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Investing in rural people

## **IFAD's Revised Approach to Graduation: The Way Forward - DRAFT**

### **Note to Consultation members**

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Consultation on the Twelfth Replenishment of IFAD's Resources —  
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**For: Review**

# IFAD's Revised Approach to Graduation: the Way Forward

## Note to Delegates

This note provides Members of the IFAD12 Consultation with an update on the status of the discussion on IFAD's graduation policy. It builds upon the graduation document discussed at the Second Session of IFAD12 (IFAD12/2/R.2/Rev.1 and IFAD12/2/R.2/Add.1) incorporates feedback received from Member States since that meeting. A number of outstanding issues are summarised in the table in Appendix 1. Following the Third Session of IFAD12 this document will be updated and annexed to the Report on the Twelfth Replenishment of IFAD's Resources.

## Introduction

1. At the first session of the Consultation on the Twelfth Replenishment of IFAD's Resources (IFAD12), IFAD Management was asked to propose a more comprehensive approach to graduation of borrowing countries, building on the existing IFAD Transition Framework<sup>1</sup>. This note summarizes the discussions and recommendations of the IFAD12 Consultation. It is intended to serve as the basis of a graduation policy to be submitted to, and expected to be approved by the Executive Board, in line with the IFAD12 Commitment.
2. The proposed approach follows the principle of universality in ensuring that IFAD's support is available to all its developing Member States, while prioritizing the poorest countries and people. It is aligned with the procedures already utilized at the World Bank, including the application of the Graduation Discussion Income (GDI) as defined by the International Bank for Reconstruction and Development (IBRD) and currently set at a GNIpc of US\$7,065<sup>2</sup>, to initiate graduation discussions.

## II. The Way Forward

3. In line with the principle of universality and IFAD's mandate to serve the needs of its developing Member States, while focusing on the poorest and most vulnerable rural people, the principles of the four pillars below have been defined as the basis of IFAD's graduation policy.

### Pillar 1: Distribution of IFAD's financial resources

- a) The IFAD12 Consultation notes that Executive Board discussions on the Integrated Borrowing Framework, and IFAD's credit rating process, have progressed to the point that IFAD is likely to be able to reliably access a diversified set of resources, beyond core replenishment and sovereign borrowings, during IFAD12.
- b) The IFAD12 Consultation, therefore, agreed that IFAD's core resources<sup>3</sup> will be fully allocated (100 per cent) to LICs and LMICs. Lending to UMICs will be funded solely from borrowed resources. UMICs are expected to receive at least 11 per cent and up

<sup>1</sup> Approved by the Executive Board at its 125th Session in December 2018.

<sup>2</sup> The IBRD GDI is set at a GNIpc of US\$7,065 as of 1 July 2020. As of July 2020, IFAD borrowers with a GNIpc above this level are: Argentina, Brazil, China, Cuba (latest data 2016), Dominican Republic, Gabon, Grenada, Lebanon, Maldives, Mexico, Montenegro and Turkey.

<sup>3</sup> Defined as replenishment contributions, reflows of loans financed through replenishments, and concessional partner loans.

to 20 per cent of the agreed IFAD PoLG<sup>4</sup>. IFAD will make all efforts to access diversified borrowed resources, [in line with the Integrated Borrowing Framework (IBF)], and meet these expectations on the availability of lending to UMICs. Special provisions are in place for small states and/or countries with fragile situations eligible for concessional resources.<sup>5</sup>

- c) On an annual basis, IFAD Management will report to the Executive Board on the status of the allocations, the distribution of resources among country groups, and changes in status of Member States in relation to the GDI.
- d) Countries that graduate from IFAD's financial support remain important partners of the Fund. They will continue to have access to diverse support and services related to the sharing of knowledge, technical expertise and policy engagement, including through instruments such as SSTC and reimbursable technical assistance.

### **Pillar 2: Financing conditions and pricing of borrowed resources**

- a) The financing conditions and pricing to be applied for borrowed resources will ensure that IFAD is able to recover the cost of borrowing and differentiate among countries of different income groups, while remaining competitive vis-à-vis countries' market financing options. This will allow IFAD to maintain financial sustainability and avoid subsidization from core resources, as well as ensure IFAD financing is available to all borrowers on competitive terms.
- b) Those UMICs above the Graduation Discussion Income (GDI) threshold will be subject to harder financial conditions relative to those UMICs below the GDI level. UMICs below GDI will be subject to harder financial conditions relative to LMICs. The financing conditions for countries that surpass the GDI threshold during a replenishment cycle will be adjusted at the start of the following replenishment cycle.

