AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND

POLICY ON EXPENDITURE ELIGIBILE FOR BANK GROUP FINANCING

OPERATIONS POLICIES AND COMPLIANCE DEPARTMENT

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ACRONYMS AND ABBREVIATIONS

ADB	African Development Bank
ADF	African Development Fund
AsDB	Asian Development Bank
CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CFP	Country Financing Parameters
CGP	Country Governance Profile
CPAR	Country Procurement Assessment Review
CSP	Country Strategy Paper
IADB	Inter-American Development Bank
IFAD	International Fund for Agricultural Development
M&E	Monitoring and Evaluation
MDB	Multilateral Development Bank
MTEF	Medium Term Expenditure Framework
OECD/DAC	Organization for Economic Cooperation and Development/ Development Aid Committee
OM	Operations Manual
PER	Public Expenditure Review
PFM	Public Financial Management
PIU	Project Implementation Unit
PRSP	Poverty Reduction Strategy Paper
RMC	Regional Member Country

EXECUTIVE SUMMARY

1. This document proposes a new Bank Group policy on expenditure eligibility for various types of expenditures often incurred in projects where direct procurement activities are necessary. The new policy is in line with current efforts within the Bank Group to focus more on results at all stages of the operations cycle. To that end, its aim is to cut transaction costs and better adapt expenditure that could be financed by the Bank to the development priorities of each regional member country, mainly through the use of country financing parameters.

2. Three types of modifications are proposed in this new policy:

- It is proposed that certain expenditures, which are currently ineligible for Bank Group financing, should become eligible under certain conditions. This is the case with taxes and duties, counterpart funds and provisional expenditures for certain infrastructure projects;

- It is proposed that, for certain expenditures which are currently eligible, the Bank should be more flexible in determining the proportion it can finance. This is the case with recurrent costs and local currency costs;

- Lastly, policy clarifications are proposed for certain expenditures on which eligibility decisions are currently determined by practice. This is the case with a set of other expenditures enumerated in the text.

3. The new policy also contains provisions for safeguarding Bank Group fiduciary standards in its implementation.

4. This new policy reflects the lessons drawn from the experience of the Bank Group and other development partners in expenditure eligibility. Such lessons include the need for flexibility, the need to cut transaction costs, and the importance of recognizing the productivity of expenditure as a key element in determining its eligibility.

5. The new policy will enable the Bank to better respond to the priorities of regional member countries, increase its impact on development, and remain competitive in a rapidly changing development aid market.

6. Lastly, it should be noted that although the specific expenditure items analyzed in this document are representative of the expenditures for which Bank Group financing is often requested, they do not constitute an exhaustive list of expenses that can be submitted to the Bank financing. Consequently, it is the productivity of expenditure and the country's capacity to comply with Bank Group fiduciary standards that will determine eligibility for any expenditure item that is not specifically considered in this policy. These aspects will be well analyzed in the appraisal reports to be submitted to the Boards for approval.

7. The Boards of Directors are invited to consider and approve the expenditure eligibility policy presented in this document.

I. INTRODUCTION

1.1 The aim of this document is to propose a new policy on expenditure eligibility for Bank Group financing. The expenditures concerned are those incurred in projects and programs where provision is made for direct procurement activities. This new policy is in line with Management's efforts to increase the Bank's focus on results through greater alignment of the expenditure eligibility policy on the development priorities of regional member-countries (RMCs). Several other considerations justify the relevance of the new policy; they include the need to remain competitive by harmonizing the Bank's practices with those of other development partners, the need to increase transparency in expenditure eligibility by formulating a clearer policy and, lastly, the need to better guide Bank staff in the selection of expenditures to be financed. These actions should also contribute to the implementation of the Paris Declaration of which the Bank is a signatory.

1.2 This document is organized as follows: Chapter II presents the Bank Group's experience in expenditure eligibility. Chapter III examines the experience of development partners in expenditure eligibility. Chapter IV presents the draft new policy on the eligibility of expenditures for Bank Group financing. Chapter V outlines the implementing arrangements of the policy. Chapter VI indicates the benefits, risks and mitigation measures, while Chapter VII presents the conclusion and recommendations.

II. BANK GROUP EXPERIENCE IN EXPENDITURE ELIGIBILITY

2.1 Expenditures eligible for Bank Group Financing

2.1.1 The key instruments of Bank Group assistance to RMCs (public sector) include: (i) grants/loans for investment projects, institutional support projects, policy-based lending operations, including balance of payment and budget support; and (ii) credit lines. The use of these instruments leads to the financing of certain expenses by the Bank and the country (counterpart contribution). For the Bank, the principle is that all justified expenditures in a project, program or study are eligible, with the exception of taxes and customs duties, expenditures on items on the negative list[1] and expenditures on procurements from non-member countries of the Bank Group.

2.1.2 Bank Group experience in expenditure eligibility shows that:

- Project/program expenditures for which financing is very often requested include: taxes and duties, recurrent costs, local currency costs, foreign exchange costs, counterpart funds, project vehicles, remuneration of PIU staff, compensation in involuntary resettlement assistance, insurance and transport, retroactive financing, second-hand goods, provisional expenses for income-generating socio-economic infrastructure projects;

- Other project/program expenditures for which financing is less often requested include: land, food, late payment penalties, bank charges for special accounts, severance pay, leased assets, current financial costs during construction (FCDC)[2];

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[1] These items concern the following: alcoholic beverages, tobacco, radioactive materials, platinum, pearls, precious stones, gold and related products; nuclear reactors and related products, weapons, ammunition and other goods used for military and/or paramil itary purposes, luxury consumer goods, goods har mful to the environment..

[2] FCDC definition and financing conditions are clarified in the Guidelines for Financial Management and Financial Analysis of P rojects (Chapter 3, page 13) .

- The Bank has fairly clear and well-applied policies on the eligibility of some of the abovementioned expenditure items. These include:

  (i) taxes and duties which the Bank does not finance, because they are considered as income and not expenditure;
  (ii) counterpart funds which are not financed. For ADB countries, the Government's contribution needs to be at least 50% of the project cost unless special circumstances warrant a different percentage[3]. For ADF countries, the contribution needs to be at least 10% of the project and program costs and 5% for studies, unless otherwise decided by the Board of Directors[4]. The aim is to encourage project ownership by the RMCs, and share risks;
  (iii) provisional expenditures[5] on income-generating socio-economic infrastructure projects that the Bank does not finance;
  (iv) local currency costs which the borrower cannot defray and which are mainly (but not in entirely) financed by the Bank. These costs are considered as essential in poverty reduction projects;
  (v) foreign exchange costs, which are entirely funded by the Bank;
  (vi) recurrent costs that the Bank may finance in ADF countries in decreasing proportion during project implementation. The objective is to gradually transfer responsibility for recurrent costs to the borrower following an agreed schedule such that the borrower can bear all costs by the end of the project implementation period, and;
  (vii) the FCDCs that the Bank finances.

- The Bank Group has no clear policies on the eligibility of some other expenditures. This is the case with remuneration of Project Implementation Unit (PIU) staff, project vehicles, land, food, late payment penalties, bank charges for special accounts, severance pay, leased assets, and recurrent costs in ADB countries. The Bank's practices on the eligibility of such expenditures have hitherto been determined by ad hoc guidelines given by Management.

2.2 Lessons to be learnt from the Bank Group experience

The following lessons could be drawn from Bank Group experience in expenditure eligibility:

- Bank Group policies are generally well aligned: On the whole, experience shows that Bank Group policies on expenditure eligibility cover expenditures for which RMCs often request Bank financing;

- Introduce greater flexibility in expenditure eligibility: Another lesson that could be drawn from Bank experience is that existing expenditure eligibility policies are a bit too restrictive, difficult to implement in certain cases, and consequently result in high transaction costs. This is the case with taxes and duties, for example, whose exclusion is difficult to verify during project implementation, especially for the operating costs, recurrent costs, and training activities. Furthermore, the policy of not financing taxes and duties may, in certain cases, undermine the integrity of country budgetary systems. The same applies to the

[3] See ADB Guidelines on Loans and Investments, 1999.
[4] See Guidelines on the Financing Policy under the 10th Reconstitution of ADF Resources. (ADF-X). ADF/BD/WP/2005/55.

[5] Expenditure needed for the operation of constructed infrastructure, before it starts generating revenue.

requirement that countries assume a growing proportion of recurrent expenses and part of the local currency costs. This requirement is sometimes difficult to implement because of the difficulties faced by countries in raising their counterpart funds under satisfactory conditions. These situations undermine the smooth implementation of projects financed by the Bank, and indirectly reduce the contribution that RMCs expect from the Bank Group. All this indicates that the Bank and RMCs would gain from making the Bank's policies more flexible with regard to the type of expenditures it can finance, and the extent to which it can finance certain expenditures;

- Clarify Bank policy for certain expenditures: There is also need to clarify Bank policy on the eligibility of certain expenditures. Examples of expenditures for which the Bank currently has no clear policy are presented in Section 2.1 above. Such clarification would enhance transparency and accountability in project design and implementation and, thereby increase the Bank Group's support to the development efforts of RMCs;

- Adapt eligible expenditures to the special context of each country: RMCs are characterized by the wide diversity of their financing capacities and fiduciary contexts. The Bank needs to address this diversity by adapting the expenditures it can finance to the specific context of each country;

- Continue with harmonization efforts: The Bank also needs to continue harmonizing its expenditure eligibility practices with those of other development partners, in order to preserve its competitiveness in a constantly changing aid market.

