

The International Development Association Meets in Nepal: Will it Help Finance South Asia Combat Climate Change Mitigation?

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Summary

The third replenishment meeting of the International Development Association was held in Kathmandu, Nepal, in June 2024. The meeting formulated strategies for future support to low-income countries. The discussions were around providing concessional loans, policy frameworks, outcome blueprints and financial commitments for the next three years for low-income countries.

Established in 1960, the International Development Association (IDA)¹ complements the World Bank's original lending arm – the International Bank for Reconstruction and Development (IBRD). Its focus is to assist low-income countries. The IDA's grants and low-interest loans aid countries to invest in their futures, improve lives and create safer, more prosperous communities around the world. It is one of the largest sources of assistance for the world's 75 low-income countries and the single largest source of donor funds for basic social services in these countries.

The IDA lends money on concessional terms. The IDA credits have a zero or very low interest charge and repayments are stretched over 30 to 40 years. More than half of the IDA countries receive all, or half, of their IDA resources on grant terms, which carry no repayments at all. These grants are targeted to low-income countries at higher risk of debt distress.

The IDA has historically been funded largely by contributions from the governments of its member countries. Donors meet every three years to replenish the IDA's resources and review its policy framework. The most recent replenishment of IDA's resources, the 20th, was finalised in December 2021, resulting in a US\$93 billion (S\$122.4 billion) financing package for the IDA countries for fiscal years (FY) 2022-2025. In addition to these concessional loans and grants, the IDA provides significant levels of debt relief through the Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative.

In the FY ending 30 June 2023, the IDA's commitments totalled US\$34.2 billion (S\$45 billion), of which US\$7.3 billion (S\$9.6 billion) were in grants. The African region received 75 per cent (US\$25.8 billion [S\$33.9 billion]) of the total commitments. Since 1960, the IDA has provided US\$533 billion (S\$701.9 billion) to 115 countries. Annual commitments have increased steadily and averaged about US\$36 billion (S\$47.4 billion) over the last three FYs

¹ "What is IDA", International Development Association, <https://ida.worldbank.org/en/what-is-ida>.

(FY2021-FY2023). Thirty-six countries have graduated, and many have become IDA donors, including China, Chile, India, South Korea and Turkey.

The IDA and the South Asian Region

The South Asian countries, such as Afghanistan, the Maldives, Pakistan and Sri Lanka, are either in debt distress or at high risk of it. In 2006, South Asia's total external debt stock increased by a record 23 per cent. In 2022, the ratio of government debt to gross domestic product in the region averaged 86 per cent, higher than that of any other emerging market and developing economy region.²

South Asia has, however, largely managed to avoid debt crises. Only Afghanistan (under the HIPC), Pakistan and Sri Lanka have restructured their external debts. Nevertheless, the World Bank South Asian Region Chief Economist's Office has highlighted³ the region's debt burden as a major factor that contributes to its fiscal fragility;⁴ while poverty estimates⁵ for the South Asian region have increased by 16 million, making it home to a majority of the world's poor who live on less than US\$3.65 (\$4.81) a day.

The countries in the South Asian region owe, on average, 47 per cent of external public debt to multilateral creditors, 34 per cent to bilateral creditors and 19 per cent to private creditors. Multilateral creditors are still prominent in the region, and, in particular, in India. Since graduating from the IDA in FY2014, India has gone on to become one of the largest borrowers of the World Bank Group's arm focused on market-based and creditworthy client countries. Pakistan, the region's only "blend" country (both IDA-eligible and creditworthy for IBRD borrowing), and Bangladesh are among the largest beneficiaries of IDA loans: US\$5.3 billion (\$6.9 billion) in FY2021 and US\$2.7 billion (\$3.5 billion) in FY2022 to the two countries combined.⁶

Significance of the IDA for South Asia

South Asia is highly vulnerable to climate change impacts and natural disasters. About 60 million people a year have been affected by natural disasters since 2013, more than in any other region in the world. About 800 million South Asians live in climate hotspots, where unpredictable rainfall and rising temperatures are reducing crop yields and increasing water scarcity and population displacements.

² World Bank, "South Asia Development Update April 2024, *World Bank Group*, 2024, <https://www.worldbank.org/en/region/sar/publication/south-asia-development-update#sections>

³ Ibid.

⁴ Patrick Kirby, "South Asia's economic outlook in five charts", World Bank Blogs, 2023, <https://blogs.worldbank.org/en/endpovertyinsouthasia/south-asias-economic-outlook-five-charts>

⁵ S K Baah, R A C Aguilar, C Diaz-Bonilla, T Fujs, C Lakner, and M C Nguyen, "March 2023 global poverty update from the World Bank: the challenge of estimating poverty in the pandemic", The World Bank Blog, 2023, <https://blogs.worldbank.org/en/opendata/march-2023-global-poverty-update-world-bank-challenge-estimating-poverty-pandemic#:~:text=At%20%246.85%2C%20the%20global%20poverty,million%20people%20living%20in%20poverty>.

