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IFAD Transition Framework – Draft 3

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Investing in rural people

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Note to Executive Board representatives

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Abbreviations and acronyms

COSOP	country strategic opportunities programme
GNIpc	gross national income per capita
IFI	international financial institution
IVI	IFAD Vulnerability Index
LIC	low-income country
MIC	middle-income country
PBAS	performance-based allocation system
SSTC	South-South and Triangular Cooperation
TFWG	Transition Framework Working Group
UMIC	upper-middle-income country

Executive summary

1. The IFAD Transition Framework represents one of the commitments made for the Eleventh Replenishment of IFAD's Resources (IFAD11). It is an important element of the new business model, which tailors activities to support borrowers' demands and needs through an evolving operational and financial framework and associated toolkit. This two-pronged business model, which combines the IFAD Transition Framework with enhanced decentralization, will greatly enhance IFAD's effectiveness, responsiveness and attractiveness to stakeholders. Through this business model, IFAD will have greater proximity to country context and development partners, enabling early identification of changing conditions to recalibrate strategies towards optimal development solutions while ensuring financial sustainability.
2. In the global development arena, a "country transition" refers to a process in which a country's gross national income per capita (GNIpc) increases past the threshold of change from low-income country (LIC) to lower-middle-income country, upper-middle-income country (UMIC) and high-income country status.¹ In addition to GNIpc, creditworthiness is the second criterion used to determine the financing terms applied to a country. Increasing income, accompanied by higher creditworthiness, leads a country to transition towards less concessional financing terms.
3. While GNIpc and creditworthiness remain the most widely agreed-upon measures of transition – and it is important for comparability and transparency that IFAD applies the same definition – there is wide recognition that these criteria do not capture each country's unique development challenges and the capacities to meet those challenges. Dialogue between the country in transition and IFAD Management is key, with flexibility limited to exceptional cases as agreed with the Executive Board.
4. The IFAD Transition Framework is not a stand-alone policy or a prescriptive document. It will continue to evolve along with IFAD's and borrowing countries' capacities and contexts. It encompasses the following elements to manage transitions more effectively, all of which support the principles of predictability, transparency and sustainability:

Phases I and II

- (i) Borrowers will transition from one stage to another based on their GNIpc and creditworthiness and on a timely dialogue between the country in transition and IFAD Management (approved by the Governing Council in February 2018 in phase I of the Transition Framework).
- (ii) Borrowers will have phasing-out/phasing-in periods to smooth their transitions to the new lending terms (the Working Group on the Transition Framework [TFWG] terms of reference [ToRs], paragraph 7(i); will be approved with this document).
- (iii) Borrowers and Management will jointly develop medium-term transition strategies for each country that identify IFAD's most appropriate mix of support (TFWG ToRs, paragraph 7(iv); revised country strategic opportunities programme procedures to be presented to the Executive Board in December 2018 for review).
- (iv) Borrowers will access a more diversified menu of lending and non-lending products from IFAD to suit their increasing internal capacities, diversified needs and specific circumstances (TFWG ToRs, paragraph 7(iii); certain

¹ See <https://datahelpdesk.worldbank.org/knowledgebase/articles/378834-how-does-the-world-bank-classify-countries>.

products are already under development such as results-based lending and regional operations, these and others will continue post-phase II).

- (v) Borrowers will step up efforts to increase domestic resource mobilization in coordination with IFAD, and IFAD will complement those efforts to sustain transitions by enhancing partnerships with multilateral and bilateral partners, in line with the long-term vision reflected in the cofinancing strategy to become an assembler of development finance (TFWG ToRs, paragraph 7(ii); strategy and action plan to be endorsed by TFWG in 2018 and reviewed by the Board in December 2018).
 - (vi) IFAD will coordinate its work to ensure that its transition support is aligned with Members' and partners' criteria (through a cross-departmental transition task force and greater coordination with other development partners as identified in paragraphs 20 and 21 of EB2017/122/R.34/Rev.1, ongoing).
 - (vii) Management will report lessons learned from implementing this IFAD Transition Framework in its midterm review of IFAD11 (cross-departmental transition task force will be set up in 2018, as identified in paragraph 20 of EB 2017/122/R.34/Rev.1, and report through IFAD11 midterm review).
5. It should be noted that the following elements pertain to topics that need to be further discussed after completion of phase II. The Transition Framework will be updated accordingly after due process. These elements have been included in order to provide a more comprehensive representation of the expected full-fledged Transition Framework once the agreed IFAD11 reforms have been realized. Management expects that the IFAD11 commitments will be fulfilled in a timely manner.

