ADF-14 Second Replenishment Meeting

Abidjan, 30 June-1 July 2016

Chair's Summary

ADF Deputies met in Abidjan, Côte d'Ivoire, from 30 June to 1 July 2016, for the second consultation meeting of the Fourteenth Replenishment of the African Development Fund (ADF-14). They were joined by representatives of various ADF recipient countries including Chad, Lesotho, Tanzania, and Senegal, as well as by observers from several international institutions. The meeting was chaired by Mr. Richard Manning, the ADF-14 Coordinator.

The AfDB Group President opened the meeting by thanking participants and noting that the Bank is on track to fully commit the remaining resources of ADF-13 by the end of 2016. He then recalled the unequivocal endorsement of the Bank Group's High 5s priorities - Light up and Power Africa; Feed Africa; Industrialize Africa; Integrate Africa; and Improve the Quality of Life for the people of Africa - by the AfDB Group Governors at the Annual Meetings in Lusaka in May. The President reassured Deputies that action on each of the High 5s is well underway: the New Development and Business Delivery Model, the Updated Decentralization Action Plan and three strategies have already been approved by the Board. Moreover, work to realign the Bank Group's processes and operations is proceeding in earnest. In this regard, the President thanked members of the Bank Group's Boards of Directors for their strong support.

The President also updated participants about the progress on institutional strengthening issues, including the ongoing competitive recruitment process for several crucial Senior Management positions and the formation of a Transformation Management Team. Deputies underscored the importance of a broad ownership of the reform process to ensure smooth implementation of the President's strategic vision for the institution. Participants commended Management for the timeliness and quality of the papers prepared for the Replenishment Meeting.

Strategic Directions for ADF-14: Operationalizing the High 5's

Management underlined the unique role of the Fund as a trusted partner for recipient countries in delivering much-needed development results. The Fund will continue to be guided by the objectives of the Bank's Ten-Year Strategy with a sharper focus on the High 5s priority areas to continue delivering on its value proposition and help Africa meet the goals of Agenda 2030. Representatives of ADF recipient countries emphasized the Fund's critical support to their respective country situations.

Deputies reiterated their support for the proposed strategic direction for ADF-14 and the alignment to Agenda 2030, but sought further information from Management on the implementation plans for the High 5s – to be included in the ADF-14 Deputies' Report. Deputies also requested that the latter be more specific about the Fund's policy commitments and expected deliverables, particularly in the various cross-cutting areas (fragility, governance, gender and climate change) critical for inclusive and sustainable growth while also focusing the number of policy commitments in line with the recommendations of the independent evaluation of ADF-13. Management reassured Deputies that the Fund will pay special attention to the four cross-cutting areas. Management informed Deputies that until recently, the emphasis has largely been on the enabling framework across the Bank Group (e.g., developing strategies, filling senior positions, etc.) and that now the implementation has started.

While supporting the ambitious plans of the High 5s, Deputies urged Management to ensure realistic targets given the limited ADF resources. Deputies highlighted the risk that some of the High 5s (e.g., Improving the Quality of Life) may be too broadly interpreted, and allow for strategic drift in the ADF-14. The implementation plans should outline the specific Fund commitments and expected deliverables for each High 5. Some Deputies asked how particular infrastructure sub-sectors (e.g., transport, water and sanitation) would be prioritized.

Deputies urged a similar approach for the four cross-cutting areas (climate change, fragility, gender and governance). Some Deputies urged Management to ensure adequate resourcing for gender which remains an unfinished agenda. On fragility, Deputies lauded the transitioning out of Côte d'Ivoire from the Transitional Support Facility: their further discussion is captured below. However, on governance, Deputies expressed concern on the increase of illicit financial flows, rising sovereign debt and poor macro-economic governance in parts of Africa and urged the Fund to work on institutional and capacity building – particularly on the regulatory environment -- to help reverse these trends. Management assured Deputies that implementation plans are in place, including for all of the infrastructure sub-sectors and the cross-cutting areas, and would be delivered in phases.

Deputies were of the view that there appeared to be a mismatch in resource allocation to climate finance and the Bank's commitments at COP21. Management explained that the climate financing was spread across the High 5s to avoid double counting. The Fund would pursue a pragmatic approach in line with the needs of poor countries and transformative partnership in energy and presented its ambition for the African Renewable Energy Initiative (AREI) whose delivery unit will be housed at the Bank. Some Deputies also called for a greater focus on renewable energy.