III. EXPERIENCE OF OTHER DEVELOPMENT PARTNERS IN EXPENDITURE ELIGIBILITY

In order to ensure development effectiveness and results, the major development partners have focused their concerns on the issue of project and program expenditure eligibility. This is the case with multilateral institutions such as the World Bank, the Asian Development Bank, and the Inter-American Development Bank. The following lessons could be drawn from their experience:

- The expenditure items often submitted to them for financing are practically the same as those submitted to Bank Group financing (see Paragraph 2.1.2 above);

- The three multilateral banks mentioned above recently revised their expenditure eligibility policies;

- The revisions mainly sought to introduce greater flexibility and clarity in their respective policies in order to better adapt to the needs of their borrowing countries;

- The revisions also underscored the requirement to comply with fiduciary standards in the application of the changes introduced; and

- There are no significant differences between the major multilateral banks with regard to expenditure eligibility (Annex VI presents the major expenditure items and their eligibility in multilateral banks).

IV. NEW BANK GROUP POLICY ON EXPENDITURE ELIGIBILITY

4.1 Guiding Principles of the New Policy

4.1.1 Bank Group policy on expenditure eligibility will be governed by a number of key guiding principles. Accordingly, to determine expenditure eligibility, the Bank will continue to ensure that:

- Projects and programs for which its financing is requested attain an adequate level of ownership by the RMCs;
- The country's financing capacity is taken into account through an analysis of the country's budget situation and debt sustainability;
- The expenditure for which Bank financing is requested is productive; that is, it makes an effective and verifiable contribution to the achievement of project objectives;
- An adequate fiduciary control system is established in the project or program to ensure efficiency of expenditure and compliance with the Bank's fiduciary mandate;
- The specific context of the country or sector in which the project will be implemented is taken into account to determine expenditure eligibility. The idea therefore is to proceed on a case-by-case basis, instead of adopting a one-size-fits-all approach; and
- There is a sufficient degree of harmonization with the practices of other development partners.

4.1.2 On the basis of the abovementioned guiding principles, it is proposed that more flexibility and clarity be introduced into the Bank Group's expenditure eligibility policy. Accordingly, it is proposed that: (i) the financing of certain expenditure items not currently financed by the Bank should be authorized; (ii) there should be greater flexibility in determining the extent to which the Bank may finance other expenditure items; and (iii) the Bank's policy on some other expenditure items should be clarified. The different modifications are presented in detail below.

4.1.3 Although the specific expenditure items analyzed below are representative of expenditures for which Bank Group financing is often requested, they do not constitute an exhaustive list of expenditures that could be submitted to the Bank for financing. Consequently, it is the productivity of the expenditure item and the country's capacity to comply with Bank Group fiduciary standards that will determine eligibility for any expenditure item not specifically considered in this policy. These aspects will be well analyzed in the appraisal reports to be submitted to the Boards for approval.

4.1.4 The goods and services on the negative lists (see 2.1.1) and those originating from countries that are not members of the Bank Group will still not be eligible for Bank Group financing.

4.2 <u>Currently non-eligible expenditures for which eligibility has been proposed</u>

4.2.1 *Taxes and Duties*

The principle of exempting Bank-financed projects from taxes and customs duties will remain valid. However, it is proposed that the Bank Group should be able to waive this principle and, on a case-by-case basis, finance taxes and duties associated with project expenditures, if it is satisfied that: (i) the country's tax system has a reasonable level of tax and duty rates; and (ii) the taxes and duties do not constitute a significant proportion of project costs or are not specifically directed at Bank-financed projects, activities or expenses.

4.2.2 *Counterpart Funds*

The principle of cost-sharing between the Bank Group and the RMC is maintained (see Paragraph 2.1.2). However, it is proposed that the ADB should be able to finance more than 50% of the total project/program costs, and the ADF to finance more than 90% of the total project/program costs and more than 95% of the total cost of studies, on a case-by-case basis, up to a limit that does not exceed 100%. The adequate percentage of total costs financed by the Bank will be assessed on a case-by-case basis according to the following criteria: (i) the country's commitment to implement its overall development program; (ii) the financing allocated by the country to sectors targeted by Bank assistance; and (iii) the country's budget situation and debt level.

4.2.3 *Provisional expenditures of infrastructure projects*

At the Government's request, the Bank could consider the possibility of financing the provisional expenditures of income-generating socio-economic infrastructure projects that have been completed and handed over to the borrower. Provisional expenditures are operating costs incurred over a specific period of time until the infrastructure financed with the Bank loan/grant resources starts generating enough resources to cover its own operating costs. The general underlying principle is that the Bank may finance costs up to 100%, on a case-by-case basis, for a period of up to 3 years. Such expenditures will be eligible if the Bank is satisfied that they: (i) constitute an integral part of the project at appraisal; (ii) represent a small percentage of project costs which cannot be financed by the project entity; (iii) contribute to the achievement of the project's development objectives; (iv) can be supported on a sustainable basis by the public or semi-public entity beyond the transitional period.

4.3 <u>Currently eligible expenditures for which greater flexibility is proposed in determining the proportion that the Bank may finance</u>

4.3.1 *Recurrent costs*

While maintaining the current eligibility of recurrent costs, it is proposed that the Bank Group should be able to finance the recurrent costs of income-generating and non-income generating projects, up to 100%, on a case-by-case basis. The rationale for this proposal is that operations in the RMCs generally have a high recurrent cost component. These costs will be financed if it can be shown that they are: (i) an integral part of the project; (ii) necessary for achieving project development objectives; and (iii) productive in the specific project financed. The percentage of financing to be borne by the Bank Group will depend on the country's financial situation (especially the country's commitment and ability to provide continued financing for recurrent expenditures after Bank financing is completed), or on the financial situation of the project management entity or entities for income-generating projects. Accordingly, Bank staff will continue to calculate the estimated recurrent costs and clearly indicate ways and means of ensuring sustainable financing.

4.3.2 ***<u>Local currency costs</u>***

Local currency costs remain eligible for Bank Group financing. The financing policy for local currency costs will continue to be guided by macroeconomic considerations (country's financial situation) and project specificities. Consequently, the Bank will continue to finance expenditures in local currency if: (i) the financing requirements for the country's program exceed the public sector resources (that is, proceeds from taxes and other revenues) and the expected domestic borrowing level; and (ii) the financing of foreign exchange costs alone are not enough to ensure effective implementation of the project under consideration. It is proposed that where all these conditions are fulfilled, the Bank should be able to finance the local currency costs up to a proportion deemed necessary for achieving the project objectives.

4.4 <u>Expenditures for which it is proposed that Bank Group eligibility policy should be clarified</u>

4.4.1 ***<u>Remuneration of PIU staff</u>***

It is proposed that clarifications be made indicating that where the establishment of a parallel PIU is inevitable, the remuneration of its staff will be eligible for Bank financing. The rationale is that such expenditures may be productive since they are necessary for the achievement of project objectives. The financing of allowances (for civil servants on secondment) or fees (for private consultants) will be subject to the following elements: (i) valid justification for the establishment of a parallel PIU and the productive nature of the expenditure; (ii) the existence of an acceptable performance contract between the PIU staff and the Government; and (iii) the competitive nature of the staff recruitment process. Where a Government structure (country system) is used for the implementation of operations, the remuneration of the staff working in that structure is not eligible for Bank financing.

4.4.2 ***<u>Project vehicles</u>***

It is proposed that clarifications be made indicating that expenditures on the procurement and maintenance of project vehicles are eligible for Bank financing, so long as such expenditures are deemed productive. Consequently, the Bank will continue to finance the procurement of project vehicles if it is satisfied that the vehicles can be effectively used for achieving the project objectives. The decision to finance such expenditures will be taken after appraisal of the viability of the country's public finance situation, and its track record in sharing project costs and managing recurrent costs related to the use of project vehicles financed by the Bank.

4.4.3 ***<u>Late payment penalties</u>***

It is proposed that clarifications be made indicating that late payment penalties to suppliers or vendors are eligible for Bank financing if they are justified. The rationale is that these penalties may arise in the normal course of business, and that the Bank may sometimes be responsible for payment delays to suppliers or vendors. Bank financing will be based on the effective existence of the contracts concerned, identification of the cause of delay, measures taken to address such delays in future and, lastly, the availability of funds.

