Lending Terms and Demand for IFAD Projects

Scott Morris, Jessie Lu

Abstract

Donor support for agriculture development is not keeping pace with developing country demand or the need for finance implied by Sustainable Development Goal 2. In order to increase the overall volume of resources available for these needs, IFAD is pursuing a reform agenda that considers providing loans on harder terms to its client countries. This study assesses whether this hardening of lending terms will affect country demand for projects. Using the World Bank experience as a proxy, this paper examines whether graduation from the International Development Association to the International Bank for Reconstruction and Development affects the sector portfolios of countries and the types of investment demands within agriculture through both statistical and qualitative country case study analysis. We find that as countries graduate, there is a relative shift away from “soft” sector investments and a different mix of investments within the agricultural sector. We argue that IFAD’s consideration of harder lending terms should also include consideration of how to respond to a different mix of country demand within the agricultural sector. Specifically, the fund should consider some scaling up of projects, increased emphasis on capital investments, and a greater emphasis on policy engagement with client countries.
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Scott Morris, Jessie Lu
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1. Introduction

Sustainable Development Goal 2 (SDG2) aims to eliminate hunger by 2030, but after decades of decline, global rates of food insecurity and hunger are again on the rise tied largely to the growing impact of climate change and increased state fragility. For the first time in nearly two decades, the worldwide prevalence of undernourishment is increasing, while the share of agriculture investments in overseas development assistance has stagnated.\(^1\) To achieve the 2030 target, the United Nations estimates an average additional investment of US$267 billion per year, with other investment gap estimates ranging from US$7 billion to US$260 billion per year.\(^2\)

A number of institutions constitute the global agricultural aid landscape and supply financial resources and research support. These actors include the three UN agencies targeted at agriculture—the Food and Agriculture Organization (FAO), the World Food Programme (WFP), and the International Fund for Agricultural Development (IFAD); the World Bank and other regional development banks; bilateral donors; public institutions; non-governmental organizations; the private sector; and philanthropies. Among these actors, IFAD stands out for its focus on financing inclusive growth through investments targeted at increasing the productive capacity of the poorest and most rural populations.

However, donor contributions to IFAD have declined over the past decade, falling from US$1,071 million to US$1,030 million to US$856 million over the past three replenishment cycles.\(^3\) It appears unlikely that direct donor support will be the basis for any scaling up at IFAD to meet SDG2. As a result, the institution will need to focus on other financial measures to achieve greater scale.

To reach better development outcomes, including progress towards SDG2, IFAD is pursuing a reform agenda focused on resource mobilization, allocation, utilization, and transforming resources into development results.\(^4\) One key component of IFAD’s proposed strategy focuses on the creation of a new lending program that leverages the agency’s balance sheet to fund a new grant-based, targeted investment mechanism focused on countries most in need. To accommodate these changes in financial structure and increase aggregate access to financing, IFAD is also considering providing loans on harder terms to its client countries.\(^5\)

This paper assesses whether a hardening of lending terms will affect country demand generally, as well as demand for the types of projects financed by IFAD. In turn, the paper considers the implications of evolving country demand for IFAD operations. Through analysis of World Bank Projects & Operations data, this analysis examines whether the

\(^{1}\) Ritchie and Mispy, 2018; FAO, 2009.
\(^{3}\) IFAD, 2019a.
\(^{4}\) IFAD, 2019b.
\(^{5}\) IFAD, 2019b.
hardening of lending terms as countries graduate from the International Development Association (IDA) to the International Bank for Reconstruction and Development (IBRD) affects the sector portfolios of countries and the types of investment demands within agriculture. This qualitative assessment is supplemented by a review of existing literature in this area.

2. Background

The global agricultural financing gap is concentrated largely in rural areas in low-income countries (LICs) and low- and middle-income countries (LMICs), as well as pockets of need within higher income countries. Of the US$260 billion annual investment gap, US$180 billion is needed in rural areas specifically, with highest need in sub-Saharan Africa and South Asia. These areas with large investment gaps parallel areas with high need. According to the most recent State of Food Security and Nutrition in the World report released in 2018, the largest populations of undernourished people live in Southern Asia and sub-Saharan Africa, where nearly a third of East Africa’s population and nearly a fourth of Middle Africa’s population are undernourished. East and Middle Africa and Southern Asia also experience the world’s highest rates of food insecurity, suggesting a strong link between malnutrition and food security. Climate change impacts also trace directly to food insecurity within countries.

Multiple types of investments contribute to progress toward zero hunger. These investment domains focus on improving primary agricultural productivity and natural resources, agro-processing operations, infrastructure, institutional frameworks, and research and development. Of these categories, public expenditure is projected to play a large role in infrastructure and institutional frameworks. Studies also suggest that capital investments such as land development, machinery and equipment, plantation crops, and livestock-related assets are also important to achieving higher agricultural productivity in LICs.

World Bank lending (IBRD and IDA) for agriculture is growing in absolute terms, reflecting an overall increase in the supply of financing driven by IBRD capital increases and expansion of IDA resources (See Figure 1). The agriculture share of total lending has also increased slightly at the World Bank, which may provide a more precise measure of current country demand. Despite an increase in available resources at the World Bank and greater emphasis on agriculture among World Bank borrowers, donor contributions to the agriculture sector as a share of total overseas development assistance has stagnated, consistent with donor behavior at IFAD. This suggests a misalignment between developing

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7 IFAD, 2019b.
8 FAO, IFAD, & WFP, 2015.
10 FAO, IFAD, & WFP, 2015.
11 IFAD, 2019b.
country preferences and the supply of financing, with supply side efforts to meet higher demand deserving more attention going forward.

Finally, it is important to differentiate the World Bank’s agriculture sector strategy from IFAD’s institutional mandate and strategies. In simple terms, the bank focuses on the agriculture sector as a means to promote development and reduce poverty within its client countries, whereas IFAD focuses on the development needs of the rural poor, with a long-standing emphasis on small-scale agriculture as a means to reducing rural poverty. These differences may appear subtle, but they lead to significantly different operational approaches.

