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Investing in rural people

Minutes of the fifth meeting of the Working Group on the Performance-Based Allocation System

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For: Information

Minutes of the fifth meeting of the Working Group on the Performance-Based Allocation System

1. These minutes reflect the discussions of the fifth meeting of the Working Group on the Performance-Based Allocation System (PBAS) held on 23 January 2017.

Agenda item 1: Opening of the meeting

2. The meeting was attended by Working Group members from Dominican Republic, France, Ghana, Ireland (via videoconference), Japan, Nigeria (Chair) and Venezuela (Bolivarian Republic of). Observers were present from Brazil, Netherlands and United Kingdom. The Associate Vice-President, Programme Management Department (PMD); Chief, Operational Programming and Effectiveness Unit, PMD; Secretary of IFAD, a.i; and other IFAD staff also participated in the meeting.

Agenda item 2: Adoption of the agenda

3. The provisional agenda, document PBAS 2017/5/W.P.1, contained four items: (i) opening of the meeting; (ii) adoption of the agenda; (iii) progress towards the operationalization of the enhanced PBAS formula; and (iv) other business.
4. Members adopted the revised provisional agenda, amended to include an item regarding the arrangements for the sixth meeting of the Working Group, under "other business".

Agenda item 3: Progress towards the operationalization of the enhanced PBAS formula

5. The Working Group noted that efforts had been made to provide options that responded to the comments of members and the Board regarding: enhancing the focus on rural poverty, taking into account vulnerability; exploring ways to provide additional resources to countries with the most fragile situations; and maintaining the simplicity of the formula to the extent possible.
6. Management presented the work done to reconstruct the PBAS formula, and the different scenarios tested, noting that their work had been guided by the principles of simplicity, efficiency and transparency. Moreover, as per the Working Group's guidance, the proposed formula included options to enhance the focus on rural poverty, taking into account countries' vulnerability, and to provide additional resources to countries with the most fragile situations. Management highlighted that the presentation marked the opening of the second phase of the PBAS review.
7. Management's presentation was structured around three main issues: the proposed changes to the formula, their implications for allocations as shown by initial testing, and next steps. As regards the first issue, Management informed the Working Group that the overall structure of the formula – which was divided into a needs and a performance component – had been maintained, and that efforts had been made to maintain the existing balance between the components.
8. With regard to changes in the individual components, in the needs component Management proposed a decrease of 0.05 in the exponent of the rural population variable in order to reduce the effect of this variable on country allocations, as recommended by the corporate-level evaluation (CLE) on the PBAS. Moreover, this change would lead to a natural increase in minimum allocations, which was one of the CLE recommendations. Management had also included the IFAD vulnerability index (IVI) in the needs component, to complement gross national income (GNI) per capita as a proxy for rural poverty, while ensuring that the relevant provisions had been made to efficiently manage eventual data gaps.
9. As regards the performance component, and as recommended by the CLE, the country policy and institutional assessment (CPIA) had been eliminated. In order to maintain the overall weight of the performance component, the weight of the CPIA

had been added to that of the rural sector performance assessment (RSPA). The weight of the portfolio-at-risk (PAR) value remained unchanged.

10. These initial changes to the formula had been tested bearing in mind IFAD's commitment to allocating two thirds of its financing on highly concessional terms, and up to 45 per cent of resources to sub-Saharan Africa.
11. Management shared the analysis undertaken for the proposal. This included considering the use of the logarithmic function of rural population and testing other exponent reductions; assessing whether the impact on allocations of the IVI was stronger when it was included within the formula, or when it was used as a discount factor external to the formula. Lastly, the analysis examined the question of the weight that should be assigned to the RSP now that the CPIA had been dropped.
12. The proposed formula for the Working Group's consideration is as follows:

$$\text{RuralPop}^{0.40} \times \text{GNI}_{\text{pc}}^{-0.25} \times (1 + \text{IVI}) \times (0.65\text{RSP} + 0.35\text{PAR})^2$$