⁶ Parateek Samal, "Up & coming: Unpacking South Asia's growing role in global debt", World Bank Blogs, <https://blogs.worldbank.org/en/opendata/coming-unpacking-south-asias-growing-role-global-debt>.

The IDA supports investments in climate change adaptation and mitigation, climate-smart agriculture, improved water resource management, effective coastal and fisheries management, biodiversity conservation and air quality management. In Pakistan, the IDA supports the Hydro-met and Climate Services Project⁷ which is strengthening the delivery of reliable and timely hydro-meteorological services to enhance community resilience to shocks. In Sri Lanka, the IDA is helping to improve the productivity of smallholder farms through the Climate-Smart Irrigated Agriculture Project.⁸ Empowering farmers with knowledge and training on climate-smart agriculture (CSA) practices is critical to addressing climate change and rural livelihood challenges in Sri Lanka. This project supported Sri Lanka's first dedicated CSA Training School for farmers. As of August 2023, 736 farmers have received training, 40 per cent of whom are women.⁹

South Asia needs to create more and better jobs for its growing working-age population. Private investment and robust growth of businesses and firms are essential to create jobs. Well-functioning and equitable social safety nets are crucial. In the wake of an unprecedented economic and financial crisis, Sri Lanka was granted “reverse graduation” from the IDA in December 2022 and the IDA moved quickly to provide a development policy credit¹⁰ and a social protection project to help restore macroeconomic stability, mitigate the impact of the crisis on the poor and vulnerable, and support inclusive private sector-led growth. In Pakistan, the Khyber Pakhtunkhwa Province Revenue Mobilisation and Public Resource Management Project¹¹ is supporting the integration of former tribal areas of Pakistan – characterised by high poverty rates and lack of basic public services – into the province. The provincial government was able to more than double revenue collection from US\$99.4 million (S\$130.8 million) in FY2019 to US\$216 million (S\$284.4 million) in FY2022.

Investing in Infrastructure

The IDA's investments in roads, bridges, renewable energy and telecommunications systems – the backbone of the region's economies – have been critical for South Asia's economies. In Bangladesh, the IDA helped build one of the world's largest off-grid solar power networks, enabling 20 million people to access electricity. The IDA, together with other funders, provided successive financing through the Rural Electrification and Renewable Energy Development Project,¹² and installed 4.2 million solar home systems in rural households and on remote shoals and islands, providing access to electricity to 12 per

⁷ “Pakistan Hydromet and Climate Service Project (PHCSP)”, World Bank, <https://projects.worldbank.org/en/projects-operations/project-detail/P163924>.

⁸ “Climate Irrigated Agriculture Project”, World Bank, <https://projects.worldbank.org/en/projects-operations/project-detail/P163742>.

⁹ Ibid.

¹⁰ “Memorandum of the President of the IDA To The Executive Directors On The Full Compliance By The Democratic Socialist Republic Of Sri Lanka With The Tranche Release Conditions For The Resilience, Stability and Economic Turnaround (RESET) Development Policy Operation”, World Bank, 2023, <https://documents1.worldbank.org/curated/en/099122123101015385/pdf/BOSIB1e6ef00920c21a638102fa9ce36027.pdf>.

¹¹ “Khyber Pakhtunkhwa Revenue Mobilization and Public Resource Management”, World Bank, <https://projects.worldbank.org/en/projects-operations/project-detail/P162302>.

¹² “Rural Electrification and Renewable Energy Development II (RERED II) Project”, World Bank, <https://projects.worldbank.org/en/projects-operations/project-detail/P131263>.

cent of the population. The IDA's financing of two innovative projects to scale up renewable energy in the Maldives – Accelerating Sustainable Private Investments in Renewable Energy and Accelerating Renewable Energy Integration and Sustainable Energy – helped to leverage significant private capital, which has ultimately driven down costs. The power purchase price decreased from US\$0.21 (S\$0.27) per unit of electricity in 2014 to less than US\$0.098 (S\$0.13) in 2022. The IDA is helping to enhance regional road connectivity in South Asia with the Nepal Strategic Road Connectivity and Trade Improvement Project.¹³ This project is improving the efficiency and safety of select transport infrastructure, increasing the efficiency of cross-border trade and strengthening strategic road network management in Nepal.¹⁴

Expanding Access to Digital Technologies

The advancement and adaptation to digital technology have made governments in the region more accountable to citizens, farmers more resilient, and water more readily available in remote areas. New technologies can help improve connectivity and access to financial services, streamline food value chains, and make agriculture more resilient to climate. In Bhutan, the IDA worked with the Bank of Bhutan and the Royal Monetary Authority to develop a new e-payment system that seamlessly supports cashless transactions between the government and the banking system so the government can get real-time financial information to manage public resources and better track expenditures.

