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Investing in rural people

Concept Note on Regional Lending Operations

Note to Executive Board representatives

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Appendices

Abbreviations and acronyms

AsDB	Asian Development Bank
AfDB	African Development Bank
COSOP	country strategic opportunities programme
GEF	Global Environment Facility
IDB	Inter-American Development Bank
IFAD11	Eleventh Replenishment of IFAD's Resources
IFI	international financial institution
PBAS	performance-based allocation system
RLO	regional lending operation

Concept Note on Regional Lending Operations

Recommendation for Working Group consideration

The Working Group on the Transition Framework is invited to analyse and subsequently endorse the proposed approach to IFAD's regional lending operations (RLOs). The work programme to be undertaken during the Eleventh Replenishment of IFAD's Resources (IFAD11) will include: (i) identifying areas of demand for potential IFAD engagement and countries with an interest in piloting regional operations; (ii) identifying pilots and necessary elements for project design and implementation, including procedures and learning areas; and (iii) the design and implementation of RLO pilots.

The proposal for consideration by the Working Group includes the following:

Identification of pilot operations: Regional divisions will promote the concept of regional lending operations among borrowing countries as part of pipeline discussions for the IFAD11 programme of loans and grants.

Eligibility criteria: IFAD11 RLO pilots: (i) must credibly demonstrate spillover effects, which yield development effectiveness and results that could not be generated through one or more single-country operations; (ii) would include two or more countries, with some flexibility for single-country operations with regional impact; and (iii) would be aligned with the strategic objectives of country strategic opportunities programmes in participating countries; and (iv) must be in an area of comparative advantage for IFAD financing relative to other sources of finance.

Financing of pilots: Pilot regional lending operations in IFAD11 may be financed through:

1. Part or all of the performance-based allocation system allocation for each participating country as per the terms established for each country category ("red", "yellow" and "green");
2. Regional grant-financed activities designed as an integral part of the RLO; and
3. Additional sources of financing, including funding for climate change and the environment such as the second phase of IFAD's Adaptation for Smallholder Agriculture Programme, and external funding sources such as the Global Environment Facility and the Green Climate Fund.

Legal establishment: Each participating country will have a separate financing agreement with IFAD for its own loan component, which will stipulate how the country-specific activities will contribute to the broader regional project. Agreements for regional grants will be signed with selected grant recipients, stipulating how the grant-funded activities will relate to ongoing IFAD loans in each participating country during implementation of the RLO.

Executive Board approval: The pilot regional lending operations will be presented to the Executive Board for approval regardless of the amounts to be financed.

Learning from the pilot: The pilot phase will emphasize learning to enhance the design of future operations; adequate resources (staff and funding) will be dedicated to this learning exercise.

The pilots are expected to be designed and launched during 2019 and 2020. Emerging findings from the design and early implementation of the pilots will be presented in a synthesis report to be presented in the context of the consultation on IFAD12. Based on these findings, a decision will be made regarding whether an enhanced approach to RLOs is needed.

Key messages

1. As the world becomes more integrated, new approaches and tools are needed to address countries' evolving development needs. Regional lending operations (RLOs) represent a new instrument that IFAD can tailor to countries and regions to support them in realizing their full development potential.
2. Regional lending operations address cross-border development challenges that single countries have limited incentives to address individually.

3. Regional operations have been financed by other international financial institutions (IFIs) for more than a decade and are a powerful tool when used in the right contexts.

4. Although they sometimes require greater attention and coordination during design and implementation, regional operations provide benefits that single-country projects cannot deliver, as evidenced by independent evaluations conducted by the African Development Bank (AfDB) and others.

5. A number of challenges faced by smallholders require – or could benefit from – transboundary and regional approaches. For example, water resource management and agricultural pests and diseases know no boundaries. These issues are exacerbated by climate change, which is increasing the reach and severity of water scarcity and floods, and the spread of invasive species and pests. These are just some of the possible entry points for cross-border rural development projects that would be closely aligned with IFAD's mandate.

6. To pilot regional operations during the Eleventh Replenishment of IFAD's Resources (IFAD11), Management is proposing to leverage existing legal and financial instruments and current allocation mechanisms as further explained in paragraphs 15, and 36-42. This will provide sufficient time and experience to evaluate a separate allocation mechanism or set aside as available in all other international financial institutions (IFIs). These considerations will be analysed in conjunction with the review of the performance-based allocation system (PBAS) ahead of IFAD12.

7. It is proposed that the pilot RLO be designed and launched during 2019 and 2020.

I. Background

8. In July 2017, the Secretary-General of the United Nations released the report Repositioning the United Nations development system to deliver on the 2030 Agenda – ensuring a better future for all. This report contains proposals in seven areas, one of which is a revamped regional approach for the United Nations.

9. IFAD's development assistance has traditionally been delivered using a country-driven model. In line with the United Nations reform process, IFAD has reaffirmed its commitment to improving cooperation with regional and subregional institutions. The Fund is strengthening its organizational architecture to better implement regional approaches. As part of its decentralization, subregional hubs are being established in all five regions covered by IFAD operations, enabling IFAD to gain efficiencies and make more meaningful contributions to regional and subregional processes.

10. In line with its enhanced regional approach, IFAD recognizes that regional lending operations can be a powerful tool to tackle development challenges that go beyond country borders. In a world that is increasingly characterized by global and regional economic integration, country-based solutions alone are not sufficient.[1]

11. Many major environmental threats to rural development are trans-boundary in nature. And many services required to address these threats – such as transport, disease prevention and natural resource and water basin management – are best provided at the regional level, building economies of scale, ensuring connectivity and extending access to goods and services. In addition, addressing these issues requires coherent regulations and standards across neighbouring countries. Multi-country solutions and pooling of resources can help leverage the resources of individual countries to achieve better and broader impact. This may be of

[1] The contribution of a regional approach to the increased effectiveness of development actions has also been stressed by high-level forums that issued the Paris Declaration on Aid Effectiveness (2005), the Accra Agenda for Action (2008) and the Busan Partnership for Effective Development Cooperation (2011).

significant benefit to small countries (such as small island developing states), and vulnerable countries that suffer disproportionately from cross-border challenges such as natural disasters.[2]

12. The introduction of regional operations is one of the proposals included in the Approach Paper to a Transition Framework approved by IFAD's Executive Board in December 2017. It responds to requests from Member States to widen IFAD's range of tools that can support countries in their development transition. Regional lending operations should therefore be seen as an additional tool that can provide tailor-made solutions to countries and regions facing cross-border development challenges.

