Debt Sustainability, Non-Concessional Borrowing and The World Bank's Anti-Free Riding Policy

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Executive Summary

The paper aims at shedding light on the non-concessional borrowing situations in LICs and reviews the recent World Bank policy proposal that has a stated aim of guarding against accumulation of unsustainable debts in LICs. We also offer suggestions for promoting sustainable debt positions in LICs through policy actions by national governments and international development partners, particularly the World Bank.

We first review the profiles and stylized facts on non-concessional borrowing in the countries. Our review shows that natural resource rich countries and countries in conflicts (that are therefore in arrears with BWIs) account for the bulk of non-concessional debt stock and flows, particularly public and publicly guaranteed types. But it would not be illogical to anticipate that post-MDRI countries too could soon start (or might have just started) contracting non-concessional debts in sizeable amounts. We also highlight the geographical concentration of bilateral external credits that characterises many countries, with outstanding credits from emerging creditors like China, Kuwait and Saudi Arabia accounting for high percentage of GDP of the borrowing countries. We point out that this could make the borrowers more vulnerable. In addition, we review the available descriptive and "qualitative" information about the activities of emerging creditors in LICs, with emphasis on the lending activities of China in Africa.

The above is followed by a review of the likely reasons that could have made the countries resort to non-concessional borrowing. There, we identify a number of supply factors at the creditors' end and demand factors in the borrowing LICs. Also, we discuss the likely prospects and benefits to the countries of borrowing as well as the likely dangers and problems with such borrowing.

The latter and larger part of the paper is devoted to a review of the World Bank's recent document on anti-free riding policy proposal. We summarise the main contents of the document, including the peculiar concept of free riding adopted and the concessionality benchmark to be used. We also summarise the proposed responses, including the use of DSF as the coordinating tool for the creditors as well as discouraging of borrowers being complicit in free riding through a combination of cuts in volume of IDA assistance and hardening of terms of IDA credits. Then, we evaluate the proposed policy document by highlighting its possible advantages and disadvantages.

The notable benefits of the proposal are identified to include reduction of the incidence of opportunistic creditors financing low-return projects; guarding against moral hazard problem of reckless borrowing by LICs with a view to becoming (or continuing being) eligible for IDA grants; strengthening through the use of DSF of bargaining position of LICs in contracting foreign loans; and discouragement of LICs from embarking on large borrowing until they have put in place adequate debt management capacity and governance institutions.

The notable disadvantages and problems, on the other hand, include the philosophy or fundamental objective, which seem to have prompted the World Bank proposal, that is

routed in inappropriate perception by the World Bank of its role as a competitor with other creditors in provision of resources to LICs and its similarly inappropriate sentiment that it is evil for it to cross-subsidise private investors, particularly emerging creditors, irrespective of the consequences on the LICs. Also, the discrimination against LICs by IDA in allocating its resources is identified as a part of the problem that drives LICs to contract non-concessional loans and the proposed policy document has nothing to offer in addressing this issue. The policy would also hinder attainment of MDGs (or financing of growth-promoting infrastructural and other large expenditure projects) by the LICs by discouraging them from borrowing, just as the penalty of further reducing IDA grant allocation to them can make them resort further to non-concessional borrowing. The implied increased financial oversight of and intrusion in the affairs of government by the World Bank in implementing the policy would also erode sovereignty of the countries, just as it would run counter to the much acclaimed principles of ownership and alignment that are a part of the Paris Declaration on Aid Effectiveness. The acceptance and legitimacy, in the eyes of LICs and creditor community, of DSF, on which the whole policy rests, are also in doubt. Besides, the proposed policy glosses over all other fundamentals that affect debt sustainability and focuses on only volume of loans. In addition, it is one sided and asymmetrical by penalising only borrowing LICs for

1. Introduction

1. Partly as a result of recent global liquidity and rising economic and international political profiles of what have now been referred to as emerging creditors, supply of credits to low-income countries (LICs) is on the increase. Similarly, debt reliefs from (mainly official) creditors to LICs and increased provision of grants to them by a number of multilateral development banks in their resource allocation policy could have created a borrowing space, just as improved macroeconomic indicators in a number of them have enhanced their debt carrying capacity that has given them an incentive to borrow more.

2. An unwanted effect of the above-noted development is that a sizeable portion of the loans are non-concessional, raising concerns about future debt sustainability in these countries. A response to this concern is a stated objective of the World Bank in its recent policy document for regulating foreign borrowing by those LICs that have either received MDRI benefit from IDA or are grant-eligible recipients of IDA allocations.

3. In this paper, we try to beam a searchlight on non-concessional borrowing by (and, hence, lending to) LICs by reviewing their borrowing profiles and stylised facts; analysing possible reasons for the borrowing; and highlighting the positive effects as well as possible dangers of doing so. Particularly, we review the aforementioned World Bank policy document that aims to prevent what is referred to there as 'free riding', whereby the grants and debt relief provided by IDA provide incentives for more non-concessional borrowing by, and lending to, the affected LICs, resulting into what is described there as cross-subsidization by IDA of these non-concessional creditors. We not only describe the main provisions in the policy document, we also analyse the possible prospects as well as likely challenges of implementing the proposed policy.

4. The rest of the paper is organised into three sections. In Section 2, we discuss non-concessional borrowing by LICs. In Section 3, we review the World Bank's anti-free rider policy while the last Section is on recommendations, summary and conclusion.

2. A Review of Profiles and Stylised Facts on Recent Non-concessional Loans to LICs and an Evaluation of Implications of the Borrowing

2.1 Categories of Non-concessional Lending

5. Following the typology adopted in World Bank (2006, Annex 1, pp. 35 – 36), we classify non-concessional lending into three - viz, officially supported export credits; commercial bank loans; and bonds - as discussed below. To these, we also add domestic credits as the fourth category.

6. ***Officially-supported export credits:*** **These are provided by creditor governments through their respective export credit agencies (ECAs)**. The bulk of DAC or OECD member countries' non-concessional credits to LICs used to be channelled via their ECAs but, recently, the volume of this type of lending by OECD

countries is being regulated and curtailed somehow through the organisation's Export Credit Arrangements, a form of "gentlemen's agreement".

7. ***Commercial (including syndicated) bank loans*:** **The terms of these are market-determined.** As pointed out in World Bank (2006), a particular form of this loan category that is prone to free riding is public sector borrowing collateralised with future receipts (CFR). The most common CFR arrangements entail collateralisation of oil and gas export receivables, which BWIs have often contended to give rise to governance concerns.

