Document:	IFAD12/2/R.2/Rev.1
Agenda:	3
Date:	11 June 2020
Distribution:	Public
Original:	English

E

Investing in rural people

Discussion Paper

IFAD’s Comprehensive Approach to Transition/Graduation

Note to Consultation members

Focal points:

Dispatch of documents:

Deirdre Mc Grenra
Chief
Institutional Governance and Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

Technical questions

Donal Brown
Associate Vice-President
Programme Management Department
Tel.: +39 06 5459 2448
e-mail: d.brown@ifad.org

Lauren Phillips
Lead Adviser, Policy & Results
Operational Policy and Results Division
Tel.: +39 06 5459 2877
e-mail: l.phillips@ifad.org

Ronald Hartman
Director
Global Engagement, Partnership and Resource Mobilization Division
Tel.: +39 06 5459 2610
Mob.: +39 331 684 7665
e-mail: r.hartman@ifad.org

Leon Williams
Senior Partnership Officer
Tel.: +39 06 5459 2809
Mob.: +39 366 783 5759
e-mail: l.williams@ifad.org

Alvaro Lario
Associate Vice-President, Chief Financial Officer and Chief Controller
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: a.lario@ifad.org

Ruth Farrant
Director
Financial Management Services Division
Tel.: +39 06 5459 2281
e-mail: r.farrant@ifad.org

Malek Sahli
Senior Regional Finance Officer
Tel.: +39 06 5459 2545
e-mail: m.sahli@ifad.org

Consultation on the Twelfth Replenishment of IFAD’s Resources — Second Session

Virtual meeting, 16-17 June 2020

For: **Review**

Contents

Abbreviations and acronyms

ADF	Asian Development Fund
AfDB	African Development Bank
AfDF	African Development Fund
EBRD	European Bank for Reconstruction and Development
GDI	graduation discussion income
GNIpc	gross national income per capita
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFAD12	Twelfth Replenishment of IFAD's Resources
IFIs	international financial institutions
LDCs	Least Developed Countries
LIC	low-income country
LMIC	lower-middle-income country
NCC	net contributor country
ODA	official development assistance
RTA	reimbursable technical assistance
SSTC	South-South and Triangular Cooperation
UMIC	upper-middle-income country

Executive summary

1. As agreed during the first session of the Consultation on the Twelfth Replenishment of IFAD's Resources (IFAD12), IFAD Management is proposing a more comprehensive approach to transition/graduation of borrowing countries. Such an approach is needed to ensure that IFAD maximizes the use of its core resources (composed of official development assistance [ODA]) for the poorest countries. It will also enable IFAD to make best use of its borrowed resources to serve middle-income countries, which continue to demonstrate need and demand for resources.

2. This discussion paper proposes additional principles and changes to IFAD's current approaches to transition/graduation. A set of measures is presented below:

   (i) IFAD's core resources, characterized by a high level of concessionality, will be fully (100 per cent) allocated to low-income country/lower-middle-income country borrowers.[1] Progression in financing terms as countries' per capita incomes increase will continue in line with the approach approved in February 2020.

   (ii) Prior to transition/graduation, upper-middle-income countries (UMICs) will have access to IFAD's borrowed resources. It is expected that in IFAD12 such resources will equal at least the amount available to UMICs in IFAD11, and up to 20 per cent of total resources.[2]

   (iii) Clear criteria and time frames are set out to determine the point at which countries transition out of IFAD's financial support. The proposed criteria – which are in line with those used by other international financial institutions, multilateral development banks and the IFAD Transition Framework – include gross national income per capita (GNIpc) and creditworthiness.[3]

   (iv) Countries with a GNIpc of US$12,235[4] or higher will not be eligible for IFAD financing. Such countries could continue to access IFAD's non-financial services on a full cost-recovery basis.

   (v) Should a country become a net contributor to IFAD, its transition out of IFAD financial support will be delayed.

   (vi) The application of these criteria will require acknowledging that reversals can occur and may require a degree of flexibility.

   (vii) Non-financial resources will remain available to Member States on a full cost-recovery basis if requested.

[1] Eligible small states (those not borrowing on ordinary terms) will be included given their fragile status.
[2] A target of 20 per cent of IFAD's total resources will be dedicated to UMICs at any given point in time.
[3] The IFAD Transition Framework already identified these two variables as key to determining transition/graduation.
[4] The threshold is indicative and reflects the 2016 GNIpc of US$12,235 currently used by the Organisation for Economic Co-operation and Development-Development Assistance Committee in compiling their list of countries that are eligible for ODA: http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/daclist.htm

I. Introduction

1. Transition/graduation involves a change in a country's status and eligibility for assistance from a development finance institution. It is a consequence of a country's development success and demonstrates that a country has developed in a way that is consistent with the institution's mandate and purpose.

2. Multilateral institutions – including multilateral development banks and international financial institutions (IFIs) – have transition/graduation policies that are based on established criteria and help guide the terms under which countries move from accessing resources on concessional terms to less concessional terms. Most policies also acknowledge, explicitly or implicitly, the possibility that countries could eventually transition/graduate from financial assistance completely.

3. During the first session of the Consultation on the Twelfth Replenishment of IFAD's Resources (IFAD12), Member States expressed various views on the topic of transition/graduation. The Chair concluded that Management would prepare a discussion paper outlining a comprehensive approach to transition/graduation to strengthen IFAD's existing framework.

4. This discussion paper builds on (i) the IFAD Transition Framework presented to the 125th Executive Board session in December 2018[5] and is consistent with (ii) the updated Guidelines for IFAD Financing Terms and Conditions (effective from January 2020). It provides specific guidance on Member States' transition/graduation away from access to IFAD's financial resources.

5. The proposals put forward are in line with the principles of the Agreement Establishing IFAD. They also draw upon the approaches used by other international organizations in determining modalities for engagement with countries at different levels of development. They focus core resources on the poorest countries, allow for access to other sources of funding (borrowed resources) for eligible upper-middle-income countries (UMICs) prior to transition, and lay out clear criteria for countries to transition from IFAD financial support. Transition/graduation from IFAD's financial resources does not imply the cessation of a relationship between IFAD and a Member State, and should be seen as an important milestone and a public acknowledgement of the success of the Member State's development path.

6. This discussion paper covers two main areas: (i) the rationale of a comprehensive approach for accessing financial resources at IFAD; and (ii) an updated set of principles and mechanisms for accessing IFAD's financial resources.