13. The Approach to a Transition Framework document (EB 2017/122/R.34) embraces the need for IFAD regional lending to supplement IFAD regional grants promoting regional innovation and capacity building. The Approach paper states that:

> Vulnerabilities are cross-border in nature. Regional operations are in all IFIs a fundamental part of the broader strategy to promote regional integration, justified by their high potential for development impact. Specific strategic and operational frameworks have been established to recognize the specific features of regional operations, which offer the potential for higher economic returns compared to national operations but also involve significant additional challenges compared to standard country operations. Regional operations are also effective in providing regional public goods.

14. Furthermore, in the context of the Consultation on the Eleventh Replenishment of IFAD's Resources (IFAD11), Management committed to "explore options for regional lending operations" (IFAD11 commitment 3.6, monitorable action 36) and the institution aims to be ready to implement a first pilot during IFAD11.

15. During the pilot phase of IFAD11, the RLO pilots will be designed by deploying available financial sources and instruments (i.e. loans and country-specific grants through the PBAS, and the limited use of regional grants through the regional grants window). Experiences from IFAD11 will inform adjustments to the PBAS,[3] other finance sources and policies to support RLOs during IFAD12 and beyond.

II. Overview of regional lending operations

16. RLOs support broader efforts at regional integration: they finance cross-border and multi-country interventions that impact a number of countries. Examples of critical issues that can best – or only – be addressed through RLOs include the following:

(a) Promoting regional connectivity: Support for transportation networks and other infrastructure that crosses borders or benefits multiple countries. Individual countries often lack incentives, regulations and planning processes, and sometimes the financial capacity (especially small countries) for these investments, which can be critical for better access to markets for groups such as smallholder farmers or nomadic pastoralists living in border regions.

(b) Expanding regional trade in agriculture and food products. Improved trade positively impacts growth, farmers' incomes and regional food security. Larger cross-border markets increase intraregional trade and help to drive innovation and growth.

(c) Protecting common goods and shared natural resources. Managing threatened natural resources (e.g. forestry and fishery resources) that cross

[2] Regional operations might also be useful to address cross-border fragility. This area will be explored further as part of IFAD's special programme for countries with fragile situations, which will be presented to the Executive Board in April 2019.

[3] A review of the PBAS formula for IFAD12 is already planned as requested by the Executive Board at its 121st session in September 2017.

national borders requires joint action by regional stakeholders. These operations can also help reverse land degradation and preserve biodiversity, as well as support multi-country disaster risk management.

(d) Developing common standards supports harmonization in countries across a region, for example of financial regulations or sanitary and phytosanitary measures.

(e) Promoting security and reducing vulnerability: supporting regional labour markets and migration-related challenges.

17. A regional approach to operations has several advantages. RLOs provide a broad strategic framework to tackle development challenges that are shared by different countries in the same area, thus optimizing both planning and operational efforts and costs. They allow a pooling of resources, which is particularly important for smaller and fiscally constrained countries. They also promote South-South and Triangular Cooperation, and they may lead to best practice innovations that can be scaled up in other regions and regional institutions.[4]

18. One major challenge of RLOs is the need for political alignment, integration and joint ownership among all countries benefiting from the operation. This requires policy dialogue and other non-lending services to pave the way for regional solutions and ensure alignment with participating countries' national priorities. Regional organizations are an integral part of many RLOs, facilitating policy alignment and ownership, and building capacity across countries. Ownership and alignment need to continue past the design stage, and be an integral part of implementation – reaching beyond the operations' life cycles.

III. Regional lending operations in other IFIs

19. Regional and multilateral organizations, such as the regional development banks and the World Bank, can act as catalysts in the provision of multi-country activities and cross-border public goods through their ability to convene, generate and transfer knowledge, assist negotiations and provide funding. Several IFIs have introduced mechanisms for financing RLOs, including the World Bank, Inter-American Development Bank (IDB), Asian Development Bank (AsDB) and AfDB.

20. The original impetus for RLOs was a recognition of the need to manage common risks and further the goal of regional integration. IFIs have a comparative advantage in supporting RLOs given their long-standing role as conveners, strong policy engagement and regional expertise. As a result, RLOs have become an important aspect of IFIs' business, and some now identify RLOs as a corporate priority that includes lending targets (IDB at 15 per cent and AsDB at 30 per cent). Some IFIs have articulated strategies for regional integration, with evolving priorities focused on: the creation of markets and economic opportunities across borders (both integrating into global markets and furthering intra-regional markets); and managing regional pubic goods. Infrastructure has been identified by several IFIs as a priority sector for RLOs.

21. IFIs' criteria for RLOs have evolved over the years, but rest on the concept of "spillover effects" – generating positive (or mitigating negative) externalities across countries, or creating cross-border economic, social or environmental benefits. Some IFIs distinguish between RLOs and multi-country operations, with the former involving spillover effects and requiring concerted actions from a group of countries to accrue the intended benefits, and the latter requiring no collective action and benefits equalling only the sum of individual loans (e.g. multi-country small and

[4] Sandler, T., "Regional public goods and international organizations", in *The Review of International Organizations*, March 2006, Volume 1, Issue 1, p. 5-25. https://link.springer.com/article/10.1007/s11558-006-6604-2.

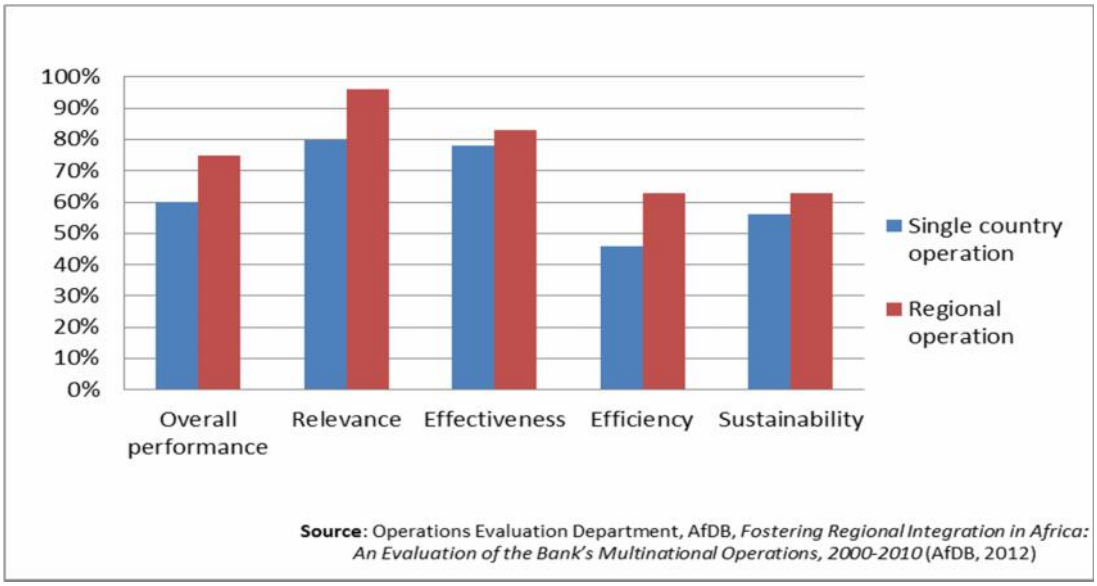
medium-sized enterprise initiatives). IFIs have varying requirements for the number of participating countries; however the majority of RLOs are single-country operations with spillover effects in other countries.