A number of Deputies highlighted the need to demonstrate how ADF-14 will contribute to address migration, a key issue for them. In response, Management encouraged Deputies to support the High 5s, particularly the Jobs for Youth initiative, pointing out that this was key to tackling some of the root causes of international migration, such as youth unemployment. Other Deputies stressed the importance of country ownership as a pre-requisite for the success of the ADF-14. They also encouraged management to ensure adequate safeguards and the application of due diligence in the utilization of concessional financial resources since they are obliged to demonstrate the additionality to tax payers in donor countries. Deputies and Management agreed that stronger partnerships between the ADF and other development partners is necessary to leverage scarce resources, including from the private sector for the continent.

In noting the various concerns and recommendations, Management agreed that the Deputies' Report would provide more details and clarifications requested by Deputies.

The Bank Group's Results Measurement Framework (RMF) 2016-2025

Deputies noted the importance of a robust results framework for the implementation of ADF-14 and welcomed the opportunity to contribute to such a framework ahead of Board approval. Deputies' overriding message was the importance of maintaining the quality of the portfolio and setting realistic targets in line with the Fund's delivery capacity.

Deputies appreciated the articulation of levels 1 and 2 of the revised RMF around the High 5s, but asked that the links to the SDG framework be strengthened. Likewise, Deputies requested that, to the extent possible, the RMF should be clear about what results ADF would specifically be held to account to, versus those that the AfDB would be responsible for. Likewise, Deputies asked that indicators associated with the various crosscutting issues should receive more attention, though several Deputies expressed satisfaction with the more rigorous approach on gender issues, notably on collection and reporting of sex-disaggregated data, and encouraged Management to seek opportunities to deepen this work. Moreover, one Deputy encouraged the AfDB to further strengthen data collection on country levels, in particular in countries affected by fragile situations.

Several Deputies cautioned against using indicators with potentially perverse results. One Deputy expressed that Levels 3 and 4 should rely on surveys only when necessary. Likewise, others cautioned that at level 3 indicators of speed and quality of ADF interventions could work against each other. Some Deputies requested some more thinking into the argument that outcomes in each 3-year period could not reasonably be linked to the ADF for the cycle under consideration. Several Deputies highlighted that beyond the specifics of the RMF, a results-culture was needed across all parts of the AfDB Group for the RMF to truly deliver on its aspirations.

Finally, several Deputies cautioned against including too many new indicators in the RMF. Management agreed with Deputies on the importance of keeping a focused and limited set of indicators for the RMF, which would also help contain the cost of administering the RMF. Management indicated that more detailed comments from Deputies would be welcome by end the end of July and agreed to share a final draft of the RMF ahead of the third ADF-14 replenishment meeting, and that Deputies would have an opportunity for a further round of comments before presentation to the Bank's Boards (and its committees) in December.

Role of ADF-14 in supporting countries in situation of Fragility

Deputies agreed that the Fund's work in fragile situations remains critical and that the Bank needed to clarify the nature of its engagement across the spectrum of fragile situations. Deputies also agreed that the Transition Support Facility is an important source of resources for the most vulnerable of Africa's low-income countries. However, some Deputies regretted the envisaged reduction of the share of the TSF in the replenishment envelope in comparison with ADF-13 and that the TSF did not increase in size in proportion to changes in the proposed financing scenarios. Management assured Deputies that total resources to transition states, including PBA, would increase though in response a Deputy indicated that the share to current TSF recipients also appeared to fall. Management elaborated on the potential trade-off between increasing the allocation to the TSF and the capacity for ADF-13 to absorb CDLs/BLs but accepted that it would only be possible to assess the extent, if any, of this in the light of CDL/BL pledges. Some Deputies encouraged Management to consider how to make more resources available to fragile states and to help address the migration challenges via planned job creation and regional operations.

Deputies agreed to increase the level of unallocated reserve from 10% to 15% for Pillar 1 to support African countries in vulnerable to fragile situations. The increased unallocated reserve will enhance the Bank's ability to act in these situations and provide timely support to countries during turnaround situations. The utilization of this reserve will be reviewed during the ADF-14 MTR to decide on a possible re-allocation of these resources. Deputies also endorsed Management's proposal for South Sudan's country allocation to be rolled over into ADF-14 in case the resources are not fully committed by the end of 2016, but urged that improved governance should be a key consideration in its use. Deputies also expressed strong support for continuing to finance the African Legal Support Facility (ALSF) under Pillar 3 of the TSF.

Deputies agreed that the overall size of the TSF resource envelope as well as the final amount for each pillar would be discussed during the last meeting.

Role of ADF in Private Sector Development

Management presented to Deputies a holistic view on the Bank Group's historical and current support towards private sector development in ADF countries as well as the significant challenges that remain. Management presented various options for expanding the ADF's support towards private sector development, including an expansion of the PSF's resources (Option A) by an additional UA 200 million as a priority for ADF-14. Management made the case that this would help maintain the momentum and support the scale up of investment under the High 5 agenda. There was a strong support for Option A, while it was agreed that the two other options (i.e. creating a Pillar IV in the TSF to support non-sovereign operations – Option B - and supporting private sector through blended finance investment – Option C) needed additional time to be fleshed out as well as evidence that the Bank has the capacity to manage the implementation of those options well. These two options were not ripe for the replenishment negotiations, but could be revisited at, say, the Mid Term Review of ADF-14.