II. Rationale and proposed comprehensive approach

7. At the heart of IFAD's mission lies the principle that IFAD's resources are available to all borrowers, albeit prioritizing the poorest countries and people. Universality is a key principle. For this reason, IFAD's resource allocation strategy considers both need and performance, and differentiates the concessionality of its financial offer based on country conditions.

8. Management recognizes the need to prioritize further the Fund's allocation of its concessional resources (i.e. core resources) to the poorest countries, who also suffer from limited access to financial resources and more limited institutional capacity. This concept is reinforced by the Agreement Establishing IFAD,[6] which stipulates that the allocation of its resources should place special emphasis on the needs of low-income countries (LICs), and countries characterized by ongoing exposure to exogenous shocks and limited creditworthiness. As a fund rather than

---

[5] See document EB 2018/125/R.7/Rev.1.

[6] Article 7, section 1(d), "In allocating its resources the Fund shall be guided by the following priorities: (i) the need to increase food production and to improve the nutritional level of the poorest populations in the poorest food deficit countries … eligibility for assistance … with special emphasis on the needs of the low income countries".

development bank, IFAD also needs to ensure that usage of its resources is prioritized for the poorest countries with the greatest need.

9. Management also recognizes that upper-middle-income economies still face challenges in tackling pockets of poverty in rural areas and that, in some cases, IFAD financing may play an important role in helping countries address these. However, their level of development and creditworthiness allow them access to financial resources over and above concessional or official development assistance resources, through the mobilization of domestic resources and private investment. Therefore, it is appropriate that, as IFAD's sources of financing diversify, upper-middle-income economies access resources leveraged by the Fund (i.e. borrowed resources) at less concessional rates.[7]

10. In addition to the ongoing needs of UMICs, Management recognizes the important role that these countries play in the **sustainability and competitiveness** of the Fund through (i) contributing to its activities and operations, including through core replenishment contributions; (ii) enhancing the quality of IFAD's capital adequacy ratios and the creditworthiness of the portfolio of loans, enabling IFAD to leverage borrowed resources; (iii) contributing to the programme of loans and grants through reflows and supporting, through their borrowing costs, the concessional rates at which IFAD can offer resources to poorer countries; and (iv) disseminating their accumulated knowledge and expertise through South-South and Triangular Cooperation (SSTC) as well as other forms of knowledge-sharing.

11. Furthermore, it is important to recall IFAD's commitments to the Addis Ababa Action Agenda (2015), which encourages IFIs to develop sequenced and phased transition/graduation policies. The principles of the action agenda underline the need to couple the transition/graduation process with appropriate measures so as not to jeopardize development progress of the country in question, and to apply a principle of gradualism to avoid back-slipping or sudden stops of financing.

12. Transition/graduation is a significant milestone that acknowledges a country's progress in reaching a significant level of development. Countries that transition/graduate from IFAD's financial support remain important partners of IFAD, and will be encouraged to contribute to the governance of the Fund as ongoing Members. They also will be able to share knowledge and expertise with other members, including through SSTC and, if desired, can continue to tap IFAD's technical expertise through instruments offered to all interested Member States, such as reimbursable technical assistance (RTA).

III. Principles and mechanisms for accessing IFAD's financial resources

13. IFAD's comprehensive approach to transition/graduation builds on practice at other IFIs and similar United Nations agencies, while recognizing that IFAD is a development fund and not a development bank.

14. Management proposes to build upon IFAD's established procedures on transition between lending terms to determine access **to different types of financial resources available from the Fund** (core and borrowed resources). While LICs and lower-middle-income countries (LMICs) will continue to have access to core resources, allocated through the performance-based allocation system on terms consistent with their gross national income per capita (GNIpc) and creditworthiness, UMICs will have access solely to borrowed resources through a mechanism to be established in agreement with the Executive Board.

[7] See annex I for a definition of borrowed resources.

15. In addition, Management will provide **clear criteria, milestones and time frames for UMICs to transition/graduate out of accessing IFAD's borrowed resources** should they choose not to become net contributors to the Fund.

16. Finally, IFAD proposes updating the principles underpinning transition/graduation. The current IFAD Transition Framework commits to upholding the principles of **predictability**, **transparency** and **sustainability**. Management proposes **flexibility** as an additional principle for transition/graduation.

17. The addition of flexibility reflects the need to acknowledge that countries can stagnate or regress (reverse) due to vulnerability to external shocks or weak economic policies. A flexible application of criteria under such circumstances would be a principle of IFAD's transition policy, in line with the policies of other multilateral development banks and United Nations agencies.

A. Updated mechanisms for access to IFAD's financial resources

18. **Access to core resources**. IFAD proposes that core resources, characterized by their strong level of concessionality, are allocated in full (100 per cent) to LIC/LMIC borrowers. Special provisions are in place for small island developing states and/or countries with fragile situations eligible for concessional resources.[8] The differentiation of the level of concessionality of core resources provided will continue to be driven by IFAD's current policies for transition from highly concessional and semi-concessional to ordinary terms resources, including those on blend terms (the so-called International Development Association "gap countries").

19. **UMICs access to IFAD's borrowed resources**. IFAD Management proposes that UMICs no longer access core resources but rather borrowed resources. The allocation of such resources is expected to be demand driven, and eligibility will be evaluated on the basis of development effectiveness and creditworthiness. A detailed proposal on the principles for allocating borrowed resources will be presented to IFAD's Executive Board.[9]

20. **Pricing of borrowed resources.** The level of concessionality of borrowed resources provided will continue to reflect pricing based on a borrower's GNIpc, while taking into account fragility and transitional aspects. In order to reflect the diverse economic status of IFAD's borrowers, the proposed approach is characterized by differentiated pricing, implemented through an increased variation in maturity premium and in spreads between categories of borrowers, with LICs paying slightly less and UMICs paying slightly more. In this way, UMICs will support the concessional rates available to poorer countries while ensuring that pricing remains competitive vis-à-vis market financing options (e.g. bond issuance).

21. The assessment of a country's eligibility for access to core or borrowed resources will take place prior to the start of each replenishment period. In order to ensure the predictability of IFAD's offer, any change in income status to a higher category during the replenishment cycle will be reflected at the start of the next cycle. Any reversal during the replenishment cycle may be considered by the Fund from the beginning of the following fiscal year.