4.4.4 ***<u>Bank charges for special accounts</u>***

It is proposed that clarifications be made indicating that bank charges for special accounts for the entire period of project implementation are eligible for Bank financing. The rationale is that special accounts are opened solely for the purpose of implementing Bank-financed projects, and that bank charges are a regular component of normal project costs.

4.4.5 *Severance pay*

It is proposed that clarifications be made indicating that severance pay is eligible for Bank Group financing if the Bank Group and the Government agree on a public sector reform program. The Bank Group may finance severance pay within the context of a public enterprise reform program expected to result in an increase in public sector productivity. In financing severance pay, the Bank will consider factors such as the impact and sustainability of the public sector reform program, which includes proposed staff reductions, and the conclusions of an economic analysis of the costs and benefits.

4.4.6 *Leased assets*

It is proposed that clarifications be made indicating that leased assets are eligible for Bank financing. The rationale is that it may be more efficient and more economical in some projects to resort to alternative solutions instead of purchasing capital goods or operating property. For example, financing leases could be an attractive alternative way of acquiring fixed assets. Before financing leased assets, the Bank will assess if leasing is the most appropriate way of acquiring the assets. If the Bank feels that this is the case, it will look for the most appropriate lease option (capital or operating)[6] taking into consideration the duration of the lease contract in comparison to the duration of the project. With regard to contract award and financial management, procurements will be made in accordance with Bank regulations.

4.4.7 *Food*

It is proposed that clarifications be made indicating that food for human consumption and expenditures for the production, storage and distribution of food are eligible for Bank financing. The rationale is that averting or correcting under-nutrition and malnutrition is essential for economic and social development. Bank funding of food expenditures may be appropriate if food supply is an essential component of a project designed to combat malnutrition, if such financing is deemed to be the most feasible and cost-effective alternative for achieving the set objectives, and if the food supply can be limited exclusively to persons belonging to a given target group.

4.4.8 *Land acquisition*

It is proposed that clarifications be made indicating that land acquisition for a project is eligible for Bank financing. Indeed, the related expenditure may be necessary for achieving the development objectives of the project. Land costs are expected to be financed by the borrower's counterpart contribution, and the Bank's commitment to finance such costs must take this consideration into account. Bank financing of land acquisition will be carefully considered by the Operations Committee. In financing land acquisition, the Bank will ensure that this option remains the most cost efficient after considering certain elements such as: (i) the country's land tenure system and legal land ownership situation; (ii) the project objectives; (iii) the productivity of the land; (iv) the growth and liquidity prospectus of the land market; (v) land acquisition risks; and (vi) monitoring/evaluation arrangements.

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[6] The capital lease is a lease paid on property for a period covering most of its active life. The operating lease is one paid on property for a short period. It is comparable to rent for the property.

V. IMPLEMENTATION ARRANGEMENTS

5.1 General Guidelines

5.1.1 The new policy will be implemented according to the following procedure:

- Since expenditure eligibility will depend on the context of each country, the country financing parameters (CFPs) will guide expenditure eligibility decisions;

- the Bank will use CFPs already developed by the World Bank for 38 African countries (Annex II). For example, Annex IV proposes the CFPs for Gambia;

- For countries with no CFPs, an operation memorandum will be prepared in collaboration with the World Bank to guide expenditure eligibility in such countries;

- Since the World Bank's CFPs cover only cost-sharing and three other expenditure items (local currency costs, taxes and duties, and recurrent costs), the staff will be guided by the current Bank policy for other eligible expenditures and the CFP preparation guidelines prepared by the World Bank for its staff[7]. The Bank Group will supplement these guidelines with those governing provisional expenditures on infrastructure projects, remuneration of PIU staff, and project vehicle costs. These technical guidelines will be made available to Bank Group staff. For example, Annex V presents the procedure for defining and revising new CFPs.

5.1.2 Since the Directors of Regional Departments closely monitor the macroeconomic and portfolio performance of RMCs, they will, in coordination with the World Bank, ORPC and other departments concerned, be responsible for: (i) disseminating and reviewing the existing CFPs, and (ii) screening expenditures eligibility in projects/programs. Once the CFPs are disseminated, they will be applied to the financing of new operations. For each of the first two years following introduction of the new policy, the Regional Departments will prepare an annual implementation progress report. The report will, in particular, present the lessons learnt from implementation of the Bank's new expenditure eligibility policy, as well as an assessment of the implementation of similar policies at the World Bank.

Box 1:
Definition of Country Financing Parameters (CFP)

CFPs are expenditure eligibility parameters defined for each country according to its individual situation. They are part of efforts to tailor expenditure eligibility to specific country needs, rather than adopt a standard approach for all countries. The objective of these parameters is to establish the overall framework for Bank financing of all projects in a particular country. The parameters themselves depend on several factors, including the macroeconomic situation of the given country, its particular development needs, its fiduciary environment as well as all other specific arrangements made by the Bank in collaboration with its RMCs. The World Bank CFPs for Gambia are provided in Annex IV for illustration.

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[7] See World Bank (2004). "Bank financing Guidelines to staff" April 2004, OPCS, Washington DC

5.1.3 These arrangements are intended to ensure consistency and facilitate harmonization with sister institutions, such as the World Bank. The Bank Group Operations Manual and the Country Strategy Paper (CSP) will reflect the new policy and CFPs. The new policy on eligibility of taxes and duties is taken into consideration in the review of the General Conditions applicable to the sovereign loans and grants of the Bank Group.

5.2 Institutional and Fiduciary Oversight Implications

5.2.1 *Institutional capacity building:* To implement this new policy, the Bank will make efforts to accelerate the implementation of its institutional reforms, strengthen the analytical capacities of staff and RMCs through training and institutional support, and reallocate the necessary resources to reinforce the Bank's operational review processes. Furthermore, collaboration initiatives between the Bank and other development partners, such as the World Bank, would be encouraged.

5.2.2 *Fiduciary oversight:* Increasing flexibility in expenditure policies requires strong fiduciary oversight. *At the country level*, the challenge for the Bank is to ensure that borrower systems provide sufficient guarantee that expenditures financed by contributions from the Bank and Government are appropriately incurred for project purposes in order to attain development objectives. The country team would be required to assess, along with other donors, the country's financial management system using the existing relevant instruments (CFAA, CPAR, PERs, and CGPs, PEFA, etc.) either at the CSP stage or at any other moment. In order to strengthen fiscal sustainability, the Bank will continue to work closely with other donors to consolidate all aspects of the public finance management (PFM) system in RMCs, including fiscal revenue collection, budgetary planning and implementation, project management, procurement, debt management, accounting and control. The CFPs discussed earlier will take into account the overall quality of budget management and fiduciary network. *At the project level*, Bank staff would be required to ensure that loan resources are used only for the purposes for which the loans are granted, with due attention to considerations of economy and efficiency, and to assess and monitor the financial management - an activity that includes auditing and reporting on the capacities of project implementation agencies. This audit would be folded into the due diligence process followed during project preparation and implementation. Staff and document review groups would continue to assess the quality assurance at-entry of projects.

VI. BENEFITS AND RISKS

6.1 Benefits

The proposals contained in this document would better align the expenditures eligible for financing on the needs of borrower countries and improve the competitiveness of the Bank Group. The Bank and the countries stand to gain a lot from the proposals contained in the new policy and from the reduced transaction costs. The CFPs are useful for streamlining the choice of eligible expenditures when preparing projects. Furthermore, they help to ensure the establishment of relevant oversight arrangements for risk management and the proper use of Bank financing. The Bank will gain from this initiative through improved effectiveness in the delivery of development assistance in RMCs.

6.2 Risks and Mitigating Factors

The main implementation risk of the proposed new policy is that acceptable fiduciary arrangements may not be put in place to ensure that loan proceeds are effectively used for the intended purposes. The impact of this risk could be mitigated by many factors. *First*, many RMCs are already committed, through current donor-financed programs, to improving their public finance management systems. *Second*, the Bank's determination of appropriate country financing parameters (CFPs) will take into account the overall quality of budget management and fiduciary framework, given that different countries have different performance in these areas. *Third*, the Bank is currently improving its operational business process to capture new best practices. *Lastly*, the Bank's ongoing decentralization policy, which allows for the opening of more field offices, will facilitate implementation of these recommendations. For countries that do not have field offices, the Bank would monitor the fiduciary conditions through enhanced coordination of its operations with those of other development partners, in particular the World Bank.

VII. CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusion

7.1.1 The new policy on expenditure eligibility moves the Bank's current focus from a slightly restrictive to a more suitable framework that gives it the flexibility required to finance expenditures that are both appropriate in the country context and necessary to meet the development objectives of operations supported by Bank financing. The new expenditure eligibility policy, under certain conditions, proposes financing of the following expenditures: taxes and duties, counterpart funds, and provisional expenditures for income-generating socio-economic infrastructure projects. Greater flexibility is also proposed in the financing of recurrent and local currency costs under certain conditions. This document also makes proposals for clarifying the conditions under which the Bank may finance other eligible expenditures, especially those related to project vehicles, remuneration of PIU staff, late payment penalties, bank charges for special accounts, severance pay within the framework of public sector reforms, leased assets, land acquisition, food and interest during construction. Furthermore, it outlines the implementation arrangements of the new policy. The proposals, including implementation arrangements, are fully harmonized with practices of other development partners, particularly the World Bank, to ensure consistency and minimize transaction costs.