22. RLOs are predominantly financed through project investment lending instruments. In all cases, financing is provided through legal agreements for individual country loans. Grants for technical assistance, institutional development and capacity-building are common features of RLOs. The most common structure of an RLO is either a single-country loan or a sequenced or multi-phased operation with several participating countries, each receiving a single-country loan. Only the World Bank has supported RLOs including several countries simultaneously pursuing a common objective under the umbrella of a single regional project agreement supported by single-country loans.

23. Two hallmark characteristics of RLOs in IFIs are that: (i) most have dedicated funding (additional to PBAS funds) that has spurred significant demand;[5] and (ii) many RLOs include a role for regional organizations. IFIs collaborate with regional organizations by engaging them: to coordinate and facilitate RLOs; or by providing indirect support that is critical in enabling policy reforms to drive regional integration or other regional goals. These regional organizations can be sovereign entities (in rare cases taking on the IFI loans themselves) or specialized technical bodies. While the primary role of regional bodies is facilitation and coordination, national entities usually implement these operations.

24. The benefits of RLOs are in creating development impact that could not be achieved through a single-country operation with a national focus. Evaluations of RLO programmes at the World Bank (2007), AfDB (2012) and AsDB (2015) strongly suggest that RLOs perform as well or better than single-country operations (see figure 1). However, these results indicate that RLOs require additional time and costs due to the need for enhanced coordination and attention during design and implementation. Over the years, there have also been reports of slower-than-average disbursements though RLOs. Other challenges include: complex safeguard, financial management, procurement and legal issues; coordination challenges across countries and with regional organizations; additional needs for capacity-building at the regional and national levels; and internal challenges within IFIs.

Figure 1
Percentage of satisfactory operations financed by AfDB (2000-2010).



[5] Evidence suggests that when incentive funding is reduced, demand for RLOs declines.

25. The vast majority of previous RLOs have financed infrastructure. Trade is another relatively common (although often difficult) issue addressed by RLOs. More challenging – and less common – RLOs finance the management of common resources. Few RLOs have focused on agriculture, primarily as a result of challenges in the sector. Agriculture is limited to certain geographic areas while the public sector's role is focused on services delivered at the national (not regional) level, and private-sector investments are typically not cross-border in nature. These challenges have made financing RLOs in agriculture less attractive to IFIs than those in other sectors. Experience suggests that there may be opportunities for RLOs related to agricultural value chains focused on: (i) developing common standards (i.e. for inputs or for output quality) to enhance competition and trade; (ii) cross-border public goods (such as crop technology development and adoption, and weather data); (iii) cross-border pest invasion; and (iv) nomadic pastoral livelihoods.

26. As part of the work programme for developing IFAD's RLO mechanism, the Fund will continue to learn from best practices in other IFIs. In order to build on these best practices and leverage the extensive experience of other IFIs, their RLOs (particularly those in the agricultural and rural development sectors) will be examined further for their relevance to IFAD, their impact and how this impact was measured.

IV. IFAD's comparative advantage for regional operations

27. With its focus on single-country sovereign loans, IFAD is currently unable to provide sufficient support to countries in addressing development issues that are cross-border, multi-country or regional in nature. IFAD does support a number of regional activities through its regional grant programme[6] and other regional initiatives are funded through Global Environment Facility (GEF) supplementary funds.[7] However, these financing mechanisms are insufficient for many regions, sub-regions and countries to tackle pressing cross-border challenges. As a result, there is considerable unmet demand for IFAD's services.

28. IFAD has a comparative advantage that can complement and fill gaps left by other IFIs. These include bringing the needs and perspectives of smallholders into dialogues on identifying solutions to regional and cross-border issues. The Fund can also advocate for more attention to the regional dimensions of development challenges related to agriculture and rural development. These areas do not receive substantial support from other IFIs' regional programmes, which tend to focus on infrastructure.

29. A number of challenges faced by smallholders require trans-boundary and regional approaches. For example, water resource management and agricultural pests and diseases know no boundaries. These issues are exacerbated by climate change, which is increasing the reach and severity of water scarcity and floods, and the spread of invasive species and pests. Environment and natural resource issues such as biodiversity, air and water quality, water availability, soil functionality and climate stability have important impacts on agriculture and related value chains. These issues in turn impact socioeconomic development objectives such as food security, food safety, rural viability and animal welfare. Such challenges provide several entry points for cross-border rural development projects aligned with IFAD's mandate.

[6] Examples include support to the Farmers' Organizations in Africa Programme, the Alliance for a Green Revolution in Africa and the African Green Revolution Forum.
[7] Examples include the hub project aimed at providing regional services to the pilot programme on Fostering Sustainability and Resilience for Food Security in Sub-Saharan Africa – An Integrated Approach.

30. IFAD already has experience in addressing challenges related to climate change with a regional approach. The GEF-financed programme on food security (see footnote 7), which IFAD leads, aims to increase the adoption of resilient, improved production systems for sustainable food security and nutrition through integrated landscape management and sustainable food value chains in 12 African countries. IFAD has integrated a regional component into the programme, which promotes regional collaboration and South-South learning. This programme is a replicable example of how IFAD could work at the regional level.

