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Response of IFAD Management to the corporate-level evaluation on IFAD's performance-based allocation system

Note to Executive Board representatives

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For: Review

Response of IFAD Management to the corporate-level evaluation on IFAD's performance-based allocation system

I. Introduction

1. Management welcomes the corporate-level evaluation on IFAD's performance-based allocation system (PBAS). Management is committed to internalizing the lessons of this evaluation to further enhance the relevance, effectiveness and efficiency of the system, under the guidance of the Executive Board and its subsidiary committees.

II. Performance

2. Management welcomes the evaluation's confirmation that the PBAS ensures greater fairness in the allocation of IFAD's resources across developing Member States and that it is generally well tailored to IFAD and has aligned IFAD's resource allocation system with those found in similar organizations.¹ Importantly, the PBAS has consistently enabled IFAD to provide at least 50 per cent of its resources to Africa, and 45 per cent to sub-Saharan Africa. It has also ensured the provision of two thirds of its resources on highly concessional terms, as envisaged in the Policies and Criteria for IFAD Financing.²
3. Management is satisfied with the overall evaluation rating of 4.3, which is above the moderately satisfactory threshold, and the finding that the system is considered relevant (rated 4.6), effective (rated 4.2) and efficient (rated 4.1). With regard to effectiveness, Management acknowledges that the practice of managing minimum and maximum allocations and the capping of allocations contribute to making IFAD's PBAS a flexible mechanism. In terms of efficiency, it is worth noting that Management is already taking further steps, as suggested by the evaluation, such as the development of guidelines on the functioning of the PBAS, and the development of a customized system for calculating country allocations.

III. Methodology

4. Management appreciates the substantive changes made to the final report following Management comments on the draft, in particular the incorporation of practices from other international financial institutions (IFIs).³
5. Management acknowledges the robust statistical model used in the report, which with IOE's support, can be instrumental in fine-tuning the system moving forward. However, Management finds that the report does not sufficiently translate the background analysis into clear conclusions with actionable recommendations, particularly with regard to:
 - (a) Adjusting the needs component by adding additional variables. Lessons learned from other IFIs show that issues related to the availability, comparability and validity of alternative indicators have been among the more persistent barriers to adjusting the formula. Limited data availability has direct effects on the fairness and robustness of the results, because of the need for proxies. Final adjustments are the product of trade-offs between robustness and availability. An understanding of the costs and benefits of alternative sets of variables would have significantly benefited the evaluation. With regard to the suggested new variables, Management did not find a clear conclusion to the elasticity analysis undertaken in annex IV. Management will need to confirm that the addition of the suggested variables to the formula

¹ EC 2016/91/W.P.2, paragraph 50.

² Policies and Criteria for IFAD Financing, <http://www.ifad.org/pub/basic/lending/e/ifad-financing.pdf>.

³ Management maintains a fruitful dialogue with other IFIs in the context of the Multilateral Development Bank's Working Group on Performance-based Allocation Systems, of which IFAD is an active member.

would sufficiently increase overall elasticity to justify the investments required to collect and analyse these new data. Second, Management does not find that the evaluation provides sufficient guidance for treating the compounding effect of existing and potential new variables, i.e. the likelihood that the variables are correlated with other variables of the current formula (within and across components) and therefore produce a final effect that is disproportionate to their nominal weight in the formula. This risk seems to increase when the proposed new variables are indexes, such as the Human Development Index (HDI).⁴

