

**ELIGIBILITY OF EXPENDITURES IN  
WORLD BANK FINANCING**

**INCIDENCE OF RECURRENT COST FINANCING –  
JULY TO DECEMBER 2005**

**Operations Policy and Country Services  
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**ELIGIBILITY OF EXPENDITURES IN WORLD BANK FINANCING:  
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1. On April 13, 2004, Executive Directors approved changes to the policies that determine the expenditures that the Bank may and may not finance in investment lending.<sup>1</sup> At that time they requested Management to report semiannually during the first two years of implementation on the incidence of recurrent cost financing in newly approved loans. This report covers the first half of FY06 (July 1 to December 31, 2005).<sup>2</sup>

2. **Types of Recurrent Costs.** Recurrent costs are costs that need to be regularly or periodically incurred after the life of the project. Major types of recurrent costs typically include (a) operation and maintenance of infrastructure projects such as civil works for maintenance of roads, and irrigation and drainage infrastructure; (b) in health projects, costs such as drugs, pharmaceuticals, medical supplies, and salaries of medical care providers (these are not considered as recurrent costs in specialized health projects in which they would not be regularly or periodically incurred beyond the life of the project); (c) in education projects, costs such as textbooks, instruction material, salaries, stipends, tuitions/scholarships, and school maintenance; (d) project operating costs such as vehicle operation and maintenance, office space rent and utilities, office operation and maintenance, consumables, communication, travel, staff salaries, and administrative expenses.

3. **Recurrent Cost Financing Policy.** The Bank's new policy provides that the Bank may finance recurrent costs, taking into account the country's commitment to provide continued financing for recurrent expenditures after Bank financing is completed and its ability to do so as reflected in the impact on fiscal and debt sustainability at the appropriate levels, including that of the project entity or entities. The new policy is applied to projects in a given country after the country financing parameters for that country are established.<sup>3</sup> As of December 31, 2005, the Bank had established country financing parameters for 91 countries. Since then the Bank has established country financing parameters for 4 additional countries, for a total of 95 countries with parameters. In the first half of FY06 (July to December 2005), the Bank's total

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<sup>1</sup> See *Eligibility of Expenditures in World Bank Lending: A New Policy Framework* (R2004-0026/1), April 1, 2004.

<sup>2</sup> See *Eligibility of Expenditures in World Bank Lending: Incidence of Recurrent Cost Financing – July to December 2004* (SecM2005-0169), April 6, 2005, for the report covering the first half of FY05. The report for the second half of FY05 was integrated into the FY05 report on overall implementation of the new policy; see *Eligibility of Expenditures in World Bank Financing: FY05 Report on Implementation Experience* (SecM2005-0516), October 12, 2005.

<sup>3</sup> Country financing parameters are communicated to Executive Directors when established and, together with supporting analysis, are posted on the Bank's internal website (see <http://opcs.worldbank.org/eligibility/cp-All.html>). Country financing parameters are reviewed during the preparation of the Country Assistance Strategy (CAS), reflected in the CAS or similar documents such as Interim Strategy Notes (ISNs), and disclosed as part of the CAS. When prepared on a stand-alone basis, country financing parameters and supporting analysis notes are made publicly available after they are communicated to the Executive Directors.

investment lending commitments were \$6.83 billion for 98 approved projects.<sup>4</sup> A vast majority of these projects – 93 projects with lending commitments of about \$6.68 billion (95% of total approved projects, and 98 percent of total investment lending commitments) – were approved when the new policy was in effect for the countries concerned.<sup>5</sup>

4. **Country Financing Parameter on Recurrent Costs.** According to the new policy, the country financing parameter on recurrent cost financing should indicate any country-level limit on recurrent expenditures that the Bank may finance in the country. In establishing the recurrent cost financing parameter, the Bank takes into account aspects such as the borrower's actual and expected economic and public finance performance (e.g., fiscal and debt situation and prospects), the share of Bank financing and other official development assistance in the borrower's development expenditures, the adequacy of the borrower's budget preparation and execution processes, the borrower's commitment and ability to sustain the financing for recurrent expenditures after Bank financing is completed, and the expected type and level of recurrent cost financing for the Bank's program in the country. For each project, the Bank also examines sustainability issues at the project and sector levels.