For the World Bank, the agriculture sector certainly implies a focus on rural areas, but not exclusively. Further, a sector-focus does not necessarily target rural poor populations, as it seeks to increase overall productivity and growth within the agriculture sector. Of course, the bank will identify impacts on these populations as outcome measures in its projects, but a rural poor focus is not motivating or constraining in the same way that it is for IFAD.

In terms of operations, we can observe a number of differences between the two institutions following from these differentiated roles:

- First, the World Bank’s agriculture projects are much larger than IFAD projects (see Section 3.3). Where the bank is aiming for sectoral impacts, IFAD typically proceeds from targeted interventions focused on the needs of a specific rural population.

- Second, bank operational strategy tends to be guided by a focus on the economic rate of return of a project within the sector, with higher return projects prioritized over lower return projects. This approach can benefit the rural poor, but it does not necessarily prioritize particular populations and in fact can lead to gaps in terms of distributional impacts (poor versus less poor, as well as geographical impacts). In turn, IFAD’s approach does not necessarily prioritize overall growth effects in seeking to reduce poverty for targeted populations.

- Finally, the World Bank’s sectoral approach tends to prioritize policy-level engagement with national governments in order to promote better policymaking at the national level when it comes to agriculture investments. IFAD’s more targeted interventions certainly have policy implications and depend on a favorable policy environment, but they do not align as strongly with policy-level partnerships with national actors as does the bank’s work on sector strategies.

We will further explore the implications of these differences in the final section of the paper. In particular, we consider the degree to which changes in IFAD’s financial model will

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depend on changes in the fund’s strategy and operational model, informed to some degree by differences with the World Bank model.

Figure 1. World Bank agricultural lending as share of total (2000-2018)


3. Sectoral Changes Related to Changes in Lending Terms

3.1 Overview

Although the current picture appears to reflect strong demand for agriculture financing that outpaces the supply of financing globally, this does not necessarily indicate borrower country behavior in the face of changing financing terms. Existing literature informs this question indirectly and, to a more limited degree, directly. There is significant literature assessing the effects of grant-based financing on growth, relying on cross-country regression analysis. In this context, Galiani et al. (2016) find a negative growth effect from country graduation from the World Bank’s IDA window. However, this study is not capturing the hardening of financing terms per se at the World Bank; rather, it is measuring the overall decline in grant-based aid for graduating countries, recognizing the degree to which major donors tie their aid decisions to IDA eligibility rules.

13 Rajan and Subramanian, 2008; Clemens, Radelet, and Bhavnani, 2004; Easterly, 2003; Burnside and Dollar, 2000.
More directly, a recent sectoral regression analysis by Gatti and Mohpal (2019) examines project-level data at the World Bank and finds that as countries graduate to harder lending terms, lending for human development sectors such as education, health, and social protection decreases, both because overall lending declines and the portfolio of lending shifts away from “soft” sectors. The study does not assert that harder terms causes a change in country demand, but it does observe a strong correlation between the two. These findings appear to support a common view among donor agencies that grant-based aid is associated with social sector investments (“soft” sectors) and non-aid flows are targeted toward infrastructure and industry (“hard” sectors).

Given the limited empirical literature in this area, and particularly the lack of specific results for agriculture spending, this paper provides a qualitative survey of country spending decisions linked to their borrowing status within the World Bank, with a focus on agriculture. Specifically, we track countries during the transition period from IDA-eligible borrower to IBRD borrower, assessing the overall distribution of their project portfolios according to “hard” and “soft” sectors. We then assess the agriculture portfolios for any evolution in agriculture projects as financing terms change.

### 3.2 Portfolio Data Analysis

The World Bank’s graduation policy adjusts financing terms for countries according to their status as IDA- or IBRD-eligible. Current IDA financing terms, as applied to most IDA countries, are 38-year maturities with a 6-year grace period and 0.75% interest rate. These terms are considerably “softer”, or more concessional, than IBRD financing terms, which vary by country groupings. Countries can choose various maturities up to 20 years. Terms are LIBOR plus a minimum spread of 0.65% up to 1.85% depending on the country and maturity.

In addition to financing terms, access to financing differs between IDA and IBRD. IDA’s “performance-based allocation system” sets lending levels for each eligible country based on a policy-derived formula, whereas IBRD lending levels are largely a function of overall portfolio risk and equity considerations across countries.

In both cases, choices about the composition of lending are guided by the borrowing country government in partnership with World Bank staff. In this sense, changes in the portfolio mix as countries move from IDA to IBRD eligibility can reasonably be assessed as a reflection of borrower country attitudes and objectives. In turn, because a change in financing terms is the defining difference between IDA and IBRD, any changes in the

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14 Gatti and Mohpal, 2019.
15 IDA graduation policy is based on two criteria: 1) GNI per capita (using the Atlas method) in excess of an agreed-upon operational cutoff, which as of 2019 was set at USD $1,145, and 2) creditworthiness (to be lent IBRD resources), as determined by the bank. Both IDA policy and practice make it clear that graduation is not an automatic or mechanical process, but rather based on a set of triggers, some discretionary, intended to achieve an incremental adjustment in concessionality from IDA’s “softer” terms to the IBRD’s “harder” terms. See Morris and Gleave “The World Bank at 75” (2015) available at https://www.cgdev.org/publication/world-bank-75.
portfolio can also be assessed as some measure of country attitudes toward these terms. In this sense, examining country behavior at the World Bank as they transition from IDA to IBRD can serve as a useful input for IFAD’s consideration of a more diversified array of financing terms and products.