Post-Phase II

- (viii) In those cases where borrowers choose not to access IFAD's financial resources, IFAD will, as requested, tailor its support with other forms of development assistance (to be further developed after phase II as per TFWG ToRs, paragraph 8).
- (ix) IFAD will recalibrate its resource allocation as countries transition, and proactively make adjustments to those mechanisms in order to reflect changes in borrowers' needs and composition (to be further developed after phase II as per TFWG ToRs, paragraph 8).
- (x) Management will continue to strengthen IFAD's financial architecture and risk management practices to expand its toolkit and increase resources available to all borrowers (update of financing terms as per paragraph 22 of EB2017/122/R.34/Rev.1, other topics to be further developed after phase II as per TFWG ToRs, point 8).

Recommendation for approval

The Executive Board is invited to approve the IFAD Transition Framework, inclusive of the elements elaborated in paragraphs 1 to 21.

IFAD Transition Framework

I. Introduction

1. During the Consultation on the Eleventh Replenishment of IFAD's Resources (IFAD11), Members requested that Management develop a transition framework to complement IFAD's evolving financial architecture and the enhanced IFAD11 business model. The principal aim of the IFAD Transition Framework is to ensure a smooth, predictable, sustainable and equitable transition for borrowers by providing expanded and tailored lending and non-lending support. This requires that IFAD both upgrade and expand its existing lending and non-lending products. IFAD recognizes that tailoring the focus of its investments and the range of products and financing terms it offers can make a significant difference in terms of development effectiveness and impact.
2. IFAD's support contributes to inclusive and sustainable rural transformation, supporting countries' own development plans so that as they develop, these countries leave no rural people behind. The empirical analysis in the 2016 Rural Development Report shows that if countries are not proactive during their transitions, rural poor people will indeed be left behind. Inclusive rural transformation does not happen automatically, but must be facilitated.

II. Experiencing transitions

3. The transformation of previous LICs into lower-middle-income countries and middle-income countries (MICs) has accelerated in the last 20 years. Three quarters of the world's poor people – especially rural people – live in these countries. Upper-middle-income countries (UMICs), the most heterogeneous group, are home to approximately 22 per cent of the world's extremely poor people; the number of countries classified as UMIC is growing. UMICs range from small islands to large economies like China, Brazil and Mexico.
4. As countries transition to higher income levels, the importance of agriculture to the national economy tends to diminish. In fact, there is a strong inverse correlation between agriculture's share of gross domestic product and gross domestic product per capita. Transitions bring a progressive decrease in IFAD's core financing, but should be accompanied by non-lending activities. The challenge is to move beyond thinking of IFAD's support simply as funding, towards envisioning IFAD as a strategic partner that leverages broader instruments and advice, as proposed in the IFAD11 business model.

III. Defining transitions

5. Transition refers to the process in which the gross national income per capita (GNIpc) and creditworthiness of a country eligible to borrow from IFAD increases to the threshold for receiving financing on less concessional terms. Reversal refers to the process in the opposite direction, where due to a decrease in GNIpc and/or creditworthiness, a country becomes eligible to financing on more concessional terms.

6. Management recognizes that classifications based only on GNIpc do not fully capture a country's unique development challenges and capacities to meet those challenges. IFAD considers many of these issues in its performance-based allocation system (PBAS) through indicators such as the IFAD Vulnerability Index (IVI) and in analysing country context as a part of the country programming process. However, while imperfect, GNIpc remains the most utilized measure of transition across development status in all international financial institutions (IFIs).
7. To capture the multiple dimensions of transition, IFAD revised its PBAS to better reflect its borrowers' rural development transitions. In February 2018, the Governing Council amended the Policies and Criteria for IFAD Financing to generate greater predictability in financing. With growing GNIpc, Members have become more sophisticated in their demands from IFAD, requesting more diverse services and options. While transition is a positive milestone, there are both challenges and opportunities in managing a country's transition that require further refinement of IFAD's approach and options.