8. ***Bonds*:** **These are negotiable instruments issued at commercial interest rates by borrowing governments in the international and domestic capital markets.** But bond issuance is more common with emerging economies than LICs, although a sizeable volume of bonds issued recently by LIC governments in their respective domestic markets have been held by foreign residents. As pointed out in IMF and World Bank (2006, p. 9, Footnote 4):

> *For instance, there has been increased foreign investor interest, including in domestic publ*

PPG debt while, in flow terms (See Table 1), Angola alone accounted for 85 percent of the total non-concessional PPG inflows.

11. **It is noteworthy that most of these countries are resource rich,** a feature that makes them find it easy to access external financial markets by collateralising their future exports receipts. **A good number of others are in conflicts or in arrears** (i.e., inactive with the BWIs), thereby hindering their access to concessional external resources, including eligibility to receive IDA resources – a likely factor that makes them resort to non-concessional PPG external loans.

12. **It should also be noted that not many of such countries are MDRI beneficiaries or even HIPCs.** First, many HIPCs, because of debt burden, had little access to external loan market. Second, most of HIPCs and MDRI beneficiaries had little freedom to borrow externally due to the limits on such loans that often feature as a part of conditionalities under the IMF's PRGF programme that is a precondition for eligibility under the HIPC Initiative. Third, because of the universal coverage of all types of external creditors (whether commercial or official) under the HIPC Initiative, many

Table 1: Non-concessional Loan Disbursement, as percentage of Total, in 2004 by Type of Creditor

	19 Countries eligible for MDRI as of end-June, 2006							Countries that are "Red Light" in 2005/06					Countries that are "Yellow Light" in 2005/06		
	Bolivia	Ethiopia	Ghana	Mauritania	Niger	Zambia	remaining 13 countries1/	Bhutan	Chad	Sudan	Togo	remaining 26 countries2/	Angola	Ethiopia	The remaining 17 countries3/
Non-Concessional	**23**	**22**	**19**	**13**	**10**	**10**	**30**	**76**	**6**	**41**	**57**	**22**	**99**	**22**	**6**
Bilateral	0	0	0	0	0	0	1	76	0	17	0	0	0	0	0
Multilateral	23	1	4	11	10	10	21	0	6	0	57	16	0	1	5
Bonds	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Commercial Banks	0	21	15	2	0	0	5	0	0	0	0	0	94	21	0
Other Private Creditors	0	0	0	0	0	0	0	0	0	24	0	5	5	0	0
Concessional	**77**	**78**	**81**	**87**	**90**	**90**	**70**	**24**	**94**	**59**	**43**	**78**	**1**	**78**	**94**
TOTAL	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: World Bank, June 2006, Annex VI. (Note that DAC's concessionality definition, and not that of IMF/IDA, as discussed in the text, is the one adopted here).

1/ The remaining 13 countries include 3 red or yellow light MDRI-eligible countries, namely Guyana, Nicaragua and Rwanda.

2/ The remaining 26 countries include 2 MDRI-eligible red light countries, namely Niger and Rwanda.

3/ The remaining 7 countries include 2 MDRI-eligible yellow light countries, namely Guyana and Nicaragua.

	Bolivia	Cameroon	Honduras	Nicaragua	Zambia	remaining 14 countries1/	Bhutan	Chad	Demo. Rep. of Congo	Rep. of Congo	Guinea	Sierra Leone	Cote d'Ivoire	Kyrgyz Rep.	Liberia	Somalia	Sudan	Togo	Myanmar	The remaining 17	Angola	Lesotho	Ethiopia	Nicaragua	remaining 6 countries3/
Non-Concessional	**20**	**32**	**19**	**21**	**22**	**69**	**59**	**10**	**30**	**64**	**10**	**13**	**48**	**10**	**46**	**19**	**54**	**24**	**17**	**44**	**99**		**22**		**6**
Bilateral	0	27	6	11	10	28	59	3	21	42	6	10	12	7	7	16	32	21	2	19	0		0		0
Multilateral	19	4	11	3	5	27	0	5	6	5	4	2	12	2	22	1	2	2	0	17	0		1		5
Bonds	0	0	0	0	0	0	0	0	0	0	0	0	24	0	0	0	0	0	0	0	0		0		0
Commercial Banks	0	1	1	7	0	10	0	0	0	15	0	0	0	0	16	0	16	0	10	2	94		21		0
Other Private Creditors	1	1	1	1	7	5	0	2	4	2	1	1	0	0	2	2	5	0	5	7	5		0		0Othere7449.5 TD (0)64I23
Concessional	**80**	**68**	**81**	**79**	**78**																				

	2000	2001	2002	2003	2004	Average 2000-	2000	2001	2002	2003	2004	Average 2000-
"Red Light" Countries												
Afghanistan												
Bhutan	64	79	62	73	76	71	34	48	50	56	59	49
Burundi	8	13	9	19	0	10	3	3	3	4	3	3
Cambodia	0	0	0	0	0	0	0	0	0	0	0	0
Central African Republic	0	0	0	0	0	0	10	10	24	9	9	12
Chad	0	16	1	31	6	11	10	9	8	11	10	10
Comoros	0	0	0	0	0	0	4	3	4	4	4	4
Congo, Dem. Rep. of	0	0	0	16	0	3	60	60	30	30	30	42
Congo, Rep. of	0	0	0	0	0	0	56	55	55	54	64	57
Cote d'Ivoire	12	15	5	4	3	8	54	55	50	49	48	51
Djibouti	0	4	10	0	0	3	0	0	3	4	3	2
Eritrea	2	0	0	0	0	0	6	4	3	3	3	4
Gambia, The	0	0	0	0	0	0	4	3	3	2	2	3
Guinea	14	5	3	11	0	7	14	13	12	12	10	12
Guinea-Bissau	0	0	0	0	0	0	15	9	8	6	4	8
Haiti	0	0	0	0	0	0	0	0	0	3	3	1
Kyrgyz Rep.	9	3	0	0	0	2	28	23	17	13	10	18
Lao, People's Dem. Rep.	0	0	0	0	0	0	0	0	0	0	0	0
Liberia	0	0	0	0	0	0	45	45	45	46	46	45