### **Pillar 3: Trajectory for UMICs reaching GDI threshold**

- a) The criterion to determine the start of a graduation process is the achievement of an income level above the GDI, as defined by the IBRD.
- b) Member States that achieve the GDI threshold and wish to continue borrowing from IFAD would engage in a structured dialogue with IFAD that will be reflected in a new or updated country strategic opportunities programme (COSOP).
- c) The COSOPs for countries achieving the GDI will guide the final phase in the country's borrowing from IFAD, recognising that they may remain important partners of the Fund and have access to the support and services outlined in Pillar 1(d) above.
- d) These COSOPs will outline an expected trajectory of the country's development, including benchmarks and triggers for the graduation process, and the variables to be considered when assessing the country's progress. These variables will include those used in the IBRD graduation approach (i.e. the country's ability to access external capital markets on reasonable terms, and the country's progress in establishing key institutions for economic and social development), variables that are consistent with IFAD's Transition Framework<sup>6</sup>, and those consistent with the Agreement Establishing IFAD, such as rural poverty and food security status. This

<sup>4</sup> [The Borrowed Resources Access Mechanism (BRAM) is currently being discussed by the PBAS Working Group. Eligibility and access to borrowed resources is proposed to be determined based on development effectiveness, demand and creditworthiness criteria, and considering the financial safeguards to ensure the financial sustainability of both IFAD and potential borrowers as well as to avoid concentration risk. Individual country demands will be taken into account when assessing demand for financing.]

<sup>5</sup> As defined by the Policies and Criteria for Financing.

<sup>6</sup> EB 2018/125/R.7/Rev.1.

- will ensure that they are reflective of IFAD's specific mandate and that economic cycles and unexpected shocks that alter a country's development trajectories are taken into account.
- e) COSOPs will be submitted to Executive Board for review within 3 years of the country attaining and maintaining the GDI<sup>7</sup>. When available, the COSOPs will be informed by the most recent country strategy and programme evaluations (CSPEs) and their recommendations will be included as an appendix in the COSOPs. Where no CSPE has been performed within the last five years, Management will propose their prioritization during the annual work programme discussions with IOE.
  - f) COSOPs for UMICs which: (i) have already exceeded the GDI threshold for at least three years prior to the beginning of IFAD12; and (ii) wish to continue borrowing from IFAD, will be presented during IFAD12.
  - g) Graduation is based upon an assessment of a country's capability to manage its own development processes. It is expected that the duration of COSOPs for countries above the GDI will conform to the standard timelines, without unnecessary extensions<sup>8</sup>. Progress in implementing these COSOPs will be reviewed at the mid-point of the COSOP period and upon completion, when a decision will be made as to whether: (i) the country has made sufficient progress towards the criteria to graduate from IFAD's financial support and will cease borrowing; or (ii) the country has not made sufficient progress in which case the COSOP may be extended or renewed after consultation with the Executive Board.

#### **Pillar 4: Addressing reversals due to economic shocks**

UMICs reverting to below the GDI level after having graduated from IFAD financial support (having met the conditions for graduation determined in the COSOP) may request to initiate a consultative process with IFAD to re-gain access to financial resources in the following replenishment period. IFAD will assess the request, taking into consideration the criteria set out in the graduation policy and the country's last COSOP, and determine whether to initiate the consultative process. The Executive Board will be consulted on these requests prior to the initiation of any consultative process. Following the consultative process, a new COSOP would be prepared and submitted for EB review prior to initiating any new lending to the country.

<sup>7</sup> If a country drops below the GDI again during this period no new COSOP will be required and the deadline for submitting the COSOP will be reset when the country again exceeds the GDI.

<sup>8</sup> As per the revised Guidelines and Procedures for Results-based Country Strategic Opportunities Programmes (EB 2018/125/R.24).

## Appendix 1. Summary of Main Outstanding Issues

**Table 1. Summary of Main Outstanding Issues**

<b>Paragraph/ Pillar Reference</b>	<b>Issue</b>	<b>Options for Feedback</b>
Para 1.	Some Member States have raised concerns about imposing a timeline on the Executive Board to approve the graduation policy.	The following text has been proposed: "It is intended to serve as the basis of a graduation policy to be submitted, and expected to be approved by the Executive Board, in line with the IFAD12 Commitment"
Pillar 3 (d)	Several Members have requested that reference to IFAD-specific variables such as food security and nutrition, are included here in addition to those used in the IBRD graduation approach, and those consistent with the Transition Framework.	A reference has been included to variables "consistent with the Agreement Establishing IFAD, such as rural poverty and food security status."
Pillar 3 (e) and 3 (f)	Normal timeline for submission of COSOPs for countries above the GDI to the Executive Board, and in the specific case of countries which have already been above the GDI for longer than the normal timeline. Timelines of 18 months to 3 years have been discussed.	An 18 month timeline is likely to be too short for countries which are just moving above the GDI. Given volatility of GNI per capita it would be recommended to ensure that it is sustained for at least one-two years before beginning work on a new COSOP, which would imply a three year timeline for submission to the Executive Board. As such the three year timeline has been proposed.
Pillar 3(g) (and (c))	The role of the Executive Board in a decision to extend/renew the COSOP for a countries above the GDI.	It is proposed that no unnecessary extensions would be permitted, and that extension would only be done following consultation with the Executive Board.