22. Management proposes that the share of total resources allocated to UMICs in IFAD12 **remain at least the same as the share provided in IFAD11.** Additionally, aggregate resources for UMICs would increase in line with IFAD's borrowing, with a ceiling of up to 20 per cent of total IFAD resources. This overall envelope of resources ensures that as new countries move to UMIC status and

[8] As defined by the Policies and Criteria for IFAD Financing
[9] LIC and LMIC countries that are not in debt distress or high debt distress may also demonstrate demand for borrowed resources.

other UMICs transition/graduate from IFAD's financial support, there are sufficient resources to meet the needs of all UMIC states.[10]

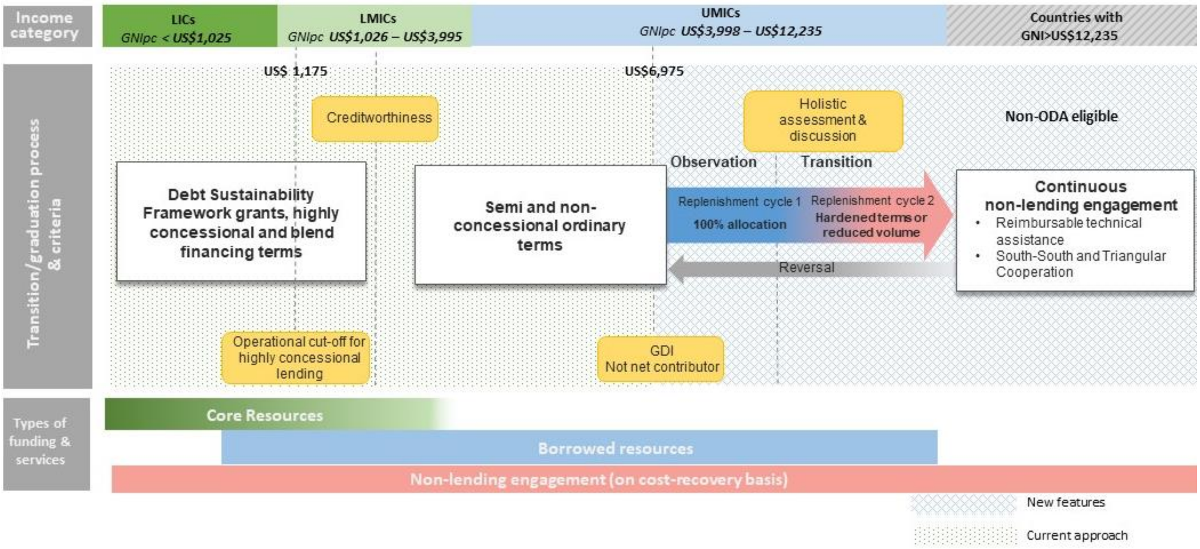
23. **Transition/graduation from access to IFAD financing**. IFAD also proposes to put in place specific time-bound criteria and indicators for Members to transition/graduate from IFAD's financial support. These criteria will be utilized if a country chooses not to become a net contributor to IFAD's resources.

24. The key criterion that would be used to determine the start of a transition/graduation process is achievement of graduation discussion income (GDI) as defined by the International Bank for Reconstruction and Development (IBRD), which is a proxy for access to adequate capital and strong institutions.[11]

25. Countries that have reached GDI would have a fixed period of time – proposed as **six years or two cycles of IFAD replenishments** – either to transition/graduate out of IFAD's financial support or to become **net contributors** to the Fund. Any reversals of income under GDI during this transition period would delay discussions on transition/graduation.

26. During that time, access to IFAD's resources would be phased out, with reduced volumes of lending and/or hardened terms.[12] Once the conditions above are met, and after discussions with the Member State, IFAD Management will present the Executive Board with a "graduation decision" for information.

Figure 1
Transition/graduation process



27. Transition/graduation is a significant milestone and can have a positive signalling effect that facilitates access to financing for sustainable development (i.e. through increased access to international private sector creditors). However, the development indicators and creditworthiness of a country would be carefully assessed and monitored as countries can stagnate or regress (reverse) due to vulnerabilities to external shocks or weak economic policies.

28. Should a country experience a reversal in one of the criteria above (i.e. a decline in GNIpc under the GDI) after they have transitioned/graduated from IFAD financial

---

[10] At present, 60 countries are classified as upper-middle income according to the World Bank. The list is updated every year. In June 2019, for example, four countries were reclassified as UMICs, and three countries were reclassified as LMICs.

[11] The IBRD GDI is set at a GNIpc of US$6,975 as of 1 July 2019. As of April 2020, IFAD borrowers with a GNIpc above this level are: Argentina, Brazil, China, Cuba, the Maldives, Mexico, Montenegro, Lebanon, Turkey and the Bolivarian Republic of Venezuela.

[12] The baseline for comparison will be the total allocation (core or borrowed resources) that the Member State borrowed in the most recent replenishment period.

support, they may be eligible to access IFAD's financial resources again after an evaluation period, with the approval of the Executive Board.

29. Management will report regularly to the Executive Board on countries with the potential to transition/graduate from IFAD's financial support. It will also provide the Executive Board with updates on discussions with Member States in official documents (e.g. country strategic opportunities programmes).

30. Finally, it is suggested that only countries with a GNIpc of less than US$12,235 be eligible to access IFAD financing. Countries exceeding this level could continue to access IFAD's non-financial services on a full cost-recovery basis.

B. **Continued engagement without financial resources**

31. The transition/graduation from access to IFAD's financial resources does not signify the termination of a country's relationship with IFAD. Member States will continue to have opportunities to engage with IFAD, most notably by participating actively in IFAD's governance as countries that have reached a significant level of development, and potentially as contributors to the Fund. Such Member States would be encouraged to participate in policy discussions and knowledge exchange.

32. Should Members also seek to avail themselves of IFAD's technical expertise, or to make their own expertise available to other borrowing members, RTA and SSTC will be important aspects of their partnership. RTA is a vehicle for transmitting IFAD's operational and policy expertise to all requesting countries, including those without a lending relationship with IFAD. It is provided on a full cost-recovery basis.

33. SSTC is an increasingly important dimension of national development strategies and IFAD has a crucial role as a broker of SSTC in smallholder agriculture and rural development. SSTC would allow IFAD to leverage the successes and development experience of UMICs or high-income countries to support LICs and LMICs in their approaches to rural development.