Current Concerns for the IDA

Like all other funding institutions, the IDA also finds its constituent countries to be facing competing demands for the limited resources available to it. On the other hand, these countries are facing rising debt levels, unemployment, climate vulnerabilities and challenges on the health and education fronts and hence need assistance from the IDA at a faster and higher rate. However, the shift to less-concessional financing reflected changes in creditor composition, which has increased borrowing costs significantly. Between 2010 and 2019, the share of non-concessional borrowing in the total external debt of the IDA-eligible countries increased from 43 to 60 per cent. Although the share of non-concessional debt among the IDA-only borrowers has seen only a modest increase (from 44 per cent to 48 per cent of total external debt), the share of non-concessional finance in the IDA gap and blend countries has risen from 42 per cent of total external debt to 66 per cent. The increase in non-concessional borrowing from bilateral and private creditors has exposed countries to shorter maturities and greater rollover risks and has crowded out other public spending. During the FY2010-19 period, variable rate debt as a share of total external debt for IDA-eligible countries increased, on average, from 11 per cent to 16 per cent.¹⁵

¹³ “Nepal Strategic Road Connectivity and Trade Improvement Project”, World Bank, <https://projects.worldbank.org/en/projects-operations/project-detail/P170409>.

¹⁴ Maldives – Accelerating Sustainable Private Investments in Renewable Energy (ASPIRE) Project, World Bank Group, <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/402251468300650153/maldives-accelerating-sustainable-private-investments-in-renewable-energy-aspire-project>.

¹⁵ Origins of the Sustainable Development Finance Policy, World Bank Group, <https://ieg.worldbankgroup.org/evaluations/international-development-associations-sustainable-development-finance-policy/chapter-2>.

Enhanced borrowing over the past decade has drawn attention to weaknesses in debt transparency that hindered full awareness of and accountability for exposure to fiscal risk. The World Bank has clear reporting standards for debt transparency in place for its borrowers. Specifically, the World Bank's borrowers are required to provide regular, detailed reports on long-term external debt owed by a public agency or by a private agency with a public guarantee. However, these standards have not led to full disclosure of external debt, particularly debt contracted by public entities that do not benefit from a sovereign guarantee. Information on the terms and conditions of some debt instruments, such as bilateral debt restructuring by non-traditional creditors, is also limited.

Two significant issues emerged at the IDA 21 replenishment meeting in Kathmandu. Firstly, lenders need to factor in the reality that fragility continues to be a key challenge in the IDA countries. It has to then capture the focus on prevention of vulnerabilities and institution-building, assess the IDA's impact and consider what IDA can do better, and discuss the role of partnerships and the leveraging role of IDA in development finance in attracting private capital. Secondly, private Investments should articulate the level of aspiration for the region, emphasise its links with jobs and the role of an enabling environment, highlight the continued importance of de-risking and of the IDA's Private Sector Window, and discuss the International Finance Corporation's own-account commitments in the IDA countries.

Meanwhile, the G-20 Expert Group on Financial Restructuring of Multi-Lateral Development Banks (MDBs) has proposed, as a part of the new growth agenda, that concessional aid plays a central role, especially for health and education in low-income countries. The IDA is the largest source of long-term, cheap financing to low-income countries, but it is too small to properly address the needs for adaptation, resilience and mitigation. Accordingly, it has recommended a tripling in the size of the IDA by 2030, and that the IDA should preserve its focus on low-income countries, where the degree of additional investments is large relative to their capabilities for domestic resource mobilisation, and where non-concessional borrowing is precluded due to a lack of creditworthiness. The approach of development finance in the context of lending on softer terms and the importance of private lending to cope up with the new challenges of climate change vulnerable countries are likely to shape the future of Development lending and also the restructuring of MDBs to a large extent.

Conclusion

In the context of the increasing threat of climate fragility in some of the heavily indebted nations of the South Asian region, there is a need to examine the entire issue of the future of development finance in the context of the IDA's lending and the vulnerabilities of the borrowing countries. This would require a very detailed assessment of the position as obtained in some of these countries, ascertaining the quantum and quality of assistance that they would require and then making a presentation to the IDA to encourage donor countries to enhance their lending for the targeted need of the specified country. The IDA has a vast potential to help countries leverage themselves out of debt crises and achieve sustainable growth. India is one such country which by investing in its people and communities could improve literacy and health infrastructure. It has now become a donor to the IDA. Nepal is another country which has used the IDA's assistance to improve its education, health and connectivity infrastructure and has made impressive strides in the last

decade. With its strong global footprint and longstanding engagement in the poorest countries, the IDA brings significant comparative advantages in supporting the IDA countries to respond to the crisis and get back on track to achieving their long-term development goals. The IDA's country-driven model ensures that financial support is tailored to each borrowing country's needs, performance, and development plans, and is structured to help governments sustainably manage their finances in close collaboration with other development actors.

The need for critical investment in infrastructure such as roads, bridges, airports, renewable energy, health and education will help harness the vast capacity of the region for manufacturing and innovation to profitably participate in the global supply chain. Additionally, the requirement for funding climate adaptation and mitigation will require a very strong private-public partnership in funding. All agencies engaged in funding for resolute climate action have underlined the critical need for hybrid varieties of private investment. Thus, while the bulk of lending could be sourced through the IDA and other MDBs, private investors have a pivotal role to play in the way climate finance finds its way to innovation and growth in the region.

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