7.1.2 Once the new policy is adopted, Management will: (i) provide staff with the CFPs and CFP technical guidelines prepared by the World Bank, while ensuring that they are in conformity with the present policy and the Bank's rules of procedure; (ii) prepare, in collaboration with this institution, operational memorandums for countries with no CFPs; (iii) propose the review of the General Conditions applicable to the sovereign loans and grants of the Bank Group for taxes and customs duties; and (iv) take into account the new policy in the Operations Manual, and ultimately in other policy papers and operational guidelines.

7.2 Recommendations

Management believes that the proposed changes will enable the Bank to further enhance development effectiveness in RMCs and its competitiveness within the community of development partners. The Board is therefore invited to consider the proposed policy on eligible expenditures financing, and to approve the proposals as presented in this document.

ANNEXES

Annex I

BANK GROUP POLICY ON EXPENDITURE ELIGIBILITY
SUMMARY OF MAIN PROPOSALS

Selected Expenditure Items	**Current Status**	**Proposals**
1. Counterpart funds	Not eligible	Eligible under certain conditions
2. Taxes and customs duties	Not eligible	Eligible under certain conditions
3. Provisional expenditures on infrastructure projects	Not eligible	Eligible under certain conditions
4. Local currency costs	Eligible with restrictions	Eligible with new flexibility
5. Recurrent costs	Eligible with restrictions	Eligible with new flexibility
6. Remuneration of PIU staff	Eligible, but with streamlining problem	Eligible with new policy statement
7.Vehicles	Eligible, but with streamlining problem	Eligible with new policy statement
8. Severance pay	Eligible. Rarely financed. Eligible, No policy statement.	Clarification. Eligible with new policy statement.
9. Late payment penalties	Eligible. Rarely financed. Eligible, No policy statement.	Clarification. Eligible with new policy statement.
10. Bank charges for special accounts	Eligible. Rarely financed. No policy statement.	Clarification. With new policy statement.
11. Land acquisition	Eligible. Rarely financed. No policy statement.	Clarification. With new policy statement.
12. Food	Eligible. Rarely financed. No policy statement.	Clarification. With new policy statement.
13. Leased assets	Eligible. Rarely financed. No policy statement.	Clarification. With new policy statement.
Second-hand goods, involuntary resettlement assistance, insurance and transport, retroactive financing	Eligible. No policy statement.	No change

ANNEX II

38 RMCs FOR WHICH COUNTRY FINANCING PARAMETERS HAVE BEEN ESTABLISHED (by the World Bank)

1. Angola
2. Benin
3. Burkina Faso
4. Burundi
5. Cameroon
6. Cape Verde
7. Central African Republic
8. Comoros
9. Congo, Democratic Republic of
10. Congo, Republic of
11. Djibouti
12. Egypt
13. Ethiopia
14. Gabon
15. Gambia
16. Ghana
17. Guinea Bissau
18. Lesotho
19. Liberia
20. Madagascar
21. Malawi
22. Mali
23. Morocco
24. Mauritius
25. Mauritania
26. Mozambique
27. Niger
28. Nigeria
29. Uganda
30. Rwanda
31. Sao Tome and Principe
32. Senegal
33. Sierra Leone
34. Tanzania
35. Chad
36. Tunisia
37. Zambia
38. Zimbabwe

Sources: World Bank (2005, 2006)

ANNEX III

EXPENDITURE ITEMS FOR WHICH GUIDELINES TO STAFF AND CFPs HAVE BEEN PROVIDED BY THE WORLD BANK

EXPENDITURE ITEMS FOR WHICH GUIDELINES TO STAFF EXIST:

1. Cost sharing
2. Recurrent costs
3. Local cost financing
4. Taxes and duties
5. Land
6. Food expenditures
7. Severance pay
8. Interest during construction
9. Second-hand goods
10. Leased assets
11. Late payment penalties

EXPENDITURE ITEMS FOR WHICH CFPs ARE AVAILABLE:

1. Cost sharing
2. Recurrent costs
3. Local cost financing
4. Taxes and duties

2. THE WORLD BANK'S PROCEDURE FOR IMPLEMENTING THE POLICY

2.1 To implement the policy, a framework for expenditure eligibility has been set out in a new operational policy statement and Bank procedures statement (OP/BP 6.00, *Bank Financing).* It has been complemented by the technical guidance to staff with respect to setting CFPs and making decisions on financing selected expenditure types in individual projects. A series of management reviews has been put in place for both country- and project-level financing decisions, adapted to the risks of the activities concerned. These decisions would be transparent – in the case of country-level decisions, through the SAP and a CFP website maintained by the Operations Policies and Country Services (OPCS); and in the case of project-level decisions, through disclosure project appraisal documents. For each of the first two fiscal years after introduction of the new policy, Management has to prepare for discussion with Executive Directors a review of implementation experience, and identify any areas where changes may be needed. More detailed information on the implementation arrangements has been provided to Executive Directors separately.

2.2 CFPs for 38 African countries have been established. An operational memorandum has been prepared to guide expenditure financing for countries that do not have CFPs. CFPs are prepared on an as-needed basis. The established CFPs cover cost sharing (counterpart funds), local currency costs, taxes and duties, and recurrent costs, as recommended by the Board of Directors. The CFPs note for these priority expenditure items is annexed to the Country Strategy Paper (CSP) or constitutes a stand alone paper. C ountry teams have the responsibility to determine, on a country-by-country basis, the CFPs for the remaining expenditure items. The stand alone paper CFPs are published in the internal website. Once the Bank establishes CFPs for a given country (on cost sharing, recurrent costs financing, local cost financing, and taxes and duties) – that is, after the Regional Vice-President has approved them and notified the Executive Directors – the policy will apply to all projects appraised in that country. The policy may then be applied to other projects under preparation or implementation in that country, if: (a) the borrower so requests; and (b) the Bank considers the proposed change to be justified in terms of meeting the objectives of the projects, and when the benefits exceed the costs of changing such projects

The Gambia: Country Financing Parameters prepared by the World Bank
Background Note

Summary

1. This note describes the application of the new policy for expenditure eligibility in World Bank financing for The Gambia program by outlining the financing parameters for the country. The new framework allows the Bank[8] to finance expenditures needed to meet the development objectives of the operations it supports, within an overall framework that addresses risks related to fiscal sustainability and the appropriate use of Bank resources, in a way that is consistent with the Articles of Agreement. The new policy increases the Bank's flexibility to allow the use of Bank loan proceeds for a number of expenditures. It rests on three guiding principles: (a) the expenditures financed from the Bank loan proceeds are productive; (b) the impact of operations financed under such loans on the borrowing country's fiscal sustainability is acceptable; and (c) oversight arrangements on the use of Bank funds are acceptable.

2. The Gambia's country team is satisfied with the new policy. Discussions were held with officials of the Department of State for Finance and Economic Affairs (Ministry of Finance) and with the staff of various projects funded by the Bank. On the whole, the new policy was well received and the authorities were satisfied with its main aspects. The country team will make use of its greater financing flexibility, especially for the health and community development project which is being designed. However, there is need to monitor debt and public finance management carefully, in order to guarantee the sustainability of Bank initiatives. Cost sharing and the financing of local currency costs could be reinforced. The need to finance recurrent costs as well as taxes and duties will be assessed on a case-by-case basis.

Context

3. Recent macroeconomic performance has been strong, according to the fiscal and monetary indicators. Real GDP has been growing by an average annual rate of 5.7% since contracting by 3.2%t in 2002. The authorities regained fiscal and monetary discipline characterized by low fiscal deficits, low inflation and a stable exchange rate. The overall fiscal balance averaged a deficit of 4.6 percent of GDP the past three years. Primary balance indicates an even stronger performance, highlighted by a surplus of 9.6 percent in 2004 and a project 9.0 percent in 2005. With the stabilization of the economy, it will be crucial for the authorities to focus on implementation of the PRSP program, including the strengthening of public financial management (PPM).

4. The Gambia is a HIPC country and reached its Decision Point in November 2000. The most recent update of the debt sustainability analysis conducted by the Fund for its 2005 Article lV indicated that the authorities will have to place a top priority in achieving public and external debt sustainability. While all key ratios for gauging sustainability are projected to decline, they are expected to remain above the sustainability threshold for poorly performing, low income countries. Hence, meeting external financing needs through non-debt-creating flows would mitigate the current situation. At present, new Bank assistance to the country will consist only of grants.