31. IFAD will focus its support to RLOs on sectors and issues that draw on its comparative advantages and complement the work of other IFIs. In figure 2, the largest circle represents all the sectors covered by RLOs in other IFIs, the middle circle represents the sectors related to IFAD's mandate and the smallest circle represents the issues most closely aligned with IFAD's comparative advantages (and that complement the work of other IFIs). This last group is most likely to be identified as pilot RLOs.

Figure 2
Thematic focus of RLOs and IFAD's mandate

V. Demand for IFAD support for regional operations

32. There are several potential areas of IFAD's work that could benefit from regional operations. In each area, IFAD's comparative advantage in providing solutions will need to be compared with those of other institutions.

33. Building on early indications of demand for an IFAD RLO pilot, the following examples illustrate what the Fund's RLOs could focus on:[8]

    (a) South Asian agricultural trade. IFAD's main areas of investment could comprise cross-border trade of agricultural products and support to agricultural logistics. A regional operation could be used to strengthen the marketing focus of IFAD-supported operations in this region, especially to facilitate transport from one South Asian Association for Regional Cooperation (SAARC) country to another. This would not only reduce waiting time at borders, but would also harmonize quality criteria, facilitate the development of agri-logistics facilities and enable the processing of higher-value products based on regional market demand.

    (b) Caribbean climate-smart agriculture. Small island developing states, including those in the Caribbean, are particularly vulnerable to climate and economic shocks. However, these states also offer significant potential to increase the production of fresh fruits and vegetables, and develop fisheries by exploiting idle agricultural lands and waters. Such efforts could also mitigate these countries' high youth unemployment and migration. A programme focused on climate-smart agriculture and youth entrepreneurship in agricultural and fisheries value chains could: improve the attractiveness of rural jobs for youth using innovative technologies; motivate young people to remain in rural areas; and improve the quality of local diets.

    (c) Africa's inland lakes. There are opportunities to strengthen the management of fishery resources in Africa's large inland lakes such as Lake Victoria and Lake Tanganyika. Proposals for regional operations, though grant-financed, have already been requested by the Lake Victoria Fisheries Management Organization, a specialized body of the East African Community.

    (d) Regional livestock and nomadic pastoralists. IFAD-financed projects could contribute to managing significant cross-border livestock trade (e.g. South-East Asian, East African and Western African pastoral systems), and transhumance across East Africa, the Horn of Africa and the Sahel.

34. Management proposes to undertake an extensive consultation in order to identify possible candidates for pilot RLOs. This consultation will be facilitated by IFAD's enhanced field presence and undertaken in conjunction with discussions on PBAS programming, with a view to identifying one or more pilot operations by the end of 2018. This process will include the identification of regional operations led by other institutions that IFAD could cofinance, bringing the perspectives of smallholders to these operations' design and implementation.

35. Other IFIs have created incentives – such as dedicated windows and funding in addition to PBAS allocations – for countries to tackle regional issues. This has eliminated the dilemma many countries face in choosing between regional and national priorities, and will need to be addressed by IFAD after the pilot phase.

[8] RLO pilots must be approved by the Executive Board. Therefore, the examples included in this concept note are for illustrative purposes only.

VI. IFAD's approach in the pilot phase and beyond

36. Other IFIs including the World Bank have developed their approaches to RLOs over time, based on lessons learned. IFAD's Management proposes a similar approach by assessing experiences gained through the pilot (based on interim procedures) to inform future operational guidelines. The proposed way forward is outlined below.

37. Pilot and learning phase. The IFAD11 period (2019-2021) would constitute a pilot and learning phase in which IFAD's current financial instruments would be used to pilot two or three regional operations. The pilot RLOs would be governed by interim procedures.

38. The interim procedures for RLOs in IFAD11 will build on the following:

(a) Identification of pilot operations: In order to identify operations for the pilot phase, IFAD regional divisions would promote the RLO concept among borrowing countries as the programme of loans and grants for IFAD11 is being developed. These discussions would include options for RLOs in which IFAD takes the lead and assembles the required financing, and project ideas identified by other IFIs to which IFAD could provide cofinancing and influence the design by sharing smallholders' perspectives.

(b) Project design: The Fund's RLOs would build upon ongoing work and relationships with regional organizations and IFIs. The RLO design process may be more time-consuming than single-country operations since it requires significant policy engagement and coordination between borrowers to agree on common objectives, implementation modalities and timelines. Key characteristics of the design process include the following:

(i) In order to optimize the design and treat each RLO as one integrated project, the design process would be managed by one country programme manager or country director in coordination with the other country programme managers in participating countries.

(ii) All of IFAD's policies, procedures and review processes would apply to the design of RLOs, including its new development effectiveness matrix and assessments related to financial management (see appendix III for details). These policies and procedures would apply even if IFAD cofinances a RLO led by another institution.

(iii) The costs of RLO project design would be closely monitored to maintain parity with the budgets for single-country operations. IFAD's decentralization would facilitate coordination and engagement with partners throughout the RLO design process. Additional funds for RLO design may be sought from potential cofinancers.

(c) Financing of RLOs: RLO pilots in IFAD11 would be financed through IFAD's current financial instruments, regardless of whether IFAD is the lead agency or cofinancier:

(i) The PBAS allocation to each participating country in the RLO: participating countries could choose to include their full country allocation or a partial allocation in the RLO.[9] According to the financing terms of each country, PBAS allocations could consist of loan funds (for

[9] Other IFIs offering RLOs operate with ceilings on the share of performance-based allocations that countries can use for regional operations. The shares range from 10 per cent at the AfDB to 20 per cent at the AsDB and the World Bank. One rationale for these ceilings is to ensure that funds are also available for national priorities, especially in countries with small allocations. However, these other IFIs have larger performance-based allocations and usually finance several projects in one country. Since IFAD offers smaller PBAS allocations, it would not be efficient to set ceilings for IFAD11 RLO pilots since they might become too small. This issue may be reconsidered if a window for additional financing to RLOs is introduced at a later stage.

"green" and "yellow" countries), country-specific grants (for "green" countries only) or Debt Sustainability Framework grants (for "yellow" and "red" countries).[10] For "green" countries, country-specific grants[11] could be used to finance RLO-related activities such as incremental regional coordination, South-South and Triangular Cooperation, cross-border knowledge management and other activities supporting countries' efforts towards regional integration.

