

# What's the value of a World Bank Policy-Based Guarantee?

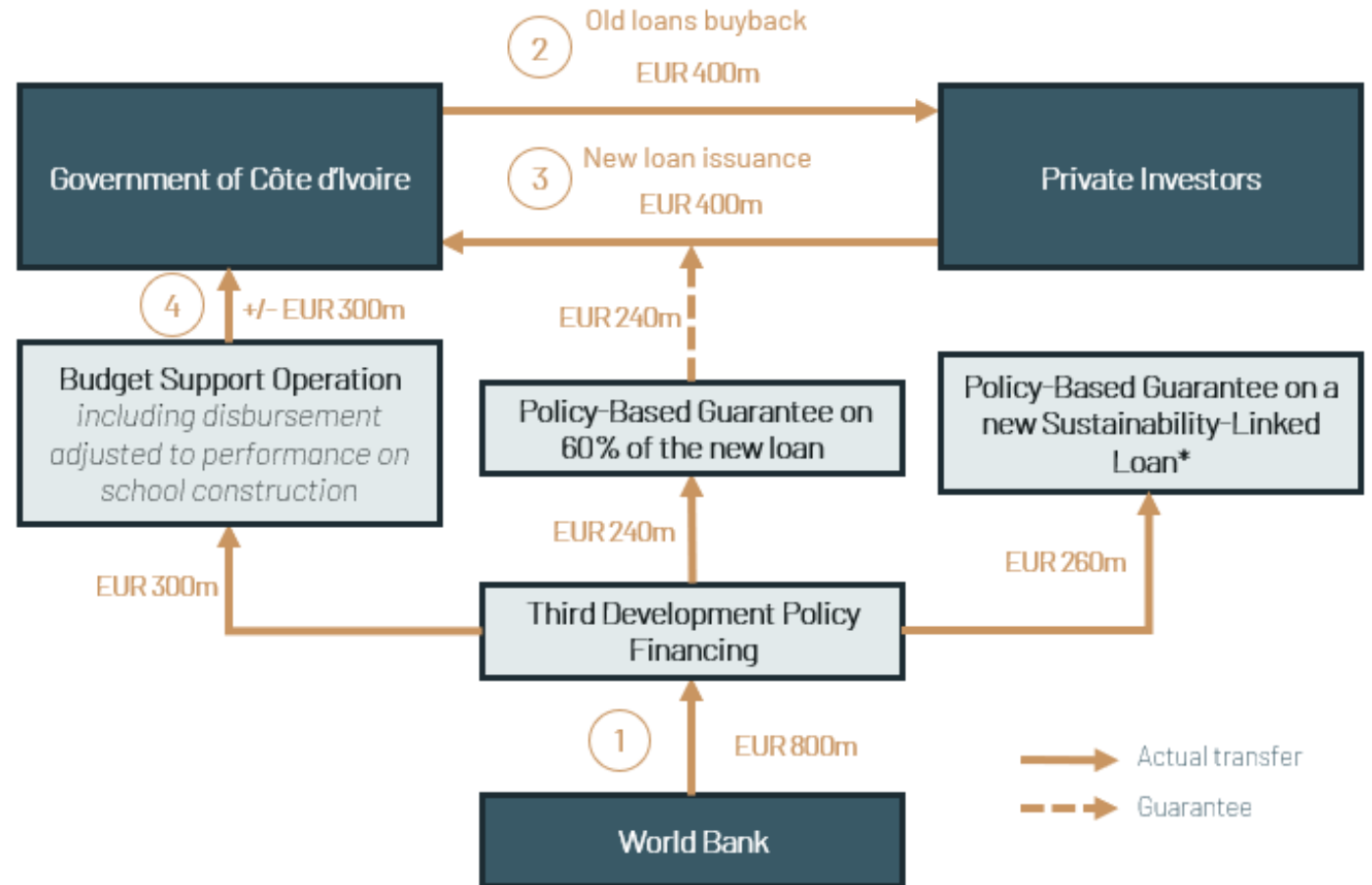
Looking into the Côte d'Ivoire Debt Swap

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**FDL**

# The deal & the questions

1. Is the LMO a good deal for RCI?
2. Is the WB PBG better than a WB loan?
3. Does the PBG have signaling value for “illiquid” countries?
4. Ideas for an improved PBG..



