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Investing in rural people

IFAD10 Consultation Intersessional Paper

Issues arising from the third session

Note to Consultation members

Focal points:

Technical questions:

Mohamed Beavogui

Director and Senior Adviser to the President
Partnership and Resource Mobilization Office
Tel.: +39 06 5459 2240
e-mail: m.beavogui@ifad.org

Iain Kellet

Associate Vice-President
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: i.kellet@ifad.org

Gerard Sanders

General Counsel
Tel.: +39 06 5459 2457
e-mail: g.sanders@ifad.org

Dispatch of documentation:

Deirdre McGrenra

Head, Governing Bodies Office
Tel.: +39 06 5459 2374
e-mail: gb_office@ifad.org

Consultation on the Tenth Replenishment of IFAD's Resources —
Pre-Fourth Session

For: Information

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Abbreviations and acronyms

DSF	Debt Sustainability Framework
IFAD10	Tenth Replenishment of IFAD's Resources
IOE	Independent Office of Evaluation of IFAD
KfW	KfW Development Bank
MICs	middle-income countries
PBAS	performance-based allocation system
PoLG	programme of loans and grants

IFAD10 Consultation Intersessional Issues Paper Issues arising from the third session

I. Introduction

1. The following paper is designed to clarify a number of issues raised by Members during the third session of the Consultation on the Tenth Replenishment of IFAD's Resources (IFAD10). The paper addresses three key areas: financial scenarios and borrowing; complementary contributions; and defines a roadmap for sharpening the IFAD's work in middle-income countries (MICs).
2. The first section of the paper aims to provide members with a transparent picture of financial scenarios and resulting allocation implications should borrowing be pursued during the IFAD10 period.
3. In this regard, the best possible scenario for the institution would be that it receive core replenishment resources in the amount of US\$1.44 billion. Should this level of replenishment not materialize, IFAD would pursue sovereign borrowing as per the General Borrowing Framework currently under discussion in the Audit Committee and planned for submission to the Executive Board for approval in April 2015.
4. However, as clearly expressed by the President of IFAD in his opening statement at the third session: "the contribution of Member States must remain the 'core' of IFAD's resources. It must remain the backbone of this institution. There is a simple reason for this. IFAD is both a United Nations body and an international financial institution. To work in the most fragile of states, to work in the most conflict-affected of states, IFAD's United Nations hat and identity must remain [and]...IFAD's United Nations mission can only be ensured with direct Member State support."
5. Were IFAD to pursue the option of sovereign borrowing to reach the US\$3 billion target of programme of loans and grants (PoLG) during the IFAD10 period, the scenarios that Management wishes to share with the Membership through this paper would nevertheless demonstrate that borrowing would be beneficial to all categories of IFAD Member States, and in particular to the low-income countries. This is because the application of the performance-based allocation system (PBAS), as it is currently designed, would automatically channel the bulk of the core resources released as a result of borrowing towards low-income countries. This is how the PBAS was set up to work, and any sovereign borrowing would simply reinforce this existing resource allocation mechanism.
6. It is important to point out that Management has taken a very conservative approach to the financial scenarios presented herein, assuming that zero complementary contributions are pledged. That said, Management is actively seeking complementary contributions for four agreed priority themes: the mainstreaming of climate change and of nutrition-sensitive agriculture and the enhancement of South-South and Triangular Cooperation and public-private-producer partnerships. The second section of the paper provides a clear definition of complementary contributions and details how such contributions will be administered during IFAD10 to help the institution meet its target PoLG of US\$3 billion.
7. Finally, the paper lays out a clear road map for ensuring that IFAD responds to the distinct needs of its MIC members – who are, and will remain, an important IFAD client group as well as significant contributors to IFAD's financial sustainability in the coming years. A refined strategy for IFAD's work and engagement with MICs will be a top priority in the coming years.

