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Investing in rural people

## Comments of the Independent Office of Evaluation of IFAD on the

## PBAS formula and procedures

### Note to Executive Board representatives

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For: Review

## Comments of the Independent Office of Evaluation of IFAD on the PBAS formula and procedures

1. Background. The Independent Office of Evaluation of IFAD (IOE) completed a corporate-level evaluation (CLE) of the performance-based allocation system (PBAS) in 2016 (document EB 2016/117/R.5). In December 2016, IFAD Management presented an Approach to the review of the PBAS to the Executive Board (document EB 2016/119/R.5). This was the basis for the major changes that were further tested and then introduced in the present management document.

### Changes to the PBAS process and its governance

2. Overall, there have been clear efforts to follow up on the CLE recommendations. This is particularly the case for the recommendations related to: (i) streamlining the PBAS process for better effectiveness; (ii) improving efficiency; (iii) improving management and governance; and (iv) generating learning.
3. The proposals to conduct a rural-sector performance assessment (RSPA) only once during each PBAS cycle and to establish an internal peer review process within IFAD will favour the enhanced quality and transparency of the RSPA exercise. This is important, as the CLE found wide disparities in the procedures followed in the past to arrive at an RSPA score.
4. The proposal to discuss and review PBAS allocations in interdepartmental coordination committees follows the CLE's recommendation to establish a "more-corporate approach" to the PBAS. Similarly, the proposed practice of deepening reporting on the PBAS to the Executive Board and preparing a PBAS manual may enhance clarity of procedures and the transparency of decisions. While, in the future, Management may continue to apply minimum and maximum allocations and the capping of allocations for some countries, by preparing a PBAS manual, it will have an opportunity to set clear rules and criteria for doing so.
5. In order to preserve the integrity of the spirit of the PBAS, it will be important to limit the number and extent of discretionary choices and to provide a synthetic discussion, in reporting to the Board, of the differences between baseline case country allocations without reallocations and capping and actual situations in which reallocations and capping have been applied.
6. Finally, IOE welcomes the proposal to organize PBAS learning events for IFAD staff and to develop an information technology system to calculate allocations automatically and to allow partner countries to simulate the allocation process and the resulting country allocations.

### Changes to the PBAS formula

7. Exclusion of the IRAI. The proposed exclusion of the International Development Association (IDA) Resource Allocation Index (IRAI) score responds to a question posed by the CLE. It noted that, as IRAI scores were not available for 30-38 per cent of the countries to which IFAD made allocations between the Seventh Replenishment of IFAD's Resources (IFAD7) and IFAD9, IFAD had adopted a practice of reweighting the other two variables in the country performance component. However, this practice introduced a potential bias in favour of those countries without an IRAI score (see CLE, paragraphs 116-117 and 238). By removing the IRAI from the formula, this source of bias would be eliminated. In order to mitigate potential information losses, the document proposes adding to the RSPA questionnaire some of the macroeconomic indicators embedded in the IRAI.
8. The introduction of the IFAD Vulnerability Index (IVI) is a welcome addition to the PBAS formula and its relevance to IFAD's mandate. It fills a gap highlighted by the CLE: the absence of indicators that closely relate to the typical poverty aspects prevailing in the areas in which IFAD operates, such as food security,

nutrition and inequality. The efforts made to turn an index that was originally focusing on climate change vulnerability into a proxy index for broader rural welfare conditions are a positive contribution of the document. However, the IVI has been included in the formula with an exponent equal to 1, which may limit the weight it carries in determining the country score and PBAS allocation. In this regard, the document discussion could have included sensitivity analysis of the effects of increasing the exponent applied to the IVI.

9. The portfolio and disbursement (PAD) variable is a revision of the previous portfolio-at-risk indicator. The main changes are inclusion of a disbursement ratio, weighted by the age of the portfolio, and of a formula to adjust the PAD calculation to the size of the portfolio, without penalizing small portfolio size. These are consistent with the findings and recommendation of the CLE. More explanation of the parameter specification for the logistic function in the PAD formula could have been added in annex II.
10. The revised formula introduces several improvements, but dominance of the rural population factor persists. The proposed new formula (as presented in paragraph 25 of the document) incorporates some desirable features. For example, according to the paper (paragraph 32), the formula would align the highest allocations to about 5 per cent of the total resource envelope, thus reducing the need to set an artificial cap on maximum allocations. It would also yield a minimum allocation of about US\$1.5 million per year, so that minimum allocations do not need to be artificially increased. This would benefit the transparency of the formula and process.
11. In spite of the improvements made, the allocation formula is still dominated by the variable of the size of the rural population. The correlation coefficient between the total country projected allocation 2016-2018 (using data from appendix II, table 1, of the document) and the rural population is 0.697, while it is -0.306 for GNI per capita, 0.253 for the IVI, 0.128 for the RSPA and 0.144 for the PAD. Compared with the correlations computed by the CLE, the level of correlation has decreased only marginally for rural populations (from 0.706, appendix - annex IV, table 3, of the CLE), but significantly for the RSP (from 0.224, *ibid.*). The correlation has increased notably for the PAD, although no direct comparison can be made with the previous formula, given that the definition of the indicator has changed.
12. One CLE finding was that the formula did not sufficiently reflect the rural poverty mandate of IFAD. Thus, options to further increase the "weight" of vulnerability (the IVI) in the formula could have been considered.
13. Overall, it can also be observed that correlation of the projected country allocations remains stronger with country needs indicators than with performance indicators, a finding already made by the CLE. This is acknowledged by the document (paragraph 40) and, to a large extent, is the consequence of the constraints applied by Management (paragraph 22), such as two thirds of core resources allocated under highly concessional terms and 40-45 per cent of core resources to be allocated to sub-Saharan African countries.

#### Other observations

14. In the sensitivity analysis presented in the document (table 1, page 8), the simulated shocks are not applied across indicators systematically. All suggested shocks are of different relative sizes (for example, for the IVI, +-0.3 represents more than three standard deviations, while for the RSP, +-0.9 represents less than two standard deviations). An alternative way to better compare the effects of the different simulated shocks could have been to set the shocks at one standard deviation or 1 per cent.
15. The proposed revision of the RSPA aims to simplify the rating process by reducing the number of categories (from 12 to 6) and the number of questions and

subquestions. The planned establishment of a peer review group within IFAD, a practice that already exists in other international financial institutions, can enhance the rigour and consistency of the process between countries. Based on the experience of other organizations, lack of specific data or studies is likely to be a constraint, hence the importance of strengthening the in-house peer review process so that it benefits from the exchange of staff experience.

16. A related caveat is that the RSPA now incorporates data on the macroeconomic situation of countries. As noted, this partially fills the gap caused by the elimination of the IRAI score from the formula. However, it has the potential to introduce indicators that do not bear a clear or linear relationship to the conditions experienced by the rural poor. The risk is that of generating “noise” to the relevant information that may be conveyed in other indicators.
17. Final remarks. Overall, IOE commends the efforts made by Management to improve the PBAS process and enhance the level of rigour, transparency and quality of the information provided to the Executive Board and thus enhance its oversight function.
18. A number of improvements have been added to the allocation formula, which now incorporates indicators that approximate welfare conditions of the rural poor in the areas served by IFAD. The formula remains, nonetheless, largely driven by the size of the rural population.
19. IOE encourages Management to carefully consider the above comments in the forthcoming discussions of the interdepartmental coordination committees and with the Executive Board PBAS Working Group.