Definitions

Borrowed resources. Funds that IFAD borrows from any source including bilateral loans, sovereign agencies, social impact investors, as well as reflows from loans sourced by the aforementioned resources.

Core resources. Replenishment funds, concessional loan reflows and concessional loans (e.g. concessional partner loans).

Creditworthy borrowers. A borrower eligible for ordinary term loans at IFAD, in line with the definition used by IBRD.

Transition/graduation. A process by which a country progresses, as it develops, across the lending terms and income categories to eventually cease to access the Fund's financial resources.

Net contributor. A country whose contributions during a replenishment period exceed the face value of their borrowing from IFA

Transition frameworks and graduation policies of other IFIs and United Nations agencies

IFAD has undertaken a benchmarking exercise on the transition and graduation policies of IFIs with similar business models and of two United Nations agencies. Several key features emerge from this analysis that could inform IFAD's practice (see table below).

Institution	*Criteria for eligibility*	*Explicit transition policy in charters*	*Criteria for transition*
International Development Association (IDA)	• GNIpc < established cut-off (currently US$1,175) • Lack of creditworthiness (IBRD analyses)	Yes	Based on GNIpc and creditworthiness, countries transition from more concessional to less concessional lending terms and then to IBRD-only
International Bank for Reconstruction and Development (IBRD)	Graduation from IDA to IBRD-only status	Yes	• GNIpc above GDI • Creditworthiness • Level of development by key economic institutions • Capacity to sustain long-term development without recourse to IBRD financing • Institutional development • Measures of economic vulnerability
Asian Development Fund (ADF)	• Same as IDA: GNIpc < established cut-off (currently US$1,175) • Lack of creditworthiness (ADF analyses)	Yes	Based on GNIpc and creditworthiness, countries transition from more concessional to less concessional lending terms: Group A: ADF grants and concessional resources Group B: concessional and regular resources (ordinary capital resources) Group C: only ordinary capital resources
Asian Development Bank	Graduation into Group C (above)	Yes	• GNIpc above GDI (as per World Bank) • Availability of commercial capital flows on reasonable terms • Attainment of a certain level of development by key economic and social institutions
African Development Fund (AfDF)	• Same as IDA: GNIpc < established cut-off (currently US$1,175) • Lack of creditworthiness (IBRD analyses)	Yes	Based on GNIpc and creditworthiness, countries transition from more concessional to less concessional lending terms: Category A: AfDF resources only Category B: blend countries – both AfDF and AfDB Category C: AfDB resources only
African Development Bank (AfDB)	Graduation into Category C (above)	No	N/A
Inter-American Development Bank	• GNIpc lower than the threshold of US$2,919 in 2017 prices • Insufficient creditworthiness for borrowing 100 per cent on ordinary capital terms, as indicated by a country's score on a synthetic creditworthiness indicator	No	N/A
European Bank for Reconstruction and Development (EBRD)	• Be located in an EBRD country of operations • Have strong commercial prospects • Involve significant equity contributions in-cash or in-kind from the project sponsor • Benefit the local economy and help develop the private sector to satisfy banking and environmental standards	No	Monitoring of transition indicators to assess if: • All relevant transitions have been completed • There is no more need for EBRD lending • EBRD's investments have been fully securitized
United Nations Development Programme	• Four-year average GNIpc < established net contributor country (NCC) threshold (US$6,660 for 2018-2021)	No	• Four-year average GNIpc > established NCC threshold • Biennial update system (midpoint of the programmatic period) whereby countries that cross the NCC threshold are considered as transitional NCCs for two years before they stop receiving assistance, if they remain above the thresholds
United Nations Capital Development Fund	• Categorized as Least Developed Countries (LDCs) according to the United Nations classification ○ Three-year average GNIpc < established threshold (US$1,230 in the 2018 triennial review) ○ Human Assets Index ○ Economic Vulnerability Index	No	• Has not been categorized as LDC for more than three years • Funding for another two years can be still provided on a 50/50 cost-sharing basis with either the Government or a third party, until funding ends

Summary of Informal Meeting on Transition/Graduation 11 May 2020

1. **Background**. During the first session of the Consultation on the Twelfth Replenishment of IFAD's Resources (IFAD12) in February 2020, the issue of transition/graduation was raised, and a range of opinions were expressed. During the meeting it was agreed that Management would prepare a paper outlining options for a way forward. The paper would be discussed at an informal meeting open to all IFAD Member States and would then be presented to the second session of IFAD12 Consultation, together with a note summarizing the key points arising at the informal meeting (as contained in the present document).

2. **Summary of discussions**. Member State representatives from 54 countries, IFAD Management and staff met virtually on Monday, 11 May 2020 for an informal meeting to discuss the issue of transition/graduation. While recognizing the complexity and sensitivity of this issue, IFAD Management highlighted the importance of addressing it and working towards reaching a consensus among Member States that sets a clear long-term direction for the Fund and leads to the best possible outcome for the IFAD12 Consultation.

3. Management noted that the purpose of this informal meeting was to facilitate an initial exchange among Member States on a set of overarching principles that could underpin the discussion on IFAD's approach to transition/graduation going forward, as part of the replenishment consultation process. Details could be developed on the basis of these principles once they had been agreed upon.

4. Management highlighted the **four main pillars of the proposals** outlined in the discussion paper:

   (i) **Distribution of IFAD's financial resources.** IFAD's core resources, characterized by a high level of concessionality, would be fully (100 per cent) allocated to low-income countries/lower-middle-income countries (LICs/LMICs) with provisions for small states (including small island developing states) and countries with fragile situations. Borrowed resources would be allocated to upper-middle-income countries (UMICs), as well as LICs and LMICs which are able to absorb additional resources on ordinary terms without creating an unsustainable debt burden. The objective would be to allocate up to a maximum of 20 per cent of total resources to UMICs, compared to 11 per cent in IFAD11. The detailed proposal on the principles for allocating borrowed resources will be presented to IFAD's Executive Board during 2020.

   (ii) **Transition trajectory for UMICs reaching graduation discussion income (GDI).** Specific triggers and processes for Members to transition/graduate from IFAD's financial support would be put in place, with the GNIpc used by the International Bank for Reconstruction and Development as the GDI proposed as the key criterion. Countries meeting this criterion would transition/graduate from IFAD's financial support over two replenishment cycles (six years) unless they chose to become a net contributor (defined as contributions greater than nominal value of borrowing within a particular replenishment period). In the latter case, the country could continue to access IFAD financing (from borrowed resources) until reaching high-income/non-ODA-eligible status, as long as they remained net contributors to the Fund.