II. Borrowing scenarios for achievement of the IFAD10 target: amounts and implications for loan portfolio composition

A. Background and assumptions

8. At the third Consultation session, members supported a replenishment that would permit the maintenance of a PoLG of at least US\$3 billion (as in the case of IFAD8 and IFAD9). They agreed that highest priority must be given to mobilizing the US\$1.44 billion in core and unrestricted complementary replenishment contributions required to reach a target level for IFAD10 of US\$3 billion.¹
9. The US\$1.44 billion replenishment target assumes that all sources of funds would be in the form of core contributions, since these constitute the strongest support for the Fund.
10. This analysis presents the borrowing scenarios that Management would need to consider if replenishment contributions (both core and complementary) were to fall short. In other words, the scenarios that would enable it to compensate for the shortfall to achieve a PoLG of US\$3 billion.
11. For the purpose of this analysis, it is assumed that borrowing will:
 - (i) Be on such terms that borrowed funds can only be onlent at ordinary terms and used as substitution funding for the amount of ordinary lending that is projected in each scenario.
 - (ii) Be financially self-sustainable in isolation, i.e. would not require the use of IFAD's own resources.
 - (iii) Free up a portion of IFAD's core resources that would be redistributed through the PBAS. The application of the PBAS would enable all IFAD recipients to access greater resources than they otherwise would, and to meet their PBAS allocation shares. It would ensure a "fair" redistribution in line with IFAD's mandate.
12. However, under the US\$1.1 billion replenishment contribution scenario, if IFAD were to assume that: (a) any borrowing would be on similar terms to those of the loan from KfW Development Bank (KfW); i.e. it can only be onlent at ordinary terms; and that (b) IFAD wishes to leave the shares of lending on ordinary, blend and highly concessional terms and grant deployment in the same proportion as generated by the PBAS;² then it would not be possible to rise to a level of PoLG of US\$3 billion. This is for the simple reason that, with a US\$1.1 billion replenishment, IFAD would require a significant amount of borrowing to achieve a PoLG of US\$3 billion, which would substantially increase the portion of IFAD's resources allocated to ordinary term lending; in other words, the MICs. In so doing, existing PBAS shares would undergo a fundamental change. IFAD itself would undergo a substantive change, and not through a strategic decision by its Membership but as an outcome of limited core funding.
13. Therefore, the combination of (i) and (ii) above would impose a de facto restriction on the amount of borrowing that IFAD can undertake if it wishes to continue to respect existing PBAS shares and to remain a Fund that is focused on low-income countries. This is what prevents IFAD from achieving a US\$3 billion PoLG in the

¹ IFAD10/3/INF.2/Rev.1 - Summary of the Chairperson: third session of the Consultation on the Tenth Replenishment of IFAD's Resources.

² The projected amount of lending under each scenario results from the shares generated by the PBAS. These are: highly concessional, 43 per cent; ordinary, 19 per cent; blend, 10 per cent; and Debt Sustainability Framework and grants, 28 per cent. This is in line with the Policies and Criteria for IFAD Financing, which states: Those developing Member States: (a) having a gross national product (GNP) per capita of US\$805 or less in 1992 prices or classified as International Development Association (IDA)-only countries, shall normally be eligible to receive loans from IFAD on highly concessional terms. The total amount of the loans provided each year on highly concessional terms shall amount to approximately two thirds of the total amount lent annually by IFAD.

lowest replenishment scenario. IFAD Management wishes to be completely transparent with the Membership on the full implications of this scenario: IFAD would by definition, either have to shrink (accepting a PoLG of less than US\$3 billion) or have to accept to stay at its current size while shifting the focus of its operations to MICs (achieving a PoLG of US\$3 billion). In scenarios II and III, however, this is not the case, as the total amount IFAD would need to borrow to reach a PoLG of US\$3 billion does not exceed the percentage that has been allotted to ordinary rate clients historically.

14. Finally, as evidenced in table 1, for every dollar decrease in replenishment contributions, borrowing needs to increase by a larger amount due to the loss of IFAD's ability to retain future loan repayments. As replenishment contributions decrease, so do the internal resources that they generate. This results in proportionally higher borrowing amounts in order to reach the same level of PoLG.

Table 1.

IFAD10 borrowing scenarios

(Billions of United States dollars)

	<i>Scenario I</i>	<i>Scenario II</i>	<i>Scenario III</i>	<i>Target</i>
<i>Core contributions</i>	1.10	1.20	1.30	1.44
<i>Gap in core contributions vs. target of US\$1.44 billion</i>	(0.34)	(0.24)	(0.14)	
<i>Complementary contributions</i>	-	-	-	-
<i>PoLG resulting from Replenishment contributions (Core PoLG)</i>	2.31	2.52	2.72	3.00
<i>Borrowing needed to reach US\$3 billion (or close to)</i>	0.55	0.48	0.28	0.00
<i>Internal resources (net of administrative expenses)</i>	1.21	1.32	1.42	1.56
<i>PoLG</i>	2.86	3.00	3.00	3.00

Note: All borrowing scenarios are assumed akin to the KfW agreement. That is, they contain the same terms and cost structure as the KfW facility; and they are assumed to fund only IFAD ordinary term lending and entail no additional administrative costs.