# 1. A good deal for RCI? YES, if...

## Financially profitable

- LMO: E400m new loan, wt a PBG of E240, used to retire expensive old loans (of E400m)
- LMO reduces NPV debt by E60m, and debt service during next 5 years by E300m.
- IF opportunity cost is to use E400m for domestic spending..
- **THEN, deal profitable only if RCI discount factor < 9% ..**

## Institutional

- LMO also a debt for development swap (get 30 new schools) ..
- Structure offer several valuable innovations:
- No expensive SPV
- Expenditure use country system
- Use for country own priorities
- **In effect, WB finance LMO that uses gains to expand WB finance of government projects**

# World Bank treatment of PGB and implication

- PBG for \$100 of debt uses as much WB capital as \$100 loan (18%)
- But to encourage demand, it only uses 25% of country allocation.
- This changes the country calculus of opportunity cost: instead of using E240m for a PBG, RCI can get only E60m as a loan to finance domestic expenditure.
- The arithmetic of the LMO-cum-swap changes: it is profitable as long as RCI's discount factor is smaller than 30%
- This makes the deal even more profitable – in effect, RCI and its LMO subsidized by the WB
- But the *signaling value* of the operation is also lower

## 2. PBG best instrument for the LMO only when “subsidized” (accounted at 25% value)

- To finance the LMO, two possible alternatives to the PBG backed loan: (i) loan from market; (ii) loan from WB.
- We need to compare
  - Cost of retired loans: 9%
  - **Cost of PBG backed loan: 6% (given by market)**
  - Cost of a (hypothetical) market loan: 7%
  - Cost of a blend 60 WB/40 market loan: 5.68%
  - Cost of a 15 WB/85 market loan: 6.67%
- Evidence of “value erosion” reflects
  - Market inability to price the PBG
  - Possible design weaknesses

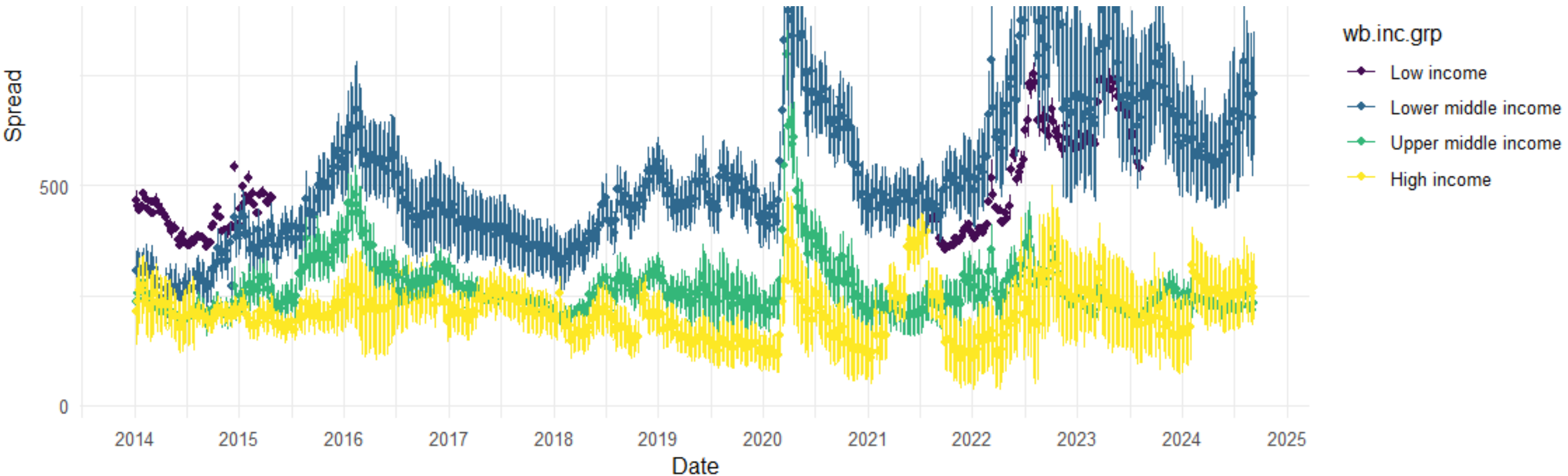
### 3. PBG as a signal

- If PBG does not have an intrinsic financial value, why use it?
- One possibility is that PBG backed LMO signals creditworthiness.
- DPO also a signal? Yes, but a weak signal: (i) IFI seniority; (ii) moral hazard potentially beating conditionality.
- PBG potentially a more credible signal: country believes that it has a low risk of default -- since otherwise, better use the funds for domestic expenditure, than to rearrange future debt service.
- But the 25% treatment weakens the signal: it only reveals that discount factor  $< 30\%$ , vs  $< 9\%$  if PBG was not “subsidized”.