(ii) Regional grants: According to IFAD's Policy for Grant Financing, IFAD grants should: (i) make a significant contribution to a global, regional or national public good related to IFAD's mandate; (ii) focus on interventions in which grant financing has clear added value and a comparative advantage over regular loans; and (iii) not be used as a substitute for resources from IFAD's administrative budget. IFAD regional grants are subject to competitive approval processes and are implemented by third parties (i.e. non-governmental entities). It is proposed that regional grants be used to finance regional public goods as an integrated part of RLOs, or to finance regional activities that would otherwise support the effectiveness of RLOs. The grants would seek to explicitly address issues that the investment loans could not.

(iii) Additional cofinancing and partnerships: In line with IFAD's proposed cofinancing strategy, Management proposes to identify and seek out additional sources of financing to complement core resources in financing RLO pilot operations. This includes mobilizing additional resources through the second phase of its Adaptation for Smallholder Agriculture Programme and IFAD's partnerships with GEF and the Green Climate Fund, including from their regional windows. Management will learn from approaches taken with GEF in order to address regional and trans-boundary environmental challenges, and achieve results.

(iv) IFAD may choose to cofinance RLOs identified by other organizations. In this case, the IFAD financing would be focused on issues relevant to IFAD's mandate using the previously mentioned instruments.

(d) Legal establishment: It is proposed that each participating country have a separate financing agreement with IFAD drawing on its PBAS allocation. Schedule 1 of the financing agreement – project description and implementation arrangements – would stipulate how the country-specific activities would fit into the larger regional project. Agreements for regional grants would include clear language detailing how regional activities will be coordinated with national actors during RLO implementation.

(e) Negotiations of financing agreements: Prior to the formal negotiations, IFAD would engage in thorough consultations with all participating stakeholders in IFAD-led RLOs to ensure their agreement on activities within each country and across the entire region. Schedule 1 of the financing agreement on the project description and implementation arrangements should include similar elements. The formal negotiation process for each financial instrument would take place individually, building on prior agreement on the project description and implementation arrangements.

[10] Financing terms of each country are governed by the Policies and Criteria for IFAD Financing, and Proposed Arrangements for Implementation of a Debt Sustainability Framework at IFAD (EB/2007/90/R.2).
[11] Country-specific grants are included in countries' PBAS allocations and are equivalent to 1.5 per cent of IFAD's programme of loans and grants. Only "green" countries (countries not eligible for Debt Sustainability Framework grant financing terms) are eligible to receive this grant financing. Country-specific grants comprise: (i) loan-component grants (i.e. part of an investment project); or (ii) stand-alone grants. Both types of country-specific grants could be used to finance RLOs.

(f) Lending terms: The applicable lending terms would be those of each borrowing country.

(g) Eligibility criteria: The eligibility the of specific sector and project types for RLOs would be governed by IFAD's current suite of policies in the same manner as single-country loan operations, including the Targeting Policy, Environment and Natural Resource Management Policy, and the IFAD Policy on Gender Equality and Women's Empowerment. However, in order to ensure development effectiveness, a unique set of eligibility criteria has been developed to prioritize selection of RLO pilots in IFAD11:

(i) Proposed regional operations must credibly demonstrate spillover effects yielding development effectiveness and results that could not be generated through one or more single-country operations.

(ii) RLO pilot operations in IFAD11 would include two or more countries, with some flexibility for single-country operations with regional impact. This practice is in line with those of peer organizations.

(iii) The focus of RLO pilot operations would be aligned with the strategic objectives of participating countries' country strategic opportunities programmes (COSOPs).

(iv) IFAD would need to have a clear comparative advantage in order to finance an RLO, relative to other sources of financing. It is important that these operations focus on IFAD's mandate of enabling inclusive and sustainable transformation of rural areas, based on lessons learned from similar operations.

(h) Mainstreaming agenda. RLOs would contribute to the IFAD11 mainstreaming agenda in the same fashion as single-country operations. They would need to be: nutrition sensitive; gender transformative; have a focus on environmental sustainability; and mainstream youth employment.[12]

(i) Synergies would be sought within IFAD's decentralized structure, taking advantage of the Fund's new regional hubs and regional approach to country programme delivery.

(j) Learning module at the project level: In pilot operations, special attention would be paid to monitoring, evaluation and learning, including adequate funding for learning from experience. At the design phase of the RLOs, there would be a focus on ensuring that the projects: (i) present a clear theory of change; (ii) make explicit any questions to be answered in future assessments; and (iii) have a clear data-collection strategy. Similar to single-country operations, RLOs would be analysed against IFAD's Development Effectiveness Framework.

(k) Approval: RLOs would be presented to the Executive Board for approval regardless of the amount to be financed. Ideally, all financing agreements would be presented to the Executive Board at the same time, although this is not a legal requirement. IFAD would coordinate with borrowing countries and grantees to ensure appropriate timing of loan and grant approvals.

39. Synthesis report with lessons learned. In late 2019 or early 2020 (once some RLO pilot operations have been designed and implementation started), IFAD will assess the benefits and challenges of this approach in order to estimate further demand for RLOs among borrowing countries. The findings will be summarized in a synthesis report that will be presented to the Executive Board. These findings will

[12] An overview of the overall commitments to mainstream nutrition, gender, youth and climate in IFAD11 can be found in table 1 on page 30 of the Report of the Consultation on the Eleventh Replenishment of IFAD's Resources (GC 41/L.3/Rev.1)

draw on both IFAD-led RLOs and those cofinanced by IFAD. Based on the findings of this assessment, Management will decide whether to pursue the development of an enhanced approach to RLOs and mainstream this approach into IFAD's service offerings.

40. Impact assessment. Upon project completion, at least one of RLO pilot will undergo a full impact assessment (even if it will be too late to inform an institutional approach). Efforts will be made to compare RLO impacts to those of single-country IFAD projects.

41. Enhanced approach to regional lending operations. Subject to the findings of the impact assessment mentioned above, an enhanced approach to RLOs would be included in the IFAD12 Consultation, which is expected to begin in 2020.

42. As with other IFIs, an enhanced approach would likely include a specific window for countries to access funds in addition to PBAS allocations for RLOs. IFAD's grant programme would be revisited at that time to assess whether regional grants should be enhanced or other grant sources mobilized to support RLOs. This enhanced approach would also identify the need for specific policies or strategies related to RLOs, along with any legal or procedural changes for RLOs beyond the pilot phase.[13] COSOP guidelines may also be adjusted to integrate the agenda for regional integration, which RLOs could help to further.

[13] According to the Agreement Establishing IFAD, the Fund can also provide loans to inter-governmental organizations in which IFAD Members participate. In this case, IFAD may require governmental or other guarantees. Financing through inter-governmental organizations is another approach to regional operations that could be explored in IFAD12 or later. This approach does not seem feasible for IFAD11 since the PBAS currently allocates funds to countries and not regional entities.