Our analysis proceeds on that basis. World Bank Projects & Operations data were collected for the 44 countries that have made the full transition from IDA to IBRD eligibility, beginning five years before the graduation year, including the graduation year, and ending five years after the graduation year for a total of an eleven-year period. Countries were excluded if they had too little data (i.e. very few projects or only IBRD projects prior to graduation); had degraded; had graduated in 2017 leading to limited post-graduation data; or, in the case of the Philippines, graduated and regraduated within a two-year period. Egypt and Indonesia had both graduated, degraded, then regraded. In both these cases, data from the second graduation were used. The included and excluded countries are summarized in Table 1 below.

**Table 1. Included and excluded IDA graduated countries**

<table>
<thead>
<tr>
<th>Included Countries (n=22)</th>
<th>Excluded Countries (n=22)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Albania</td>
<td>• Bolivia</td>
</tr>
<tr>
<td>• Angola</td>
<td>• Bosnia and Herzegovina</td>
</tr>
<tr>
<td>• Armenia</td>
<td>• Chile</td>
</tr>
<tr>
<td>• Azerbaijan</td>
<td>• Colombia</td>
</tr>
<tr>
<td>• Botswana</td>
<td>• Congo, Rep.</td>
</tr>
<tr>
<td>• Cameroon</td>
<td>• Costa Rica</td>
</tr>
<tr>
<td>• China</td>
<td>• Cote d'Ivoire</td>
</tr>
<tr>
<td>• Dominican Republic</td>
<td>• El Salvador</td>
</tr>
<tr>
<td>• Ecuador</td>
<td>• Equatorial Guinea</td>
</tr>
<tr>
<td>• Egypt*</td>
<td>• Georgia</td>
</tr>
<tr>
<td>• India</td>
<td>• Honduras</td>
</tr>
<tr>
<td>• Indonesia*</td>
<td>• Jordan</td>
</tr>
<tr>
<td>• Korea, Rep.</td>
<td>• Nicaragua</td>
</tr>
<tr>
<td>• Macedonia</td>
<td>• Nigeria</td>
</tr>
<tr>
<td>• Mauritius</td>
<td>• Philippines*</td>
</tr>
<tr>
<td>• Montenegro</td>
<td>• Sri Lanka</td>
</tr>
<tr>
<td>• Morocco</td>
<td>• St. Kitts</td>
</tr>
<tr>
<td>• New Guinea</td>
<td>• Swaziland</td>
</tr>
<tr>
<td>• Paraguay</td>
<td>• Syria</td>
</tr>
<tr>
<td>• Serbia</td>
<td>• Tunisia</td>
</tr>
<tr>
<td>• Thailand</td>
<td>• Vietnam</td>
</tr>
<tr>
<td>• Turkey</td>
<td>• Zimbabwe</td>
</tr>
</tbody>
</table>

*indicates second graduation
Projects were classified based on whether they were approved pre- or post-graduation. The graduation year was considered pre-graduation as countries received both IDA and IBRD funding during graduation years. Analysis focused on major sectors, since major sector classification was available for all projects and it captured the sectoral breakdown of overall country borrowing portfolios.

These major sectors were then divided into two categories: “soft” investments, which encompass socially-oriented and small-scale investments, and “hard” investments, which include investments in physical infrastructure and other large-scale, commercially-oriented investments. The full list and classification of major sectors are in Table 2. At this stage of the analysis, we assess agriculture as a soft investment, with a more detailed assessment of agriculture as a soft or hard investment in the next section.

**Table 2. Major sector classifications**

<table>
<thead>
<tr>
<th>“Soft” Investments (small-scale and/or social sectors)</th>
<th>“Hard” Investments (large-scale and/or commercially oriented)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Protection</td>
<td>Water</td>
</tr>
<tr>
<td>Education</td>
<td>Sanitation and Waste Management</td>
</tr>
<tr>
<td>Health</td>
<td>Transportation</td>
</tr>
<tr>
<td>Agriculture, includes Fishing and Forestry</td>
<td>Industry</td>
</tr>
<tr>
<td>Public Administration</td>
<td>Energy and Extractives</td>
</tr>
<tr>
<td></td>
<td>Trade and Services</td>
</tr>
<tr>
<td></td>
<td>Financial Sector</td>
</tr>
</tbody>
</table>

Data on whether each project was IBRD-funded, IDA-funded, or blend-funded were also collected. Given the analytical goal of understanding the relationship between lending terms and portfolio changes, each funding mechanism was examined according to the ratio of soft investments pre- and post-graduation.

Analysis summarized in Table 3 reveals a relatively consistent decline in soft investments (social and small-scale projects) as countries graduated from receiving funding from IDA and IBRD to IBRD only. When both IDA and IBRD provide project funding to countries, IDA generally provides more soft investments than IBRD. On average, countries allocated most of their IDA and blend financing (66% and 70% respectively) to soft sectors and just 28% of IBRD financing to soft sectors. Combining all categories of lending in the pre-graduation period (IDA, blend, and IBRD), half of all lending on average went to soft sectors. Post-graduation, average allocation to soft sectors was just 38%. This analysis suggests that a hardening of lending terms correlates with decreased levels of soft
investments. These findings are consistent with the regression analysis conducted by Gatti and Mohpal (2019).