Selected Low-income Countries	Main Emerging (non-DAC) Creditor	from the main emerging creditor	from all non-DAC creditors	from DAC creditors	of the main emerging creditor	of all non-DAC creditors
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already very active in sub-Saharan Africa – channelling billions of dollars in non-concessional loans to countries eligible for, or undergoing, debt relief. In 2005, China lent $814 million on non-concessional terms to Sudan – a country with an external debt burden more than four times the sustainable thresholds… China has recently signed memorandum of understanding for several large-scale infrastructure projects, such as $2.6 billion for two dams in Mozambique and $500 million for Ghana's Biu Dam. In addition, China's commitments at the UN Millennium Review Summit include the provision of $10 billion in concessional loans and preferential export buyer's credit to developing countries over the next three years. It is unclear how much of this assistance actually will be concessional. India, meanwhile, has committed $500 million in Export-Import Bank lines of credit to West African countries under its Techno-Economic Approach for Africa-India Movement. With significant oil revenue windfalls, Middle East and OPEC countries also are expected to significantly ramp up their development assistance activities in low-income countries largely in the form of loans. Although increased export-based lending from OECD bilateral creditors is also cause for concern, efforts are currently underway within OECD's Working Party on Export Credits and Credit Guarantees (ECG) to adopt guidance contained in the debt sustainability framework (i.e., DSF of IMF AND World Bank).

21. **Second "qualitative" Source:** Another source of information about the activities and features of emerging creditors is that of IMF and World Bank (2006, p.8, Box 1), describing these in the following manner:

Over recent years, a number of emerging creditors have increased their official bilateral aid flows to LICs. According to debtor data, the share of these creditors in total official assistance to LICs is still small (around 10 percent) but is increasing steadily. In several cases,, official loans from a single emerging creditor represent a large share of the recipient's GDP, but in most cases are still well below the share from traditional creditors. … Emerging creditors are numerous. The six largest non-Paris Club bilateral creditors to LICs are Brazil, China, India, Korea, Kuwait, and Saudi Arabia. … Available data indicate that China has become, by a large margin, the largest creditor in this group, with claims of US$5 billion as of end-2004 (compared with US$2.5 billion in 1994). Kuwait, the second largest creditor in this group, had claims of US$2.5 billion. Although precise data are not yet available, there is evidence that lending by emerging creditors, and particularly China, has increased very sharply in 2005 and 2006.

22. **Third "qualitative" Source:** Some other sources focus on the emerging creditors' (particularly, Chinese) lending to Africa. For example, Swann and McQuillen (Nov. 2006) contend that China has in fact displaced the World Bank in terms of volume of resource transfer to the continent. They claim that:

*China has committed $8.1 billion this year to Nigeria, Angola and Mozambique, according to World Bank figures. That compares with $2.3 billion pledged to Sub-Saharan Africa by the Washington-based World Bank. China may announce more deals (*which it actually did*) at a Sino-African forum starting today in Beijing, cementing its place as the top official source of finance to Africa … China has a more commercial*

agenda than the World Bank, the US and France, the top Western donors, and terms of some of its loans are less favourable. The US provided a net $3.5 billion in loans and grants to sub-Saharan Africa in 2004, according to the Organisation for Economic Cooperation and Development. France extended $3 billion. Eximbank, China's overseas lending arm, has provided about $12.5 billion in infrastructure loans to Africa since 1994, a figure that excludes mining and oil projects, according to the World Bank.

23. **<u>Fourth "qualitative" Source:</u>** Still on Chinese lending and other resource transfers to Africa, another commentator, Nnanna (Dec. 2006), has this to say:

Sinopec, one of China's leading oil companies, signed oil exploration pact with Johnson-Sirleaf (Liberian President) delegation to the Beijing summit. … Earlier this year, the China National Offshore Oil Company (CNOOC) bought a 45 percent in a Nigerian oil and gas field for $2.27 billion. CNOOC currently own oil blocs in Equitorial Guinea, Gabon and Chad and has investments worth several million dollars in some Zambian mines. … China National Petroleum Corporation (CNPC) bought into the Sudan consortium in 1996. … Sonatrach, Algeria's biggest corporation, which over the years has been reluctant to open up to foreign companies, also signed a deal with CNPC during the (November 2006 Sino-African) summit. … Even before the summit, CNPC had started drilling activities at the Tenere bloc in Niger Republic… CNPC today operates in Mauritania, Nigeria, Chad, and Egypt. Reports indicate that the corporation is currently considering the construction of oil pipelines that will link northern and western Africa together. …

According to reports, China at the Beijing summit decided to double its assistance to Africa by 2009, provide $3 billion preferential loans and $2 billion preferential credit to Africa over the next three years. There were also agreements to set up China-Africa Development Fund to the tune of $5 billion to encourage Chinese companies to invest in Africa. China has also promised to open its market to Africa by increasing the number of export items from 190 to 440 and receiving zero tariff treatment from the least developed countries in Africa which have diplomatic ties with it. Over the next three years, China has decided to train 15,000 African professionals, build 30 hospitals and malaria prevention/treatment centres in Africa. In addition, the Asian Tiger has decided to dispatch 300 youth volunteers to Africa, build 100 rural schools and increase the number of Chinese government scholarships to Africa from the current 2,000 to 4,000 a year by 2009. …

2.3. A Review of Possible Supply and Demand Factors Driving Non-concessional Borrowing by Low-income Countries (LICs)

(a) <u>A Review of Possible Supply or "Push" Factors</u>

25. **<u>Multilateral lenders that exclude DAC members as major shareholders</u>**: As for multilateral lenders, those involved are outside lenders (like the World Bank, AfDB, AsDB, IADB, etc) that have DAC countries as major shareholders. Instead, the prominent ones would include the ones where major oil-exporting countries are prominent members, e.g. Islamic Development Bank, OPEC Fund, Arab Bank for Economic & Social Development, Arab Bank for Economic Development in Africa, Arab Monetary Fund, etc. **Expectedly, the performance of petroleum energy products in the world market would be a driving force for their export2ng counEmin 9.6nbrs, thoseas dito68 692.88 364.08 568.08 145.9273.76 695.4 25069 5710 -13.8**

liquidity and compressed spreads in emergin markets, private external creditors have also extended their activities in LICs to a number of Sub-Saharan African countries".