13. Management remarked that the proposed formula would allow IFAD to maintain, and slightly increase, the share of allocations to sub-Saharan Africa. For countries with the most fragile situations, the formula would lead to a 5 per cent increase in allocations. In this regard, Management noted that during IFAD10 these countries already received 23 per cent of total allocations. The increase was due to the fact that the majority of countries with the most fragile situations were also vulnerable, and therefore benefited from the effect of including the IVI within the formula. Management underlined that while a 5 per cent increase might at first glance seem small, countries with the most fragile situations already received a sizable share of IFAD allocations and had at times shown absorptive capacity constraints.
14. Finally, Management presented the findings regarding the impact of the proposed formula on various groups of countries. These showed that, at the aggregate level, vulnerable countries, countries with the most fragile situations, low-income countries (LICs) and Small Island Developing States would see an increase of between 3 and 5 per cent in their allocations. Middle-income countries, countries borrowing on ordinary terms, and heavily populated countries, instead, would see their allocations reduced by between 3 and 5 per cent. These results were obtained by including in the analysis the list of countries that are currently active in IFAD10, and their current needs and performance.
15. Representatives thanked Management for the detailed presentation and for the hard work done to break down the complicated formula and summarize its contents. Members expressed concern about the timeline for finalizing the formula, since further analysis had yet to be conducted. They requested that the Working Group have an opportunity to provide more input for the analysis of each variable to better determine the impact of the weighting of the different variables. Management reminded the Working Group that, irrespective of the short timeline, they were working towards finalizing the revisions to the formula as per the commitment made.
16. One member asked for more detailed simulations on how the reduction of the rural population index exponent from 0.45 to 0.40 would affect the allocations, as compared to using the logarithm. One observer mentioned that the 0.05 reduction would be difficult to explain to Member States. Management explained that the use of the logarithm of rural population was more appropriate for regional development banks as these tended to have more homogeneous partner countries, rather than for organizations like IFAD with global reach and a wide variety of Member States in terms of country size. Moreover, Management reiterated that it had undertaken a series of tests using different degrees of reduction in the rural population exponent. A reduction of 0.05 achieved the dual effect of eliminating the need to apply a maximum allocation, while also naturally increasing the minimum allocation. Both these effects had been recommended by the CLE. In addition, in line with the other

changes presented, this option did not disrupt the current equilibrium between needs and performance, something that would happen if the logarithm of rural population were used. Members also requested that Management provide more details to comprehensively illustrate the changes in allocations as a result of eliminating the CPIA, in addition to the results presented for the three sample countries.

17. Management underlined that the proposed formula provided a base scenario to which further adjustments could be made, based on the Working Group's guidance. It also stated that the next steps of the review would entail further testing, including a sensitivity analysis to assess the robustness of the proposed formula, in particular as this relates to changes in poverty levels and fragility, and the elasticity of single variables. In addition, the PAR variable would be refined and the review of the RSP variable would be concluded. Enhancements to the PBAS management process would also be proposed.
18. Members expressed appreciation for Management's efforts to address their comments and concerns and for the analytical work undertaken to date. They also welcomed Management's intention to conduct a sensitivity analysis to obtain a dynamic view of the formula. Similarly, members welcomed the inclusion of the IVI in the formula, which would generate a 10 per cent increase in allocations to countries with fragile situations. One member referred to the need to assess whether the weight currently given to GNI per capita should be maintained.
19. Another member encouraged Management to continue working on the analysis and to share with the Working Group how each change to the individual variables, especially rural population, affected the allocations. This would facilitate members' understanding and depict more explicitly the impact of such changes on allocation variations. Moreover, members wished to see how changes to the formula would affect the allocations for LICs, lower middle-income countries and upper middle-income countries.
20. Management responded that it would continue with the analysis, ensuring that the current balance between the needs and performance components was maintained. Management would also continue to rely on the guidance of the Working Group to develop options for refining the base formula by testing different coefficients.
21. Management pointed out that the analysis presented to the Working Group maintained the external parameters currently in place that constrain the formula, i.e. the share of financing to sub-Saharan Africa and provision of two-thirds of IFAD financing on highly concessional terms. Management underlined that these parameters would be incompatible with an eventual increase in the weight of the performance component, as this would lead to an increase in resources to better performing, less fragile and less vulnerable countries.
22. Some members encouraged Management to disclose the dataset used for the analysis. Management explained that given the datasets' complexity, members would find it difficult to replicate the PBAS calculation process. While members responded that this would not be a problem for them, Management reiterated it would make the consultation process more difficult to manage. Efforts were being made to make the process more efficient and more systematic. Furthermore, data on single variables were public and could be accessed by members.
23. Some members emphasized the opportunity to enhance the performance component, which now had a weight of 35 per cent within the formula, but without penalizing LICs, and asked Management to explore technical mechanisms that would obtain this result. One observer proposed that a mechanism for doing this would be to pre-define the amount of financing for least developed countries and other country categories before producing the country allocations, and apply the performance-based principle to each country grouping. By doing this, performance

