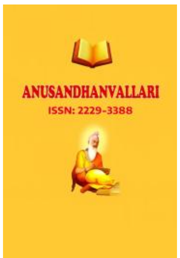

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India and the International Development Association (IDA) of the World Bank: A Critical Assessment

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Abstract

India was one of the largest and most significant creditors for the past five decades of the International Development Association (IDA), the World Bank's soft loan window. The combination of India's rapid economic growth and the recent GDP growth means that India has surpassed the income limit of IDA's eligibility. Formal graduation carries significant implications and implications for other creditors. This paper aims to understand IDA's structure and its relationship with India prior to its graduation. How has IDA's relationship with India changed after its graduation? What are the implications for India as well as IDA after its graduation? Specifically, India's relationship with the World Bank, as well as the broader questions about the country's new income status.

Keywords: Development, India, World Bank Group, International Organisations, United Nations

Introduction

India has reached the middle-income status that allows it to 'graduate' out of the International Development Association (IDA) of the World Bank Group. The process to escort a borrower out of the eligibility of the Bank's soft loan facility (IDA) is termed 'graduation' by the World Bank Group. This turning point marks a new status, specifically 'middle-income borrower', which means that states are now eligible only for the Bank's standard loans, as determined by the International Bank for Reconstruction and Development (IBRD). Although India is not the first country to graduate from the IDA. Many states, such as China, Egypt, Indonesia, etc., have gone before it. What makes India's graduation crucial is its history and the role that India has played in making the Bank more accessible and transparent towards developing countries.

IDA is distinctive in its composition and the concept it embodies. It emerged in 1960, during the period of decolonisation, largely with countries like India in mind. As a facility for long-term, low-interest development financing for the world's poorest countries.

Financing IDA

The two main lending arms of the World Bank Group are the original International Bank for Reconstruction and Development (IBRD), founded at Bretton Woods in 1944, and the International Development Association (IDA), established in 1960 "as an institution that could lend to very poor developing nations on easier terms" (World Bank 2007b:17). The World Bank's IBRD and IDA arms share the same staff and physical facilities, report to the same managers, Directors and Governors, and generally apply common standards to evaluate prospective loans. But their financial models are fundamentally different. The Bank's IBRD loans are primarily financed by selling its AAA-rated bonds to private and institutional investors. These bonds are guaranteed by contributions from wealthy member countries of the bank. Countries do not pay banks these amounts, except for a small portion that contributes to the banks' working capital. Rather, the subscriptions are retained as "callable capital" – "a kind of guarantee pooled together by the promises of all members" (Woods 2006: 196). In fact, there is no need for banks to withdraw capital due to the borrowers' good overall performance in meeting their debt service obligations and maintaining strong bond ratings. According to the Bank, "Even though IBRD does not maximise profits, it has earned a positive net income each year since 1948". Since this modest profit gives the Bank some operational independence, defrays its capital and staff expenditures, and in part cross-subsidises IDA operations, the IBRD lending arm is critical to the Bank's overall business model. They encompass extensive fiduciary, social, environmental, and broader policy conditions that create additional compliance costs for borrowers. In contrast to the IBRD's bond-backed loans, IDA credits and grants are financed mainly through contributions, in the Bank's terminology, from donor countries. IDA is replenished and follows a donor dialogue process every three years. Donor contributions have financed about 71 per cent of IDA assistance since its inception, mainly through IBRD, but recently the International Finance Corporation (IFC, the Group's private sector lender for developing countries). Regarding formal decision-making, IBRD and IDA share the same Board of Executive Directors.

The five major donor countries (the US, the UK, France, Germany and Japan) are each entitled to appoint Executive Directors to the Board. IDA's "Part I" member countries – essentially, industrialised donor countries – have a voting power of 57.97 per cent, as compared to 42.03 per cent for "Part II" developing countries. This weighted voting system created a power hierarchy within the Bank's governance, which determines other formal decision-making rules and procedures. The US still retains veto power for certain types of high-level decisions requiring an 85 per cent supermajority in the IBRD. Collective European donor votes outweigh the US share, which would be significant if they coordinated their policy positions. In reality, decision-making is generally by consensus. Critics of the Bank argue that "consensus" is merely a substitute for donor dominance, especially to maintain US influence in economic and financial organisations.