(b) A Review of Possible Demand or "Pull" Factors

28. These are the factors that are making LICs embrace external loans, separate from the above-discussed "push" or supply factors. **Expecte**

grassroot population, etc through the popular participation that is embedded in the required PRSP process. In practice, government spending programme would have been driven, either mainly or equally with the grassroot participation at the domestic level, by the BWIs due to the clout they have in determining the contents of PRSP. Whether the government spending programme has been driven by the BWIs or grassroot participation at the domestic level, the fact still remains that spending programmes that are favoured by the drivers would necessarily be oriented towards poverty reduction, with emphasis on social expenditure items (on health, education, gender issues, micro-enterprises development, provision of clean water, etc) that would hardly lead to an immediate and "big bang" substantial economic growth. These pro-poor government spending programmes, by their nature, are oriented towards small-scale projects and the bulk of whatever positive impacts they have on growth would take a very long term to materialise. Large-scale infrastructural and similar projects for bringing about high growth that would have been on the radar screen of the government would have been relatively neglected in the interim. So, attainment of post-MDRI status provides the earliest opportunity for the

the extent of concessionality, or lack of it, of such loans. **It is not appropriate to generalise by saying raising of new loans is good or bad.** Having said that, we discuss below some likely benefits of raising new loans, after which we highlight possible dangers that this may pose.

(a) Benefits and Prospects

35. **Borrowing from international financial markets can help LICs to imbibe, over time, responsible borrowing culture and start cultivating proper relationships with creditors.** The World Bank (2006, paragraph 2

sometimes, justifiably) forgo the so-called concessional for non-concessional resources. For example, resource transfers from China, even if non-concessional from the perspective of financial terms, may often be more "concessional" in terms of not having many strings attached.

(b) Problems and Challenges

40. As rightly pointed out by IMF and World Bank (2006), expansion in the volume and sources of funds available to LICs carries a number of risks.

41. **Hard loan terms may apply.** The terms of new financing, if non-concessional, could burden poor countries with market interest rates or close to market interest rates and/or short

47.

52. A prototype free riding, depicting Chinese lending to Sudan, as described in an IMF Staff Report, is reproduced in Box 1. The typical sentiments of BWIs to free riding cases, and what appear to be the three actual reasons for the sentiments, are also stated there. It would be noted that **the concern about debt sustainability of the borrowing country is just one of such reasons and it is, in fact, mentioned last. The other reasons - subsidising China and the possible losses to parliamentarians in the BWIs' donor countries – seem to loom larger.**

(b) Concessionality Benchmarks to be used by IDA in Identifying Cases of Free Riding

53. The document establishes a concessionality benchmark for differentiating between concessional and non-concessional lending. For a number of reasons, it deems the generally accepted DAC's definition of concessionality to be inappropriate. **Instead, it opts for the IMF's definition of concessionality that is used in connection with external borrowing limit conditionality in the PRGF programmes with client countries.** First, in line with the IMF's PRGF programme and as opposed to DAC's interest rate that has always been pegged at 10 percent, it adopts the commercial reference interest rate (CIRR) that is currently about 5 percent, in view of global downward movement of interest rates, in computing the net present value (NPV) of future debt service payments. This means that it is the CIRR that is used in deriving the grant element (GE), defined as: (nominal value of debt – NPV of debt) ÷ nominal value of debt. Therefore, the GE would be lower than that of DAC. Second, unlike the DAC's definition

of concessionality as loans with GE of 25 percent or above, the GE threshold is now 35 percent. A consequence of this is that many loans that are regarded as being concessional according to DAC will not meet the concessionality standard under the present situation, meaning that the concept of concessionality is more conservative and stricter than that of DAC. To illustrate this, the document presents the comparison, reproduced here as Table 5, between the present concessionality concept and that of DAC.

Country	*DAC Methodology*	*Proposed IDA Methodology*
Angola	2,350	3,387
Cambodia	11	64
Gambia	0	19
Guyana	0	4
Malawi	0	6
Sierra Leone	0	10
Sudan	39	257
Tajikistan	0	23

Source: World Bank (June 2006, p. 12, Box 2)

- Ø "Green light": Low risk of debt distress. 100 percent credits.
- Ø "Yellow light": Medium risk of debt distress. 50 percent credits, 50 percent grants (with the grant portion subject to 20 percent volume discount and, hence, 10 percent overall reduction on the combined transfers of credit and grant).
- Ø "Red light": High risk of debt distress. 100 percent grants, subject to 20 percent reduction because it is in grant form.

58. In the present situation of free riding, as explained later, it is the DSF that is proposed to be the document for determining whether loans are concessional; for rallying creditors into forming a united front in addressing free riding; and as a basis for sanctioning LICs that raise non-concessional loans.

(b) Enhancing Creditor Coordination around the DSF

59. **Creation of an institutional framework for a formal creditor coordination process is proposed, using the DSF as a coordinating tool among creditors.** It is envisaged that the DSF could help the global creditor and donor communities achieve a common understanding of the appropriate level of overall concessionality for LICs. This is based on the assumption that more and more creditors will be using DSF as their standard "credit rating" document by relying on it as their analytical basis for a common approach to concessionality.

60. While noting that some creditors and donors, particularly bilateral ones that are Paris Club members as well as Asian Development Fund and African Development Fund, have started to rely on the DSF in their decisions on resource transfer to LICs, it proposes that IDA establishes "with the IMF a common approach to increase acceptance of the DSF among other multilateral institutions and official bilateral lenders". There is also the plan to get inputs through a number of creditor consultation initiatives underway and provide all creditors easy access to the debt sustainability analyses (DSAs) that have been jointly prepared by the World Bank and IMF (See Box 2 for the distinction between DSF and DSA). High-level fora such as the G8 and the G20 would also be used to signal the need for creditors and donors to reflect debt sustainability considerations in their lending.

Box 2: Some IDA-specific Terminologies and Concepts

For easy understanding of some terms that are more or less specific to IDA, they are explained below:

DSA and DSF
As explained in Footnote 2 of the IMF and World Bank (November 2006):

"'DSF' (or Debt Sustainability Framework) refers to the new framework for joint debt sustainability analyses in LICs. 'DSA' (or Debt Sustainability Analysis) refers to an analysis of debt sustainability in a particular country. At times, the DSAs performed under the DSF are referred to as 'low-income country DSAs', in order to differentiate them from the debt sustainability analyses conducted prior to the introduction of the framework".