Key Features of Regional Lending Operations across IFIs

KEY FEATURES OF REGIONAL LENDING OPERATIONS ACROSS IFIs*				
	WB	**IDB**	**AsDB**	**AfDB**
Program Launch	2003 (for IDA countries as part of replenishment)	2005/2011	1994	1996 (formalized in 2000 framework)
Strategy/Key Documents	IDA Replenishment, mid-term reviews, and dedicated IDA reports on Regional Operations (2003-2018)	Grant financing only (2005); IDB Support to Global and Regional Integration in LAC (2010); Sector Strategy to Support Competitive Global and Regional Integration (2011) and 2012 Action Plan; Guidelines for the Classification and Validation of Operations Eligible for the GCI-9 Regional Cooperation and Integration Lending Priority (2013)	Regional Cooperation Policy (1994), Regional Cooperation and Integration Strategy (2006); Operational Plan for RCI (2016)	Economic Cooperation and Regional Integration Policy (2000); Regional Integration Strategy 2009-2012; Strategic and Operational Framework for Regional Operations (2008); Regional Integration Policy and Strategy 2014-2023 (2015)
Corporate Priority	Priority for IDA/ concessional financed countries	One of five strategic corporate priorities; target of 15% lending for Regional Operations (2011)	Emphasized in Strategy 2020 with lending target of 30% by 2020	Priority for ADF/ concessional financed countries
Comparative Advantage	Country and regional engagement dialogue underpinned by analytic work; leadership and convening power; experience with design of complex projects	Honest integration broker; access to regional networks and external resources; ability to bring together regional actors; high technical and operational standards; trusted partner; regional knowledge; regional ownership of IDB	Finance; knowledge; capacity building (for national and regional bodies); honest broker (catalyst and coordinator for regional cooperation and integration	Leadership role for continental initiatives; knowledge broker and strategic partner for regional integration
Defining Characteristics	Spillover effects—generating positive externalities or mitigating negative ones across countries. Require a concerted action from a group of countries for all benefits to accrue	Cross-country focus; regional additionality; national subsidiarity; compensation of coordination failures	Direct or indirect cross-border economic, social or environmental net benefits	Benefits are superior to individual country operations or a multi-country operation; projects with regional impact and positive cross-border effects
	WB	**IDB**	**AsDB**	**AFDB**

Number of Participating Countries	Minimum 3 countries (2003); or 2 countries if one is FCS (2011); or single country project if deemed transformational (2014/15)	Single-country with regional spillovers, or multi-country.	Single-country with regional spillovers, or multi-country.	Single-or multiple country with cross-border benefits.
Type of Instruments	Investment Project Lending; grants	Regional policy-based lending and investment lending; grants	Investment lending; grants	Investment lending; grants
Loan Structure**	Both multiple single-country sequenced loans and multiple single-country coordinated loans	Predominantly one single country loan and multiple single-country sequenced loans	Predominantly multiple single-country sequenced loans and also one single-country loans	Predominantly one single country loan and multiple single-country sequences loans
Dedicated/top up Funding	Dedicated window for IDA countries; each RO funded with 1/3 PBA and 2/3 RO window. Cap of 20% annual PBA for ROs for small countries (2009); grant funding	Grant funding; launched in 2015 a modest set-aside for global and regional integration	Set-aside for ADF (concessional) countries; began with 5%, later raised to 10%, of overall ADF resources. 50% from PBA and 50% from set-aside. Ordinary Capital Resources (OCR), i.e. non-concessional, country set-aside introduced in 2015 with $500 million pilot; grant funding	Dedicated envelope for concessional countries requiring 1/3 from PBA and 2/3 from dedicated RO envelope (with a 10% ceiling on PBA for small countries); grant funding
Lending volumes	$14.1billion cumulative 2002-18	$14.5billion for regional integration and $103million for regional public goods	$26billion 2003-14	$3.8billion 2009-17
Sector focus	65-85% infrastructure; 7% agriculture	Primarily transport, energy and ICT; <1% agriculture	Primarily transport and power; 1% agriculture	Primarily infrastructure, with >50% transportation and energy; significant agriculture in early 2000s but since declined to 4%
	WB	**IDB**	**AsDB**	**AfDB**

Evaluations	The Development Potential of Regional Programs (2007); Approach Paper (2017) for evaluation of WBG support for fostering regional integration (evaluation forthcoming 2018)		Support for Regional Cooperation and Integration (2015)	Fostering Regional Integration in Africa: Evaluation foo AfDB Multinational Operations 2000-2010 (2012)
Evaluation Findings	% satisfactory outcomes was higher for regional projects than overall average		Performance of RCI projects on average 81% successful compared with AsDB average of 61% and non-RCI of 59%	ROs rated satisfactory at 96% for relevance and 86% for effectiveness compared to 80% and 78% for single-country operations. 63% rated satisfactory for efficiency and sustainability compared to 46% and 56% for single-country operations

* Each IFI has a specific name and acronym for its regional activities. The information in this table is culled from available documents, some of which have not been updated in recent years.

**** Spectrum of Regional Operations (operational structures used in varying amounts by each IFI)**

Challenges of Regional Lending Operations. The challenges noted across the IFIs are relatively consistent, stemming from the technical complexity of the operations and the additional coordination and financing challenges inherent in multi-country operations. Challenges include:

- Lengthy timelines and higher project costs. One estimate[14] suggests that preparation and supervision costs for RLOs can be as much as 1.5 times that of single-country projects. Another estimate[15] suggests that RLOs are 73% more expensive to design and 36% more to supervise.
- ROs often generate very complex safeguard-related issues which require close and lengthy monitoring processes to ensure that affected people and concerned sites are dealt with in accordance to highest international standards.
- Procurement and financial management is complex, especially due to the number of counterparties involved.
- Additional support is needed for capacity building of both regional and national institutions.
- Risks from unexpected events (e.g. civil disturbance, political crises) in one or more countries can cause delays in the overall project.
- There is significant legal complexity, including multiple legal processes for each loan in a multicountry RO, which can delay project effectiveness and project start.[16]
- Donors wrestle with the complexities of supporting regional programs, and donor coordination and alignment issues are considerable.
- Regional institutions are key to implementing ROs but in many cases their political commitments have exceeded their capacity to deliver complex regional investment projects. The enabling environment for market integration is critical as is the framework for regional cooperation through eg Regional Economic Communities (SADC, SAARC, OECS) and sector/project specific regional institutions.
- Coordination between participating countries and regional organizations serving as implementing agencies can be challenging. Strong leadership is needed by national and regional champions as are strong and clear implementation and governance arrangements.
- Internally, the IFI business model remains a single-country operation model and is not well-adapted to the requirements of multi-country operations. This affects issues such as systems needed for tracking/monitoring regional projects, and how projects are rated upon completion.[17]

Key lessons learned: A number of lessons appear to emerge from the review of IFI experience, including: (i) defining and drawing on IFI comparative advantage and role for RLOs; (ii) country alignment and ownership; (iii) defining the role of regional organizations; (iv) timing and project duration; and (v) internal IFI capacity and resources.

