Sustainable Development Finance Policy

Promoting sustainable borrowing and lending practices in IDA Countries

Effective July 1, 2020

INTRODUCTION

Debt in developing economies has increased rapidly over the past decade. Rising debt vulnerabilities in the poorest countries could jeopardize their development goals at a critical time to meet the 2030 Development Agenda.

The International Development Association (IDA) has introduced the new Sustainable Development Finance Policy (SDFP) as part of the international community's efforts to help IDA countries manage rising public debt vulnerabilities and risks.

The SDFP's objective is to incentivize IDA-eligible countries to move towards transparent and sustainable financing, and promote coordination between IDA and other creditors by:

» supporting IDA clients to strengthen policies, institutions, and practices for transparent and sustainable financing of development goals; and

» enhancing coordination among IDA recipients, creditors and other development partners.

HOW DOES THE NEW POLICY (SDFP) DIFFER FROM THE PRECEDING POLICY (NCBP)?

The Non-Concessional Borrowing Policy (NCBP) was aimed at addressing situations in post-Multilateral Debt Relief Initiative (MDRI) and grant-eligible IDA-only countries, in which debt relief or IDA grants could potentially: (i) cross-subsidize creditors that offer non-concessional loans to recipient countries, or (ii) create incentives for these countries to overborrow, thereby eroding the gains to debt sustainability obtained from debt relief and grants. The NCBP was in place from July 2006 to June 2020. The SDFP framework builds on the lessons learned during the implementation of the NCBP and adapts it to the new debt and creditor landscape. The SDFP will have a broader scope and a greater focus on addressing debt vulnerabilities.

	NCBP		SDFP
Objective and Coverage	**Broad objective** Covering inter alia debt sustainability.	→	**Clearer objectives** Enhanced focus on debt sustainability and debt transparency.
	Narrow country coverage Applies to post-Multilateral Debt Relief Initiative (MDRI) and IDA grant recipients.	→	**Broader country coverage** Applies to all IDA-eligible countries systematically.
Borrower Objectives	**Remedies** Volume reductions and hardening of terms in response to unsustainable non-concessional borrowing.	→	**Incentives** Debt Sustainability Enhancement Program with a strong and proactive focus on debt-related policies, institutions, and practices.
Creditor Outreach	**Active outreach, but limited scope**	→	**Program of Creditors Outreach** Facilitate more information sharing, dialogue, and coordination.

PILLARS OF THE SDFP

The SDFP is in effect from July 1, 2020 onwards with a strong focus on incentivizing IDA-eligible countries to move towards transparent, sustainable financing and on promoting coordination between IDA and other creditors in support of countries' efforts. This will be achieved through two programs:

I Debt Sustainability Enhancement Program

- Incentivizes countries to move toward sustainable borrowing and investment practices.
- Involves completion of performance and policy actions to:
  - improve debt transparency,
  - enhance fiscal sustainability, and
  - strengthen debt management.

II Program of Creditor Outreach

- Promotes stronger collective action, greater debt transparency and closer coordination among IDA recipients, and creditors, including multilateral development banks, bilateral lenders, and private sector creditors, to mitigate debt-related risks.
- Encourages creditor outreach and coordination on transparent and sustainable lending practices.

IMPLEMENTATION FRAMEWORK

PILLAR I: Under the **Debt Sustainability Enhancement Program (DSEP),** countries will implement performance and policy actions (PPAs) informed by country programs, including lending, diagnostics and technical assistance. The program will enhance incentives for IDA-eligible countries to move toward transparent and sustainable financing. The DSEP will be implemented in four steps:

1. **Screening –** All IDA countries will be screened annually for debt-related vulnerabilities in order to identify those IDA countries for which PPAs will need to be defined and implemented.

2. **Defining PPAs –** PPAs for each country will be established based on a sound analytical framework that will help identify and prioritize areas critical in addressing debt vulnerabilities, such as strengthening debt transparency, fiscal sustainability, and debt management. These PPAs could take various forms, depending on the country context and the underlying factors that contribute to debt vulnerabilities. PPAs will be defined in consultation with IDA and updated each fiscal year.

3. **Implementing PPAs –** The World Bank will support the design and implementation of PPAs through analytical work and lending instruments. Progress made by countries in implementing their PPAs will be assessed relative to their defined milestones.

4. **Allocations –** Performance against the PPAs will have implications for IDA allocations. Countries that do not satisfactorily implement their PPAs would not be able to access 10 or 20 percent of their annual Country Allocations, depending on their level of risk of debt distress. Those countries would also not be eligible for frontloading (other than for small states where limited access may be needed to facilitate operational delivery) and reallocations. Repeated or severe breaches of PPAs could lead to hardening of terms of IDA financing.

PILLAR II: Through the **Program of Creditor Outreach,** and in coordination with the World Bank's broader agenda to encourage debt transparency as a critical part of improving the investment climate and building greater trust in governments and institutions, IDA will seek to:

1. **Advance dialogue among a broader range of development partners** towards putting in place a set of principles on transparent and sustainable financing.

2. **Facilitate coordination at the country level among different creditors,** including traditional and non-traditional creditors and the International Monetary Fund, on actions to promote sound economic policies, prudent debt management, and sustainable lending practices.

3. **Enhance transparency and communications on sustainable financing** through new information sharing initiatives and dialogue on the SDFP.

IMPLEMENTATION PRINCIPLES

SDFP implementation will be guided by the following principles:

Equity of Treatment: An equitable application of the policy across all IDA countries, calibrating performance and policy actions consistent with country context and capacity.

Simplicity and Predictability: The policy will be anchored to a simple and predictable implementation framework, which includes steps by borrower countries and IDA.

Rules-Based Approach: Focused on clearly defined rules, including on monitoring and reporting.

For more information about the SDFP:
https://ida.worldbank.org/debt/sustainable-development-finance-policy

SDFP AND COVID-19

Given the unprecedented crisis of the COVID-19 pandemic at the time of the launch of the SDFP, a phased approach will be adopted in implementing the SDFP. IDA countries are vulnerable to the COVID-19 pandemic and its economic and social implications; therefore, addressing debt vulnerabilities is critically important to help IDA-eligible countries deal with this crisis. While all IDA countries identified through the screening process will be expected to define PPAs for FY21 (July 2020-June 2021), these actions are expected to focus primarily on debt transparency and to some extent on debt management – which would help, among others, in the implementation of the COVID-19 Debt Action, with less emphasis on structural fiscal sustainability issues.

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July 2020

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