While Management's proposals focused on proposed set-asides, several Deputies urged a broader and more integrated vision, with a focus on improving the business environment and also building local capital markets. The President urged Deputies to reconsider a new proposal at the November meeting on how to expand the ADF work with the Private sector in fragile situations and support to SMEs and marginalized segments, separate from the Deputies Report. However, several Deputies requested this not be part of the commitment for the ADF-14 negotiation process and could be part of a longer conversation during ADF-14.

ADF Policy Innovation Lab

The ADF Policy Innovation Lab presented their preliminary findings on the impact of hardened terms on debt sustainability. Hardened terms are a growing reality in development finance as part of the common ground between donors facing serious fiscal problems at home and African countries needing ever larger volumes of development finance. The Lab's analysis suggests that hardened terms, which would still be highly concessional relative to commercial borrowings, are unlikely to be a tipping factor in debt sustainability for ADF borrowers as long as such hardened terms displace more expensive market borrowing and by improved policy dialogue with ADF countries. The Lab indicated that this preliminary conclusion will be further tested by extending the analysis to all ADF countries.

Deputies welcomed the presentation, although many cautioned that development finance with hardened terms could cause deterioration in the creditworthiness of some countries and that it was important not to view the ADF in isolation from other changes in the development finance landscape. Deputies agreed with the need for the ADF to champion sound macroeconomic frameworks in ADF countries working in collaboration with IDA and IMF.

In a separate session, the Representative of Tanzania highlighted that the Bank's New Credit Policy had enabled her country to borrow an additional UA500 million on AfDB terms, harder than the terms envisaged by the Policy Lab.

Innovative Financing Instruments

Deputies welcomed Management's proposed options on innovative financial instruments which would help to ensure that ADF-14 is sufficiently resourced to deliver on the ambitious operational priorities while underlining the need to protect the Fund's long-term sustainability. Deputies discussed the key parameters proposed by Management for the acceptance of concessional development loans (CDLs) and bridge loans (BLs). They noted the positive evolution of the proposals for each since the two were first muted during ADF Working Group. Deputies agreed to the proposed introduction of the mechanism to buy down interest rate of CDLs and BLs to meet target concessional rate. Some Deputies representing potential loan providers, while accepting the main parameters, raised various details that were important for their capitals. For example, a few Deputies asked for flexibility in computing the maximum interest rates or allowing the use of other devices (i.e. "internal buy-down") to meet the entry requirement, while keeping unchanged the discount rate. Some Deputies representing countries not considering loans questioned the changes made to the discount rate and the substitution rule and considered that some parameters, notable the proposed discount rate, were rather generous to loan providers and overstated the Fund's grant benefit. Agreement was reached on proposals that will have to be attached to the Coordinator's Summary, including the proposed discount rate of 2.65%. Some Deputies wanted to know as soon as possible the maximum cross-currency swap rates for CDLs, so as to ease the associated decision-making in their capitals. Some Deputies also requested that the Buy-Down Mechanism be kept as a fall back option. Management agreed to keep Deputies apprised of its overall discussions with potential loan providers.

Several Deputies thought that Management's proposal for any 'extra' loans over the indicated limits to be on-lent on 'hardened' terms was problematic, given debt sustainability concerns and the need to take a more holistic view of development finance while some others emphasized the importance of the Fund's role in providing technical assistance to strengthen debt management capacities when providing such loans. Management took the view that such financing would still be concessional, with terms far more favorable than market alternatives with even more hardened terms. Since it was not clear that there would in fact be any 'surplus' loans, it was agreed to return to this issue at the final Replenishment meeting, if still relevant.

At least one Deputy wanted to know whether there could be exceptions to the 80:20 rule.

Liquidity Policy

Some Deputies queried why the significant increase in expected liquidity in the next few years would not contribute more significantly to the ACC. Management explained that the assumed returns were in line with experience with other institutions. After discussion, Deputies agreed with the policy as set out by Management and welcomed that the introduction of innovative financing options can be managed within the existing liquidity framework.

ADF-14 financing framework

Responding to the proposal presented to them in the financial paper, Deputies approved the ADF-14 accelerated encashment framework and took note of the significantly decreased ACC compared to ADF-13, as well as the revised financing scenarios for ADF-14. One Deputy asked for a waiver to the accelerated encashment framework. In addition, several Deputies asked Management for clarifications on criteria for the reference exchange rates.