The appeal of IDA to borrowers is straightforward: IDA assistance comes on considerably softer terms than IBRD loans. IDA "credits" are loans at no interest (though with a "service charge" of about 0.75 per cent), with a 10-year grace period on repayment of principal, even beyond their long 25–40-year maturities. For some extremely poor states, IDA essentially still plays the role envisioned for it nearly 50 years ago: lending credits to countries that are eschewed by the private sector or for whom market loans would be prohibitively costly. For these borrowers, there are few options available. In contrast, for a large, relatively resourceful, and creditworthy borrower such as India, the biggest appeal of IDA lies in the cheap line of credit it provides for bridging finance gaps in infrastructure, social sector investment, and other development objectives.

IDA's mandate is a "transitional arrangement," in which the list of borrower countries fluctuates over time, primarily for allocating aid and determining whom to provide it to. According to the World Bank, IDA eligibility is a transitional arrangement that gives the poorest countries access to substantial resources before they can obtain the financing they need from commercial markets. As their economies grow, countries graduate from IDA eligibility. The repayments, or "reflows," that they make on IDA loans are used to help finance new IDA loans to the remaining poor countries (WB, 2007b, pp. 19-20)

IDA's Graduation

IDA eligibility is based on two criteria: (a) per capita income below a certain threshold and (b) lack of creditworthiness that prevents the country from borrowing in international markets. Once a country breaches the operational income threshold for three consecutive years, it begins the graduation process, first losing access to the most concessional terms and then losing access to IDA funds altogether. IDA countries with a per capita income below the threshold enjoy the most concessional borrowing terms, including a 40-year maturity, a 10-year grace period, and interest and service charges of 0.75%. IDA countries with a high risk of debt distress receive only grants, those with a medium risk receive half grants and half concessional loans, and those deemed to have low risk receive loans on standard IDA terms. Countries that are below the IDA operational cut-off but deemed creditworthy for limited IBRD borrowing are eligible for IDA lending under slightly harder "blend" terms. How does IDA identify states? The Bank's long-time General Counsel, the late Ibrahim F.I. Shihata, relates a discussion from the fifth IDA replenishment in 1977, for which the office of the Bank's president (then McNamara) prepared a memorandum on "the criteria underlying the allocation of IDA credits which would provide a basis for review by the IDA Executive Directors." In interpreting the IDA Articles of Agreement, the president's note reiterated that in order to be eligible for IDA funds, borrowers must be relatively less developed, lack creditworthiness for conventional lending, and be in a position, as indicated by their economic performance and absorptive capacity, to use IDA effectively (Shihata 2000: 557). The note went on to discuss other issues impacting IDA access, and made special mention of India with respect to population size:

Population size is a basic criterion for allocating IDA resources among eligible countries. However, allocations based solely on population would result in a heavy concentration of IDA resources in a few countries, such as India, which would account for over half of the allocations to currently IDA-eligible countries. It could be argued that aid efforts, including those of IDA, are essentially aimed at individuals rather than states, and accordingly, that the per capita criterion should be given a predominant position. However, a strict allocation of IDA resources according to population size would, for example, considerably reduce the share of some of the sparsely populated countries of Sub-Saharan Africa. These countries face problems that justify a more generous allocation of concessionary assistance. Those problems include limitations in trained manpower, the wide dispersion of small populations over large areas, and a small market size that cannot support broad-based industrialisation efforts. These factors, along with minimum project size and the requirements of a continuing lending program, have introduced the so-called "small country bias" in IDA lending.

These allocation issues became particularly significant in the 1980s as donor contributions to IDA stagnated in real terms, and even more so since the 1990s as HIPC and other debt initiatives have made relief to Africa a high priority. The flip side of the "small country bias" is what Michael Lipton and John Toye, in a 1990 study of aid to India, refer to as the "large country effect." They explain that donor countries would like to "appear as generous in as many different countries as possible, and can win friends in twenty medium-sized poor countries, by economizing on aid to one large country like India" (1990: 3). This effect has implications not only for India's IDA share and other multilateral assistance, but also for its aid volume overall. In per capita terms, the contrast between India and other developing countries was striking even

a quarter-century ago: Lipton and Toye show that total 1985 aid to India worked out to around US$1.90 per person, versus US$16.20 for other developing countries. The Indian position in IDA presents a double bind for the World Bank. On the one hand, given India's size and share of the world's poor – and its relatively sound aid administration, at least compared to many other low-income borrowers – it conceivably could generate projects and programs that would

take up the entire pool of IDA resources. On the other hand, this great size is precisely the problem at the same time. Allowing India to dominate IDA on the merits – or even allocating its aid on something closer to per-capita parity with other low-income countries. To address this issue, the Bank developed a 'blend' concept (WB Group).