5. The PRSP was finalized in May 2002 and discussed by the Executive Boards of the Bank and the Fund in July 2002. The main objective of the PRSP is to reduce poverty by promoting growth and employment through private sector development, enhanced provision of social services, strengthened governance, community development, and mainstreamed cross-cutting policies for

[8] i.e. the World Bank

gender, HIV/AIDS, population and the environment. The main priority sectors are agriculture, education and health. The PRSP's poverty analysis indicates that the focus of the strategy should be the rural agricultural sector, particularly groundnut farmers. The first PRSP Progress Report was finalized in December 2004, and the Bank and the Fund produced a Joint Staff Advisory Note (JSAN) which highlighted the need to accelerate implementation.

6. The current Country Assistance Strategy (CAS) 1 was approved by the Bank's Board of Directors in February 2003. Its overall objective is to support the implementation of the country's PRSP, focusing on improving public expenditure management (PEM), enhancing the equity and quality of service delivery, and

promoting private sector led growth. The base case lending scenario called for US$ 25 million of new IDA lending for FYO3-05 covering the areas education, health, and CDD. In addition to these areas under the base case, the high case called for an energy sector project and an economic reform budget support operation which would increase IDA lending to US$ 37 million. The country at present remains in the base case.

7. Improving PFM remains a key focus of the reform agenda in the country. The authorities have been implementing public revenue and expenditure management reforms with the support of the donors, including the Bank through it Capacity Building for Economic Management Project (CBEMP). Recent diagnostics such as the Country Financial Accountability Assessment (FY03), the second HIPC AAP (FY04) and the Public Expenditure Review (FY04 and FY05) indicate that the authorities need to strengthen their REM capacity. In the second HIPC AAP, four out of the sixteen benchmarks were met. The PER indicated that updating the public accounts, upgrading the present PEM IT system and eventually implementing a medium term expenditure framework will be essential to ensuring proper implementation of the PRSP. Based on the recommendations of recent diagnostics, the authorities are presently implementing a reform agenda focused on integrating the recurrent and development budgets, improving the realism of the budget, updating the public accounts, and establishing a national Revenue Authority. The authorities should continue to carefully consider the recurrent cost implications of new spending proposals. Donor financing are in general fairly well integrated into the Government's budget, although integration of some external grants should be further improved.

8. The Gambia is an average performer in Sub-Saharan Africa with respect to its policies, institutions and governance according to the latest CPIA ratings. The Bank's portfolio totals US$ 61 million, of which USS 37 million was disbursed as of October 2005. The portfolio consists of four projects in economic management capacity building, municipal development, trade gateway, and HIV/AIDS, with currently three out of the four projects rated satisfactory. There are currently two projects in the lending pipeline, an education project and a combined Community Driven Development (CDD)-health project.

9. Continued improvements in portfolio performance will depend on maintaining Government commitment to proactive project management and capacity building in the public sector. DOSFEA indicated that it would conduct regular multi-sectoral meetings to closely monitor implementation progress of the projects, and the planned Country Portfolio Performance Review (CPPR) will present an opportunity to further implement measures to improve project performance. Given the flexibility of the proposed CFP, the Bank could consider tightening financing parameters if there are indications of reduced Government ownership and commitment, or the Bank could utilize alternative measures such as: completing critical actions upfront; involving beneficiaries, such as the local government and communities in planning, implementation and monitoring; ensuring inclusion in the PRSP and the Government's budget; and regular consultations between senior Bank and senior government officials.

Cost Sharing

10. The maximum cost sharing by Bank financing would be set at 100 percent of individual projects, but most projects are expected to include contributions from the Government and cost sharing arrangements for individual projects will be based on project specific considerations.

11. The Bank currently provides on average financing up to 90 percent of the total cost of projects, with up to 100 percent for certain categories of expenditures. The Bank financed projects are aligned with the country's overall development program outlined in the PRSP. The enhanced flexibility provided by the 100 percent cost sharing ceiling would be particularly appropriate for the CDD operation currently being prepared, but typically the authorities would be expected to contribute some share towards the cost of the project to encourage local ownership and commitment. Cost sharing arrangements for the two projects in the lending pipeline are in general expected to be similar to those of the current ongoing projects where foreign costs are financed at or close to 100 percent while local costs are typically financed a lower share. Hence, in general setting the maximum cost sharing at 100 percent is not expected to result in increased level of Bank financing, particularly given that combining the two projects in health and CDD has already resulted in reduced overall financing. Any further need for adjustment due to higher cost sharing can be met by reducing project sizes.

12. The country's public expenditure spending indicates that the authorities are committed to funding the development program, but donors are an important source of financing due to resource constraints. Based on preliminary figures, the Central Government from 2002 to 2004 spent on average 6.3 percent of GDP on the development program, comprised of 1.4 percent of GDP on development expenditures and 4.9 percent on recurrent expenditures in social and economic services. External assistance provided 6.8 percent of GDP on development expenditures. Thus domestic funding on average financed 48 percent of the total development program, a fairly high figure given the recent emphasis on restraining expenditures. It indicates that the authorities are committed to its development program. Bank and other donor financing are fairly well integrated into the Government's budget. The authorities are continuing to make efforts to improve the quality of the budget process such that the recurrent and development budgets are better integrated, public accounts are comprehensive and timely, and the budget is more realistic.2 Bank financed projects are aligned with the PRPS. There are no taxes or duties that the Bank would not be willing to finance.

Recurrent Cost Financing

13. There should be no country level limit to recurrent cost financing. Recurrent cost financing would be determined by project specific considerations. In particular, the Bank will take into account impact on fiscal and debt sustainability as well as sustainability issues at the sector and project levels in determining Bank financing of recurrent costs in individual projects. The Bank's new assistance will have minimal direct impact on fiscal and debt sustainability given that they will be provided as grants. The recent return to fiscal discipline, as evidenced by relatively low fiscal deficits and historically high primary balances, indicate that the country has been proactive in improving its debt sustainability situation. The country already fully funds recurrent costs from its own resources, as the recurrent budget in 2004 was 17.7 percent of GDP while the domestic revenue was 20.1 percent

14. Currently the Bank finances only the development budget, but in reality the development budget is a mixture of current and capital expenditures and therefore the Bank has already been financing current expenditures which have. recurrent characteristics. Examples of Bank financed current expenditures include training, workshops, material and supplies and transport cost.

However, the Bank currently does not directly fund the recurrent budget, including salaries of civil, servants. Formally allowing for recurrent cost financing would increase the flexibility of Bank projects in financing current expenditures which are integral to the success of the projects. The allowance for recurrent cost financing would encourage more transparent reporting of public expenditures through proper classification of current expenditures included in the development budget, and greater integration of the recurrent and development budgets in the Government's budget. However, in general only short term recurrent expenditures which are necessary for project implementation are expected to be financed, and hence the level of recurrent cost financing in Bank projects is not expected to be significant. In general, ongoing recurrent expenditures of the central government are not expected to be financed under the new policy, but the CDD project will explore the possibility of financing recurrent costs of local governments given their lack of resources.

15. The recurrent budget is relatively better prepared and executed than the development budget. The authorities continue to make efforts in improving the capacity of their overall budget process. Overall aggregate fiscal control has improved with the recent implementation of a cash budgeting system, but the possible adverse impacts of the system on budget preparation, bureaucratic burden, service delivery and managerial autonomy of spending agencies should be monitored. The authorities need to more carefully consider the recurrent cost implications of new spending proposals in order to ensure sustainability.

16. The experience in the past indicates that the implementation of Bank projects has generally been satisfactory with respect to development outcomes, but there have been some exceptions with respect to sustainability of project initiatives. One notable exception is the most recent project in agriculture which closed in 1999. High recurrent costs seemed to have been one of the factors which undermined sustainability of the project. In response, the Bank's current reengagement in the agricultural sector through a CDD project supports local level initiatives with lower and more sustainable recurrent cost implications.

Local Cost Financing

17. The Bank would finance local costs because the country satisfies the two requirements for local cost financing. At present, Bank projects generally finance 100 percent of foreign expenditures, but the share of Bank financing for local expenditures are generally less than 100 percent. The exact share of local cost financing varies categories, but range from 40 to 90 percent for goods, 70 to 100 percent for consultants and training, and 70 to 90 percent for civil works. Greater flexibility in local cost financing would eliminate any perverse incentives for the borrower to prefer foreign over local expenditures as the former is financed at 100 percent.