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## Why signal valuable?

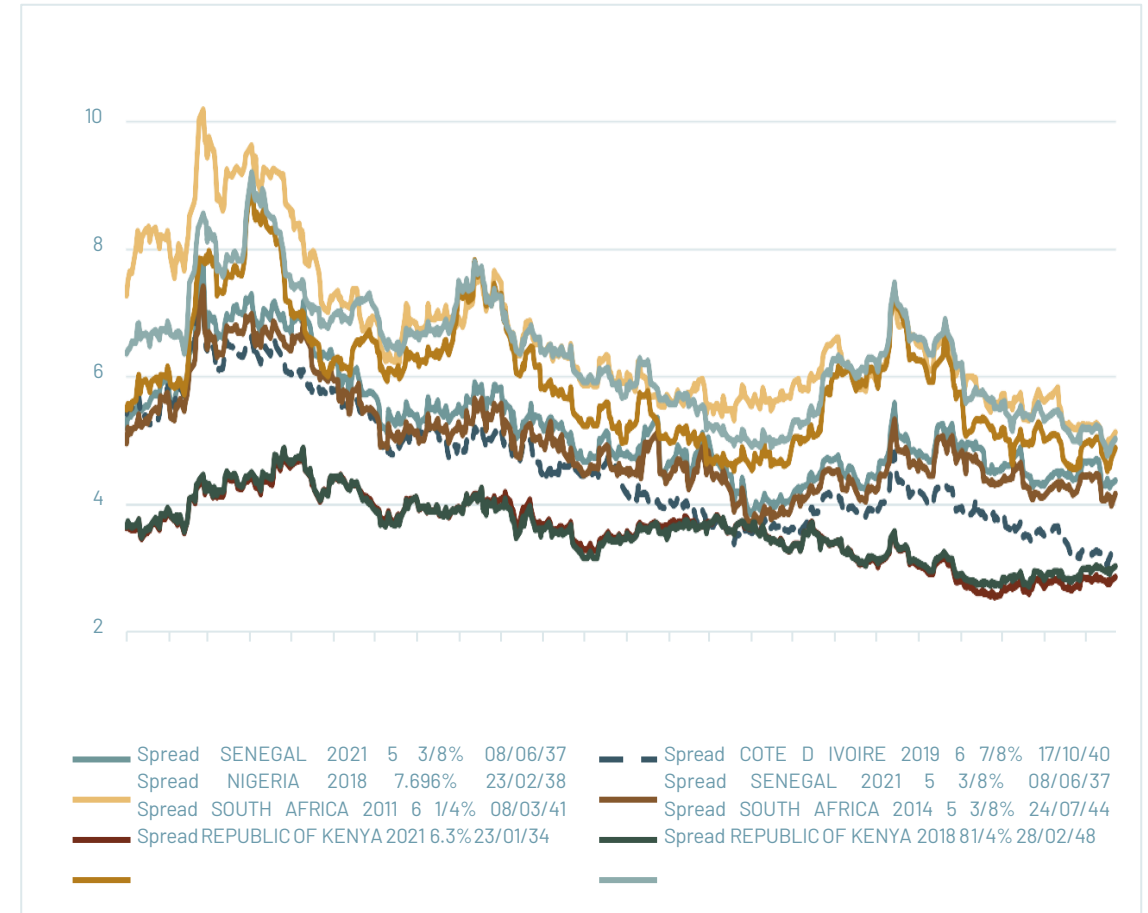
- LLMICs spreads recover slowly after each “market panic”
- This reflects slow release of credible information on ability of DCs to “adjust”
- Spreads have come down after peaking in early 2023
- And they show more variability than before the crisis



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## RCI's spreads have come down over time

- RCI spreads jumped from 300bps to over 600bps in 2023
- They were always lower than Kenya's spread
- They gradually recovered, from a Senegal level, down to a South Africa level