IV. Managing transitions

8. This framework is based on the following three principles:
 - **Predictability.** Transitions must be predictable in order to ensure sustainability and follow clear and transparent rules. The provision of IFAD's loans and grants to countries is predictable when borrowers are confident about the amounts, timing and pricing of resources allocated to them. IFAD can ensure more predictable financing terms by applying new financing terms over a replenishment cycle instead of on a yearly basis; and using a phasing-in period together with periodic recalibrations of resource allocation.
 - **Sustainability.** Sustainable transitions call for differentiated approaches that have long-lasting effects to limit reversals. Each country's situation is complex and multidimensional, influenced by financial, economic and social factors as well as exogenous factors and shocks. As these circumstances change, a broader menu of lending and non-lending products will increase the sustainability of IFAD's interventions beyond the life of a single project. Domestic and international resource mobilization ensures the complementarity of interventions. Above all, strong government ownership is critical for ensuring sustainability. As agreed in the IFAD11 Consultation report, IFAD's financial sustainability is also a key principle to be considered in the road map for IFAD's financial strategy and the development of lending and non-lending support.
 - **Transparency.** Transparency demands better data quality, fair, equitable and more efficient use of resources, careful monitoring, better policy compliance and benchmarking.² Transparent financing, in line with International Aid Transparency Initiative standards, requires development partners and borrowers to use objective criteria for resource allocation and publish information in an accessible and timely manner.
9. The Framework has the following elements, all of which support the principles of predictability, sustainability and transparency.
 - (i) Borrowers will transition from one stage to another based on their GNIpc and creditworthiness.
10. Country transitions are based on two criteria: GNIpc and creditworthiness. However, transitions cannot be driven solely by mathematical formulas. Management pays close attention to countries approaching eligibility at the end of each replenishment period as the transition should be accompanied by a timely

² Development Assistance Committee, *Aid Predictability – Synthesis of Findings and Good Practices* (October, 2011).

dialogue between the country in transition and IFAD. Since it is important to ensure transparent, fair and equitable access for all borrowers on a consistent basis, the scope for flexibility will be evaluated and agreed on a case-by-case basis with the Executive Board.

11. While developing a tailored approach to address countries' specific needs during the transition period, Management will use objective variables that complement GNIpc to assess countries' overall development situations. These include:
 - The IVI;
 - The Rural Sector Performance Assessment, including macroeconomic indicators;
 - Measures of the pervasiveness of rural poverty;
 - Tax revenues and public expenditure on rural development; and
 - The portfolio performance and disbursements variable – an indication of the use of previous resources provided by IFAD.
 - (ii) Borrowers will have phasing-out/phasing-in periods to smooth their transitions to new lending terms.
12. Transitions typically extend over several years if not decades. The changes in the Policies and Criteria for IFAD Financing provide for more predictable and transparent planning as financing terms for each country are revised once in each replenishment cycle. The gradual process of transition in IFAD's financing terms, which involves phasing in less concessional terms, smooths countries' transitions.
13. For countries undergoing a reversal, this will normally be addressed on an annual basis to assist governments in mitigating the cause of the reversal, unless faster application is needed. The transition programme should foster the conditions necessary to help borrowers to return to their former status as soon as feasible.
 - (iii) Borrowers and Management will jointly develop medium-term transition strategies for each country that identify IFAD's most appropriate mix of support.
14. Transitions are medium- to long-term processes that must be planned and resourced adequately. IFAD's country strategic opportunities programmes (COSOPs) create a foundation for IFAD's interventions in enhancing the impact of government development policies and programmes in the rural sector. Updated COSOP guidance will play a central role in outlining IFAD's medium-term strategy to flexibly – yet predictably – respond to each country's expected development needs. This strategy is an important tool for delivering a cohesive package of interventions, foreseeing expected results and potential risks, and designing mitigation actions. The country assessment will include a set of variables focused on macroeconomic conditions, the agricultural and rural sectors, rural poverty, the most vulnerable areas and the policy and institutional context – all aimed at capturing diverse country dimensions and allowing for early identification of events that may trigger country transitions.
15. COSOPs will become living management documents. An in-depth COSOP results review (CRR) will take place every two years to reassess the needs, priorities, solutions and strategies on which COSOPs are based. In addition, an annual status update will be undertaken as part of the portfolio review process so as to reflect significant changes in country conditions, if needed. IFAD will work with other IFIs and bilateral agencies to ensure a coordinated approach, especially in cases of prolonged arrears, fragility and in small states.