   (iii) **Exceptions for countries facing economic slide back.** The approach would have the flexibility to allow reversal for those countries experiencing a decline in GNIpc.

   (iv) **Financing conditions.** IFAD would continue to apply differentiated pricing based on a borrower's GNIpc, while taking into account fragility and transitional aspects. The differentiated pricing would reflect greater variation in maturity premiums and in spreads between categories of borrowers, with LICs paying slightly less and UMICs paying slightly more and/or having shorter maturities. In this way, UMICs would support the concessional rates available to poorer countries while ensuring that pricing remained competitive vis-à-vis market financing options (e.g. bond issuance). In addition, the proposed approach took into consideration IFAD's own financial sustainability.

5. A number of participants agreed that the paper prepared by Management provided a useful starting point for the sensitive discussion and reiterated their commitment to working towards a consensus on a common way forward. However, other participants felt that the paper was unbalanced, did not reflect the principle of universality, and contained certain elements on which it would be difficult to reach consensus. A number of participants also expressed concern about the timing of the discussion, which was happening at a moment of significant economic uncertainty for all Member States due to the COVID-19 pandemic. Others noted that the crisis was placing additional demands on ODA budgets, making it even more important to ensure that limited core resources were focused on the poorest countries.

6. With regard to the four pillars outlined above, the following points were raised:

(i) **Distribution of IFAD's financial resources**. There was general recognition that the allocation of IFAD's core resources should prioritize the poorest countries. Most participants were broadly supportive of the proposal to allocate core funding to LICs and LMICs (as well as small states and countries with fragile situations) and to finance lending to UMICs primarily through borrowed resources. It was noted that this would be in line with the prioritization stipulated in the Agreement Establishing IFAD. A number of participants highlighted that this would also strengthen their ability to make the case for increased contributions to IFAD12. However, other participants objected to the proposal and preferred to maintain the current 90:10 allocation of core resources, highlighting that UMICs also had pockets of rural poverty.

A number of participants recognized that until greater assurance could be provided of IFAD's ability to mobilize adequate borrowed resources at competitive pricing, shifting to a 100:0 allocation would create uncertainty for affected UMICs. Management noted that its current proposal guaranteed that UMICs would receive at least the same level of resources in IFAD12 as they received in IFAD11, with the possibility of an increase of up to 20 per cent of total resources, providing that sufficient funds were mobilized for both core and borrowed resources. This would be further expanded on in the financial scenarios to be presented to the Consultation.

Participants requested additional details on how the borrowed resources mechanism would work in practice, particularly the principles on which it would be based and the financing terms applicable to these borrowed resources. Management noted that the borrowed resources would be allocated on a demand-driven basis, taking into consideration a country's creditworthiness (ensuring that access to additional resources would not create an additional unsustainable financial burden) and prioritizing projects with the highest expected development effectiveness. These principles would be further elaborated and presented to IFAD's governing bodies for decision in the coming months.

(ii) **Transition trajectory for UMICs reaching GDI**. There was support for Management's efforts to draw on the best practices of other international financial institutions (IFIs) and United Nations agencies to determine the criteria for transition/graduation. However, several participants suggested including additional indicators that are currently being utilized in other multilateral development banks and that are relevant to IFAD's mandate (e.g. institutional capacity, market access, and rural poverty), rather than relying only on GNIpc.

A number of participants requested clarification on whether graduation would be voluntary or mandatory, noting that IFIs typically have flexible graduation processes, and generally questioned the proposal of mandatory graduation.

With regard to the proposed timing for transition/graduation, views were varied. A number of participants considered that six years would provide an adequate time frame for the transition process; others felt that this was too short and that the timing should not be defined at this stage; other participants stated that the six-year time frame was too long.

As for the concept of net contributor, a number of participants found this to be an interesting idea that deserved further consideration but requested clarifications on the exact definition (including the types of contributions that could be counted) and the time frame during which a country could continue to access resources as a net contributor.

Others commented that it could be an unrealistic requirement, and could be seen as prioritizing resource mobilization over the principles of graduation. Management noted that the concept was to be further defined based on discussions with Member States.

With regard to high-income countries (HICs), a number of participants noted that these countries also had pockets of rural poverty and that different variables should be considered in determining whether they could access IFAD borrowed resources, not just their income status. However, other participants indicated that it was inappropriate for IFAD to provide financing to HICs and that mechanisms were required to ensure that IFAD financing was restricted to ODA-eligible countries.

(iii) **Exceptions for countries facing economic slide back.** Taking the current context as an example of the type of exogenous shock that could lead to a reversal of development gains, participants generally agreed on the importance of flexibility in the context of a transition/graduation policy. The difference in time lag between transition/graduation and reversals – i.e. that upward transitions would take place in the next replenishment cycle while reversals would come into effect in one fiscal year – was also noted and further clarifications on the rationale and timing for this were requested.

(iv) **Financing conditions**. While accepting the reinforcement of the current principle of differentiated pricing based on countries' GNIpc for ordinary term loans, a number of participants preferred a faster hardening of terms for countries over the GDI thresholds. Several participants wished to know what was meant by the statement in the discussion paper "LICs paying slightly less and UMICs slightly more" (paragraph 20). Management explained that detailed proposals were being developed and would include such aspects as offering loans with relatively shorter maturities to UMICs compared to LICs to reduce concessionality.

7. In addition participants discussed the concept of universality, noting the differing interpretations of the term. A number of participants interpreted universality as the right to access financial resources regardless of country income category, while others focused on universality of commitment to IFAD's mandate and engagement with the organization, whether as borrowers and/or contributors. A number of participants States emphasized that transition/graduation should be considered a positive process as it indicated achievement of higher levels of economic development and transition from being primarily a recipient of ODA to becoming a provider of ODA.

8. With regard to the timeline going forward, a number of participants supported the aim of reaching consensus on the key elements of the approach during 2020, as part of the Consultation process, with the possibility of the Executive Board working out details in 2021, prior to the start of IFAD12 implementation in 2022. For a number of participants, the fact that IFAD currently lacks any clear graduation policy is a key concern that needs to be addressed, not just for the replenishment, but as part of the broader policy framework of an IFI. However others felt that it could take time to reach consensus on all elements of the proposal. Most participants recognized that it would be preferable to have greater assurance about access to borrowing and more details on the borrowed resources mechanism before implementing a new policy.