5. **Strategic Approach.** The intent of the new policy is to lead toward a more strategic approach regarding recurrent cost financing. While the emphasis on sector- and project-level sustainability issues continues, it is strengthened by consideration of the country's overall fiscal and debt situation and the Bank's CAS for that country. For 72 of the 95 countries for which country financing parameters have been established, the parameters did not introduce a country-level limit on overall recurrent cost financing. For the other 23 countries, the recurrent cost financing parameter contains limitations on what the Bank may finance—for example, not allowing recurrent cost financing for sectors in which user-fee arrangements are considered essential; restricting recurrent cost financing to particular types of expenditures such as human capital spending, or to specified circumstances; restricting or not financing salaries; or specifying fiscal and budget management criteria for recurrent cost financing. (See Box 1 for a typology of country-level limits, and Annex A for specific country examples.) In 50 of the 95 countries, the country notes indicate that, given expected project and sector conditions or country preferences, recurrent cost financing is expected to stay at modest levels, and hence the fiscal and debt sustainability impacts will be limited. At the country level, the Bank will continue to monitor the fiscal and debt situation in borrower countries and its implications for recurrent cost financing, and can make adjustments as warranted (as in fragile states, where greater recurrent cost financing might be considered essential to implementation and achievement of project development objectives).

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<sup>4</sup> This figure and the analysis in this paper do not include IBRD and IDA guarantees, as the new policy does not apply to guarantees.

<sup>5</sup> The remaining five projects were approved in countries that did not yet have country financing parameters.

**Box 1. Recurrent Cost Financing: Typology of Country-Level Limits**

**Restrictions on recurrent cost financing in some sectors.** In determining the appropriateness and level of recurrent cost financing for projects in such sectors as health, urban, water, electricity, or roads in Lesotho, Madagascar, Mozambique, Tanzania, Uganda, and Zambia, the Bank will take account of the country's sector strategy for financing recurrent costs through user fees, tariffs, or other revenue-generating mechanisms. In determining recurrent cost financing in India, the Bank will take into account the CAS guidelines for Bank lending in key sectors, which include sector financing strategies.

**Restrictions on financing salaries.** In Afghanistan, Bolivia, Cambodia, Chad, Croatia, Djibouti, Indonesia, Lao PDR, Romania, and Yemen, the Bank will not finance salaries or salary supplements, or will finance them only in specified circumstances (e.g., funding salaries only as part of a civil service reform program; or funding PIU salaries only in the context of integration into line ministries or other measures that ensure sustainability).

**Country preferences.** In Ecuador, the country's public finance strategy restricts recurrent cost financing to specific types of expenditures (e.g., human capital spending). In Turkey, the Government is not currently interested in Bank financing of civil servant salaries.

**Limiting recurrent cost financing to specific circumstances.** In Russia, the Bank will finance recurrent costs only to assist in the implementation of reform, if there is evidence of the efficiency and effectiveness of the government institution that would receive the recurrent cost financing.

**Fiscal and budget management criteria.** In Bosnia-Herzegovina, Brazil, and Nicaragua, the Bank has agreed with the government on fiscal and budget management criteria for recurrent cost financing.

6. **Incidence of Recurrent Cost Financing.** As Management previously reported to Executive Directors, between FY01 and FY05 recurrent cost financing ranged between 4 and 6 percent of the Bank's total investment lending commitments (Table 1).<sup>6</sup> In the first half of FY06, the level of recurrent cost financing appears to have moderately increased over the previous period. For the 98 projects approved in the first half of FY06, recurrent cost financing amounted to \$515.66 million and represented 7.6 percent of total investment lending commitments. In the 93 projects approved when the new policy was in effect for the countries concerned, recurrent cost financing was also 7.6 percent of investment lending commitments. However, over half of the 7.6 percent (3.9 percent of total investment lending commitments) is accounted for by two projects, the Mexico Tertiary Education Student Assistance Project and the Brazil Ceara Multi-sector Social Inclusion Development Project.<sup>7</sup> Management will continue to monitor the incidence of recurrent cost financing in newly approved operations for FY06 and will report to Executive Directors on it in the second annual report on implementation experience.