Categories or Status of IDA Resource Recipients
The explanation below is from the IDA free-rider document (IDA, June 2006)

Blend country: A blend country is the one that is eligible to receive both IDA and IBRD resources. Blend terms comprise 35 years maturity, 10 years grace period, 0.75 percent service charge, 0 – 0.5 percent commitment fee, with a grant element of 57 percent.
Notional blend country: This is a borrower that have a capacity or history of market-based borrowing and a per capita income below the IDA eligibility threshold, and which are currently unable to borrow from IBRD due to marginal or deteriorating creditworthiness. The main difference between blend and notional blend status is that the per capita income is below IDA's operational cutoff for the latter. Blend terms equally apply to "notional blends".
Hardened-term country: This is an IDA-eligible country whose per capita incomes are above IDA's operational cutoff for more than 2 consecutive years. Hardened terms comprise 20 years maturity, 10 years grace period, 0.75 percent service charge, 0 – 0.5 percent commitment fee, with a grant element of just 40 percent.
***Gap country*: This is a borrower that has been above the IDA operational cutoff for many years, but whose access to IBRD is still very limited.
IDA-only, non-gap country: This is a country whose per capita income is below IDA's operational (or has not been above it for consecutive years). Cutoff and has no access to international credit markets. It is only such countries that are eligible for IDA grant allocation. Standard IDA credit terms (viz:40 years' maturity, 10 years grace period, 0.75 percent service charge, 0 – 0.5 percent commitment fee, with a grant element of 60 percent) apply to such countries.

Box 3: Countries Currently subject to IDA's Free Riding Policy 1/

"Red Light" Countries		"Yellow Light" Countries	Post-MDRI "Green Light" Countries
Afghanistan	Guinea	Angola	Benin
Bhutan	Guinea-Bissau	Ethiopia (MDRI)	Burkina faso
Burundi	Haiti	Guyana (MDRI)	Cameroon
Cambodia	Kyrgyz Rep.	Lesotho	Ghana
Central African Republic	Lao, PDR	Malawi	Madagascar
Chad	Liberia	Mongolia	Mali
Comoros	Nepal	Nicaragua (MDRI)	Mauritania
Congo, DRC	Niger (MDRI)	Samoa	Mozambique
Congo, Republic of	Rwanda (MDRI)	Tajikistan	Senegal
Cote d'Ivoire	Sao Tome & Principe		Tanzania
Djibouti	Sierra Leone		Uganda
Eritrea	Solomon Islands		Zambia
Gambia. The	Tonga		

Source: World Bank (June, 2006, page 30, Table 3)
1/ The list would have change since June 2006, after when, for instance, Malawi and Sierra Leone reached post-completion point of the HIPC Initiative.

(c) <u>Discouraging Free Riding through Borrower Disincentives</u>

61. The list of LICs to be covered by the policy is as provided in Box 3. This list could change as more countries reach the completion point under the HIPC Initiative.

62. **The stated rationale for resorting to penalising LICs that breach the concessionality guidelines is due to likelihood of not being able to sufficiently rally other creditors through the DSF.** According to the document (p. 20, paragraph 45), "The mere adoption of a common approach to concessionality is unlikely to prevent free riding by opportunistic lenders. … While the Bank and Fund work closely together in broadening acceptance of the DSF also among bilateral and commercial creditors, it is recognised that IDA's main channel to reduce the incidence of free riding by opportunistic lenders is through country (i.e., LIC) disincentives". This is the basis for resorting to disincentives, through sanctions, aimed at the LICs and these take the form of reductions to allocated volumes of assistance or hardening of the terms of such assistance – or a combination of both - which can even escalate to total disengagement of IDA from the sanctioned LICs, if the breach of concessionality is deemed severe enough.

63. **Ordinarily (i.e., in the absence of escalated sanction being applicable), an LIC in breach of the concessionality requirement would be subjected to either a reduction in volume or hardening of terms of the assistance, but not both. Volume reduction would apply to those grant eligible IDA-only LICs (irrespective of whether or not they are MDRI recipients) that are characterised with greater risk of debt distress, viz: those belonging to either the afore-mentioned "red light" or "yellow light" debt distress classifications.** The proposed sanction would initially be a reduction that would bring the affected country's grant volume down by 40 percent after taking into account the afore- [illegible]

- Ø a less concessional “hard-term” window (blend terms plus interest rate at 200 basis points below IBRD lending rate in fixed-rate terms - for MDRI “green light” countries with high levels of market access.

65. **Two exceptions are singled out in the document. The first applies to those “red light” or “yellow light” grant eligible IDA-only countries that, despite their high debt distress risk status, do have access to financial markets,** as in the case of extractive mineral export-based economies that could easily borrow from financial markets by collateralising their future receipts from the exports. For such LICs, suspension of access to grants and hardening of terms – possibly in combination with volume cuts – could be IDA’s response. **The second exception applies to a “green light” MDRI recipient that, despite its belonging to low debt distress risk category, still has structural weaknesses** (like absence of economic diversification, small export base, etc) that make the country vulnerable to slipping easily back to “yellow light” or even “red light” status when subjected to exogenous shocks. IDA would likely apply volume reduction, as opposed to hardening of terms, to such a country.

66. In all the above cases, the sanctions are stated to have the aim of reducing the incidence of free riding to prevent serious breaches before they occur. These could range from a 1-year to a multiple year application of the disincentive mechanism, and at the extreme end of the spectrum there could be withdrawal of IDA from all future financial assistance in a given country or even disengagement from the country (i.e., complete withdrawal that includes both financial and technical assistance).

(d) Operationalising the Borrower Disincentives

67. **Pragmatism and case-by-case treatment are to form the basis of implementing the anti-free riding policy sanctions.** In other words, it would be “discretion-based”, as opposed to “rules-based”. In several parts of the paper, it is acknowledged that one-size-fits-all approach would not be suitable and country-specific circumstances would be considered. As stated in World Bank (2006, Paragraph 49), “A flexible application of the measures available to IDA is required in order to take into account country-specific characteristics and circumstances. Ironclad rules or ‘one-size-fits-all’ responses are counterproductive to the extent that there are a wide variety of country circumstances requiring appropriately-tailored approaches”.

68. **Having stated the above, the same document enunciates those important factors that would guide the pragmatism and use of discretion.** Specifically, factors enunciated in Box 4 below are mentioned, and further elaborated upon by the points below:

- **Magnitude of the breach.** Small breaches of concessionality benchmark (i.e., marginal deviation from the 35 percent concessionality benchmark) would not normally attract sanctions, which would mainly aim at large breaches “that result from politically-motivated decisions to borrow and/or from the actions of opportunistic commercial lenders, who feel that the space freed up by grants make lending possible to otherwise risky countries”.

- **Size of the breach relative to a country's IDA allocation.** If the breach is large in absolute terms or as a share of the country's IDA allocation, the initial disincentive may not be sufficient, pointing to the need for a stronger disincentive.
- **Frequency/repeat violation.** For a country with a known record of non-concessional loan despite the guidance to the contrary by IDA staff, or where there is an allegation of fraud or corruption, stronger measures may be necessary.
- **Notified ex-ante or found out ex-post.** For countries reporting ex-ante that explored alternatives with Bank staff, a shorter application of the disincentive may be warranted.

the only bank providing loans to Africa. No individual organisation can monopolise relationships with African countries. China needs Africa, and Africa needs China".