Table 3. Percentage of soft investments in countries by funding mechanism

<table>
<thead>
<tr>
<th>Countries</th>
<th>PRE IDA</th>
<th>Blend</th>
<th>IBRD</th>
<th>TOTAL</th>
<th>IBRD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% Soft</td>
<td>% Soft</td>
<td>% Soft</td>
<td>% Soft</td>
<td>% Soft</td>
</tr>
<tr>
<td>Albania</td>
<td>56%</td>
<td>50%</td>
<td>--</td>
<td>55%</td>
<td>29%</td>
</tr>
<tr>
<td>Angola</td>
<td>75%</td>
<td>--</td>
<td>--</td>
<td>75%</td>
<td>33%</td>
</tr>
<tr>
<td>Armenia</td>
<td>70%</td>
<td>100%</td>
<td>41%</td>
<td>59%</td>
<td>33%</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>70%</td>
<td>20%</td>
<td>30%</td>
<td>44%</td>
<td>11%</td>
</tr>
<tr>
<td>Botswana</td>
<td>20%</td>
<td>--</td>
<td>0%</td>
<td>13%</td>
<td>33%</td>
</tr>
<tr>
<td>Cameroon</td>
<td>63%</td>
<td>43%</td>
<td>38%</td>
<td>48%</td>
<td>64%</td>
</tr>
<tr>
<td>China</td>
<td>94%</td>
<td>85%</td>
<td>25%</td>
<td>55%</td>
<td>26%</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>100%</td>
<td>--</td>
<td>0%</td>
<td>75%</td>
<td>50%</td>
</tr>
<tr>
<td>Ecuador</td>
<td>75%</td>
<td>--</td>
<td>0%</td>
<td>43%</td>
<td>45%</td>
</tr>
<tr>
<td>Egypt*</td>
<td>70%</td>
<td>80%</td>
<td>100%</td>
<td>75%</td>
<td>60%</td>
</tr>
<tr>
<td>India</td>
<td>67%</td>
<td>33%</td>
<td>15%</td>
<td>48%</td>
<td>30%</td>
</tr>
<tr>
<td>Indonesia*</td>
<td>75%</td>
<td>69%</td>
<td>38%</td>
<td>53%</td>
<td>49%</td>
</tr>
<tr>
<td>Korea, Rep.</td>
<td>75%</td>
<td>67%</td>
<td>20%</td>
<td>41%</td>
<td>36%</td>
</tr>
<tr>
<td>Macedonia</td>
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<td>75%</td>
<td>50%</td>
<td>53%</td>
<td>62%</td>
</tr>
<tr>
<td>Mauritius</td>
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<td>0%</td>
<td>38%</td>
<td>17%</td>
</tr>
<tr>
<td>Montenegro</td>
<td>25%</td>
<td>100%</td>
<td>0%</td>
<td>27%</td>
<td>43%</td>
</tr>
<tr>
<td>Morocco</td>
<td>100%</td>
<td>100%</td>
<td>17%</td>
<td>33%</td>
<td>43%</td>
</tr>
<tr>
<td>New Guinea</td>
<td>67%</td>
<td>67%</td>
<td>33%</td>
<td>56%</td>
<td>67%</td>
</tr>
</tbody>
</table>
The same analysis was conducted examining the agricultural sectors—agriculture and fishing and forestry—only (Table 4). For agriculture alone, the same trends are evident, though less pronounced. During the pre-graduation period, about one-third of IDA and blend financing went to agriculture compared to just 16% of IBRD financing. On average, 26% of pre-graduation financing in total went to agriculture. Post-graduation, this share fell to 21%.

Table 4. Percentage of agricultural investments in countries by funding mechanism

<table>
<thead>
<tr>
<th>Countries</th>
<th>IDA PRE</th>
<th>Blend PRE</th>
<th>IBRD PRE</th>
<th>TOTAL PRE</th>
<th>IBRD PRE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% Ag, F&amp;F</td>
<td>% Ag, F&amp;F</td>
<td>% Ag, F&amp;F</td>
<td>% Ag, F&amp;F</td>
<td>% Ag, F&amp;F</td>
</tr>
<tr>
<td>Albania</td>
<td>25%</td>
<td>0%</td>
<td>--</td>
<td>20%</td>
<td>14%</td>
</tr>
<tr>
<td>Angola</td>
<td>0%</td>
<td>--</td>
<td>--</td>
<td>0%</td>
<td>22%</td>
</tr>
<tr>
<td>Armenia</td>
<td>10%</td>
<td>20%</td>
<td>18%</td>
<td>16%</td>
<td>11%</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>20%</td>
<td>20%</td>
<td>10%</td>
<td>16%</td>
<td>11%</td>
</tr>
<tr>
<td>Botswana</td>
<td>20%</td>
<td>0%</td>
<td>0%</td>
<td>13%</td>
<td>17%</td>
</tr>
<tr>
<td>Cameroon</td>
<td>63%</td>
<td>43%</td>
<td>25%</td>
<td>43%</td>
<td>55%</td>
</tr>
<tr>
<td>China</td>
<td>41%</td>
<td>46%</td>
<td>13%</td>
<td>27%</td>
<td>11%</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>67%</td>
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<td>50%</td>
<td>0%</td>
</tr>
<tr>
<td>Ecuador</td>
<td>75%</td>
<td>--</td>
<td>0%</td>
<td>43%</td>
<td>36%</td>
</tr>
<tr>
<td>Egypt*</td>
<td>20%</td>
<td>60%</td>
<td>100%</td>
<td>38%</td>
<td>20%</td>
</tr>
<tr>
<td>Country</td>
<td>41%</td>
<td>33%</td>
<td>8%</td>
<td>30%</td>
<td>16%</td>
</tr>
<tr>
<td>---------------</td>
<td>-----</td>
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</tr>
<tr>
<td>India</td>
<td>33%</td>
<td>0%</td>
<td>8%</td>
<td>30%</td>
<td>16%</td>
</tr>
<tr>
<td>Indonesia*</td>
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<td>0%</td>
<td>14%</td>
<td>15%</td>
</tr>
<tr>
<td>Korea, Rep.</td>
<td>50%</td>
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<td>29%</td>
</tr>
<tr>
<td>Macedonia</td>
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<td>50%</td>
<td>25%</td>
<td>16%</td>
<td>15%</td>
</tr>
<tr>
<td>Mauritius</td>
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<td>0%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Montenegro</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
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<td>14%</td>
</tr>
<tr>
<td>Morocco</td>
<td>50%</td>
<td>100%</td>
<td>17%</td>
<td>27%</td>
<td>33%</td>
</tr>
<tr>
<td>New Guinea</td>
<td>67%</td>
<td>33%</td>
<td>33%</td>
<td>44%</td>
<td>50%</td>
</tr>
<tr>
<td>Paraguay</td>
<td>33%</td>
<td>0%</td>
<td>33%</td>
<td>30%</td>
<td>36%</td>
</tr>
<tr>
<td>Serbia</td>
<td>15%</td>
<td>0%</td>
<td>50%</td>
<td>21%</td>
<td>0%</td>
</tr>
<tr>
<td>Thailand</td>
<td>50%</td>
<td>--</td>
<td>35%</td>
<td>37%</td>
<td>30%</td>
</tr>
<tr>
<td>Turkey</td>
<td>75%</td>
<td>100%</td>
<td>0%</td>
<td>30%</td>
<td>28%</td>
</tr>
<tr>
<td>Grand Total</td>
<td>32%</td>
<td>37%</td>
<td>16%</td>
<td>26%</td>
<td>21%</td>
</tr>
</tbody>
</table>