<sup>6</sup> See *Eligibility of Expenditures in World Bank Financing: FY05 Report on Implementation Experience* (SecM2005-0516), October 12, 2005, and *Eligibility of Expenditures in World Bank Lending—A New Policy Framework: Initial Implementation Experience* (OM2004-0057/1), September 17, 2004.

<sup>7</sup> In the Mexico project, recurrent cost financing was estimated at \$162.17 million (about 90 percent of Bank financing for the project); in the Brazil project, it was estimated at \$105.34 million (about 70 percent of Bank financing for the project).

**Table 1. Recurrent Cost Financing: FY01-05 and FY06 (first half)**  
 (% of investment lending commitments)

<i>Fiscal year</i>	<i>Recurrent cost financing (%)</i>
FY01	5.8
FY02	5.0
FY03	4.3
FY04	3.5
FY05	3.7
FY06 first half	
• All projects	7.6
• Projects approved when the new expenditure eligibility policy was in effect for the countries concerned	7.6

7. ***Influencing Factors.*** The new policy has provided the flexibility to finance recurrent costs in projects and countries where such financing is needed and appropriate. While the level of recurrent cost financing appears to be largely influenced by project- and country-specific factors, other factors that appear to influence the aggregate level of recurrent cost financing include (a) the sectoral composition of investment lending; (b) borrower preferences and public finance strategies (e.g., limiting or not borrowing for recurrent spending); (c) Bank assistance strategies in some countries to move social sector lending, notably health and education, from investment lending to poverty reduction support credits; and (d) extent of sectorwide approaches, especially in the social sectors, where it is typically difficult to clearly separate Bank financing for capital and recurrent expenditures.<sup>8</sup>

<sup>8</sup> The extent of recurrent cost financing in sectorwide approaches varies depending on the project. The estimates in this report are based on data in the Project Appraisal Documents or, when specific items of expenditure cannot be identified, on consultations with the project teams.

## COUNTRY-LEVEL LIMITS ON RECURRENT COST FINANCING

<i>Country</i>	<i>Country-level limits on recurrent cost financing</i>
Afghanistan	Ad hoc salary top-ups and supplements to civil servants, other than standard Government allowances, would be ineligible for Bank financing except under all but the following exceptional circumstances: (a) there is a credible exit strategy for the arrangement, (b) the top-ups or supplements are essential for a sustainable process of institution building, (c) there is no feasible alternative for ensuring project implementation, and (d) the Government has confirmed that this will not, in its view, lead to unmanageable distortions in pay policy.
Bolivia	Human capital financing would follow strict government regulations, including salary ceilings.
Bosnia and Herzegovina	Recurrent cost financing will be permitted if the following strategic criteria at the country level have been met: (a) fiscal sustainability, (b) demonstrated commitment to sound fiscal management, and (c) high level of budget management and execution. This policy will be reviewed annually against these criteria and the country's efforts to raise domestic savings.
Brazil	Recurrent cost financing would be on temporary basis, and after considering the following criteria: fiscal sustainability, demonstrated commitment to sound fiscal management, demonstrated temporary financing need, high level of budget management and execution, and demonstration of sustainability of Bank-financed recurrent activities. Salaries would be financed only with government endorsement. Project implementing unit (PIU) salaries would be financed only in the context of an overall approach on financing of PIUs that is aimed at ensuring sustainability.
Cambodia	The Bank would finance remuneration only when a sustainable and institutionalized program for gradual financing by Government is agreed. The Bank would not finance ad hoc salary supplements.
Chad	Bank financing of salaries would be limited to positions that (a) are highly demanding in terms of time and workload and therefore call for appropriate financial incentives; (b) require in-depth knowledge of the administration; or (c) involve skills that cannot be found in the private sector.
Croatia	Government employees' salaries would be excluded from Bank financing. PIU salaries would be financed for new projects only if the borrower requests Bank financing.
Djibouti	The Bank would fund remuneration only if it occurs under programmatic lending or in the context of a sectorwide approach. Criteria for funding of remuneration will include fiscal sustainability analysis, institutionalization (i.e., the remuneration component is part of a civil service reform program, and not a stand-alone, ad hoc arrangement), and agreement that the Government would increase its contribution over time, eventually taking over the cost obligation. The Bank would fund remuneration that is part of officially endorsed Government programs to accelerate civil service reform, but would not fund ad hoc salary supplements.
Ecuador	Recurrent cost financing would be limited to human capital spending, which is defined in the country's budget law as resources for education, health, water and sanitation, and income-generation activities, which increase the productivity of the labor force.
India	Recurrent cost financing would take into account sector-specific considerations (e.g., based on the CAS guidelines for Bank lending in key sectors).