could be emphasized. Management observed that its work on the PBAS review followed IFAD's current financial architecture, which did not foresee any earmarking of resources allocated through the PBAS for specific groups of countries.

24. An observer asked why the formula was multiplicative, and whether a simpler option could be explored, given the desire for simplicity. The observer also pointed out that the Working Group would welcome seeing scenarios that were very different from one another, with an explanation of the differences between the underlying formulas. Management informed members that the formula was harmonized to the extent possible with the formulas of other multilateral development banks for comparative and other purposes. Members re-emphasized the need to ensure simplicity of the formula. Management noted that the emerging consensus in the Working Group up to now had been to make relevant but modest adjustments, and underlined that more radical changes would require Executive Board guidance and agreement on the direction in which the resources would go.
25. Management clarified that the weights of the needs and performance components had been assessed by the Independent Office of Evaluation of IFAD (IOE) using static values. Consequently, the assessment did not reflect the dynamic of the performance side, which already has an increasing influence on allocations over time. Management underlined that, following this meeting's discussion, its next step would be to work on balance and weights of components, taking into account options for change that move in this direction.
26. Management underlined that the changes presented were aligned with current allocations, in terms of regional, income and lending terms distribution, while exploring the feasibility of further increasing resources to the countries with the most vulnerable and fragile situations. Management also underlined that the dimension of changes could be widened, based on guidance from the Working Group.
27. One observer also sought to understand if and how the PBAS would be applied to resources raised by IFAD through the Sovereign Borrowing Framework (SBF). Management explained that, as agreed when the SBF was approved, SBF financing would continue to be allocated through the PBAS.

Agenda items 4: Other business

28. The Secretary of IFAD, a.i., provided the Working Group with details of the timeline for presentation of documentation for the sixth meeting scheduled for the 3 March 2017. The Working Group was informed that the revised PBAS formula and procedures document would be shared in English only, on 27 February. Members expressed concern about the late availability of translated versions of the document, which would make it difficult for their capitals to make a decision. The Secretary, a.i., informed Members that there would be time for consultations with the capitals because the same document would be posted in all languages for the Evaluation Committee and the Executive Board on 10 March 2017. Working Group members were encouraged to freely contact the technical team working on the PBAS formula in PMD and, where possible, to link the team up with their capitals for further consultation and feedback.
29. The Chairperson and the Secretary of IFAD, a.i., thanked Ireland for proactively engaging with the IFAD technical team, and providing their comments and feedback in a timely manner. Other members were encouraged to contact the team if they had any questions or comments prior to the next meeting.
30. The Chairperson thanked all the members, observers and Management for their contributions to the discussion, and declared the meeting closed.