### 3.3 Discussion

Country borrowing behavior at the World Bank tends to confirm perceptions in the aid community that governments match “soft” money with “soft” sectors and harder money with hard sectors. As financing terms become harder, governments seek to ensure that project borrowing can generate an identifiable economic rate of return sufficient to cover the cost of borrowing over the term of loan. On softer terms, and particularly grant terms, this is less of a binding constraint and thus enables greater consideration of social investments.

There are important questions about the institutional biases within governments and the degree to which they affect portfolio decisions. Do finance ministries, which typically play a leading role in international borrowing decisions, tend to favor one sector over another? Again, general perceptions suggest that these ministries tend to seek some discipline in selecting projects and sectors with an identifiable rate of return in order to match project returns with loan servicing costs. This could also entail judgments about investment time horizons. For example, health sector investments could generate much higher returns over a twenty-year horizon than a road project. The 38-year maturities of IDA loans would tend to favor the health investments as a result. However, IBRD’s shorter maturities, whether five or ten years, would tend to favor the road project, even if the overall return is lower.
Agriculture spending does not fit neatly into this framework, though our analysis suggests that borrower country governments tend to treat agriculture broadly as a soft sector, with the agriculture share of the portfolio declining over the transition from IDA to IBRD borrowing. To some degree, this could be a judgement about project scale. In principle, a small-scale rural agriculture investment could have as high or higher rate of return as a large-scale power project, but governments may tend to favor the bigger projects with bigger absolute returns as borrowing terms become harder. Project size generally increases as countries transition from IDA to IBRD borrowing: average IBRD project size is $289 million compared to $179 million.16 This holds for agriculture projects as well. For the current World Bank portfolio (June 2019), average IBRD project size in the agriculture sector is $142 million compared to $79 million for IDA.

It is important to understand allocation decisions within the agriculture sector to better identify borrower behavior. Does a hardening of terms and shortening of maturities cause a shift in the allocation of projects within the agriculture sector? We consider this question next.

4. Changes within Agriculture Related to Changes in Lending Terms

In 1985, the World Bank began classifying projects by theme as well as by sector.17 Nearly 200 sub-themes fall under eight broad categories: economic policy, environment and natural resource management, finance, human development and gender, private sector development, public sector management, social development and protection, and urban and rural development.

We analyzed data for the countries that have graduated from IDA since theme data became available (Table 5). Within the agriculture sector, 68 themes appeared in these 15 countries. These themes were almost exclusively focused on environment and natural resource management as well as urban and rural development. In order to assess the degree to which the composition of agricultural portfolios change as lending terms change, we aggregated agriculture project themes across all 15 countries. Given the limited number of agricultural projects within the time frame, many of the 15 countries lacked data generally or lacked data for pre- and post-graduation time periods. As a result, we also chose four countries for case studies based on greater data availability (pre- and post-graduation) in order to better understand whether the broader trends noticed at the sectoral level—that soft investments tend to correlate with softer lending terms—held true within countries’ agriculture portfolios.

16 Gatti and Mohpal, 2019.
Table 5. Graduated countries with available data for agricultural portfolio analysis

<table>
<thead>
<tr>
<th>Country</th>
<th>Graduation Year</th>
<th>Number of Ag Projects</th>
<th>Included for Further Analysis? (Y/N)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>2008</td>
<td>17</td>
<td>N</td>
</tr>
<tr>
<td>Angola</td>
<td>2014</td>
<td>6</td>
<td>N</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>2011</td>
<td>13</td>
<td>N</td>
</tr>
<tr>
<td>Bolivia</td>
<td>2017</td>
<td>23</td>
<td>N</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>2014</td>
<td>9</td>
<td>N</td>
</tr>
<tr>
<td>China</td>
<td>1999</td>
<td>76</td>
<td>Y</td>
</tr>
<tr>
<td>Egypt</td>
<td>1999</td>
<td>14</td>
<td>Y</td>
</tr>
<tr>
<td>Georgia</td>
<td>2014</td>
<td>10</td>
<td>N</td>
</tr>
<tr>
<td>India</td>
<td>2014</td>
<td>101</td>
<td>Y</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2008*</td>
<td>39</td>
<td>Y</td>
</tr>
<tr>
<td>Montenegro</td>
<td>2008</td>
<td>2</td>
<td>N</td>
</tr>
<tr>
<td>Philippines</td>
<td>1993*</td>
<td>21</td>
<td>N</td>
</tr>
<tr>
<td>Serbia</td>
<td>2008</td>
<td>5</td>
<td>N</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>2017</td>
<td>22</td>
<td>N</td>
</tr>
<tr>
<td>Vietnam</td>
<td>2017</td>
<td>42</td>
<td>N</td>
</tr>
</tbody>
</table>

* indicates final graduation year

We analyzed themes based on their World Bank parent classification (economic policy, environment and natural resource management, finance, human development and gender, private sector development, public sector management, social development and protection, or urban and rural development) and according to our criteria of soft or hard investments. Soft investments refer to socially-oriented and/or small-scale investments, while hard investments include investments in physical infrastructure and/or other large-scale, commercially-oriented investments.
4.1 Aggregate Theme Analysis

The 15 countries with available data (Table 5) received financing for 400 agriculture projects, with 288 projects approved during pre-graduation (ungraduated) periods and 112 projects approved during post-graduation (graduated) periods. Themes that appeared in more than 10% of projects in either period were selected for further analysis, summarized in Table 6 below. If the change in prevalence was less than 15% between the ungraduated and graduated periods, the theme was designated as not changing between the two periods.