B. Scenarios: Effect of borrowing on overall PoLG as a substituting funding source for ordinary term loans

Scenario I: Replenishment contributions of US\$1.1 billion

15. Replenishment contributions of US\$1.1 billion would support a core PoLG of US\$2.31 billion. To keep the allocation of funds unchanged as per IFAD's PBAS, IFAD could borrow up to US\$548 million. Table 2 shows the level of the projected loan programme from replenishment contributions, and the amount of increase to each loan/grant window resulting from borrowed funds. In this scenario, as explained in paragraph 12, the total PoLG cannot reach the US\$3 billion target.

Table 2

Projected loan amount based on replenishment contributions of US\$1.1 billion

(Millions of United States dollars)

	<i>Ordinary</i>	<i>Blend</i>	<i>Highly concessional</i>	<i>DSF^a and grants</i>	<i>Total</i>
PoLG from replenishment contributions and internal resources	443	233	1 000	635	2 311
Percentage allocation^b	19%	10%	43%	28%	100%
PoLG from redistribution of borrowed resources	105	55	237	151	548
Total	548	288	1 237	786	2 859
Final percentage allocation	19%	10%	43%	28%	100%

^a Debt Sustainability Framework.^b Based on existing PBAS shares.**Scenario II: Replenishment contributions of US\$1.2 billion**

16. Replenishment contributions of US\$1.2 billion would support a level of core PoLG of US\$2.52 billion. To reach a PoLG of US\$3 billion, IFAD would need to borrow US\$483 million. Table 3 shows the level of projected PoLG from replenishment contributions, and the impact from borrowing. In this scenario, the borrowed amount is such that it would allow IFAD to arrive at a PoLG of US\$3 billion while respecting the PBAS.

Table 3

Projected loan amount based on replenishment contributions of US\$1.2 billion

(Millions of United States dollars)

	<i>Ordinary</i>	<i>Blend</i>	<i>Highly concessional</i>	<i>DSF and grants</i>	<i>Total</i>
PoLG from replenishment contributions and internal resources	483	254	1 088	692	2 517
Percentage allocation	19%	10%	43%	28%	100%
PoLG from redistribution of borrowed resources	93	49	209	133	483
Total	576	303	1 297	825	3 000
Final percentage allocation	19%	10%	43%	28%	100%

Scenario III: Replenishment contributions of US\$1.3 billion

17. Replenishment contributions of US\$1.3 billion support a level of core PoLG of US\$2.72 billion. To reach a PoLG of US\$3 billion, IFAD would need to borrow US\$277 million. Table 4 shows the level of projected PoLG from replenishment contributions, and the impact from borrowing. In this case, as in scenario II, the amount borrowed would respect PBAS shares.

Table 4

Projected loan amount based on replenishment contributions of US\$1.3 billion

(Millions of United States dollars)

	<i>Ordinary</i>	<i>Blend</i>	<i>Highly concessional</i>	<i>DSF and grants</i>	Total
PoLG from replenishment contributions and internal resources	522	275	1 178	749	2723
Percentage allocation	19%	10%	43%	28%	100%
PoLG from redistribution of borrowed resources	53	28	120	76	277
Total	576	303	1 297	825	3 000
Final percentage allocation	19%	10%	43%	28%	100%

18. In summary, as shown in table 5, in the event that replenishment contributions support a PoLG of less than US\$3 billion, borrowing could free up replenishment resources, which would enable all IFAD borrowers and grant recipients to benefit in the same proportions as in the target scenario. This in turn would mean that low-income countries would benefit the most, as they do under any PBAS application.

Summary of scenarios

Table 5

Summary of scenarios compared to target

(Millions of United States dollars)

	<i>Average projected IFAD10 percentage allocation</i>	<i>Scenario I</i>	<i>Scenario II</i>	<i>Scenario III</i>	<i>Target</i>
Replenishment contributions		1 100	1 200	1 300	1 437
PoLG from replenishment contributions		2.311	2.52	2.72	3.00
Borrowing		548	483	277	--
Ordinary	19%	548	576	576	576
Blend	10%	288	303	303	303
Highly concessional	43%	1 236	1 297	1 297	1297
DSF and grants	28%	786	825	825	825
Total	100%	2 858	3 000	3 000	3 000

III. Complementary contributions

19. Replenishment contributions are the pillar of the Fund. While core contributions are Management's preferred option, as they are at the core of IFAD's governance and long-term sustainability, complementary contributions provide an important opportunity for ensuring the full success of the Replenishment. Management highly values the commitment and efforts by members to mobilize such resources.
20. Through thematic complementary contributions, members can provide additional replenishment resources which remain fully aligned with IFAD's agenda for efficiency and effectiveness. While supporting thematic corporate priorities for

IFAD10, complementary contributions do not distort the existing transparent and fair resource allocation system.