- (b) Rebalancing needs and performance components. While recognizing the comprehensiveness of the model used, and agreeing with the spirit of the proposal, Management finds that the evaluation does not provide sufficient justification on the marginal utility of the suggested changes from a managerial perspective. First, although counterintuitive (because this is a composite formula), a larger (or even much larger) weight in the formula for one variable (or component) does not necessarily imply that countries that have better scores in that variable receive more resources, even if that variable scores better than any other variable in the formula. Whether the effect is positive or negative depends on the ratio of the score of that variable to the scores of other variables in comparison to other countries. Therefore, unintentionally, a composite formula weakens the effect of PBAS as an incentive for better country performance, even if the weight of this component is increased. More systematic insights by the evaluation in this regard would have contributed to enhance the overall value for money of the system. Second, adding new variables and changing their relative weight may have conflicting effects. For example, increasing the weight of the performance component could penalize vulnerability and fragility, offsetting the gains that more fragile and vulnerable countries would obtain by including fragility and vulnerability as additional variables in the needs component, as recommended in the evaluation.
6. Management notes that in addition to changes to the PBAS formula, the evaluation proposes the introduction of several additional features to the existing system.⁵ While some of these could enhance functionality, they could also increase complexity at various levels of the system. In particular, the effect of some of these proposals may offset some of the current good practices recognized by the evaluation with regard to efficiency, such as the relatively low direct staff costs of managing the PBAS (paragraph 249), the process for project-at-risk rating, as part of IFAD's consolidated self-evaluation system (paragraph 272) and the efficiencies in managing IFAD resources obtained through the capping process (paragraph 278). In making a decision on how to move forward, it is therefore important to strive to maintain the current level of efficiency in terms of both PBAS process management and robustness of the PBAS formula.

IV. Clarifications

7. Focus on food security. Food security remains a key element of IFAD-financed projects. However, the spectrum of IFAD-financed activities has widened over time in alignment with partner countries' changing needs and demands, and IFAD's strategic thrust.⁶ Management therefore believes that any change to the PBAS

⁴ HDI has recognized limitations regarding the equal weighting of the components and the difficulty in measuring quality as opposed to quantity. A comparative assessment of the fitness of other measures such as the Multidimensional Poverty Index and the Index of Sustainable Economic Welfare would have been useful.

⁵ Such as enhanced quality assurance mechanisms, additional in-country consultations, the creation of a new inter-departmental management committee, and knowledge management practices.

⁶ In developing the programme of work associated with PBAS allocations, "the President is guided by the strategic framework established from time to time by the Executive Board", see Policies and Criteria for IFAD Financing, paras. 9-10.

should reflect IFAD's current priorities as established in the Strategic Framework 2016-2025 approved by the Executive Board.

8. Access to PBAS allocations. Before the start of a new PBAS cycle, all countries that express interest in accessing IFAD resources over the next three-year period are included in the initial PBAS calculation. At the end of the cycle, the number of countries for which financing actually materializes may be significantly lower. This may be due to several reasons, including the understanding between a Member State and IFAD Management that it is more effective and efficient to focus on improving the performance and results of ongoing operations rather than embarking on new ones.

V. Recommendations to Management

9. In responding to the recommendations, Management wishes to state its views regarding each sub-action bundled within the proposed five recommendations for adequate and transparent follow-up.