70. **Thus, an appraisal of the World Bank policy document must not be one-sided, but evenly balanced.** This is to prevent the evaluation from making a case and being a megaphone for China if the evaluation is too critical of the policy document and from being a megaphone of the World Bank if it mainly praises the document as the best that has ever happened. Accordingly, we will try to be as balanced as feasible below by highlighting both the strengths and weaknesses or challenges of the policy document as we perceive the pros and cons to be.

(a) Prospects and Advantages for LICs of Implementing the Anti-free riding Policy

71. We earlier discussed the problems and dangers of non-concessional foreign borrowing (See Paragraphs 41 – 47). Most of these dangers can be guarded against through implementation of the proposed measures. Thus, some of the benefits of implementing the anti-free rider policy identified below would inevitably overlap with the previously discussed problems of non-concessional borrowing.

72. **Lower-return projects are now being more prone to being financed by lenders.** There might be a tendency for opportunistic creditors to finance low-return projects due to reduced risk of future debt servicing associated with such lending as a result of MDRI relief and prospects of future grants. As pointed out by IMF and World Bank (2006, paragraph 3), "A key concern is the risk that some non-concessional creditors may be willing to finance even low-return investments, since lowered debt ratios and the prospect of future IDA grants provides reassurance to creditors that post-MDRI borrowers will be able to service their loans".

73. **Similarly, the potential moral hazard problem of reckless borrowing, with a view to continuing to maintain, or be re-classified into, grant-receiving status under IDA's and regional development banks' grant-credit mix policy, will also be discouraged.** It is in this vein that the World Bank (2006, paragraph 9) states that "There is also a potential moral hazard problem vis-avis borrowers. IDA grants and debt relief may introduce an incentive for countries to over-borrow from other creditors, which would force IDA to increase the grant share of its assistance. Incentive measures aimed at borrowers could help address this problem".

74. **Potentially, the use of DSF in the context of anti-free riding policy can strengthen the bargaining position of LICs while negotiating loans from non-IDA sources, including bilateral (e.g., Chinese) and commercial ones, as they would now have a basis for negotiating the terms towards the concessionality threshold prescribed by IDA.** This means they will be strengthened in convincing would-be lenders that, while they are willing to contract the loans, they are rather incapacitated in doing so unless the terms would not make them breach IDA's concessionality threshold so as to enable them receive IDA resources under favourable terms. Also, from the creditors' side, a sort of peer pressure against non-concessional lending can develop (e.g., through "naming and shaming" of non-concessional lenders, especially official creditors). Probably this benefit is what IMF and World bank (2006, paragraph 28) envisages by stating that "A minimum concessionality requirement can help borrowers obtain more suitable credit terms by raising awareness among lenders of their financial vulnerabilities".

75. **It is desirable for a number of countries to wait a bit more before starting to borrow from abroad, particularly on a large scale, until after they have put in place adequate debt management and governance institutions.** Implementation of the anti-free riding policy can prevent such countries from rushing into pre-mature foreign borrowing, which was a major cause of unsustainable debts in the past. As the IMF and World Bank (2006 Paragraph 34) rightly points out, "In many LICs, improvements in public debt management are necessary prior to borrowing from private external creditors on a significant scale. In particular, a desirable debt-management framework should assign the legal authority to borrow, and identify permissible instruments and accountability mechanisms…".

76. **There is also the argument in the World Bank's anti-free riding policy document that governments who take on irresponsible non-concessional borrowing are usually not taking into account what is best for their countries' long-term poverty reduction goals.** This is to counter the view (See Paragraph 82 below) that the penalty of grant volume reduction in response to a breach of IDA concessionality guidelines would starve the government of funds needed for implementing policy on poverty reduction and other MDGs, probably forcing the government to resort to further non-concessional borrowing.

77. **Finally, implementation of the proposal can possibly discourage the type of lending that is adjudged by international standard to be unethical.** A case that is often cited in the literature is lending to dictatorial and oppressive regimes, particularly in countries like Sudan, which continues to be strengthened by resource transfers from China in its repeated human rights violations and brutality the Darfur region despite the international outcry and protests against the practice. Another case is commercial bank lending, particularly from Chinese commercial banks, that run foul of what is referred to as the Equator Principles - a voluntary code of conduct, formulated under the auspices of the International Finance Corporation, pledging that projects financed by commercial bank loans would meet prescribed social and environmental standards and which are claimed to be in observance by over 80 percent of bank lending and which Chinese commercial banks have generally not been observing.

(*b*) *Problems and Challenges of the Proposed Anti-free Riding Policy*

78. We earlier discussed the possible benefits of foreign borrowing, even of non-concessional type, by LICs, including post-MDRI ones (See Paragraphs 35 – 39). Most of these benefits can be reduced or prevented as a result of hindrances that can be posed to judicious borrowing through implementation of the proposed anti-free rider measures. Most of these benefits can be lost, as a result. Thus, some of the problems of implementing the anti-free rider policy identified below would inevitably overlap with losing of the previously discussed prospects and benefits of foreign borrowing.

79. **A major problem with the proposed policy is the underlying conceptual framework and perception of IDA regarding what it role should be – as to whether it should be a competitor with other international creditors in the loan markets of LICs or as a promoter that should catalyse credits from other sources into these usually neglected credit outlets.** As can be seen from Box 1 and elsewhere, typical perception in the BWIs (including IDA) on

81. **In addition, by discriminating against LICs in its resource allocation, the IDA itself is a part of the problems that drive the LICs to resort to foreign non-concessional borrowing in the first place and, therefore, a part of the solution lies in reforming its allocation policy.** As discussed earlier, IDA allocation policy discriminates against LICs, resulting into reduced volumes of IDA resource transfers to them, in a number of ways. First, the PBA approach is regressive, to the disadvantage of LICs. Second, the 20 percent volume discount against IDA grant recipients reduces what they receive from IDA accordingly. Third, the IDA's implementation of MDRI entails netting off, possibly resulting into little or no new net transfers from IDA to such post-MDRI countries.

