criterion is not met. Maldives faces chronic fiscal and external imbalances. A Fund-supported program (under SBA and Exogenous Shock Facility (ESF) arrangements) approved in December 2009 aimed to address these imbalances but quickly went off track owing to significant fiscal slippages. The fiscal deficit is estimated to be around 13½ percent in 2012, with public debt reaching 80 percent of GDP in 2012.

After growing by about 7 percent in 2010 and 2011, the economy is projected to slow substantially to 3½ percent in 2012, and to recover only slowly thereafter. The current account deficit is projected to widen from 20 percent of GDP in 2011 to 29 percent in 2012, driven by lower tourism receipts and higher public imports. While the currency peg has historically kept inflation in check, a 20 percent devaluation adopted in April 2011 in response to building pressures on international reserves quickly passed through to domestic prices, causing inflation to surge to 17 percent by the end of the year. Inflation is projected to remain elevated at 8 percent by the end of 2012 due to high commodity prices and tax increases.

The banking system as a whole remains sound, but vulnerabilities remain. Financial supervision has been weak, particularly with respect to the main state bank. Many commercial banks are also not in compliance with prudential regulations.

The most recent DSA shows that Maldives' risk of external debt distress is high. Under the baseline scenario, reflecting current policies, the public external debt path is projected to worsen through

2030. The debt path is clearly not sustainable, and additional fiscal consolidation measures are needed in the near term.

The Maldives' short-term vulnerabilities clearly remain significant and neither the country's high income nor its market access is sufficient to qualify it for graduation from PRGT eligibility.

*Staff proposes maintaining the Maldives' PRGT eligibility given the presence of serious short-term vulnerabilities, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.*

## **Vietnam**

Vietnam's market access, measured by public and publicly-guaranteed external bonds and commercial loans inflows, amounted to more than 500 percent of the country's IMF quota cumulatively over 2007-2011, well above the graduation threshold of 100 percent of quota. However, credit agencies have just recently downgraded the country's credit rating for the first time since 2010, citing a stuttering economy and mounting contingent liabilities.

Vietnam's GNI per capita reached US\$1,260 in 2011, which is above the minimum income threshold that applies to the market access criterion. Income has been on an increasing trend over the past five years.

Vietnam weathered the global crisis well, but the country has seen large swings in macroeconomic conditions in recent years, mainly due to policy reversals. Real GDP growth is projected to decline to 5 percent in both 2012 and 2013. Inflation has been volatile in recent years, and is projected at single digit levels by end-2012 after peaking above 20 percent in mid-2011. International reserves have recently recovered somewhat, but they remain low at around two months of imports by end-2012 (up from 1.4 months of imports at end-2010 and end-2011).

The fiscal deficit is projected to widen in 2012 from 3 percent of GDP in 2011 to 5½ percent in 2012, resulting in an increase in public debt to 53 percent of GDP by end-2012. Urgently needed structural reforms in the banking and state-owned enterprise sectors remain largely unaddressed. Following a credit boom and strong lending to state-owned enterprises in 2009–10, the banking system is characterized by poor asset quality, under-provisioning, low profitability, and foreign exchange risks. Weaknesses in the banking sector continue to undermine stability and constrain growth.

The 2012 LIC-DSA confirmed a low risk of external debt distress, but also concluded that the outlook for public debt calls for continued fiscal consolidation. Risks to debt sustainability arise from potential contingent liabilities stemming from both the financial sector and state-owned enterprises.

Vietnam's market access is not sufficient to qualify the country for graduation from PRGT eligibility given the country's serious short-term vulnerabilities, as well as signs of weakening prospects for future access of international financial markets.

*Staff proposes maintaining Vietnam's PRGT eligibility given the presence of serious short-term vulnerabilities, with the expectation that it will be reassessed at the time of the next PRGT-eligibility review.*

## Annex II. Countries that Meet the Criteria for Entry

### Marshall Islands

The Republic of the Marshall Islands (Marshall Islands for short) is currently not PRGT-eligible, but it has IDA-only status under the small island economy exception. At US\$3,910, GNI per capita is just over three times the IDA operational cutoff. The country has a population of around 50,000 people and does not have market access (see Table 2).

Marshall Islands remain highly dependent on foreign aid, mainly from the United States. Grants under the Compact Agreement with the United States are steadily declining and are set to expire in FY2023. The buildup in assets in the Compact Trust Fund set up to compensate for the expected loss in grants has been slow. While the economy experienced an impressive recovery after the recession in 2009, the rebound proved short lived, and near-term growth prospects are weak. Marshall Islands are also highly vulnerable to commodity price shocks, with food and fuel products constituting almost half of the CPI basket. Continued outward migration and climate change also pose long-term risks to growth. External debt amounted to 64 percent of GDP by end-September 2011, but most of it is on concessional terms and it is projected to decline. A formal DSA has not been conducted for Marshall Islands in recent years.

*Staff proposes the immediate entry of Marshall Islands.*

### Micronesia

The Federated States of Micronesia (Micronesia hereafter) is currently not PRGT-eligible but it has IDA-only status under the small island economy exception. Its per capita GNI of US\$2,900 is about 2½ times the IDA operational cutoff. The country has a population of around 100,000 people and does not have market access (see Table 2).

Micronesia remains highly dependent on foreign aid, mainly from the United States. Growth prospects are weak, owing to a lack of economic diversification and a sluggish private sector. With imports around 55 percent of GDP, the country remains highly vulnerable to commodity price fluctuations. Continued outward migration and climate change also pose long-term risks to the outlook. Grants under the Compact of Free Association Agreement with the United States are steadily declining and set to expire in FY2023, threatening long-term fiscal sustainability. Public debt is all external, much of it owed to the Asian Development Bank (ADB) on concessional terms. Gross public debt in FY2011 was at a manageable level of 28 percent of GDP. A formal DSA has not been conducted for Micronesia in recent years.

*Staff proposes the immediate entry of Micronesia.*

**Tuvalu**

Tuvalu joined the IMF and the World Bank in June 2010—it is the smallest member of the Bretton Woods institutions, with a population of only 11,000 people. GNI per capita amounted to US\$5,010 in 2011, or just over four times the IDA operational cutoff. In November 2011 Tuvalu was granted IDA-only status under the small island economies exception, in light of its limited diversification, vulnerability to disasters, and isolation. The country does not have market access (see Table 2).

The potential for economic diversification is minimal, and nearly all goods are imported, including petroleum products and food. Tuvalu is thus extremely vulnerable to international price fluctuations. With its highest elevation only 15 feet above sea level, it is also highly vulnerable to the effects of climate change and sea level rise. Real GDP growth has been slow since the global financial crisis. After two consecutive years of decline, the economy recovered in 2011, growing 1.1 percent. In the near term, real GDP growth is projected to remain around 1 percent.

The recent and first LIC-DSA for Tuvalu found a high risk of debt distress. External debt and debt service ratios breached many indicative thresholds under the baseline scenario, and stress tests confirmed that the debt burden is highly vulnerable to deteriorating macroeconomic conditions. The DSA also concluded that greater access to grants would be essential for Tuvalu to meet its development needs. Public and publicly-guaranteed debt stood at 50 percent of GDP in 2011, and it is projected to remain above 40 percent of GDP in the near term.

*Staff proposes the immediate entry of Tuvalu.*