18. The country satisfies the first requirement that its development program exceeds the public sector's own resources and expected domestic borrowing. According to preliminary figures for the 2005 budget, the development program is expected to be approximately 13.3 percent of GDP. in 2005, and domestic revenue and domestic borrowing are expected to be 21.6 percent of GDP.3 However, the develop program should be considered larger than the domestic revenue and domestic borrowing for the following reasons. First, development budget, in the 2005 budget was drastically reduced in order to meet the Government's fiscal balance targets, and therefore it does not adequately reflect the country's true development needs. Preliminary figures indicate that the development program was initially approximately 18.2 percent of GDP for the 2005 budget. Second, even the initial figure budgeted for the development program is significantly smaller than what would be needed to implement the development agenda outlined in the PRSP. The projected financing gap in 2005 for implementing the PRSP is 5.5 percent of GDP, which would increase development program to 23.7 percent of GDP. The estimate for the development program is based on the expected development budget and the expected recurrent budget for social and economic

sectors. The expected recurrent budget for 2005 is assumed to be the average for the three previous years, 4.9 percent of GDP, based on preliminary figures reported in the PER (FY04). Third, the authorities need to reduce their reliance on domestic borrowing in order to reduce their large domestic debt services. Reduced domestic borrowing would further reduce the coverage of the development program by domestic resources.

19. The country satisfies the second requirement that the financing of foreign expenditures alone would not enable the Bank to assist in the financing of individual projects. As indicated in paragraph 17, Bank projects currently finance a large proportion of local expenditures M a result, disbursements against local costs accounted for 81, 64 and 73 percent of total investment lending disbursements in FY02, FY03 and FY04 respectively. Hence, it would not be realistic to expect the country to provide significant additional amounts of its own funds to finance local expenditures given its tight resource constraints. The projects that are currently in the lending pipeline will continue to include many activities such as civil works and goods which have large shares of local expenditures, and therefore allowing flexibility in local cost financing will be crucial in enabling the Bank to assist in the financing of individual projects.

Taxes and Duties

20. There are no taxes or duties that the Bank should not finance. At the project level, the Bank would consider whether taxes and duties constitute an excessively high share of projects costs.

21. Taxes are generally considered reasonable, although there are a large number of sectoral taxes and duties which should be consolidated and rationalized4. The income tax is progressive, ranging from 0 percent up to 35 percent according to the level of income. The income tax base should be broadened. The corporate tax is the higher of 35 percent of profits or 3 percent of turnover. The sales tax is 15 percent on most goods and some services, is percent for telecommunication services, and 10 percent on imports Import tariffs are moderate and consist of three non-zero bands with 18 percent the highest rate. However, instances of use of discretion in duty exemptions should continue to be monitored. There are a number of sectoral taxes and fees, such as the tourism tax, stamp duty, entertainment tax and license fees. A new Income and Sales Tax Act was enacted in 2005 which improves the tax regime and tax administration. There are several benefits to allowing Bank financing of local taxes and duties, including reduction of transaction costs and elimination of distortions

22. There is no differential tax treatment of Bank supported activities, and there are no major issues related to tax administration which would impact consideration of Bank financing of taxes and duties. The authorities are initiating a major tax regime administrative reform in, the form of a national Revenue Authority. The Bank would have the option of modifying the Percentage of Bank financing for projects depending the outcome of such major tax reforms, but at present the proposed reforms are not expected to entail any major changes to Bank financing. Changes in the local tax regimes will need to be monitored as decentralization progresses as they could impact the CDD-health project currently in the pipeline. At the project level, the Bank would consider whether taxes and duties constitute an excessively high share of projects costs, and make necessary adjustment during the project preparation phase to ensure that taxes are not being financed.

The Gambia — Diagnostic Assessment of Investment Climate. Foreign Investment Advisory Service, World Bank, June 2004.

The Gambia: Country Financing Parameters

Item	Parameter	Remarks/Explanations
Cost sharing: Limit on the proportion of individual project costs that the Bank may finance	Up to 100%	Based on Gambia's external financing requirements to meet PRSP objectives, we expect some projects will require at least some components to be 100 percent financed by the Bank. However, the Bank will continue to place an emphasis on cost sharing, including through counterpart funding contributions and cofinancing of individual projects, in order to encourage Government ownership. In addition, the Bank will consider alternative measures that would assure ownership and commitment, but also provide added flexibility. Possible measures could include: completing critical actions upfront; involving beneficiaries, such as the local government and communities in planning, implementation and monitoring; ensuring inclusion in the PRSP and the Government's budget; and regular consultations between senior Bank and senior Government officials.
Recurrent Cost Financing: Any limits would apply to the overall amount of recurrent expenditures that the Bank may finance	No country level limit	Recurrent cost financing will be determined by project-specific considerations. Generally, only short-term recurrent expenditures necessary for project implementation have been – and are expected to be – financed, and hence the level of recurrent cost financing in Bank projects is not expected to be significant. However, in preparing the CDD project, the possibility of financing recurrent costs of local governments will be explored. In determining Bank financing of recurrent costs in individual projects, the Bank will take into account sustainability issues at the sector and project levels.
Local Cost Financing: Are the requirements of local expenditures met, namely that: (i) financing requirements for the country's development program would exceed the public sector's own resources (e.g. from taxation and other revenues) and expected domestic borrowing; and (ii) the financing of foreign expenditures alone would not enable the Bank to assist in the financing of individual projects.	Yes	The two requirements for Bank financing for local expenditures are met. The Bank can therefore finance local costs in the proportion needed in individual projects.
Taxes and Duties: Are there any taxes and duties that the Bank would not finance?		The current taxes and duties are generally not unreasonable. Changes in the local tax regimes will need to be monitored if decentralization progresses. At the project level, the Bank will consider whether taxes and duties constitute an excessively high share of project costs, and make necessary adjustment during the project preparation phase to ensure that taxes are not being financed.

Source: World Bank (2005)

Annex V

PROCEDURE FOR PROCESSING NEW COUNTRY FINANCING PARAMETERS

1. Objectives: The aim is to propose a general procedure for establishing CFPs. It will be useful, *inter alia*, for preparing CFPs for bank charges for special accounts (not prepared by the World Bank) and those for project vehicles, remuneration of PIU staff and provisional expenditures for income-generating socioeconomic infrastructure projects (specific to the Bank).

2. Country Financing Parameters: CFPs are parameters established for each country according to its individual situation, and represent an effort to tailor eligibility of costs to specific country needs, rather than apply a one-size-fits-all approach. The objective of these parameters is to establish the overall framework for Bank financing of all projects in a particular country. The parameters themselves depend on several factors, including the macroeconomic condition of the given country, its particular development needs, and the legal framework and any other specific arrangements established by the Bank in collaboration with its RMCs.

3. Guidelines to staff to construct new CFPs: The guidelines to staff will be the basis upon which Bank's staff will proceed to construct CFPs. They will be flexible enough to allow staff to exercise professional judgment, and to allow adjustment, if circumstances so require, during policy implementation. The World Bank's guidelines will be used for the aforementioned eligible expenditure items. For expenditures not covered by the World Bank's guidelines, an interdepartmental working group will be established to prepare the Bank's guidelines.

4. Procedure for establishing and reviewing new CFPs: Regional departments, supported by country teams, would process these CFPs based on the guidelines to staff, and in consultation with RMCs. This work would be an integral part of CSP development, although for some RMCs, it would be carried out as a stand-alone exercise. The Bank's Country Teams would work closely with their development partners, particularly the Operations Complex Country Teams at the World Bank, to determine and review the parameters. The objective would be to adopt similar criteria and methodologies, without duplicating assessments. This would ensure consistency, accelerate harmonization and reduce transaction costs for RMCs. If the new CFPs are defined as part (i.e. in an Annex) of the CSPs, procedures for approval of these documents will be followed. If the CFPs are established as a stand-alone exercise, in consultation with RMCs, the proposals and corresponding supporting note would be submitted by Regional Directors to ORVP for approval. The Regional Departments would then post each CFP to the Bank's internal website, after consulting with the associated RMC. If changes need to be made to the new CFPs, these would be undertaken by Country Teams and would become effective when approved by ORVP in an Operational Memorandum.

5. Sources of Information: In addition to macroeconomic studies conducted by the Bank, the construction of CFPs will require additional, complementary sources of information available such as public expenditure reviews, country financial accountability assessments, country procurement assessment reports, medium-term expenditure frameworks, country-owned development strategies, especially poverty reduction strategy papers, and other relevant country analytical work on the country undertaken by the Bank, the country or third parties[7].