[14] AfDB 2008 "Strategic and Operational Framework for Regional Operations", 2008
[15] WB "IDA14 Mid-term Review of the IDA Pilot Program for Regional Projects", Nov 2006
[16] Legal issues identified by the World Bank included: Agreeing on Protocols, International Legal Relationships Between Countries, Legal Status of the Regional Organization, Legal Covenants for Implementation, Assuring Commitment of Member States, Cross-effectiveness, and States under Provisional Status. See IDA14 Mid-term Review of the IDA Pilot Program for Regional Projects (Nov 2006).
[17] IFIs need to determine the weight of individual project ratings and how they affect the overall project rating. For instance, if the Completion Report for a four-country project suggests a Satisfactory in three countries but an Unsatisfactory in one country is the overall project rated Unsatisfactory?

The Concept of Regional Public Goods

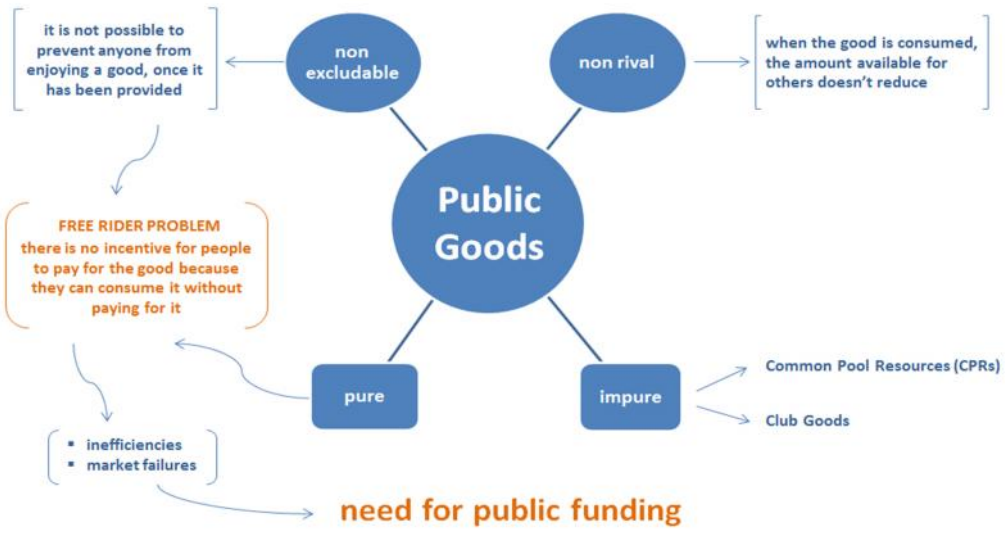
1. A good or service is defined as "public" when it satisfies the two criteria of being non-rival and non-excludable.[18]

   (a) Benefits are non-rival when each individual's consumption of such a good leads to no subtraction from any other individual's consumption;

   (b) Benefits are non-excludable when they are available to all would-be consumers once the good is supplied and it is infeasible to price units of a good in a way that prevents those who do not pay from enjoying its benefits.

2. These two properties of pure public goods give rise to market failures that may require either government provision or some form of cooperation among the benefit recipients. Non-exclusion results in a market failure because a provider cannot keep non-contributors from consuming the good's benefit (the free rider problem). Once the public good is provided, consumers have no incentive to contribute because their money can purchase other goods whose benefits are not freely available. Thus, the public goodwill be either undersupplied or not supplied. Benefit non-rivalry means that extending consumption to additional users results in a zero marginal cost. Exclusion based fees are inefficient because some potential users, who derive a positive gain, are denied access even though it costs society nothing to include them.

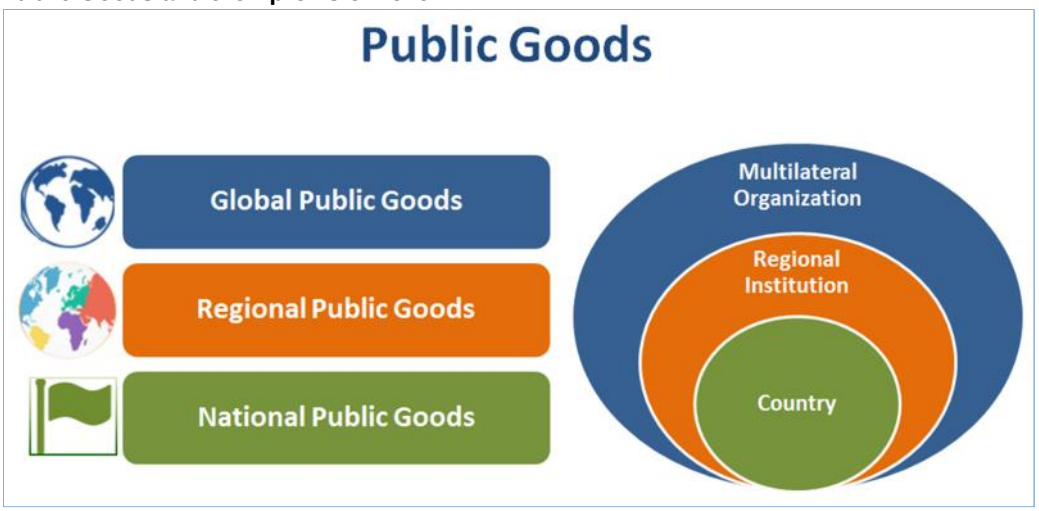
Figure 1
The nature of Public Goods



3. Pure regional public goods are those services or resources whose benefits are shared by countries in a region and that satisfy the two above-mentioned conditions (non-rivalry and non-excludability). For purely public regional public goods, intervention by a global institution, regional organization, or other collective is required for provision.