9. Management closed the discussion by thanking participants for the fruitful exchanges. Management reiterated the importance of having such discussions and working towards a compromise to ensure a strong IFAD12 replenishment. Management reminded participants that, as agreed during the first session of the Consultation, the same discussion paper on transition/graduation, together with a summary of the informal meeting discussions would be presented to the second session of the Consultation scheduled on 16-17 June. Member States and Management would then be in a position to take stock and determine the next steps.

Management Responses to Written Comments from Member States on the Discussion Paper on IFAD's Comprehensive Approach to Transition/Graduation and to Questions Raised during the Informal Meeting

I. Management Responses to Written Comments Received on the Member States Interactive Platform

A. Comments from Ethiopia

1. **Ethiopia appreciates IFAD for bringing Comprehensive Approach to transition in to the discussion among the member states. The Financial Assistance of IFAD has been aiming to catalyse a country and global progress for rural people to overcome poverty and achieve Sustainable Development Goals and indeed, the hands of IFAD has reached millions and escaped the large number of peoples out of poverty, hunger and wretched life.**

3. **The transition or graduation approaches will enables IFAD to provide predictable and sustainable financial assistance to low income countries to cope up the SDGs. Therefore, we welcome the comprehensive approach to graduation at this critical time of unprecedented economic and health crisis which will consolidate the financial sustainablity of the Fund.**

4. **Above all, low income countries in Africa will be worst victim of COVID-19 posed economic crisis exacerbated by desert locust and re-current floods. Similarly, these countries are at the risk of heavy debt which affects the potential access to bilateral and multilateral loans. In this regard the comprehensive approach to transition enables low income countries and lower middle income countries to get financial assistance that catalyse their agricultural transformation, which is the mainstay of their economy.**

5. **Accordingly, the Comprehensive Approach to graduation will bring back the off track countries into the path of achieving Sustainable Development Goals. It is also a commitment to ensure the plea of No one left behind.**

6. **Finally, we call on all stake holders to enhance cooperation that enables low income countries and lower middle income countries to get financial stimulation that enables them to end poverty and hunger which is one of the primary causes of vicious circle of the global problems ranging from climate change to Migration.**

Response

7. Management appreciates Ethiopia's comments on the discussion paper. The overall goal is to increase IFAD's programme of loans and grants and expand the funding available to low-income countries (LICs), lower-middle-income countries (LMICs) and upper-middle-income countries (UMICs), while ensuring distribution is aligned with IFAD's overall mandate.

B. Comments from the United Kingdom

8. **The UK would like to thank IFAD for the discussion paper on transition/graduation. We underline the critical importance of the contribution of all Member States in ensuring the success of IFAD. Over recent years IFAD has been increasing its capacity for borrowing, allowing IFAD to deliver more for all members and focusing core resources on the most fragile, poorest countries least able to self-finance. We support the full use of borrowed resources to continue to strengthen IFAD's engagement with Upper Middle-Income Countries in line with IFAD's Transition Framework. We also note that the share of total resources**

allocated to UMICs in IFAD12 would remain at least the same as the share provided in IFAD11.

9. **The paper mentions that "UMICs will have access solely to borrowed resources through a mechanism to be established in agreement with the Executive Board". It would be good to have more detail on how this would work; how it relates to and would affect IFAD's credit rating; and whether IFAD would continue with its "one-balance sheet".**

10. **We recognise that the level of borrowing may be difficult to define at this stage. However, we look forward to discussing the overarching principles set out in the paper to reach agreement in readiness to decide on the detail next year, ahead of the start of IFAD12 in 2022. This would also allow IFAD to provide more information on how they might increase levels of sovereign borrowing, subject to the credit rating process.**

11. **As countries evolve, it is important to ensure that IFAD tailors its partnership with member states accordingly and sets out that trajectory clearly. We are interested in hearing more about the idea of a net contributor, as IFAD seeks to increase donor resources for the replenishment, and what that might entail.**

12. **In terms of criteria, the Transition Framework identifies GNI per capita and creditworthiness (with the comprehensive analysis of short-and-long term vulnerabilities that entails) as the most widely agreed-upon indicators of economic transition and we support the continued use of these indicators in line with other financial institutions.**

13. **Clearly transition/graduation is a very long process over a number of years, but it would be helpful to discuss the broad timeline for IFAD when entering into transition/graduation discussions with members. We also welcome greater use being made of reimbursable technical, advisory assistance and IFAD ensuring that projects with UMICs pilot innovations that are effectively used for knowledge sharing with learning benefits for other countries.**

14. **We look forward to listening to the range of views on this topic and working closely together with other Members to define a constructive way forward to reach consensus. This will also help towards achieving our shared objective across the membership of ensuring a successful IFAD12 replenishment, which will be particularly important as the Organisation addresses other key issues, such as the Debt Sustainability Framework, in this critical time when the world needs IFAD more than ever.**

Response

15. A successful credit rating exercise will facilitate IFAD’s access to additional borrowed resources and also influence the pricing at which IFAD passes on the cost of its borrowing to countries. Additionally, we confirm that IFAD will continue with its one-balance sheet. At the moment, and consistent with the paper, borrowed resources would be allocated on a demand basis, taking into consideration a country’s creditworthiness (ensuring that access to additional resources would not create an additional unsustainable financial burden) and prioritizing projects with the highest expected development effectiveness.

16. Additional information on the net contributor status is provided below in part 2, noting that we are proposing a change in terminology so as to encourage increases in contributions as part of the development progress of UMICs.

C. Comments from Mexico

17. **Regarding the document under discussion, I have the following questions:**

18. **Can you clarify if the proposal for graduation is voluntary or mandatory? Paragraph 26 mentions "discussions" with a Member State after some conditions are met.**

19. **On paragraph 14, it is mentioned that UMICS would have access solely to borrowed resources through a mechanism to be developed.**

    (i) Please clarify what kind of mechanism is envisaged.

    (ii) The creation, in the practice, of a second window or allocation system for UMICs, is an attempt to have something similar like IDA and IBRD? that is: two different mechanisms under the same institution, but working with countries that have different level of development?