COMPARATIVE TABLE OF ELIGIBLE EXPENDITURE POLICIES
OF THE ADB GROUP AND OTHER MULTILATERAL BANKS

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
1. Cost sharing operations /counterpart funds	**Eligible -** The principle of cost-sharing between the Bank Group and the RMC is maintained (see Paragraph 2.1.2). However, it is proposed that it should be possible for the ADB to finance more than 50% of total project or program costs, and for the ADF to finance, on a case-by-case basis, more than 90% of total project/program costs and more than 95% of the total cost of studies up to a limit that does not exceed 100%. The adequate percentage of total costs financed by the Bank will be assessed on a case-by-case basis according to the following criteria: (i) the country's commitment to implement its overall development program; (ii) the financing allocated by the country to sectors targeted by Bank assistance; and (iii) the country's budget situation and debt level. Staff would use the same CFPs as the WB for this item.	**Eligible –** The WB may finance activities for which the borrower has demonstrated ownership and commitment by, among other things, providing funding from its own resources. The Bank judges the adequacy of this funding in the context of the borrower's overall development program (in general) and on its funding commitment to sectors in which Bank assistance would focus. This arrangement provides the WB with the flexibility to finance up to 100% of a project's costs. CFPs determining whether and to what extent the WB may finance this item have been established for 38 countries.	**Eligible – C**ountry ceilings based on the aggregate portfolio of AsDB operations projected and agreed to with the DMC over the Country Strategy and Program (CSP) period. The context is the RMC's overall public sector investment program. Commitment to, and ownership of this program, and the interventions agreed to under the AsDB portfolio also constitute key guiding principles. The country ceiling is established based on special macroeconomic assessments, including the country's: (i) existing and projected fiscal stance; (ii) fiscal sustainability; (iii) quality of the public sector investment program and its specific financing plan; (iv) quality of the public financial management system; (v) quality of the mechanisms for budgeting and its implementation; (vi) specific tax regime; (vii) general governance considerations in relation to fiscal and other matters; and (viii) the quality and soundness of fiduciary oversight arrangements. The assessments also cover debt sustainability, exchange rate regimes, balance of payments and other relevant macroeconomic indicators. The proportion to be financed by AsDB in the case of each project under the portfolio will vary depending on project specific, sector and client considerations - following	**Eligible –** It is recognized that a country's sense of project ownership should be reflected in its efforts to achieve the development objectives at a more aggregate level (as shown, for instance, in the percentage of the national budget dedicated for the purpose) and that local counter part funding need not be required in each project to demonstrate the borrower's commitment to the objectives. This is especially true when the domestic resources devoted to such objectives are significant and greater than the external financing being sought. Up to 100% of the costs of specific projects could be financed without detriment to the principle of ownership, and with an improvement in effective and timely project implementation, provided that the IADB is satisfied with the general level of the borrower's own funding. The IADB determines the counter-part requirements based on the borrowing country's overall commitment to funding its development program. The Bank conducts an analysis to determine whether the borrower devotes sufficient funds to its general development program and to the particular sector or sub-sector. Operational guidelines are produced to orient personnel on the agreements regarding share of costs at

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
			the concept of sound banking principles. Staff instructions provide guidance on working with the new policy framework.	both the country and project level, so as to produce harmonization with the WB.
2. Local Cost Financing	**Eligible.** Local currency costs attached to direct project loans and grants remain eligible for Bank financing. The Bank may finance local expenditures when it is satisfied that (i) financing requirements for the country's development program would exceed the public sector's own resources (e.g., from taxation and other revenues) and expected capabilities for domestic borrowing, and (ii) the financing of foreign expenditures alone would not be sufficient to support an individual project. When these conditions are met, the Bank may finance local currency costs in any proportion needed through direct project loans and grants. Staff would use the same CFPs as the WB for this item.	**Eligible**. The WB may finance local expenditures when it is satisfied that (i) financing requirements for the country's development program would exceed the public sector's own resources (e.g., from taxation and other revenues) and expected capabilities for domestic borrowing, and (ii) the financing of foreign expenditures alone would not be enough to support individual projects. When these conditions are fulfilled, the Bank may finance local currency costs in any proportion needed through direct project loans and grants. CFPs determining whether and to what extent the WB may finance this item have been set for 38 countries.	**Eligible –** Project investment plans do not distinguish between currency denominations of project components. Project financing plans are structured around the concept of sound banking principles, and thus take into account the cost recovery profile of each transaction and its capability for sustainability. Financing plans distinguish between the finance provided by AsDB, the Government, and others. The financing plan also distinguishes between finance to be provided in foreign and local currencies**.**	**Eligible –** Eliminating the restriction on Bank financing as a share of total project cost, as set forth in the financing matrix, eliminates the restriction on foreign exchange financing of local costs, in accordance with the changes to the matrix.
3. Taxes and duties	**Eligible** - The principle whereby projects financed by the Bank Group are exempted from taxes and customs duties will remain valid. However, it is proposed that the Bank Group should be able to waive this principle and finance taxes and duties costs associated with project expenditures on a case-by-case basis if it is satisfied that (i) the country's fiscal regime imposes taxes or duties at levels that the Bank considers non-excessive, and (ii) taxes and duties do not constitute a high share of project costs or are not specifically directed at	**Eligible –** The WB may finance reasonable taxes and duties costs associated with project expenditures provided that (i) the country's fiscal regime imposes taxes or duties at levels that the Bank considers non-excessive, and (ii) taxes and duties do not constitute a high share of project costs or are not specifically directed at WB financed projects, activities, or expenditures. CFPs determining whether and to what extent the WB may finance this item	**Eligible –** AsDB may finance the reasonable cost of taxes and duties associated with project expenditures. Transparency, competitive neutrality, and sustainability arrangements are taken into account. Staff instructions provide guidance on the definition of the term "reasonable" cost of taxes and duties, and on carrying out the assessments required**.**	**Eligible –** At a borrower's request, IADB financing may cover associated taxes and fees representing a major cost of goods and services (import taxes, consular or port fees, or value added taxes), provided that the amounts are reasonable for the Bank. Income tax charged in addition to the cost of a service will not be recognized. Operational guidelines will be produced to orient staff in determining reasonable amounts of taxes and fees, using a procedure similar to that used at the WB.

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
	Bank-financed projects, activities, or expenditures. Staff would use the same CFPs as the WB for cost sharing. .	have been set for 38 countries.		
4. Recurrent costs	**Eligible** - While maintaining the current eligibility of recurrent costs, it is proposed that the Bank Group should be able to finance, up to 100%, the recurrent costs of income-generating and non-income generating projects, on a case-by-case basis. The rationale is that operations in RMCs usually have a major recurrent costs component. These costs will be financed if it is shown that: (i) they are part of the project; (ii) they are necessary for attaining project development objectives; and (iii) they are productive in the context of the specific project being financed. The percentage of financing to be borne by the Bank Group will depend on the country's financial situation (especially the country's commitment and ability to provide continued financing for recurrent expenditures after the Bank financing is completed), or on the financial situation of the project management entity or entities for income-generating projects. Hence, Bank staff will continue to calculate estimated recurrent costs and clearly indicate ways and means of ensuring sustainable financing. Staff will use the same CFPs as the WB for this expenditure item.	**Eligible –** The WB may finance recurrent expenditures. In determining whether and to what extent to finance recurrent expenditures, the WB considers the impact on fiscal and debt sustainability (including the country's commitment and ability to provide continued financing for recurrent expenditures after World Bank financing is completed) at the appropriate levels, including that of the project entity or entities. CFPs determining whether and to what extent the WB may finance this item have been set for 38 countries.	**Eligible –** No policy changed, although current restrictive practices will be reexamined in the context of individual projects. Fiscal and debt sustainability assessments will be carried out in the context of the more recurrent expenditure-driven projects. AsDB financing of recurrent expenditures is limited to funding requirements during the project implementation period. Another cap (and exit strategy) on the financing of recurrent expenditures arises out of the concept of sound banking principles. AsDB and others can only finance what a particular project can absorb. The Credit Risk Management Unit screens and evaluates the financial structure of public and private sector projects.	**Eligible –** At a borrower's request, the IADB will consider financing recurrent expenditures. These will be eligible if it is shown that (a) they are a part of the project, (b) they are necessary to the project's development objectives, and (c) they are productive in the context of the specific project being supported. To determine whether, and to what extent, they are appropriate for financing in each case, the Bank will consider their fiscal impact and their impact on indebtedness. In all cases, project proposals must show which features justify consideration of such expenditures. In addition, when financing for such costs must continue after a project ends, they must be shown to be sustainable. Operational guidelines will be produced to orient Bank staff in conducting analysis of fiscal and debt impact at the appropriate levels, in a form similar to that employed at the WB.

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
5. Provisional expenditure on infrastructure projects	**Eligible.** At the Government's request, the Bank could explore the possibility of financing provisional expenditures on income-generating socio-economic infrastructure projects that have been completed and handed over to the borrower. Provisional expenses are operating costs needed for a given period until the infrastructure, financed with the loan/grant resources of the Bank, starts generating enough resources to cover its own operating costs. The general underlying principle is that the Bank may finance costs up to 100%, on a case-by-case basis, for a period of up to 3 years. Such expenditures will be eligible if it is shown that they: (i) are an integral part of the project at appraisal; (ii) represent a small percentage of project costs which cannot be financed by the project entity; (iii) contribute to the attainment of the development goals of the project; (iv) can be supported on a sustainable basis by the public or semi-public entity beyond the transitional period.	Not taken into consideration.	Not taken into consideration.	Not taken into consideration.
6. Project vehicles	**Eligible.** It is proposed that clarifications be made indicating that expenditures on the procurement and maintenance of project vehicles are eligible for Bank financing, so long as such expenditures are deemed productive. Consequently, the Bank will continue to finance the procurement of project vehicles if it is satisfied that the vehicles can be effectively used for achieving project objectives. The decision to finance such expenditures will be taken after appraisal of the viability of the country's public finance situation, and its track record in	**Eligible** but no policy statement.	**Eligible** but no policy statement.	**Eligible** but no policy statement.

