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Investing in rural people

IFAD at a fork in the road

Note to Executive Board representatives

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For: **Review**

IFAD at a fork in the road

1. In the context of the ongoing Executive Board governance reform, members requested that, as part of the Board agenda, a strategic discussion be introduced at the beginning of Board sessions, in which the President would set out his vision for IFAD's future strategic direction.

2. This short paper responds to this request. Rather than define a long-term vision for IFAD, it focuses on four items that address the challenges and opportunities lying ahead for the institution as part of this strategic discussion. The paper will touch on:

   (a) IFAD's engagement with red light[1] countries

   (b) Balance between loans and grants

   (c) Vertical fund approach

   (d) Human capital

IFAD's engagement with red light countries

3. Over the past few months, the Board and Management have been engaged in finding a solution for the Debt Sustainability Framework (DSF) issue. This engagement will be discussed as a specific agenda item at this session of the Board. Management has made a proposal for the DSF based on a pre-financing mechanism whereby the level of future DSF financing to countries in high debt distress will be linked to the level of replenishment. Further options may also be considered and it is hoped that a decision will be reached.

4. The most pressing issue, however, is the likely capping of the maximum level of resources to be allocated to DSF as a result of the replenishment target. While a special effort to solve the DSF issue for the Twelfth Replenishment of IFAD's Resources (IFAD12) will be made, we are aware that the long-term pressure on official development assistance (ODA) may not allow for a decisive increase per replenishment cycle. Bearing this in mind, Management is seeking to leverage additional resources through borrowing. However, red countries will not be in a position to benefit from the resources leveraged from this increase because of their debt distress. Indeed, an unintended consequence could be a significantly reduced engagement by IFAD in red countries, while still meeting such statutory obligations as the 90:10 ratio and a 50 per cent allocation of resources to Africa, and a drift in focus towards "yellow " and "green" low-income countries (LICs) and lower-middle-income countries (LMICs), which are in a position to access loans from both core and borrowed resources.

5. This scenario – combined with IFAD's mandate that stipulates a focus on the poorest of the poor and, by consequence, the most fragile situations – poses the question: is this the direction that the Fund should take? Should the Fund not find a way to remain engaged in the red countries? If not, can we continue claiming that our focus is on the poorest?

Balance between loans and grants

6. Globally, we estimate that 57 per cent of IFAD's resources are used as grants (either as grant elements of DSF concessionality or under the IFAD grant programme). However, IFAD currently has no special grant-based windows for its interventions. At times this has been a major impediment to IFAD's ability to respond in post-crisis circumstances, or address climate adaptation and resilience issues and other situations where the grant mechanism is more suited.

[1] See IFAD11/2/R.6: red light = low debt sustainability; 100 per cent grant; yellow light = medium debt sustainability; 50 per cent grant, 50 per cent loan; and green light = high debt sustainability; 100 per cent loan.

7. In 2016, the Board approved the strategy for engagement in countries with fragile situations, which empowered IFAD to undertake activities in countries that would lead to inclusive and sustainable rural transformation. These activities include re-engagement with countries where fragility has caused suspension or prevented engagement under regular financing from the performance-based allocation system. The strategy further empowers Management, in cases of severely weakened institutional frameworks, to work through non-government partners – including the private sector and civil society – to address urgent development needs. Limitations on grant resources have however prevented IFAD from engaging actively in these countries.

8. The multilateral development banks have various schemes to respond to the specific needs of these countries. For instance, the World Bank Group can extend totally grant-based financing through the International Development Association (IDA), while the African Development Bank has access to a concessional window through the African Development Fund.

9. Any initiative to create or increase IFAD's grant-based mechanisms could have a negative impact on the core resources (substitution risk).

10. This situation challenges us to find a balance between the loan business and the grant business: on one hand, the leveraging strategy will push IFAD towards becoming a fully fledged development finance institutions (DFI). We may also wish to consider how the multilateral development banks work and to mimic models such as the IDA and the International Bank for Reconstruction and Development; on the other hand, the creation of two new grant windows could be seen as pushing IFAD more towards the business model of a typical United Nations agency. There is not necessarily a contradiction between these two models as they are not mutually exclusive. Considering the growing debt burden of certain LICs and LMICs, the flexibility of having both a loan portfolio activity and a sizeable grant-related activity will be needed.

Vertical fund

11. Vertical funds are development financing mechanisms with mixed funding sources that allocate ODA for specific purposes. These funds have been especially popular in the health and educational sectors; some examples are GAVI (the global Vaccine Alliance), the Global Partnership for Education and the Global Fund. In a context in which there is pressure on ODA and core (unrestricted) resources in the United Nations system, earmarked resources to distinctive and narrowly defined programmes within a specific development domain or to a region have increased rapidly, and this is becoming the favoured modality of several donors. Their dedicated funding source, agility and private sector and civil society participation have resulted in decisive delivery of impact at scale for such funds.

12. A vertical fund for agriculture could potentially align efforts to tackle identified long- and short-term constraints in the sector to boost both farm and non-farm activities in support of Sustainable Development Goal 2.

13. The current global architecture for agriculture and food security comprises several pillars. In addition to the three Rome-based agencies (FAO, WFP and IFAD), the multilateral development banks (the World Bank and the regional development banks), the CGIAR, bilateral donors and the European Union, a large number of public institutions, NGOs, private businesses and philanthropic institutions are active in this space. These include funds such as the Global Agriculture and Food Security Program, the Global Alliance for Climate-Smart Agriculture, and mechanisms focused on environmental and climate finance (e.g. the Global Environment Facility and Green Climate Fund). Within this architecture, there is a large degree of heterogeneity and need for greater coordination. The World Bank and bilateral donors invest about 5 per cent of their lending in agriculture. Regional

development banks are increasingly focused on rural infrastructure or other hard investments. The CGIAR system contributes critical research.

14. In this landscape, IFAD stands out for its specific focus on investing in inclusive rural transformation by targeting the poorest people in the poorest countries. After 40 years of focusing on transforming rural economies and supporting both farm and non-farm activities, one could envisage IFAD becoming the vertical fund for rural transformation and resilience. What form should this take? And what would be the drawbacks?

Human capacity

15. The reforms of the past three years and the recent analysis undertaken by the consulting firm McKinsey have demonstrated not only the dedication of staff to IFAD's mandate, but also the limitations faced given the magnitude of the global challenge to achieve the SDGs and the level of our ambition. The human capital of IFAD to deliver is of paramount importance. While this will be discussed in the context of the budget during this session, our collective reflections must go beyond budgetary considerations. If we simply deal with the human capital aspect through a business-as-usual approach on an incremental basis, fixing what can be fixed and moving ahead despite the risks, the fear is that the challenge of inadequate capacity will remain, particularly as we move towards becoming a fully fledged DFI. We risk failing to attract the qualified young talent needed to rejuvenate the institution and the experienced talent to reinvigorate it. Similarly, the ability to retain staff will be challenged, particularly in the context of decentralization and the need for diversified skills-sets to respond to IFAD’s changing model.

Conclusion and the way forward

16. This paper has outlined some issues of importance to IFAD. It also raises some questions to trigger discussions.

17. Management looks forward to the joint lessons emanating from this exercise – the first of its kind – which we believe will guide us in subsequent sessions.