- (iv) Borrowers will access a more diversified menu of lending and non-lending products from IFAD to suit their increasing internal capacities, diversified needs and specific circumstances.
16. Based on assessed demand and robust analysis, Management will pilot new products during IFAD11 that allow it to diversify its product offer to enhance the tailored support to country circumstances, in line with its evolving business model, while at the same time maintaining its comparative advantage and strategic focus. This more diverse offering includes:
- Results-based lending. IFAD proposes to carry out two or three pilot initiatives over a six-year period and use these pilots to fine-tune the final product. This instrument is always voluntary and demand-driven. It can strengthen IFAD's focus on smallholder farmers and shift the paradigm of local-level government service provision. There is significant potential to introduce more participatory approaches: IFAD will draw on its hands-on approach and relationships with rural communities and farmer organizations to deliver results and scale up.³
 - Regional lending operations. Regional lending operations can tackle rural development and cross-border challenges such as environmental threats and a lack of integrated markets for small farmers.⁴ Services required to address these threats – such as transport, disease prevention and natural resource management – are best provided at the regional level in order to tap into economies of scale, ensure connectivity and extend access to goods and services, and thereby achieve broader impact. These solutions can particularly benefit small countries (such as small island developing states), and those confronted with natural disasters. IFAD will pilot up to three regional lending operations and develop an institutional approach based on lessons learned.
 - IFAD's enhanced approach to reimbursable technical assistance. Complementing resources available primarily for UMICs, reimbursable technical assistance helps to transmit IFAD's operational and policy knowledge to countries where it does not have a lending relationship. The product also allows countries to access IFAD's knowledge and expertise.
 - Contributions to policy making. IFAD can bring evidence from its projects and its global experience to national policy making processes. This is especially relevant to countries in which IFAD's knowledge is deemed to be as important as its financing (including many MICs). During IFAD10, IFAD put a stronger focus on country-level policy engagement as its key non-lending activity. This will be expanded during IFAD11. Decentralization of IFAD's staff places expertise close to national policymakers and policy processes. IFAD's policy engagement will be also strengthened by the new project-design process, the dedication of resources specifically for policy engagement and enhanced monitoring and evaluation.
 - South-South and Triangular Cooperation (SSTC). SSTC is an increasingly important dimension of national development strategies and IFAD has a crucial role as a broker of SSTC opportunities in smallholder agriculture and rural development. During IFAD11, SSTC will be promoted as an integral component of IFAD's business model.

³ Brookings, *Scaling up Programs for the Rural Poor: IFAD's experience, lessons and prospects (Phase 2)*, Brookings Global Economy and Development (January, 2013).

⁴ The contributions of a regional approach to development actions' increased effectiveness have been stressed at high-level forums including those that issued the Paris Declaration on Aid Effectiveness (2005), Accra Agenda for Action (2008) and Busan Partnership for Effective Development Cooperation (2011).