Indonesia	The Bank would fund salary supplements only when there is clear justification: it is only provided to selected project management staff; rates are based on market comparators; and project staff have signed the Code of Ethics/Integrity Pact and have a satisfactory performance review.
Lao PDR	The Bank would finance civil service remuneration only in the context of programmatic lending or in sectorwide approaches, and if (a) it is part of a civil service reform program including a comprehensive pay and employment strategy; and (b) a sustainable and institutionalized program for gradual increased financing by the Government is agreed.
Lesotho	In infrastructure sectors, where revenue generating mechanisms (through user fees, tariffs) are in place to cover recurrent costs and ensure sustainability, Bank financing of recurrent costs is expected to be the exception rather than the norm.
Madagascar	In determining the level and appropriateness of recurrent cost financing, the Bank would take into account sector strategies that call for revenue-generating mechanisms (e.g., user-fee arrangements) in sectors such as health.
Mozambique	The Bank will not finance recurrent costs in urban, water, electricity, roads, and similar projects for which user fees may be charged, other than in exceptional circumstances.
Nicaragua	The Bank would finance recurrent costs within a framework in which targets for the overall levels of public borrowing and for the overall composition of capital and recurrent expenditures are agreed in the context of macroeconomic policy dialogue.
Romania	The Bank would finance PIU salaries only if the PIU is fully integrated into a line ministry, or there is an agreed, clear plan to integrate it into the line ministry's structures, and with clear accountability for management oversight by the Government.
Russia	The Bank would finance recurrent costs financing only when (a) there is clear evidence of the efficiency and effectiveness of the Government institution that would receive the funding; and (b) financial support for the Government agency will assist in the implementation of reform.
Sierra Leone	The Bank would finance staff costs only when there is explicit agreement that Government will assume the cost of permanent positions after Bank financing to the project is completed.
Tanzania	In sectors in which a user fee arrangement is considered essential for sustainability—e.g., roads, water, electricity, and other urban sectors—the Bank will take this into account in determining the appropriateness and level of recurrent cost financing.
Uganda	In sectors in which a user fee arrangement is considered essential for sustainability—e.g., water, electricity, and other urban sectors—the Bank will take this into account in determining the appropriateness and level of recurrent cost financing.
Yemen	The Bank would finance remuneration that is part of officially endorsed Government programs to accelerate civil service reform, but will not finance ad hoc salary supplements. Criteria for funding of remuneration will include fiscal sustainability analysis, institutionalization (i.e., the remuneration is part of a civil service reform program, and not a stand alone, ad hoc arrangement), and agreement that the Government would increase its contribution over time, eventually taking over the cost obligations.
Zambia	In infrastructure sectors, Bank financing of recurrent costs is expected to be the exception since revenue-generating mechanisms (through user fees, tariffs) to cover recurrent costs and to ensure sustainability are in place.