On the grant compensation mechanism, one Deputy reiterated their country's disagreement about the payment on a "pay-as-you-go" basis and preferring instead that the grant compensation be integrated into a donor country's subscription to the ADF.

Deputies requested Management to present the financing scenarios with the grant elements of CDLs and BLs added to grants. Management circulated revised financing scenarios on this basis, and with alternative assumptions on the supply of CDLs and BLs. Based on the Chair's bilateral meetings with various delegations, potential supply of CDLs might be of the order of UA 1 billion and of BLs UA 300 million. The ADF Coordinator emphasized the preliminary nature of these figures which could evolve all till completion of the negotiations on the replenishment. Management agreed to provide four financing scenarios with grant resources, including grant element of CDLs and BLs, at -5%, 0%, 5% and 10% (in UA terms) compared with ADF-13. (Refer to attached tables). Several Deputies noted that the 10 percent increase scenario would be extremely ambitious for donors to meet.

Deputies need revised financial scenarios circulated electronically to make sure that countries are analyzing and making decision on the basis of the same scenarios and numbers.

Resource Allocation Framework

Deputies welcomed most of Management's proposals for the resource allocation framework of ADF-14. These included: the move to a biennial CPIA exercise; the increase of the unused reserve of the TSF Pillar I from 10% to 15%; the allocation of UA 20 million to Pillar II of the Transition Support Facility (TSF) from ADF-14 resources (to allow arrear clearance of Somalia); the rollover of any unused ADF-13 Pillar II resources; the reduction of the leveraging ceiling of the Regional Operation's (RO) contribution; and the allocation of UA 200 million to the Private Sector Facility (PSF). (One Deputy asked the Bank to consider whether any further changes in the RO leveraging ceiling would be warranted or not to enhance ADF's ability to support host countries increase livelihood opportunities for refugees). However, in the absence of consensus on the overall replenishment, it was agreed that Management will continue the discussions with Deputies on a bilateral basis and the set asides will be firmed up during the third replenishment meeting.

Meanwhile, Deputies expressed their strong support for the Fund's engagement addressing fragility. Several of them raised concerns about the relative share of total resources for the (TSF), which would decrease under ADF-14 compared to ADF-13 as suggested by the financial scenarios. While most deputies expressed a preference to keep the present PBA without introducing a fragility index, some Deputies emphasized the need for additional support to countries affected by fragility, a few others argued in favor of a revised Performance-Based Allocation (PBA) system to address some of these issues. The latter recommended that, in addition to the existing needs component, the PBA system should also be sensitive to long-term vulnerabilities of countries through the addition of a fragility component in the PBA formula. The French Deputy announced the recently launched study on designing a new conceptual framework for the use of vulnerability indicators for resource allocation in situations of fragility. The study is jointly supported by the Bank and the French Government. Deputies agreed that the outcomes of the study should inform the upcoming discussions on the improvement of the PBA process for ADF-15. In doing so, Deputies agreed with Management's proposal to leave the current PBA system unchanged for ADF-14.

The ADF President asked Deputies to allow Management do more work on potential private sector interventions to help tackle joblessness and scale economic activities in countries experiencing fragile situations, which would be presented at the next meeting. Deputies agreed with the President's proposal. However, several Deputies requested this not be binding for the ADF-14 negotiation process and could be part of a longer conversation as part of an ADF Working Group.

Draft Deputies' Report

Management agreed that a Draft ADF-14 Report will be circulated to Deputies by the end of September to allow them to provide input before the third meeting. Deputies suggested several key issues to be dealt with in the Report, including: the various cross cutting issues and the Bank Group's policy commitments, as well as the issues of both migration and job creation. Likewise, Management and Deputies agreed that two crucial pieces of information will be annexed to this Chair's Summary, as follows: (i) a document on various potential financing scenarios (0%, 5%, 10% and – 5% change in donor grant and grant-equivalent contributions in UA terms) including UA1 billion CDLs and UA300 million BLs; (ii) updated parameters on the innovative financial instruments that would include information on the cross currency swap rates.

Next Meeting

Participants welcomed the Grand Duchy of Luxembourg's proposal to host the third and final consultation meeting on ADF-14 on November 28 and 29, 2016.

Attachments:

i. Potential financing scenarios (-5% , 0%, +5% and +10%) including UA 1 billion CDLs and UA 300 million BLs, and
ii. Updated parameters on the innovative financial instruments.

Annex:

Documents agreed for the 3rd Meeting

1. Draft Deputies' Report
2. Options for use of ADF-14 Resources to Better Promote Private Sector Development
3. ADF-14 Financing Framework and Capacity including Innovative Financing Instruments
4. ADF Resource Allocation Framework
5. First Study outcomes on consultancy on vulnerability indicators for resource allocation (Study co-financed by the Bank and the French Trust Fund)