82. **Another problem is that it will reduce the likelihood of LICs attaining MDGs, as sources of external debt finance outside IDA would normally be needed for a meaningful progress towards MDGs attainment, particularly in the face of decreasing volumes of other conventional official sources.** This is particularly the case with IDA grant receiving LICs that would suffer volume reduction as a result of breaching the concessionality borrowing guidelines. This problem is recognised but neglected by the World Bank (2006, paragraph 48), stating "If a country's debt sustainability prospects are fragile, a volume-based response would be more suitable, even if it would involve fewer resources to reach the MDGs". In other words, in resolving the tradeoff between debt sustainability and meeting of MDGs, the proposed policy resolves to sacrifice the latter on the platform of the former.

83. **The converse is also applicable in the sense that penalising IDA grant receivers through volume reduction, by reducing the volume of resources available to meet the desperately desired government spending, can force such countries to resort to further non-concessional borrowing.** The World Bank (2006, Paragraph 55) anticipates this problem by stating that "there are several risks involved with a volumes-based response to free riding. The key risk is that affected countries may attampt to compensate for their reduced IDA allocations by seeking further non-concessional financing from other creditors". Despite this realisation, nothing is done to ameliorate it or otherwise reduce the risk.

84. **Also, as an elaboration of what has been pointed out earlier, restrictive conditions on borrowing would tend to deprive the countries of freedom to judiciously raise external loans to promote growth.** This has been recognised by the the World Bank (2006, paragraph 27) in stating that "there may be cases in which non-concessional borrowing would have stronger economic justification. One example could be in the financing of large initial investments in projects – including 'enclave' projects where appropriate – with potential high risk-adjusted rates of return… IDA's response will therefore require a case-by-case approach to breaches of concessionality limits given the debt sustainability and policy environment". **In other words, IDA is being paternalistic in the sense that IDA's judgement will supersede that of an elected government, which has the mandate of the people (governed) to use its discretion to promote their welfare and growth of the economy.** Bona fide exercise of such mandate would now be supplanted by that of IDA in far away Washington concerning how best the welfare and economic growth are to be promoted. It is now IDA that will tell the government how much, if any, foreign borrowing the government can raise. It is this paternalism to the LICs that Tan (2006, pp. 24, 28) has decried in the following words:

These measures imply increased financial oversight of the public finances and debt management policies of client countries by the Bank, Fund and other official creditors and greater control over what is a sovereign right of countries to enter into external financing agreements. …There is a paternalism which underpins the Bank and Fund's approach to debt sustainability, particularly in relation to the accumulation of non-concessional debt by low-income countries, which assumes that only bretton Woods institutions have the capacity to assess a country's debt sustainability and ability to assume further financial obligations instead of the country itself or international capital markets. … Correspondingly, countries are not entrusted with the task of managing their own debt, having to be reigned in by IDA disincentive measures and IMF conditionality in order for them not to fall into future debt distress.

85. **Closely related to the above is the fact that implementation of the anti-free riding proposal will likely contravene the much acclaimed principle of ownership and alignment that is one of the pillars of March 2005 Paris Declaration on Aid Effectiveness.** According to this principle, authorities in the partner countries are to formulate and own their economic programmes and development partners only have to take these as given and align their own programme of assistance to suit the partner countries' programme. But, if it is now left to IDA in Washington to give permission to the projects to be financed by external loans from non-IDA sources, this would contravene the spirit behind the ownership and alignment of the Paris Declaration.

86. **The justification and legitimacy, for the use of DSF as the credit rating document for LICs in prescribing LICs' borrowing limits and in coordinating creditors, can be questioned.** First, DSF is the document of BWIs alone, with virtually no inputs from LICs. This is not to talk of the very contentious and controversial CPIA on which the reliance on policy-dependent debt distress classification by the DSF is based. **The credibility and legitimacy of DSF in the eyes of LICs are therefore in doubt. In addition, its credibility and legitimacy in the eyes of creditors (whether commercial or non-DAC bilateral creditors or even multilateral creditors not under the influence of DAC bilateral ones) would also be in doubt** not only because they did not have inputs into its design but also because it is doubtful if they would regard it as being more reliable than those credit ratings that have been done for a number of LICs by private and more professional international credit rating agencies. At best, these creditors can use it as a supplement and at worst, they would simply ignore it. The IDA is to use the DSF in convincing the creditors that (World Bank, 2006,Paragraph 35) "Free riding may ultimately backfire as the borrowers' risk of default would probably rise and lead to losses to all creditors in proportion to their seniority and exposure". It looks obvious that these creditors are more astute than to wait to be given this information by IDA before making their lending decisions. They should better know than IDA as to which LICs are in their best interest to lend to. This view had earlier been stated in a broadly similar vein by Tan (2006, pp. 25, 26, 28) as follows:

Implicit in the (anti-free rider policy) paper is that financial markets do not make competent assessments of countries' debt sustainability or if they do make rational choices to lend to highly distressed countries, such lending must be premised only on the improved repayment prospects guaranteed by the overall reduction of debt obligations

as a result of IDA grants and debt relief. … the HIPC experience has also demonstrated that a 'common' mechanism that is designed and driven by one set of creditors – the IFIs, led primarily by the Bank and the Fund and their major shareholders – and imposed on another set of creditors (namely non-Paris Club creditors, and commercial lenders), will not be effective in achieving policy consensus and uniformity in delivery of commitments because of the perception of partiality. Similarly, under the IDA proposals, it is not only the Bank and the Fund who are setting the concessionality benchmarks to be adhered to by other creditors but these institutions are also assessing country's compliance with such benchmarks and debt sustainability thresholds under the DSF. It is therefore unlikely, and unsurprisingly so, that these measures would be adopted by other official creditors (and less so by commercial creditors) aside from possibly the Paris Club creditors who also represent the major shareholders of the Bank and the Fund.

87. Thus, as already admitted by the IMF and World Bank (2006, Paragraph 11), "Only a small number of creditors (the Bank, the Fund, and certain multilateral and bilateral creditors) use the DSF actively. Other creditors and most debtors have little familiarity so far with the instrument and little incentive to use it now, limiting its overall effectiveness".

88. I D

borrowing (which may negate achieving the objective of developing domestic bond markets in many LICs), this can be addressed by simply putting a non-zero limit on (instead of total exclusion of) domestic debt in the government loan portfolio.