Recommendation 1: Enhancing PBAS design	Management response
1.1 Management should propose necessary enhancements to the PBAS design for approval by the Executive Board.	Agree. Management agrees with the need to ensure that the PBAS reflects the evolution of the institution and will therefore further fine-tune the current system. In this regard, and as shown by the evaluation, Management has progressively made adjustments to the system since its introduction in 2002 to incorporate lessons from experience.
1.2 Strengthening the rural poverty focus of the country needs component of the formula, in particular by assessing how measures of vulnerability and fragility, income inequality and non-income poverty can be included therein.	Agree. Management agrees with the spirit of this recommendation and will undertake further analysis to make this recommendation operational in a cost-effective manner, as explained above, in the section on methodology.
1.3 Further sharpening the PBAS objectives and overall specifications, ensuring that IFAD's core mandate of promoting food production and food security is adequately reflected therein.	Agree. In addition to the suggestions made by the evaluation, Management will ensure that any refinement is aligned with IFAD's Strategic Framework 2016-2025, as this reflects the priority areas for IFAD's work as determined by its Member States.
1.4 Refining the rural sector performance (RSP) variable by revisiting the underlying indicators and questions.	Agree. Current RSP indicators reflect IFAD priorities at the time the PBAS was developed. Although not all priorities have changed over time, there is scope to revise RSP indicators and questions to ensure that they include more current IFAD priorities, as per the IFAD Strategic Framework 2016-2025.
1.5 Reassessing the balance between the country needs and country performance components of the PBAS formula.	Agree. As Management undertakes further background analysis to adjust the system and fine-tune the formula, it will reassess the balance of the needs and performance components. As stated in the section on methodology, this reassessment needs to be carefully undertaken in tandem with recommendation 1.2 as both sub-recommendations may have unexpected effects on each other. Most importantly, the formula will be assessed with the intention of strengthening its effects as an incentive for better performance.
Recommendation 2: Streamlining processes for better effectiveness	
2.1 Given the unavailability of the Country Policy and Institutional Assessment (CPIA) score for numerous countries, Management and the Board should reflect on whether to retain the CPIA variable in the country performance component of the PBAS formula.	Agree. Management will reflect on the value added of the CPIA score, particularly as it strengthens the RSP questions and variables as recommended in 1.4.
2.2 With regard to the RSP, due attention should be devoted to systematizing and strengthening the RSP scoring and quality assurance processes and take them as an opportunity to strengthen partnerships at the national level, knowledge management, and policy dialogue.	Agree. Management will continue strengthening the RSP scoring and quality assurance processes, particularly by involving more technical staff from other divisions and departments and ensuring greater consistency in scores and the use of evidence. At the same time, Management will ensure that RSP findings have a more far-reaching operational usefulness, such as offering robust analytics for the formulation of IFAD country strategies, and providing an input for conducting more evidence-based country level policy engagement.

2.3 Ways to capture IFAD's performance at the country programme level, beyond the PAR, should also be explored.

Disagree. Management is committed to strengthening its country programme approach. The revised guidelines on country strategies require that a strategy be prepared for all countries with IFAD financing. At present, however, it would be premature to establish new ways of aggregating country performance, as country strategies have not yet been developed for all countries and the elaboration of such indicators may require significant resources (including further harmonization of current methods of self- and independent evaluation). As noted in the evaluation, the advantage of using the PAR variable is that it is based on the project-at-risk value, which is a well-established measure that is part of IFAD's self-evaluation system. Therefore, it is an efficient means for assessing performance, standard across the other IFIs. As noted in the methodological section, adding additional variables without appropriate incubation and testing may lead to undesirable effects, aside from eventual quality shortcomings.

Recommendation 3: Improving efficiency

3.1 Based on a more robust and participatory process, it is recommended that the RSP score be done less frequently, rather than on an annual basis as per current practice.

Agree. Management will analyse the effects on the effectiveness and efficiency of the PBAS and on the allocations themselves of discontinuing the practice of assessing RSP scores every year. Management will explore the best timing for this exercise, given that the PBAS is a three-year process with annual adjustments.

3.2 Specific measures should be introduced to formally collect feedback on the proposed RSP (3.2.1) and PAR scores (3.2.2) from in-country authorities, before the scores are confirmed and fed into the PBAS.

3.2.1 Agree. Management welcomes the introduction of in-country authority feedback in the RSP assessment process. This would align IFAD with best practices at other IFIs.

3.2.2 Disagree. Management disagrees on the need for in-country consultation on the PAR rating. PAR is built from project performance ratings determined by Management on the basis of consultations with country partners during project supervision. These initial ratings are inputted into a transformation matrix that helps determine how the country portfolio is performing at a specific point in time. Since the PAR plays a role as an incentive for better portfolio performance (given that it is perhaps the only variable of the formula that is immediately actionable), maintaining a reasonable degree of arms-length assessment is essential. In addition, formal consultations with authorities on the ratings would require provisions to accommodate their feedback, at the risk of both diminishing the accountability of the initial supervision ratings, and the robustness of the matrix application. For these reasons, no other IFI collects in-country feedback on these scores.