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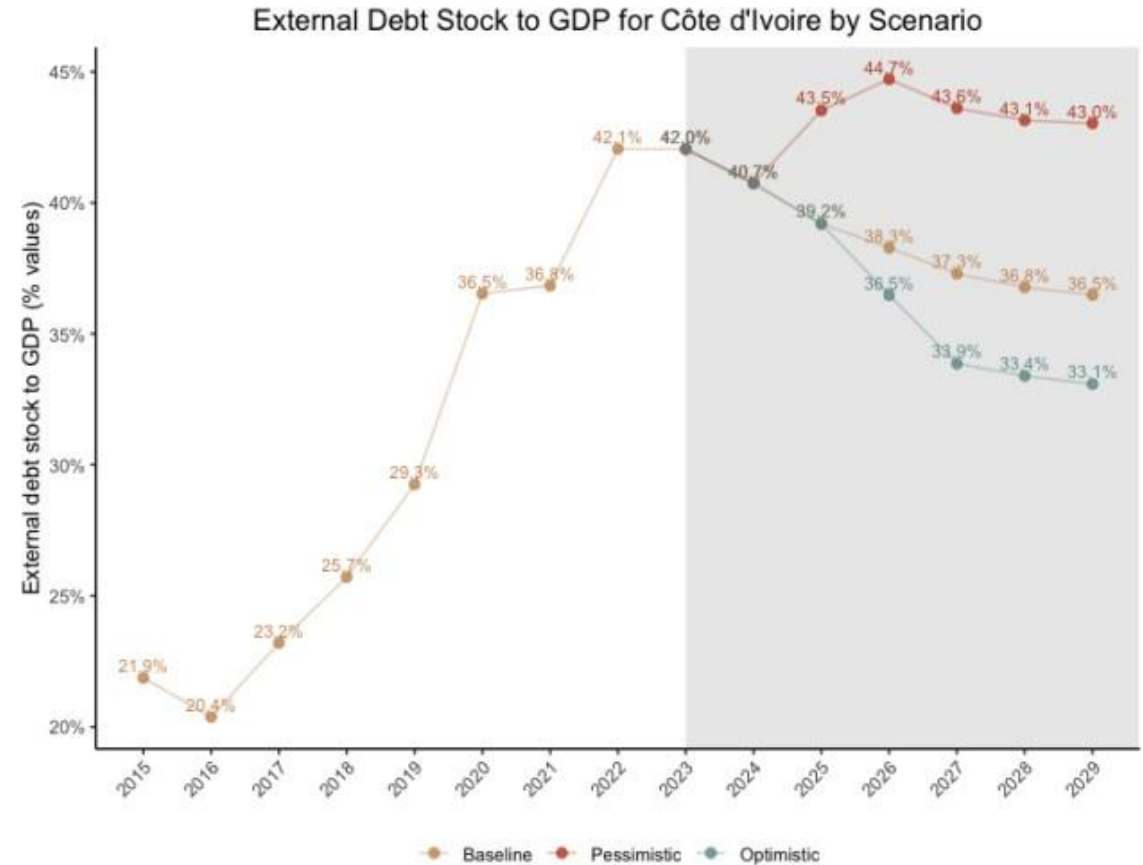
## Evidence that signal worked, but modestly

- Event study tricky given market adjustment
- DPO/PBG-backed LMO seems to have reduced spreads by same magnitude as IMF program, 1<sup>st</sup> WB DPO, and own LMO of 2023
- But fall of spreads when they are already low more meaningful

Date	Event	RCI/40	RCI Ex-post spread	RCI v.s Peers
24/05/2023	IMF EEF Board (\$3.5 b)	-86.71	5.78	-49.09
03/11/2023	WB DPO Board (\$300m)	-67.83	4.70	-49.56
05/02/2024	2040 bond & own LMO	-30.19	4.33	-36.28
05/12/2024	DPO/PBG WB Board	-59.27	3.25	-32.02

# How valuable is the LMO for RCI, and others?

- Gains in perspective (\$60m/\$300m)
  - RCI External debt ~ \$37 billions
  - Debt service 2024-28 ~ \$11 bil
  - 5yrs saving per 50 pbs ~ \$350 mil.
- How replicable?
  - 22 countries illiquid but solvent
  - But need to be willing to implement an ambitious reform program
  - I.e, to have a low enough discount rate to justify an ambitious LMO program



# 4. Conclusion

- WB's DfD/LMO swap for RCI includes several useful innovations
  - Less contestable than recent expensive deals
- The WB's PBG needs to clarify if it aims to create financial, or economic gains
  - For the PBG signal to be more credible, it must be costlier
  - Signal valuable for solvent/illiquid countries wt ambitious adjustment plans
- To improve PBGs as a signal:
  - Consider less than 100% provisioning
  - Consider reducing the subsidy
  - (also, reconsider so of the legal terms, esp. acceleration)