[18] The theory of public goods was first postulated by Paul Samuelson in "The Pure Theory of Public Expenditure", *The Review of Economics and Statistics*, Vol. 36, No. 4, November 1954.

Figure 2
Public Goods and their provision level



4. Regional efforts produce regional public goods (RPGs), and therefore are subject to the free-rider problem of financing public goods (and to market failures). Except for the largest countries, which have an incentive to supply themselves with these regional public goods, countries may seek to benefit from the investment of others.

5. The under provision of RPGs is related to the reluctance of countries to devote their national resources to supranational projects whose spill-overs are often not clearly identifiable, nor quantifiable. In many cases, in fact, the RPG itself does not generate direct revenues, but it only has an indirect positive influence. It is precisely here that a Regional or a Multilateral Development Bank (MDB) has a major opportunity to step in, since it can both coordinate as well as contribute to the financing of these essential regional capacities. To effectively exercise a leadership role, MDBs need to develop mechanisms for financing RPGs that do not depend solely on individual country borrowing decisions.[19]

Regional Public Goods in Agriculture

6. Apart from tradable commodities, such as food, fibre and fuel, agriculture also provides non-commodity outputs. The former production outputs are usually defined as the agricultural economic function. In contrast, the latter are referred to as environmental and social externalities of agriculture, which include agricultural landscapes, farmland biodiversity, water quality, water availability, soil functionality, climate stability (greenhouse gas emissions, carbon storage), food security, food safety, rural viability and farm animal welfare. Agricultural activities impact upon environmental functions, such as soil function, water purity, air quality, landscapes and biodiversity, resulting in either positive externalities (public goods) or negative externalities (public bad).[20]

[19] Pingali, P. and Evenson, R., *Handbook of Agricultural Economics*, Vol. 4, North Holland, Elsevier 2010, p. 3582-3583.
[20] Chen, Q., Sipiläinen, T. and Sumelius, J., "Assessment of Agri-Environmental Externalities at Regional Levels in Finland", *Sustainability*, n. 6, 2014.

Audit and Financial Management in Regional Lending Operations

Financial Management Assessment

1. Effective oversight and governance of IFAD's financial resources is vital to the Funds' ability to achieve its objectives and to be accountable to its stakeholders. In accordance with IFAD policies and procedures, the proceeds of IFAD financing can be used solely for the purposes intended under the financing agreements.

2. The purpose of this annex is to set some of the principles of financial management arrangements in RLOs. The non-country regional grants financial management requirements are covered by the existing grant procedures.

3. IFAD's Financial Management Services Division (FMD) will be responsible for carrying out a Financial Management assessment and associated risk for each participating country and proposed Project Implementation Units (PIUs) involved in the management of RLOs. The assessment will be performed in accordance with the risk based approach as documented in IFAD's Financial and Administrative Manual.

4. The assessment will also consider the degree of adequacy and efficiency in the following areas: (i) staffing and organisational structures; (ii) budgeting (systems of annual budget preparation and execution); (iii) funds flow and disbursement arrangements; (iv) internal control; (v) accounting systems, policies and procedures; (vi) reporting and monitoring; (vii) internal audit; and (viii) external audit arrangements.

5. As part of the financial management assessment, the opportunity to use country systems will be evaluated and promoted where appropriate standards exist[21].

Interim Financial Reports

6. Unaudited Interim Financial Reports (IFRs) will be required to be submitted to IFAD by each participating country individually. The content and format of IFRs will be prepared in accordance with IFAD Handbook for Financial Reporting and Auditing of IFAD-financed Projects. The opportunity to prepare and present to IFAD consolidated IFRs will be evaluated during design, and the relevant roles and responsibilities among participating countries will be identified and agreed.

7. The frequency of submission and period covered by IFRs, as well as any additional requirement to the minimum content of IFRs will be determined at the design stage in consultation with the participating countries. The requirements relating to the IFRs will be established in the respective financing agreements and/or letters to borrower/recipient.

Annual project financial statements and external audit arrangements

8. Borrowers/recipients of participating countries will be required to submit to IFAD unaudited and audited project-specific financial statements annually, within four months and six months respectively from the end of the fiscal year. Each

[21] IFAD has a strong commitment in the context of the Accra Agenda for Action to use country systems when appropriate standards exist

participating country under RLOs will prepare and deliver separate unaudited and audited financial statements. The opportunity to prepare and present to IFAD consolidated unaudited and audited financial statements will be evaluated, based also on the nature of underlining operations of the RLOs, during the design phase, and the relevant roles and responsibilities in this respect among participating countries will be identified and agreed, including the appointment of the auditor and the payment of its services.

9. The individual project's financial statements to be delivered by each participating country will be prepared in accordance with acceptable accounting standards[22] to IFAD. An alignment of the accounting standards adopted for preparation of individual financial statements will be encouraged.

10. In the event that a project's consolidated financial statements are prepared, a unified accounting standard acceptable to IFAD will be adopted for preparation of the individual and consolidated financial statements, and similarly for the auditing standards to be adopted for conducting the external audit.

11. The financial statements reporting period is generally twelve months and it expected to coincide with the participating countries' fiscal years. In the case of consolidated financial statements, an alignment of the reporting period will be determined in consultations with participating countries during the design.

12. As a general principle for RLOs, IFAD will require the use of consolidated IFRs, unaudited and audited financial statements whenever feasible and in agreement with participating countries.

Disbursement performance

13. The implementation of RLOs may be affected by the increased complexity of the projects, which could potentially result in slow disbursements and/or the need to extend the implementation period beyond the original time-frame. This risk will have to be taken into account during design and close monitoring and support will be required during implementation. In this respect, lesson learnt from the RLOs pilots will be documented as part of the findings which will presented to Executive Board.

Supervision and implementation support

14. FMD will carry out annual supervision missions and implementation support missions as required to identify risks and mitigation measures, follow-up on actions needed as appropriate and support the project management to ensure that effective financial management arrangements are in place. The learning from the pilot phase of RLOs will be documented and relevant procedures will be updated to incorporate lessons learnt and best practices as appropriate.

15. Similar to the arrangements indicated in paragraph 38b.a of the concept note, RLOs will ideally be managed by one IFAD Finance Officer, in coordination with the other IFAD Finance Officers assigned to countries participating in the RLOs.

[22] As per IFAD Handbook for Financial Reporting and Auditing of IFAD-financed projects