Discussion Paper

IFAD’s Comprehensive Approach to Transition/Graduation

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Consultation on the Twelfth Replenishment of IFAD’s Resources — Second Session
Virtual meeting, 16-17 June 2020

For: Review
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### Abbreviations and acronyms

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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ADF</td>
<td>Asian Development Fund</td>
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<tr>
<td>AfDB</td>
<td>African Development Bank</td>
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<tr>
<td>AfDF</td>
<td>African Development Fund</td>
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<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<tr>
<td>GDI</td>
<td>graduation discussion income</td>
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<tr>
<td>GNIpC</td>
<td>gross national income per capita</td>
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<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
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<tr>
<td>IDA</td>
<td>International Development Association</td>
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<tr>
<td>IFAD12</td>
<td>Twelfth Replenishment of IFAD’s Resources</td>
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<tr>
<td>IFIs</td>
<td>international financial institutions</td>
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<tr>
<td>LDCs</td>
<td>Least Developed Countries</td>
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<tr>
<td>LIC</td>
<td>low-income country</td>
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<tr>
<td>LMIC</td>
<td>lower-middle-income country</td>
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<tr>
<td>NCC</td>
<td>net contributor country</td>
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<tr>
<td>ODA</td>
<td>official development assistance</td>
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<tr>
<td>RTA</td>
<td>reimbursable technical assistance</td>
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<tr>
<td>SSTC</td>
<td>South-South and Triangular Cooperation</td>
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<td>UMIC</td>
<td>upper-middle-income country</td>
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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$12,2354 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.

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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-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 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, 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
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 refloows 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.

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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. 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.

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

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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.\(^\text{10}\)

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.\(^\text{11}\)

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.\(^\text{12}\) 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 GNI\(_{pc}\) under the GDI) after they have transitioned/graduated from IFAD financial

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\(^\text{10}\) 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.

\(^\text{11}\) The IBRD GDI is set at a GNI\(_{pc}\) of US$6,975 as of 1 July 2019. As of April 2020, IFAD borrowers with a GNI\(_{pc}\) above this level are: Argentina, Brazil, China, Cuba, the Maldives, Mexico, Montenegro, Lebanon, Turkey and the Bolivarian Republic of Venezuela.

\(^\text{12}\) 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 IFAD.
Annex II

**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).

<table>
<thead>
<tr>
<th>Institution</th>
<th>Criteria for eligibility</th>
<th>Explicit transition policy in charters</th>
<th>Criteria for transition</th>
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</thead>
</table>
| 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 (AIDF) | • 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: ADF resources only  
Category B: blend countries – both AIDF and AIDB  
Category C: AIDB resources only |
| African Development Bank (AIDB) | 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 |
Annex III – to be included in due course
Annex IV – to be included in due course