90. **By glossing over other important debt sustainability fundamentals (like how to improve debt management capacity and legislative framework as well as the denominators of conventional debt capacity ratio), the anti-free rider policy document wrongly presupposes that contracting of non-concessional loans is the main (and, probably, only) way of reverting to unsustainable debt situation.** The policy document hardly makes any reference to other factors that affect debt sustainability. The only notable reference to these other factors in the document is as contained in Paragraphs 43 and 44, which read "In parallel, the Banks is working with the IMF and other donors to establish a global partnership to strengthen debt management capacity in low-income countries. … Beyond debt management, capacity building on macroeconomic and fiscal management is also necessary to help reduce the need for non-concessional financing, and Bank and Fund staffs remain engaged in providing such assistance". However, such reference is just in passing, without much emphasis that it deserves. In addition, other issues that can affect accumulation of unsustainable debts, particularly governance factors and legal *cum* institutional environment (including design, promulgation and implementation of appropriate fiscal responsibility laws that would guard against politically motivated and injudicious borrowing) are glossed over. More importantly, measures that would enhance the denominators of conventional debt re-payment capacity ratios (viz: promotion of economic growth by raising the GDP or promotion of exports) are totally ignored and these matter as much as reducing debt volumes in attaining sustainable debt positions. This omission is particularly worrisome, in view of the precarious positions of many post-

creditors of generally accepted concessionality benchmarks and safeguards, as being odious.

92. **Also, the penalties proposed for a concessionality breach, in form of either volume reduction or hardened terms, can induce some of the countries to resort to hiding of facts from the IDA so as not to be seen to have breached the guidelines.** This possibility is also anticipated by the World Bank (2006, Paragraph 55) in stating that "A related risk with this incentive mechanism is that awareness of the potential IDA response to the non-concessional borrowing may increase the incentive for some countries to not fully disclose borrowing information to multilateral creditors, or develop financing strategies that attempt to mask the extent of a countr

for governments in the LICs while the last set comprises action points for the World Bank and, to a limited extent, other international development partners.

(a) Action Points for governments in LICs

95. First, policymakers in LICs should refrain from reckless and injudicious borrowing, whether domestically or abroad. They should raise loans under most favourable terms available and in moderate volumes. For concessional loans, they should be prudent about the volumes, as the loans will still have to be repaid sooner or later. Cost-benefit analysis of loans should be

a global partnership to strengthen debt management capacity in LICs as well as macroeconomic and fiscal management capacity .This is welcome as a step in the right direction. But, beyond this, development partners should actually institutionalise a multilateral framework for debt management capacity, the objective of which would include strengthening of debt management capacity in LICs; transferring to them of debt management “know how” or “technology”; and dissemination to them of best practices in debt management. Such an institution, with its own secretariat, should be modeled broadly along those of Consultative Group to Assist the Poor (CGAP) - that is an institutional collaboration among private, bilateral and multilateral agencies (including the World Bank) for assisting microenterprises in developing countries- and the Integrated Framework of Trade-related Technical Assistance (IFTTA, or simply IF) – formed as a network of six multilateral organisations (including the World Bank). While there are some private and quasi-private initiatives or outfits for providing debt management capacity building services to developing countries, this should be more formalised and made more elaborate through an institutionalised multilateral network of development partners with like minds on the subject. Given its expertise and comparative advantage, the World Bank should be at the forefront in providing and championing this multilateral initiative and it should rally bilateral agencies and other multilateral bodies like the IMF, UNCTAD, etc in support of this cause.

102. The World Bank should also catalyse and cajole national governments in LICs to diversify their export base and increase their export earnings in other to attain sustainable debt positions. In this regard, the Bank should be an advocate for the countries in international trade negotiations and policy fora, including at the Doha Development Rounds. It should also provide more aid for trade facility in concessional loans or grants.

103. The World Bank should refrain from perceiving itself as a competitor with other creditors, whether commercial, emerging bila0 Tj -36 -0 Tw han advocate for the countriesorigasholly bilatese3

105. To the extent that the World Bank must implement its anti-free rider policy, domestic debt should be covered for effectiveness.

106. Also, the anti-free rider policy should not penalise only the borrowers but the lenders too should be made to bear some responsibility. Specifically, as earlier suggested in the paper, the World Bank should be at the forefront of spearheading the creation of a sort of international agreement, convention or protocol that would treat lending to LICs, which constitutes a flagrant and extreme breach by the creditors of generally accepted concessionality benchmarks or norms, as being odious and illegitimate.

4.2 Summary and Conclusion

107. Low-income countries that presently have sustainable debt positions can ill afford to get into or revert to the vulnerable debt situations that many of them were until recent. Those that are still having unsustainable debt cannot afford to worsen the situation through reckless borrowing. All these underscore the objective of this paper, which aims to shed light on the non-concessional borrowing situations in LICs; and review the recent World Bank policy document that has a stated aim of guarding against accumulation of unsustainable debts in LICs; and suggest national and international policy interventions for sustainable debt positions in the countries.

108. We first review the profiles and stylized facts on non-concessional borrowing in the countries. Our review shows that natural resource rich countries and countries in conflicts (that are therefore in arrears with BWIs) account for the bulk of non-concessional debt stock and flows, particularly public and publicly guaranteed types. But it would not be illogical to anticipate that post-MDRI countries too could soon start (or might have just started) contracting non-concessional debts in sizeable amounts. We also highlight the geographical concentration of bilateral external credits that characterises many countries, with outstanding credits from emerging creditors like China, Kuwait and Saudi Arabia accounting for high percentage of GDP of the borrowing countries. We point out that this could make the borrowers more vulnerable. In addition, we review the available descriptive and "qualitative" information about the activities of emerging creditors in LICs, with emphasis on the lending activities of China in Africa.

109. The above is followed by a review of the likely reasons that could have made the countries resort to non-concessional borrowing. There, we identify a number of supply factors at the creditors' end and demand factors in the borrowing LICs. Also, we discuss the likely prospects and benefits to the countries of borrowing as well as the likely dangers and problems with such borrowing.

110. The latter and larger part of the paper is devoted to a review of the World Bank's recent document on anti-free riding policy proposal. We summarise the main contents of the document, including the peculiar concept of free riding adopted and the concessionality benchmark to be used. We also summarise the proposed responses, including the use of DSF as the coordinating tool for the creditors as well as discouraging of borrowers being complicit in free riding through a combination of cuts in volume of IDA assistance and hardening of terms of IDA credits. Then,

we evaluate the proposed policy document by highlighting its possible advantages and disadvantages.

111. A conclusion that emerges form our review is that whether borrowing would be beneficial or not to a low-income country depends on the circumstances of the country in question. The same consideration applies to whether the proposed World Bank anti-free riding document can have net benefit for each of the targeted LICs. Thus, while we express reservations on many aspect of the policy document, we cannot but agree with the statement in the document that “ Ironclad rules or ‘one-size-fits-all’ responses are counterproductive to the extent that there are a wide variety of country circumstances requiring appropriately-tailored approaches”.

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