3.3 Reallocations should be formally done earlier in the three-year allocation cycle than is currently the practice.

Disagree. Management believes that earlier reallocations would limit the flexibility of the system, and worsen efficiency. Reallocations take place in the final year of the cycle to ensure that every opportunity to benefit from IFAD resources is provided to all countries that expressed willingness to receive financing at the beginning of the cycle. It is not programmatically feasible for all countries that enter the cycle in the first year to begin project design during that year. At the same time, the current practice provides enough flexibility to accommodate the needs of countries that may absorb top-up resources when other countries exit the cycle, increasing efficiency. Moreover, earlier reallocations would not preclude the need to reallocate resources also in the final year, causing a negative impact on the efficiency of the current process.

3.4 Efforts need to be made to ensure a better spread in the total commitments made annually across the three years of the allocation cycle. This will require tightening forward-planning processes, in particular by ensuring better linkages between project pipeline development, country allocations and administrative budget earmarking.

Agree. Management underscores that reinforced efforts are being put in place in 2016 to ensure a better spread across the replenishment cycle by: (a) making more extensive use of additional financing and scaling-up opportunities; (b) designing projects for financing over two PBAS cycles; (c) undertaking more frequent monitoring of the status of delivery at departmental and corporate levels; and (d) identifying opportunities for reserve projects to be prepared. Regarding budget earmarking, Management has started to develop a standardized budget allocation system across the regional divisions. This will facilitate planning at country level and also facilitate monitoring, reporting and corrective action when reallocations are required to ensure that annual programme of loans and grants (PoLG) targets are met. Management has also introduced budgetary rewards for regional divisions that develop a balanced pipeline of projects across the cycle.

Recommendation 4: Adjusting management and governance

4.1 IFAD should take a more corporate approach to the PBAS in general. In this regard, one measure is to establish a standing interdepartmental committee on the PBAS, inter alia, to discuss RSP scores, the list of countries to be capped, reallocations and lessons in implementation of the PBAS. This committee would make recommendations to the Executive Management Committee (EMC) for any adjustments deemed necessary.

Disagree. While fully recognizing the spirit of this recommendation and the need to further improve the process, Management does not consider the assessment underlying this recommendation to be entirely correct. Capping decisions, for example, are discussed within the Programme Management Department's management meetings and shared with the EMC for approval; so are the list of countries entering the cycle and the proposed reallocations. For the sake of efficiency and appropriate mainstreaming of PBAS decision-making into corporate decision-making processes, Management commits to seeking guidance more systematically on PBAS from the two existing interdepartmental bodies in IFAD, i.e., the Operational Management Committee (OMC) and the EMC. Both bodies have full interdepartmental representation and decision-making authority, and therefore a new standing committee is unnecessary.

4.2 To enhance the transparency of the system, progress reports should be made more comprehensive and include information on reallocations, capping and any strategic and systemic issues warranting guidance from the Board.

Disagree. Management will consult with the Executive Board on future reporting requirements related to the PBAS. Management is open to including information on reallocations and capping in any future reporting, should the Board consider this necessary.

Recommendation 5: Generating learning

There should be more explicit monitoring and continuous learning from the implementation of the system and cross-fertilization of experiences between country programme managers and across regional divisions and countries. A consolidated review or evaluation of the PBAS should be planned six years after the revised PBAS design document is adopted by the Board. The introduction of a periodic review process should be considered.

Agree. Management concurs on the importance of conducting more explicit monitoring of the implementation of the PBAS. Regarding learning on PBAS and its implementation, IFAD draws significant learning from other IFIs through the annual meeting of the PBAS technical group. Regarding internal learning, Management would benefit from more explicit guidance on how this would be realized and on how best to gain institutional learning from PBAS-related processes.

VI. Way forward

10. Management will ensure that the findings of this evaluation are appropriately internalized and that meaningful internal and external consultations are undertaken. Accordingly, it will present the Executive Board with an update on the proposed way forward at its 119th session in December 2016. While some of the adjustments may be piloted during the Tenth Replenishment of IFAD's Resources (IFAD10) period, Management's goal is to propose a package of adjustments to be implemented in IFAD11.