Table 6. Aggregate theme analysis

<table>
<thead>
<tr>
<th>Theme</th>
<th>Prevalence in ungraduated periods</th>
<th>Prevalence in graduated periods</th>
<th>WB Parent Theme</th>
<th>Analytical Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land administration and management</td>
<td>18%</td>
<td>16%</td>
<td>Urban and rural development</td>
<td>Soft</td>
</tr>
<tr>
<td>Other rural development</td>
<td>26%</td>
<td>27%</td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
<tr>
<td>Rural markets</td>
<td>24%</td>
<td>25%</td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
<tr>
<td>Rural policies and institutions</td>
<td>28%</td>
<td>29%</td>
<td>Urban and rural development</td>
<td>Soft</td>
</tr>
<tr>
<td>Rural services and infrastructure</td>
<td>57%</td>
<td>62%</td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
<tr>
<td>Water resource management</td>
<td>25%</td>
<td>28%</td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
<tr>
<td>Gender</td>
<td>10%</td>
<td>3%</td>
<td>Human development and gender</td>
<td>Soft</td>
</tr>
<tr>
<td>Participation and civic engagement</td>
<td>30%</td>
<td>17%</td>
<td>Social development and protection</td>
<td>Soft</td>
</tr>
</tbody>
</table>
Across all countries, there was a clear decrease in soft investments within agriculture portfolios as countries graduated and received harder lending terms. There was also an increase in hard investments in graduated periods focused environment and natural resource management, although this could be a result of changing global attitudes around environmental protection over the time period. Urban and rural development activities remained relatively consistent regardless of lending terms, with no discernable shifts between hard and soft investments within urban and rural development.

### 4.2 Egypt

Egypt first graduated from IDA in 1981, then degraduated in 1991 before regraduating in 1999. In the period between 1991 and 2010 when the most recent agriculture projects were approved, the World Bank approved 14 agriculture projects, with 8 projects in the pre-graduation period and 6 projects in the post. A summary of projects and themes is included in Table 7.
### Table 7. Theme analysis for Egypt

<table>
<thead>
<tr>
<th>No change pre- and post-graduation</th>
<th>Theme</th>
<th>Number</th>
<th>WB Parent Theme</th>
<th>Analytical Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural services and infrastructure</td>
<td>13 (8 pre, 5 post)</td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Environmental policies and institutions</td>
<td>4 (2 pre, 2 post)</td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Participation and civic engagement</td>
<td>6 (3 pre, 3 post)</td>
<td>Social development and protection</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Water resource management</td>
<td>7 (3 pre, 4 post)</td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
<tr>
<td>More prevalent pre-graduation</td>
<td>Rural markets</td>
<td>4 (4 pre, 0 post)</td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Micro/small and medium enterprise support</td>
<td>2 (2 pre, 0 post)</td>
<td>Private sector development</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Rural non-farm income generation</td>
<td>2 (2 pre, 0 post)</td>
<td>Urban and rural development</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Gender</td>
<td>1 (1 pre, 0 post)</td>
<td>Human development and gender</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Improving labor markets</td>
<td>1 (1 pre, 0 post)</td>
<td>Human development and gender</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Land administration and management</td>
<td>1 (1 pre, 0 post)</td>
<td>Urban and rural development</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Other environment and natural resource management</td>
<td>1 (1 pre, 0 post)</td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
</tbody>
</table>
In Egypt, agriculture projects seem to be almost exclusively focused on rural areas, with no discernable change in demand pre- and post-graduation. Based on the limited dataset, there is some evidence to suggest that in the case of Egypt, the themes that are common pre-graduation in rural areas tend to be focused on smaller scale projects while the themes common post-graduation are focused on larger-scale themes (like policies and institutions) and private sector commercialization. This shift from small-scale investments to large-scale investments parallels the broader sectoral trend that hardening of lending terms aligns with a shift from softer investments to harder ones.

### 4.3 China

China graduated from IDA in 1999. In the period of available data, the country received 76 agricultural project loans between 1987 and 2017, with 41 projects in the pre-graduation period and 35 in the post, although these projects were unevenly distributed over time. Of note, there were far more agriculture projects in the ten-year period before graduation than in the ten-year period after. China projects are summarized in Table 8.
Like in Egypt, agricultural projects in China are largely oriented towards rural areas with no change pre- and post-graduation. There does seem to be a stronger focus on social and
softer investments in the pre-period, as themes like non-farm income generation present in the pre-graduation period seem to suggest broader orientation toward social issues. However, unlike Egypt, China did not experience the same trend toward large-scale commercialization in the post-graduation period, suggesting that there was not a clear shift from softer to harder investments as China graduated. The increased emphasis on pollution and climate change in the post-graduation period may be a result of broader changes in global attitudes around climate and environmental protection in the years post-graduation.

4.4 Indonesia

Indonesia originally graduated from IDA in 1980 but degraduated in 1999 and then regraduated in 2008. World Bank agricultural theme data are available between 1988 and 2018, with 39 projects approved in that time period. 22 projects were approved between the first graduation and the degraduation, 8 projects were approved between the degraduation and regraduation, and 9 projects approved after the second graduation. Given this relatively complicated context, Indonesian projects were assessed based on how frequently themes appeared in projects in graduated and ungraduated periods rather than pre- and post-graduation. Project themes are summarized below in Table 9.