20. **Paragraph 20 talks about differentiated pricing.**

    (iii) What would be the difference, in basic points, of the current regular rate and the proposal, as it is mentioned that "UMICS paying slightly more".

    (iv) What are your calculations regarding those "slightly more" rates vis-a-vis the different credit ratings that IFAD might get.

21. **Paragraph 28 mentions that if a country graduates and then it suffers a reverse, it "may be eligible" to access IFAD's financial resources after "an evaluation period". Please elaborate on the evaluation period, as some countries that suffer a reverse might need immediate financial resources.**

22. **Paragraph 31 mentions that, after a country graduates, it can engage in IFAD's governance. Under which List would that be?**

Response

23. Transition/graduation will be triggered by a country reaching the graduation discussion income level (GDI) at a certain point in time. The approach included in the new addendum suggests that countries that have reached the GDI threshold will initiate a dialogue that will be reflected in a new country strategic opportunities programme (COSOP). This discussion will take place on a case-by-case basis reflecting country context. During this process, the country's expected trajectory will be agreed, including the institutional and financial capacities expected to be present, as well as non-lending activities (e.g. reimbursable technical assistance (RTA), South-South Triangular Cooperation). Even when a country transitions/graduates from IFAD's financial resources, they would maintain access to other engagement mechanisms, including RTA and significant partnerships with IFAD as a contributing Member State. The proposal envisages that transition/graduation, or ceasing to be eligible to borrow from IFAD, would be mandatory for high-income countries/non-ODA eligible countries.

24. At the moment, and consistent with the paper, the proposal is to establish a borrowed resources mechanism which would allocate such resources on a demand basis, taking into consideration a country's creditworthiness (ensuring that access to additional resources would not create an additional unsustainable financial burden)) and prioritizing projects with the highest expected development effectiveness.

25. Borrowed resources would be available both to UMICs and selected creditworthy LIC/LMIC countries (on demand and for scaling up), unlike the harder cut-off in other international financial institutions (IFIs) such as the International Development Association/the International Bank for Reconstruction (IBRD) and Development and the African Development Fund/African Development Bank, in

which countries are allocated nominal resources from one or the other window while allowing bridging for blend countries.

26. IFAD proposes that countries that have transitioned/graduated and subsequently slide back within a defined period could access borrowed resources again after consultation with, and approval by, the Executive Board.

27. On the governance question, we note that following the recommendations of the Working Group on Governance, the Governing Council adopted the current List definitions as guidelines, leaving it to individual Member States to join, or transfer to, the List whose definition best matches their individual characteristics, including those which do not access IFAD's financial resources but do access services.

28. See also the responses to Switzerland below on differentiated pricing.

D. Comments from Switzerland

29. **General. Switzerland appreciates the brevity and conciseness of the document, and welcomes that fact that reasonable alignment with the approaches and policies of other IFIs is being sought, while still taking into due consideration the inherent particularities of IFAD as a fund focussed on lifting the productive and income capacities of the Rural poor in least-developed countries.**

30. **Graduation criteria. Useful is the vision to adopt fairly clear criteria for graduation from one class to another, and a grace period of 6 years (two replenishment cycles) should easily be sufficient for graduating countries to adjust.**

31. **Loans and grants. Using loans to UMICs as a means to cross-finance highly concessional loans to LICs is an interesting proposition. However, we would welcome a business case to underpin the concept that would explain how the mechanism should work in practice and what kind of financial flows it would generate. Also, we would welcome more elaboration on the concept of "net contributor". What does this entail – would it exist only within the 6-year transition period, after which net contributors become donors, or does it also ensure continued access to credit thereafter too?**

32. **COVID-19. Needless to say, we are currently in a period that is beset by severe uncertainties. However, even in "normal" times, it would be important that IFAD develop a number of scenarios to demonstrate how the proposed transitions/approach would work in practice by modelling the influence of varying external factors and alternate features within the mechanism for different possible outcomes. Obviously, this becomes even more urgent in light of the challenges brought upon us by the COVID-19 emergency. Nevertheless, despite its inherent uncertainties, Switzerland does not believe that deferring an in-depth discussion of approaches to graduation would be useful, as the coming months will bring more certainty only by degrees.**

Response

33. Currently, Management is exploring an updated approach to the differentiation of financing conditions for borrowed resources. This will be submitted to the Governing Bodies in due course.

34. In building the proposed features of financing conditions for borrowed resources, IFAD will continue to reflect differentiated pricing based on a borrower's GNIpc, while considering fragility and transitional aspects. The differentiated pricing will reflect an increased variation in maturity premiums and in spreads between categories of borrowers, with UMICs which reach the GDI paying a slightly higher spread. Given the significant level of concessionality embedded in the longer

maturity of current ordinary-term loans,[13] it is proposed that UMICs will only have access to loans on ordinary terms with shorter maturities. This means that LICs and LMICs will in effect receive loans with a higher level of concessionality than UMICs, consistent with their stage of development and income category.

35. In addition, the proposed approach considers IFAD’s own financial sustainability.

36. Any borrowing must be financially sustainable so that in principle the loans funded by such debt must be capable of repaying that debt without drawing on IFAD's core resources.

E. Comments from China

37. **With regard to the proposed discussion of IFAD transition/graduation policy, China would like to elaborate on relevant views as follows:**

38. **First, the transition/graduation policy should be consistent with the Agreement Establishing the IFAD and its mandate. As the above mentioned legal document states very clearly, "the objective of the Fund shall be to mobilize additional resources to be made available on concessional terms for agricultural development in developing Member States". Since UMICs are still developing countries with 22% of the world's rural poor, they should be definitely supported by IFAD and other multilateral development agencies through providing financial resources as well as knowledge services. If they were forced to graduate from IFAD, it means 1/5 of the world's rural poor would be excluded from IFAD’s support, which could undermine IFAD's role in international community of poverty reduction. The current voluntary graduation policy works very well and should be kept unchanged.**

39. **Second, in case to change the policy, it should follow prevailing common international practices and not beyond. At present, UN specialized agencies have no graduation policy, and those of IFIs such as World Bank and ADB are flexible and based on voluntary principle and consensus. They have no rigid time table and take various indicators into account, such as governance capacity and institutional development. In contrast, the policy proposed for discussion lacks flexibility without due consideration of conditions in developing Member States. It is suggested to delete the timetable and add more suitable indicators.**