India's Graduation: Bank and IDA's Blend in India

The process of graduation begun even before the official statement through the "blend" status as the Bank's solution for handling giant IDA borrowers like India. Having large, still poor, but relatively creditworthy countries borrow both from IBRD and IDA has suited their interests as well as the Bank's. For the blend borrower, the interest-free cost basis of IDA credits means that even under the "blend" scenario, the Bank's loan packages are priced very competitively compared to private sector alternatives, thus offsetting their higher bureaucratic costs and carrying the additional benefit of the Bank's technical and analytical work. This arrangement retains India's interest in IBRD. But if IDA credits were to fall to a very low share of the Bank's assistance to India – or to disappear altogether – then its financial appeal is greatly diminished. Simply put, the Bank needs IDA to keep itself engaged in India. However, the blend category also serves as a kind of halfway house out of IDA; at some point, as it enters the middle-income range, a blend country will eventually graduate to IBRD-only borrower status. IDA graduation is a process, not an immediate event. But for a process that more than 30 countries have undergone, it remains highly informal. There is ambiguity in the IDA charter regarding its intended purpose as a transitional facility for the poorest countries; once a borrower crosses the income threshold for eligibility, its exit from IDA should be relatively straightforward. But in fact, the process is more subjective. Graduates tend not to be altogether reluctant in their departure; by the time they go through the process, their Bank borrowings usually represent such a small share of their development investment that the loss of easy money from IDA is a transition that they can bear. There is also the political symbolism of achievement in the process – even if the country still exhibits significant levels of poverty, as do China, Indonesia, and other recent graduates. India's leaders are driven by a sense of competition with Asian neighbours; following China, Indian officialdom sees graduation from IDA as a mark of achievement and prestige. But at the same time, India's recent developmental objectives – particularly the goal of improving economic performance and poverty reduction in "lagging states" – have led it to place a higher emphasis on IDA than might be expected of a soon-to-be graduate. Usually, in the years before graduation, a country's volume of IDA borrowing tapers, and the composition of the Bank's loan blend is progressively "hardened" toward a higher share of IBRD loans.

What is interesting in India's case is that, while there has been a hardening of the blend toward IBRD terms, its absolute level of borrowing from IDA has remained about the same or even slightly increased in recent years, as its overall bank borrowings have expanded. Thus, India is bucking the usual trend (Basu, 2007). During the late 1990s, India's IBRD-to-IDA blend came closer to 50:50 (with a slight bias still in favour of IDA), in the context of total annual commitments ranging from about US$1.5 billion to US$2 billion. Beginning around 1999–2000, the blend gradually hardened to its current level of about 70 per cent IBRD – essentially an inversion of the early 1990s ratio – but within the context of an overall expansion of annual commitments to US$3–4 billion.

It was clear that the Bank was reluctant to see India leave IDA. To be sure, the Bank has many priorities. Noting that India and Indonesia were "two large IDA countries for which the issue of graduation and IDA eligibility has arisen on several occasions" – a passive construction that should not obscure the point that donors have raised the issue during replenishment talks. The great bulk of IDA support [in India] goes for the social sectors and rural poverty reduction projects. IDA funds are used, for example, to support the Bank's largest education and nutrition programs, both of which are targeted at girls. IDA also supports a large number of health programs in order to combat AIDS, malaria, and leprosy.

Without IDA, the Bank would not be able to lend to social sectors, due to the government's reluctance to borrow non-concessional funds for "soft" sectors. Moreover, although IDA funding has little impact at the macro level, its impact has increased significantly by adopting a state-focused approach. The IDA document essentially argued that India should not be graduated, as the Bank, in the staff's view, was revitalising its relationship with the borrower. To reduce IDA assistance at this particular juncture would marginalise the Bank and threaten the progress made in the last few years in promoting reforms. Given the fact that India has the largest concentration of the poor in the world, a reduction in IDA resources would not be desirable. The country's increasing creditworthiness could be reflected in a hardening of the blend through increased IBRD lending relative to IDA, rather than a decline in its IDA allocation. The opacity of the triennial IDA replenishment process makes it impossible to determine exactly which donors have contributed to India's graduation, and for what specific reasons. The Donors play a major role in pushing countries to graduate out of IDA. For instance, "Scandinavian donors" in particular have led recent calls for India's graduation (Tewari, 2008), even during IDA14 talks in 2005.