<table>
<thead>
<tr>
<th>Theme</th>
<th>Comments</th>
<th>WB Parent Theme</th>
<th>Analytical Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>No change in graduated and ungraduated periods</strong></td>
<td>Rural services and infrastructure</td>
<td>n = 26, highly concentrated in final post-graduation period</td>
<td>Urban and rural development</td>
</tr>
<tr>
<td>Water resource management</td>
<td>n = 13</td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
<tr>
<td>Land administration and management</td>
<td>n = 6</td>
<td>Urban and rural development</td>
<td>Soft</td>
</tr>
<tr>
<td><strong>More prevalent in ungraduated period</strong></td>
<td>Participation and civic engagement</td>
<td>~50% of ungraduated, ~33% of graduated</td>
<td>Social development and protection</td>
</tr>
<tr>
<td>Rural policies and institutions</td>
<td>Urban and rural development</td>
<td>Hard</td>
<td></td>
</tr>
</tbody>
</table>
Overall, the rural focus of agriculture projects remains consistent across all periods and does not decrease with graduation, as almost all projects approved by the World Bank in the post-graduation period have listed rural services and infrastructure as a theme. The scale up of rural services and infrastructure in the post-graduation period may indicate some increased commitment to harder physical infrastructure investments with harder terms. Of note, some themes that were more common in pre-graduation periods in China and Egypt were more prevalent in the pre-degradation period in Indonesia. Of note, the pre-graduation periods of China and Egypt and the pre-degradation period of Indonesia align. These trends may be more a result of contemporary priorities rather than changing country demands due to lending term changes. However, this does not account for the prevalence of the rural policies and institutions themes that appear in the ungraduated period—this theme appeared in the graduated periods of China and Egypt.

### 4.5 India

Since India graduated in 2014, there are limited data available for the post-graduation period. Between 1985 and 2018, India received 101 agricultural-related loans, but only 11 of these projects are in the post-graduation period. Of note, although India graduated from IDA in 2014, the World Bank still approved IDA-only financed projects for agricultural projects until 2016. Thus, graduation in India does not map directly to hardening of lending terms. Despite the limited data, India presents an opportunity to test whether the country will follow a similar trajectory as the countries analyzed previously.
Table 10. Theme analysis for India

<table>
<thead>
<tr>
<th>No change pre- and post-graduation</th>
<th>Theme</th>
<th>Comments</th>
<th>WB Parent Theme</th>
<th>Analytical Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Other rural development</td>
<td></td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Environmental policies and institutions</td>
<td></td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Rural non-farm income generation</td>
<td></td>
<td>Urban and rural development</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Rural policies and institutions</td>
<td></td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Water resource management</td>
<td></td>
<td>Environment and natural resource management</td>
<td>Hard</td>
</tr>
<tr>
<td>More prevalent pre-graduation</td>
<td>Gender</td>
<td></td>
<td>Human development and gender</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Land administration and management</td>
<td></td>
<td>Urban and rural development</td>
<td>Soft</td>
</tr>
<tr>
<td></td>
<td>Participation and civic engagement</td>
<td></td>
<td>Social development and protection</td>
<td>Soft</td>
</tr>
<tr>
<td>More prevalent post-graduation</td>
<td>Rural markets</td>
<td>&gt;50% of post</td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
<tr>
<td></td>
<td>Rural services and infrastructure</td>
<td>&gt;80% of post</td>
<td>Urban and rural development</td>
<td>Hard</td>
</tr>
</tbody>
</table>

As in Egypt, China, and Indonesia, the focus on rural areas does not seem to change pre- and post-graduation. The increased focus on rural infrastructure and markets in the post-graduation period suggests perhaps an increase in harder and more commercial investments. However, this increased focus on harder investments is not matched by a decreased focus on softer investments, as themes such as rural non-farm income generation and other rural development remain consistently prevalent in the pre- and post-graduation periods. Of note,
however, certain themes that appear to be more prevalent in the pre-graduation period may appear less frequently in the post-graduation period as a function of how few projects have been approved since 2014.

5. Discussion and Conclusions

5.1 Summary of Evidence

Analysis presented in this paper, as well as a review of existing literature, indicate that developing countries may move away from “soft” sectors, including agriculture to some degree, as financing terms harden at international financial institutions. It is important to note that this shift is in relative terms. Absolute levels of borrowing for these sectors may not be a function of demand and depend more on the supply of financing on harder terms. This is supported by the experience of the World Bank in recent years, where the supply of financing has increased significantly and borrowing for agriculture has also increased in absolute terms and to a much lesser degree as a share of the portfolio. Nonetheless, even where overall access to financing increases, countries may reallocate their borrowing toward “harder” sectors in relative terms.

There are important caveats to this assessment when it comes to IFAD. First, this analysis is considering country behavior in the context of the World Bank, a multilateral lender that offers country borrowers a wide array of sectoral choices when it comes to project lending. A portfolio reallocation as countries graduate from concessional financing (and financing terms harden) at a multi-sector lender does not necessarily mean that demand for IFAD financing would decline if countries faced a similar hardening of terms. In fact, the overall sectoral trend at the World Bank, as well as IFAD’s experience, suggest that demand for agriculture borrowing has increased.

It is also important to recognize that agriculture is not strictly a “soft” sector. Analysis in this paper within the agriculture sector indicates that a hardening of financing terms could lead to a reallocation of country portfolios (and country demand) within agriculture analogous to the broader trend. That is, as countries face harder financing terms, they may tend to favor a different mix of agriculture investments, characterized by larger project size, greater commercial orientation, and greater focus on agriculture-supporting infrastructure.

5.2 Policy Implications

This latter set of conclusions has significant implications for IFAD’s operational model as it considers adjustments to its financial model. Introducing harder terms (in order to better leverage the fund’s balance sheet and increase the overall level of financing available to IFAD’s borrowers) will only succeed if the fund is also prepared to respond to a different mix of country demand within the agricultural sector.