- (v) Borrowers will step up efforts on domestic resource mobilization. IFAD will complement those efforts to sustain transitions.
17. The IFAD11 Replenishment Report⁵ acknowledges that IFAD should enhance its capabilities as an assembler of development financing in addition to its role as a direct lender. A key principle of the new business model is that Members increase their efforts to provide counterpart financing for all IFAD-supported projects, commensurate with their financial status. Empirically, larger projects mobilize more domestic resources. In line with the IFAD11 commitments, a cofinancing strategy and the accompanying action plan will establish a long-term vision for IFAD's cofinancing agenda, in line with the IFAD11 Report, by setting out strategic directions for domestic and international cofinancing, and to enable the reaching of the overall IFAD11 cofinancing target of 1.4. Counterpart targets will be agreed with governments during the preparation of project concept notes and included in COSOPs. The aim is to achieve the 1:0.8 IFAD11 aggregate domestic cofinancing target. A clear methodology for the recognition and monitoring of in-kind contributions has also been established.⁶ Evidence from a study conducted by IFAD confirms other agencies' findings that increased domestic cofinancing directly contributes to a country's own performance on poverty alleviation.⁷
18. Leveraging cofinancing from external partners enables projects to cover more beneficiaries, improves aid coordination, facilitates policy engagement with governments and provides opportunities to scale up successful experiences for enhanced impact and sustainability. It is also required across IFAD's project portfolio to achieve the 1:0.6 IFAD11 aggregate international cofinancing target. In this regard, IFAD will strengthen partnerships with multilateral and bilateral organizations.
- (vi) IFAD will align its transition approaches with Members' and partners' broader approaches.
19. IFAD will continue working as part of the international community – including IFIs and bilateral financiers – to enhance communication, dialogue and collaboration, and explore multidimensional measurements of development that leave no one behind. While IFAD maintains its focus on agriculture, the space for complementary interventions is large and there is increasing knowledge exchange and learning across disciplines. This coordination is particularly important in cases of prolonged arrears, unsustainable debt, crisis, fragility and in small state economies.
20. IFAD Management will establish mechanisms to ensure coherence across financial and operational areas of the IFAD Transition Framework, and foster the wide dissemination of solutions. IFAD will formalize communications to borrowers on the time frame and impact of transitions, including discussions with ministries of finance. This will facilitate planning and ensure that all changes are made in a timely and transparent manner.
- (vii) Management will report lessons learned from implementing this IFAD Transition Framework in its midterm review of IFAD11.
21. Management will report on the implementation of the IFAD Transition Framework at the IFAD11 midterm review. This will include reporting on countries that change financing terms and on their experiences with phasing in and phasing out. Reporting will also evaluate the status of the introduction of new products and the enhanced use of current ones, as well as trends in resource mobilization. In addition, the update will include information from other donors and development

⁵ IFAD11/5/INF.2.

⁶ TFWG 2018/2/INF.1

⁷ Matthew Winters and Jaclyn Streifeld, *Splitting the Check: Bargaining Over Counterpart Commitments in World Bank Projects* (University of Illinois at Urbana-Champaign, 2013).

actors to ensure the coherence of approaches and to keep IFAD engaged in the global debate on countries in transition.

V. Moving forward

22. The following items pertain to topics that need to be further discussed after the closure of phase II. The most appropriate governing body to lead the development of such items will be decided by the Executive Board based on the recommendations of the Transition Framework Working Group.
 - (viii) Borrowers may opt not to access IFAD's core financial resources; as requested, IFAD will endeavour to tailor its support.
23. IFAD's engagement with countries can contribute to tangible improvements in development outcomes through carefully targeted activities. IFAD can play a strategic role in national planning to reduce the reliance on concessional financing in line with countries' transition strategies, accompanying this support with other forms of assistance.
 - (ix) IFAD will continue recalibrating its resource allocation as countries transition, and proactively make adjustments to those mechanisms to reflect changes in borrowers' needs and composition.
24. The PBAS reforms already include a stronger focus on vulnerability and performance. The PBAS Working Group will continue to review the allocation of resources to be tailored to countries' needs, performance and demand within the overall context of IFAD's mandate and strategic priorities.
25. Engagement in UMICs is essential for the achievement of Sustainable Development Goals 1 and 2. It also enables IFAD to act as broker of SSTC and should increasingly strengthen IFAD's financial sustainability as it develops new products and leverages its financial architecture to provide further non-core resources as well as play a pivotal role in non-lending products.
 - (x) Management will continue to enhance IFAD's financial architecture and risk management practices to expand its toolkit and increase resources available to all borrowers.
26. In line with the-IFAD11 commitments, IFAD's financial framework and strategy will be enhanced in order to tailor operations to borrowers' demand and needs. This will allow IFAD to mature as a collaborative development partner and enhance its effectiveness and impact. While replenishment contributions remain the bedrock of IFAD's capital and financial commitment capacity, borrowing will be integrated into the Fund's financial framework. This evolution will enhance IFAD's responsiveness to borrowers, also through updated financing terms. This objective will be pursued, inter alia, by reviewing IFAD's cost of capital and enhancing risk management. The IFAD11 reform process foresees the development of IFAD's financial architecture to maximize the efficiency of IFAD's capital through increased resources, ensuring financial sustainability and optimized risk management and planning.