40. **Third, the formulation of a new policy should take a consensus based approach. To ensure that the policy can address the concerns of all relevant parties, a full discussion and consultation is essential. IFAD shall avoid a policy without consensus, considering its detrimental effects on the solidarity of Member States.**

41. **Fourth, China agrees IFAD to allocate more concessional resources to LICs and LMICs, since cooperation with LICs and LMICs and with UMICs are mutual beneficial rather than zero-sum. Moreover, stronger cooperation with UMICs is of great significance to IFAD's reflows, financial sustainability, credit rating and institutional impact, which will strengthen IFAD’s capacity to better serve LICs and LMICs.**

42. **Last but not least, to fulfill the mandate of IFAD successfully, the fundamental way is to have a bigger, better and smarter IFAD, instead of UMICs mandatory graduation from IFAD without consensus. China welcomes the setting of borrowing window to diversify financing resources. If there is a comprehensive framework to guarantee UMICs’ borrowing rights, China is open to discuss the allocation ratio. Before the**

[13] Current ordinary-term loans can have a maximum maturity of 35 years and grace period of 10 years without exceeding
an average maturity of 20 years.

borrowing window works, China will insist on the allocation ratio agreed by Member States.

Response

43. Management acknowledges that significant pockets of rural poverty remain in UMICs, and that all Member States play an important role in the Fund. Management additionally acknowledges in the paper the important contribution UMICs make to the financial sustainability of the Fund.

44. Management has provided a comparison of the graduation policies of other IFIs and agencies in the annex to the paper.

45. Management agrees that any policy decisions should be taken by consensus by IFAD's Executive Board. Management seeks a political understanding of the principles of transition/graduation as part of the replenishment process, and eventual approval of a corresponding policy by the Executive Board.

II. Management Responses to Questions Raised During the Informal Meeting

A. Distribution of resources

46. **How will the borrowed resources mechanism work?**

See reply to Mexico in part 1. It should be noted that Management is currently still formulating a possible way forward. This will be presented to the Governing Bodies prior to the start of the Twelfth Replenishment of IFAD's Resources (IFAD12).

47. **How would UMICs be guaranteed the same resources as in IFAD11?**

Part of the borrowed resources would be effectively set aside for UMICs. If these are not taken up by a certain date, Management will discuss with the appropriate Governing Bodies mechanisms for reallocating these resources in order to ensure their fullest and most efficient use.

48. **What assurances can be provided about IFAD's access to borrowing and pricing of borrowed resources?**

Both the credit rating exercise, which is underway, and the change in the integrated borrowing framework are intended to facilitate IFAD's access to borrowing on terms that will enable the Fund to onlend while both recovering its internal costs and offering a competitive price.

B. Trajectory for UMICs reaching GDI

49. **How do the thresholds and criteria proposed differ from those of other IFIs/UN agencies?**

See annex II of the document for the frameworks/policies of other institutions. The most significant difference is that the proposal is for a clearer graduation out of financial resources for high-income countries (HICs), while leaving the possibility for them to access non-financial resources such as RTA and South-South and Triangular Cooperation. (See also the answer to paragraph 51 below.)

50. **What is the definition of net contributor, how is it calculated, and how long would it allow a country to delay graduating?**

A proposed definition of net contributor is included in annex I: namely a country whose contributions during a replenishment period exceed the face value of their borrowing from IFAD during that period. A net contributor could maintain access to IFAD's financial resources on appropriate financing terms until becoming an HIC, at which point its access to financial resources would cease, although it would continue contributing to the Fund. It should be noted that in the addendum, Management is proposing a slightly different terminology which emphasises the importance of members increasing their contributions as they continue their development path towards full maturity donor status.

51. **Will graduation be voluntary or not?**

In the addendum, Management aligns with the IBRD criteria and proposes that countries would start a dialogue with IFAD regarding transition and provide concrete actions in the COSOPs to allow them to feel comfortable with no longer having access to IFAD's financial resources. This would leave space for other countries to access those resources. As outlined in paragraph 49 above, access to non-financial resources is continued.

52. **What would the impact of the proposals be in practice? How would it affect the balance of financing between LICs and MICs?**

The proposal is for LICs and LMICs to access core resources, while UMICs would access borrowed resources. LICs/ LMICs that can take on additional borrowing without shouldering an unsustainable debt burden would also be eligible for additional borrowed resources. In the financial scenarios to be presented at the June and July sessions of IFAD12, Management will present the projected relative balance between income category groups.

53. **How can IFAD do more to promote RTA?**

IFAD is stepping up efforts to increase its use of RTA. The IFAD11 Midterm Review reported that five new RTAs were underway or under discussion with various countries, including countries which do not have a current performance-based allocation system.

C. Exceptions for countries facing an economic backslide

54. **What is implied by the flexibility referenced in the document? What would it mean in practice if a country reverses and how can it be applied consistently?**

If a country's GNI drops below a certain threshold, it would, in accordance with its new status, become eligible for access to IFAD's financial resources in the following replenishment period. The principle would be applied to all countries meeting this criterion. This is described in more detail in the addendum.

D. Financial conditions

55. **How would the pricing differentiation be implemented and what would the benefits be for LICs/LMICs?**

See response to Switzerland in part 1 above. Currently, Management is exploring an updated approach to the differentiation of financing conditions for borrowed resources. This will be submitted to the Governing Bodies so as to be in place for IFAD12.

In defining the financing conditions of borrowed resources, IFAD will continue to operate differentiated pricing based on a borrower's GNIpc, while also taking into account fragility and transitional aspects. The differentiated pricing will reflect an increased variation in maturity premiums and in spreads between categories of borrowers, with UMICs above the GDI threshold paying slightly higher spreads. Given the significant level of concessionality embedded in the longer maturity of current ordinary-term loans,[14] it is proposed that UMICs will only have access to loans on ordinary terms with shorter maturities. This means that in effect LICs and LMICs will receive loans with a higher level of concessionality than UMICs, consistent with their stage of development and income category.

In addition, the proposed approach considers IFAD's own financial sustainability.

Any borrowing must be financially sustainable so that in principle any loans funded by such debt must be capable of repaying the debt without drawing on IFAD's core resources.

[14] Current ordinary-term loans can have a maximum maturity of 35 years and grace period of 10 years without exceeding an average maturity of 20 years.