21. The concept of “complementary contributions” was introduced for the first time under the Governing Council resolution on the Second Replenishment of IFAD's Resources (resolution 37/IX) and has been accepted by the Governing Council in all subsequent replenishments. Complementary contributions are defined in the resolution as part of the “additional contributions” that make up the total replenishment, along with core and DSF contributions, though Members do not receive votes with respect to their complementary contributions.
22. In the context of IFAD10, the term “unrestricted complementary contributions” is used to refer to contributions that are not restricted by contributing Members as to: (a) their use by IFAD as loans (which generate reflows benefiting the Fund) or as grants; or (b) their use for any category of developing Member States. For IFAD10, the Executive Board may approve the use of unrestricted complementary contributions for mainstreaming climate change and nutrition-sensitive agriculture, as well as for enhancing IFAD South-South and Triangular Cooperation and the public-private-producer partnership (4Ps) initiative. The imposition of any restriction other than a thematic one would require contributions to be treated as supplementary funds that would not count towards the Replenishment.
23. While preserving coherence, transparency and accountability in allocating resources, the PBAS provides adequate flexibility to accommodate efficient and effective management of thematic complementary contributions.

IV. Road map for middle-income countries

24. As described above, the expansion of IFAD's access to financial resources that are additional to the IFAD10 core and complementary contributions will make it possible for IFAD to channel more of its replenishment-based resources to low-income countries (LICs), while maintaining its support to MICs, including through lending at a rate that is concessional in relation to commercial rates.
25. Indeed sovereign borrowing will expand IFAD's PoLG, funding first and foremost ordinary loans to MICs, while freeing up replenishment resources to increase operations in LICs.
26. In this context, IFAD Management will update its MIC strategy, pending approval of part I of IFAD's General Borrowing Framework (concerning sovereign borrowing, currently under development).³ It will build on the lessons learned from IFAD's work in MICs and on the findings and recommendations of the evaluation synthesis on IFAD's engagement in MICs carried out by the Independent Office of Evaluation of IFAD (IOE). It will also address issues such as IFAD's country and thematic focus. The updated MIC strategy will be submitted to the Executive Board for approval.
27. In addition, in the light of the General Borrowing Framework and IOE's planned evaluation of the PBAS, the PBAS Working Group of the Executive Board, as per its terms of reference, may wish to identify ways to improve the system, including the relative weight of different elements of the PBAS formula (e.g. GNI/capita) and the current level of minimum and maximum allocations. IFAD Management will support the Working Group and provide it with country allocation scenarios resulting from adjustments to the formula.
28. Moreover, to support this work and as part of its commitment to the efficiency and effectiveness agenda within its mandate as a United Nations specialized

³ The updated MIC strategy will cover issues detailed in annex II of the paper presented at the second IFAD10 Consultation session, Enhancing IFAD's business model for inclusive and sustainable rural transformation, IFAD10/2/R.3.

agency, and in response to questions raised by several IFAD10 Consultation members, IFAD Management will organize, along with other United Nations agencies and multilateral development banks (MDBs), a seminar for the Executive Board to share experiences on the issue of country and thematic focus.

The indicative timeline is as follows:

January 2015 - April 2016: Corporate-level evaluation of the PBAS by IOE

April 2015: Part I of the General Borrowing Framework submitted to the Executive Board for approval (sovereign borrowing)

June 2015 - December 2015: Preparation by Management of an updated MIC strategy

Autumn 2015: Seminar for Executive Board, organized by IFAD with other United Nations agencies and MDBs on country and thematic focus

January 2016 - December 2016: Building on IOE findings and recommendations, review of the PBAS mechanism by the PBAS Working Group – with support from Management – and submission of eventual recommendations to the Executive Board.

29. Findings from these reviews and studies should contribute to a rich and robust set of outputs in 2015/2016 on four strongly interrelated areas, namely sovereign debt funding, PBAS, country and thematic focus, and the MICs strategy.