The donors' basic position, as he characterised it, was "Why does India need IDA?" Pressure is plausible also in that these countries place special emphasis on aid for Africa and post-conflict states (Haarder 2004), and may see India's share of IDA 15 resources as impinging on these priorities. The Executive Director for the Nordic and Baltic countries – whose constituency is Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden – holds 5.28 percent voting power in IDA, though as noted, the special engagement and relatively high aid-to-national income contributions of some of these countries gives them a greater importance in IDA governance than the vote share would imply that donors want IDA to be many things, and India's large IDA share is apparently seen as serving less pressing priorities than debt relief and expanded aid for Africa and post-conflict areas.

India as a whole is now in the Bank's middle-income range that has shifted it to IBRD-only status, but enormous states such as Uttar Pradesh and Bihar are nowhere near this threshold. India and IDA's history have been of mutual influence, punctuated by occasional sharp tension, but recently settling into what officials on both sides refer to as a respectful "partnership".

Although India is listed as the Bank's broad "middle income" category of IBRD borrowers, but it is on the achievements of high-growth states such as Gujarat, Maharashtra, and Tamil Nadu. The agglomeration of north-central-eastern "lagging states" – and especially Bihar – have per capita incomes as low as one-fifth those of the frontrunners. The gap between these "two India's" is one of the defining challenges of political economy. While one of these India's is ready to leave IDA aid behind, the other exhibits some of the most pervasive poverty and weakest social indicators anywhere in the world. However, India's aid mandarins seem to regard its prospective graduation as a badge of honour.

India and IDA

India's very acute needs for external assistance in the late 1950s were a key impetus for the very founding of IDA in 1960. But as more newly independent developing countries became borrowers, India's position as a huge IDA borrower presented a problem. The Bank stepped up aid to India after the 1966 devaluation imbroglio – both to mend ties with the important client, and to fulfil its increasingly poverty-focused mission during the McNamara period – but the more IDA aid that India claimed, the less was available for other IDA borrowers. Even in the 1960s, the Bank had to place fixed limits on IDA assistance to India (as well as Pakistan) to reserve access for others. This picture changed from the 1990s after India's economic liberalisation, that attracted more investment commitments to infrastructure projects with private participation. It rose in 2006 than any other developing country. Indeed, commitments in India were nearly twice those in its nearest rival, Brazil, and well ahead of those in China" (Harris 2008: 3). Private infrastructure investment in India – almost non-existent in 1990 – has been on the rise since the reforms of the 1990s, with annual commitments reaching US$9 billion during 1996–7 before falling off somewhat at the end of the decade. A new surge began around 2004, and in 2006 private investors committed more than US$22 billion for almost 60 projects. However, India still faces major gaps and bottlenecks in infrastructure, particularly compared to China, and Indian leaders consistently stress the need for even greater investments to sustain their ambitious economic growth targets. There are critical needs in the rural sector – such as access to credit for small farmers – and a number of sectors where the Bank can contribute both in terms of lending and technical/analytical assistance. But it does mean that the World Bank is increasingly a relatively modest player in a very crowded investment field.

Yet as India's economy continues to grow, the Bank's contribution as a share of its developmental investment diminishes ever lower, forcing the Bank to work harder to remain relevant. Ngaire Woods notes several factors that have driven up the real costs of World Bank resources, and have made the Bank less attractive to borrowers with other options. Firstly, donors reduced their real contributions to IDA over time, limiting the size of this facility and the ability to couple IDA credits with IBRD loans for stronger clients.

Secondly, and more to the point for creditworthy borrowers, Woods notes, “an increasingly onerous bureaucratic process has grown up within the World Bank.” Between the mid-1970s and the mid-1990s, the Bank’s average administrative costs per project doubled (the Bank recently has made a concerted effort to reduce costs, with uncertain results).

Thirdly, and relatedly, the “conditions attached to loans have grown in breadth and depth” as the Bank has sought to leverage changes in borrowers’ economic policies and to apply social and environmental safeguards to projects. “The result of the three forces,” Woods says, “is that developing countries are displaying a diminishing appetite for borrowing from the World Bank” (2006: 189).

The World Bank must now work harder to retain the major developing countries it would like to have as its largest and most reliable IBRD borrowers – countries such as Brazil, China, India, Indonesia, and Mexico. However, from the other side, the Bank has come under increasing scrutiny and pressure from donor governments and NGOs, which raises the costs of doing business with it in multiple ways. Particularly significant has been the ever-expanding social and environmental safeguards carried by the Bank’s project loans – the “bread-and-butter” infrastructure investments that IBRD funds in sectors such as water and roads. Several developments over the past decade help to illustrate the challenge that the Bank faces in lending to middle-income countries, and even to relatively self-reliant countries that aren’t quite there yet.