Specifically, country demand is likely to favor larger project size (IFAD’s current average project size of $35 million compared to IBRD average agriculture project size of $142
and greater emphasis on rural markets, infrastructure, policy environment, and climate resilience, as evidenced by the country case studies.

**Project size** deserves attention. IFAD project evaluations demonstrate greater project impact when per person spending (project “intensity”) is higher. Project intensity varies according to the nature of the project, and higher intensity projects like infrastructure investments align with country preferences identified in our analysis. Within infrastructure, this can mean prioritizing greenfield investments over smaller investments—for example, installation of a new irrigation system over rehabilitation of an existing system. Average IBRD agriculture spending of $142 million may not represent an appropriate target for IFAD, but it does demonstrate there is considerable scope for scaling up.

Given the large financing gap between LICs and LMICs and high-income countries (HICs), increasing emphasis on **capital investments** for agriculture in LMICs could also maximize impact of funds. Based on agricultural expenditure data, LMICs and HICs invest similarly in agriculture in absolute terms. However, HIC investments orient investments toward capital, which translates to higher agricultural output while LMICs remain oriented toward labor. Mirroring trends in HICs by increasing emphasis on capital investments in LMICs could be considered as an option to catalyze agricultural productivity in LMICs, reduce gaps between HICs and LMICs, and work towards the goal of zero hunger.

The particular challenge for IFAD would be to pursue productivity-enhancing investments in the sector while maintaining a clear focus on targeted rural poor populations. The operational challenge relates to the relative ease of pursuing larger, capital projects over smaller, targeted projects outside of infrastructure and other capital-intensive projects. The former tends to have lower average overhead costs and affords more opportunities for partnership with other MDBs and DFIs. As a result, there is a risk that over time larger capital investments might crowd out worthy projects that are smaller in scale but more resource intensive. There is a risk that IFAD could move too far toward activities that represent lower overall value added in terms of the fund’s mandate.

To guard against this risk, it will be critical that IFAD adopt a policy framework for an evolving financing model that seeks to ensure that: one, the overall mix of financing activities remains high value-added (not simply operationally efficient); and two, the approach to capital investments is anchored in the fund’s targeted mandate in support of the rural poor. For the latter, this will mean a high standard of ex ante project due diligence that sets as a first priority clear, quantifiable benefits for the rural poor (not simply for rural areas or the agriculture sector). For the overall mix of activities, binding portfolio targets should be considered in line with prudential guidelines and the views of IFAD’s shareholders.

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18 Author interview with IFAD management.
Finally, the focus on policy environment revealed in the country case studies also reflects an important dynamic at the World Bank. IBRD borrowers have consistently favored policy lending over project loans relative to IDA borrowers. The most recent data show policy loans account for 15% of IDA lending and over 30% of IBRD lending. This strongly suggests that higher income countries borrowing on harder terms favor a different mode of engagement with the bank, one that emphasizes policy-level interventions. IFAD should consider the degree to which this represents a relevant operational model for the fund’s work and engagement with partner governments.

In particular, it is worth considering IFAD’s unique contribution to country-level policymaking, in relation to other leading actors like the World Bank. As with the bank, IFAD can bring expertise on questions about the policy enabling environment in support of its project interventions. But there is more to explore in terms of untapped potential for IFAD’s broader role in agenda-setting within countries.

As described earlier, the World Bank’s sector focus helps client governments prioritize agricultural investments and policies largely according to economic impact, seeking to ensure that countries are maximizing their productive potential in agriculture. While this approach has merit, it can also create gaps in country strategies in terms of populations and geographies.

For IFAD, a policy engagement strategy that relies on greater use of larger-scale policy lending could leverage the fund’s long-standing strengths: a focus on rural poor populations and interventions that promote the productive potential for these populations. This unique combination points to an underexploited area of national-level agenda setting. Where the World Bank is targeting economic development broadly in its policy dialogues, IFAD’s focus on poor populations has been associated more with the social safety net function within governments.

In reality, the IFAD model combines the two, and as such, the fund can bring a unique voice to the policy dialogue, one that combines growth objectives (which tend to be associated with the investment function of public budgets) and distributional objectives (which tend to be associated with the consumption-oriented safety net function). As inequality concerns increase globally, IFAD’s model, which exploits both, becomes more relevant for national policymakers. For example, policy guidance when it comes to national planning for transport can help prioritize road and other transport network development for hard to reach rural poor populations. Elevating these populations within the policy discussions can lead to different transportation planning outcomes than discussions than can often be captured by larger commercial or other political interests. That same type of prioritization could be usefully applied to softer interventions, for example, seeking to ensure that safety net programs appropriately reach rural poor populations relative to the urban poor.

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20 World Bank, 2015.
Finally, as IFAD considers policy engagement, it should also consider recent innovations in policy and project lending. The World Bank’s Program for Results (P4R) joins policy and project lending to leverage broader sector impacts by helping to shape sector-wide programs within national governments. P4R is a results-based financing mechanism and as such creates performance incentives within government policy frameworks. Country demand for P4R loans has been high since the program’s inception in 2012.21 Where typical P4R operations target delivery of road networks or services, an IFAD approach to results-based policy outcomes could focus on evidence of impact on rural poor populations, whether the government-led projects are in infrastructure or delivery of services in the softer sectors.

### 5.3 Conclusion

In conclusion, there is no added value in IFAD becoming another World Bank in the agriculture sector, and IFAD donors would be rightly skeptical of such an approach. But the value proposition associated with some changes to the fund’s strategy and operations holds great promise. On first glance, these changes might appear to take the fund closer the bank’s model—larger project size, more focus on productivity-enhancing infrastructure, and greater policy engagement. But by doing so while maintaining an overarching mandate to target the rural poor, IFAD could be in a better position to shape national agendas related to these often-neglected populations in line with the fund’s historical successes. Such an approach would uphold IFAD’s unique position in the international financing architecture while responding to evolving country needs.

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21 Program-for-Results Financing (PforR), 2019.
Works Cited