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
	sharing project costs and managing recurrent costs related to the use of project vehicles financed by the Bank.			
7. Remuneration of PIU staff	**Eligible – It is proposed that** clarifications be made indicating that where the establishment of a parallel PIU is inevitable, the remuneration of its staff will be eligible for Bank financing. The rationale is that such expenditures may be productive since they are necessary for the achievement of project objectives. The financing of allowances (for civil servants on secondment) or fees (for private consultants) will be subject to the following elements: (i) valid justification for the establishment of a parallel PIU and the productive nature of the expenditure; (ii) the existence of an acceptable performance contract between the PIU staff and the Government; and (iii) the competitive nature of the staff recruitment process. Where a Government structure (country system) is used for the implementation of operations, the remuneration of the staff working in that structure is not eligible for Bank financing.	**Eligible** but no policy statement.	**Eligible** but no policy statement.	**Eligible** but no policy statement.
8. Land acquisition	**Eligible –** It is proposed that clarifications be made indicating that land acquisition for a project is eligible for Bank financing. Indeed, the related expenditure may be necessary for achieving the development objectives of the project. Land costs are expected to be financed by the borrower's counterpart funds, and the Bank's commitment to finance such costs must take this consideration into account. Bank financing of land acquisition will be carefully considered by the Operations	**Eligible –** WB has removed prohibitions on financing land and cash compensation under resettlement plans. CFPs determining whether and to what extent the WB may finance this item have been set for 28 countries. WB management is reviewing the desirability of expanding the scope beyond the current pilot scheme in light of operational needs and experience	**Eligible –** AsDB finances land acquisition and payments for rights-of-way. A cautious approach is pursued in financing land acquisition. Staff are issued instructions on the type of assessments needed upfront.	**Eligible –** At a borrower's request, the IABD will consider financing expenditures for the purchase of land acquisition. These will be eligible if it is shown that (a) they are a part of the project, (b) they are necessary to achieve the project's development objectives, and (c) it is possible to establish the input values at market prices that are reasonable and satisfactory to the IABD.

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
	Committee. In financing land acquisition, the Bank will ensure that this option remains the most cost effective after considering certain elements such as: (i) the country's land tenure system and legal land ownership situation; (ii) the project objectives; (iii) the productivity of the land; (iv) the growth and liquidity prospectus of the land market; (v) land acquisition risks; and (vi) monitoring/evaluation arrangements. The staff will use the same CFPs as the WB for this expenditure item.	gained. Management pursues a cautious approach to financing land, and continues to have all proposals to finance land reviewed by WB's Wide Land Committee.		
9. Late payment penalties	**Eligible.** It is proposed that clarifications be made indicating that late payment penalties to suppliers and vendors are eligible for Bank financing if they are justified. The rationale is that these penalties may arise in the normal course of business, and that the Bank may sometimes be responsible for payment delays to suppliers and vendors. Bank financing will be based on the effective existence of the contracts concerned, identification of the cause of delay, measures taken to address such delays in future and, lastly, the availability of funds. . The staff will use the same CFPs as the WB for this expenditure item.	**Eligible –** These costs arise regularly in the normal course of business and, when they do come up, comprise part of project costs. The prohibition in the current policy has been lifted, and guidance on when to finance late penalties has been provided to staff. CFPs determining whether and to what extent the WB may finance this item have been set for 38 countries.	**Eligible –** Prohibitions on AsDB financing of late penalties imposed by suppliers where they form part of the project costs have been removed. Only bona fide cases are permissible. Staff assess in detail the background and rationale for the inclusion of the item.	
10. Severance pay	**Eligible –** It is proposed that clarifications be made indicating that severance pay is eligible for Bank Group financing if the Bank Group and the Government agree on a public sector reform program. The Bank Group may finance severance pay within the context of a public enterprise reform program expected to result in an increase in public sector productivity. In financing severance pay, the Bank will consider	**Eligible –** Severance pay is eligible for WB financing. The WB may finance severance pay in the context of public enterprise reform operations that are expected to result in an increase in productivity after restructuring. In financing severance pay, the Bank considers such factors as the impact and sustainability of the public sector reform program of which proposed retrenchments are a	**Eligible –** Severance pay is eligible for AsDB financing, so long as it is paid in local currency.	**Eligible –** Severance pay is eligible for IADB financing.

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
	factors such as the impact and sustainability of the public sector reform program, which includes proposed staff reductions, and the conclusions of the economic analysis of the costs and benefits. Staff will use the same CFPs as the WB for this expenditure item.	part, and carries out economic analysis on the costs and benefits. The Bank also ensures that the benefits of the downsizing are sustainable by giving particular attention to the risks of adverse selection, overpayment, and moral hazard. It also takes into consideration legal aspects, issues relating to the political and economic situation (including the affordability of the compensation package), and social impacts. The Bank also takes into account the size of severance pay financing relative to total Bank financing, and takes measures to ensure appropriate determination of severance payments. CFPs determining whether and to what extent the WB may finance this item have been set for 38 countries.		
11. Food	**Eligible –** It is proposed that clarifications be made indicating that foods for human consumption and expenditures for the production, storage and distribution are eligible for Bank financing. The rationale is that averting or correcting under-nutrition and malnutrition is essential for economic and social development. Bank funding of food expenditures may be appropriate if food supply is an essential component of a project designed to combat malnutrition, if such financing is deemed to be the most feasible and cost-effective alternative for achieving the set objectives, and if the food supply can be limited exclusively to persons	**Eligible –** Foods are eligible for Bank financing. Bank funding of food expenditures may be appropriate if the provision of food is deemed an essential and integral part of a project that is designed to (a) reduce the acute risk of disease, or reduce the severity of disease, for all age groups, (b) reduce or prevent mental retardation and poor school performance, (c) enhance children's growth and development, d) reduce adverse pregnancy outcomes for mother and child, (e) facilitate a systemic transition by supporting for a limited time the continued delivery of critical education and health programs previously provided by public sector	**Eligible –** Food expenditure is eligible for AsDB financing.	**Eligible** but no policy statement.

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
	belonging to a given target group. The staff will use the same CFPs as the WB for this expenditure item.	enterprises, or (f) facilitate a resettlement operation, or an operation that transfers production to economically justified alternative activities, by temporarily sustaining the livelihood of the affected populations. In addition, the proposed funding must be (i) the most feasible and cost-effective alternative toward accomplishing these objectives, (ii) effectively targeted, and (iii) monitored to minimize distribution of food to populations outside the target group. However, when the provision of food is proposed as a necessary and integral component of a Bank-financed program or project, the borrower should be urged to explore the availability of financing for such purchases from other sources (e.g. the United Nations World Food Program or bilateral sources). CFPs determining whether and to what extent the WB may finance this item have been set for 38 countries.		
12. Bank charges for special accounts	**Eligible –** It is proposed that clarifications be made indicating that bank charges for special accounts for the entire period of project implementation are eligible for Bank financing. The rationale is that special accounts are opened solely for the purpose of implementing Bank-financed projects, and that bank charges are a regular component of normal project costs. Staff will use the same CFPs as the WB for this expenditure item.	**Eligible –** The WB clarifies that financing of charges associated with bank accounts maintained in connection with the project are not intended to be restricted, and that such charges are eligible for World Bank financing.	**Eligible – Policy r**estrictions on financing of bank charges have been removed. However, only *bona fide* cases will be considered.	**Eligible** but no policy statement.

Expenditure items	Bank Proposed Policy	World Band (WB) Current policy	AsDB Current policy	IADB Current policy
13. Leased assets	**Eligible –** It is proposed that clarifications be made indicating that leased assets are eligible for Bank financing. The rationale is that it may be more efficient and more economical in some projects to resort to alternative solutions instead of purchasing capital goods or operating property. For example, financing leases could be an attractive alternative way of acquiring fixed assets. Before financing leased assets, the Bank will assess if leasing is the most appropriate way of acquiring assets. If the Bank feels that this is the case, it will look for the most appropriate lease option (capital or operating) taking into consideration the duration of the lease contract in comparison to the duration of the project. With regard to contract award and financial management, acquisitions will be made in accordance with Bank regulations. Staff will use the same CFPs as the WB for this expenditure item.	**Eligible – Since** leasing is a common way to finance the acquisition of capital assets, it is proposed to clarify that these costs are eligible for World Bank financing. CFPs determining whether and to what extent the WB may finance this item have been set for 38 countries.	**Eligible –** Leased assets are eligible for AsDB financing. Staff instructions specify the type of assessment s needed.	**Eligible** but no policy statement.

Source: World Bank (2004, 2005); Inter-American Development Bank (2004); Asian Development Bank (2005).