Challenges to the Bank

In 2002, the Bank’s Board of Directors weathered a significant storm with large borrowers over safeguards in loans for 19 water infrastructure projects. In the view of China and India, standards that the Bank had adopted under pressure from anti-dam activists “demanded so many precautions and perambulations that they amounted to a virtual ban” (Mallaby, 2004, p. 357), leading the Executive Directors for the two Asian giants to demand that the Bank reassess its standards. The China and India directors reminded the Bank’s managers that “between the two of them they spoke for more than 2 billion people, or one in three members of the human race” (Mallaby, 2004, p. 361). From the perspective of many critics of the Bank, these governments do not give “voice” to citizens adversely impacted by development projects. This is especially true of the authoritarian Chinese regime, but democratic India, too, comes in for criticism by the activist community – most infamously in the Narmada River context. However, this is precisely the Bank’s dilemma: it faces increasing scrutiny from NGOs and their allies in donor country governments, but its clients are developing country governments that enjoy expanded access to capital and do not appreciate the Bank’s cumbersome conditionality and safeguards. Second, even as it seeks to reverse the decline in lending, the Bank’s strategy for middle-income clients increasingly calls on its “knowledge bank” function. At least since the mid-1990s, the Bank “has made knowledge sharing an explicit objective and has increased its efforts to organize its knowledge sharing activities in a systematic way so that information can have the broadest possible impact” (World Bank 2007b: 72). The Bank’s middle-income country strategy hopes to trade increasingly on its “AAA” (Analytic and Advisory Activities) and “non-lending solutions” (basically policy and technical advice) in its relations with middle-income clients. Financial and advisory services from the IFC, the World Bank Group’s private-sector lending arm, are also expected to expand and more closely align with IBRD operations in middle countries. Indian officials seem to believe that the Bank brings valuable knowledge resources to the table, distinct from its lending contribution. Thus, this will be an important basis for a “middle-income strategy” in India, just as it has been in the Bank’s relations with other large developing countries.

Pulling against the "middle-income" theme of the Bank's India strategy is largely focused on 'lagging states', basically UP-Bihar-Jharkhand-Orissa, which represents one of the most significant concentrations of poverty anywhere in the world (Woods, 2006). Whatever other goals might crowd the Bank's perennially over-ambitious agenda, this 'other India' is where it must remain engaged if it is to contribute to the realisation of the Sustainable Development Goals. And it is not just the Bank that sees it this way; Indian leaders themselves led the reorientation of the Bank's Country Strategy away from the middle-income reforming states and toward the poorest ones.

Bank's scope in the 'Two India's'

The recent path that has led to the 'lagging states' emphasis in the Bank's strategy for India illustrates, more than ever, the essential asymmetry in the Bank's relationship with its largest borrower. But the lagging states' agenda also exposes, as never before, an uncomfortable ground reality in states like Uttar Pradesh, Bihar, Jharkhand, and Odisha – and the growing gap between "the two Indias." This hard reality does not align well with the image of a "rising power" that India presents to the world. Kapil Kapoor, the then Principal for the South Asia Region on the Bank's Public Sector Governance Board, argued that the Bank's recent assistance strategy in India "has boosted its relevance and legitimacy," but suggests that the divergence between "the two India's" has become the defining challenge in the relationship. "India as a whole may 'graduate' from IDA before Bihar, Orissa, and UP do," he pointed out. "And these are huge states, bigger than many African countries" (2008). India's largest and poorest states are more populous than many African countries, and their development indicators rank alongside those of the continent's weakest. The population of Uttar Pradesh alone is nearing 200 million; if it were an independent country, it would be the fourth or fifth most populous in the world. Poverty rates in rural Bihar and Orissa are comparable to in Burundi, and worse than in Ghana and Malawi.

Conclusion

Since India has officially graduated from IDA in 2017, IDA have received a setback in terms of its relevance. Between IDA's founding and 2020, 37 countries graduated. Another 9 graduated but suffered development reverses and re-entered. Eighty-two countries were recipients in 2019, some of whom received no new money, just disbursements from previously approved allocations. There are 30 fragile and conflict-affected states among the current recipients. Formally, the World Bank's graduation threshold for IDA is an annual per capita income of $1,205; however, this threshold is not applied. Of the 74 countries eligible for new IDA resources in principle, at least 49 have per capita incomes above the threshold. IDA has much to be proud of. But it is now underperforming in the countries with the biggest challenges. If it wants to retain its preferred status as a beneficiary of donor resources in the future, it needs a better offer to the neediest countries: not just in terms of the share of the money they get, but also the products, processes, and systems. and staff too. The case of India reflects what IDA and the Bank as a whole need to do.

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