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Investing in rural people

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

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For: Information

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

1. These minutes reflect the discussions of the sixth meeting of the Working Group on the Performance-Based Allocation System (PBAS) held on 3 March 2017.

Agenda item 1: Opening of the meeting

2. Participants included Working Group members from Angola, China, the Dominican Republic, France, Ireland (via videoconference), Japan, Nigeria (Chair) and Venezuela (Bolivarian Republic of), along with observers from Canada, Germany, Ghana, Netherlands, Norway and the United Kingdom. The meeting was also attended by the Associate Vice-President, Programme Management Department (PMD); the Director and Treasurer, Treasury Services Division; Chief, Operational Programming and Effectiveness Unit, PMD; the Secretary of IFAD, a.i.; and other IFAD staff.

Agenda item 2: Adoption of the agenda

3. The provisional agenda, document PBAS 2017/6/W.P.1, contained four items: (i) Opening of the meeting; (ii) Adoption of the agenda; (iii) Proposed changes to enhance the PBAS formula; and (iv) Other business.
4. Members adopted a revised provisional agenda with one amendment, to include the revision made to the draft minutes of the fifth meeting of the Working Group, under "Other business".

Agenda item 3: Proposed changes to enhance the PBAS formula

5. The Chairperson opened this agenda item by reminding Working Group members that they had been invited to the forthcoming session of the Evaluation Committee, at which a revised version of the document would be considered, prior to discussion at the Executive Board session in April.
6. The Chairperson referred to the work done by Management, under the guidance of the Working Group, since the Independent Office of Evaluation of IFAD had presented the findings of the corporate-level evaluation (CLE) on the PBAS at the Executive Board in April 2016. He highlighted the two-phase process, the first part of which had culminated in the document reviewed at the 119<sup>th</sup> session of the Board, showing the components and variables in the revised PBAS formula. The second phase of the PBAS review focused on the analysis of weights and development of the final PBAS formula. A formula that reduced the impact of rural population on country allocations and included the IFAD vulnerability index (IVI) in the country needs component had consequently been presented to the Working Group at its fifth meeting in January 2017. The formula also excluded the Country Policy and Institutional Assessment (CPIA) from the country performance component, absorbing its weight and relevant macroeconomic assessment into the enhanced rural-sector performance assessment.
7. Management provided an overview of the formula's rationale, individual variables and components; and outlined the changes proposed to the "portfolio-at-risk" (PAR) variable. Management viewed PAR as a fundamental variable because it was directly linked to the way countries make use of IFAD resources and, as such, had a direct effect on IFAD's development effectiveness. Management proposed adjusting the way this variable is included in the PBAS formula, by adding a disbursement performance measure to it. By doing so, countries that could make effective use of the resources allocated to them would be rewarded, which was essential for achieving development effectiveness. This variable would be renamed "portfolio performance and disbursement" (PAD).
8. Management further noted that potential problem projects would no longer be included in the calculation of this variable. This alteration would correct the current

disincentive to identifying potential problem projects early, to avoid affecting resource allocation. It would also allow IFAD to put an early-warning system in place to flag deteriorating projects before they became problematic. With this last change incorporated, the formula presented at the Working Group's January meeting had been modified as follows:

$$[\text{RurPop}^{0.4} \times \text{GNIpc}^{-0.25} \times (1 + \text{IVI})] \times (0.65 \times \text{RSP} + 0.35 \times \text{PAD})^2$$

9. Management stated that the enhanced formula was harmonized with those of other multilateral development banks (MDBs) and introduced a new and unique feature, the IVI, to strengthen the poverty focus by including non-income poverty considerations, in line with the Fund's mandate.
10. Management presented the results of the sensitivity analysis performed in response to the request made by Working Group members in January, explaining that the purpose of the analysis was to assess the formula's robustness to potential shocks and future changes in the values of the variables. Management focused particularly on the impact of a number of expected future changes in key variables during the next two cycles (IFAD11 and IFAD12) – specifically rural population and gross national income per capita (GNIpc) – on the overall distribution of allocations among the different country groupings (most fragile situations (MFS), upper-middle-income countries (UMICs), lower-middle-income countries (LMICs) and low-income countries (LICs), and countries with the largest rural populations). The aim was to understand how the distribution of allocations would change over time, as the size of rural populations or income levels vary among the different countries, assuming that their population and income would maintain recent patterns of increase or decrease over the next few years. The results of the analysis showed that the overall distribution of allocations among different country groupings remained relatively constant over time on aggregate, and thus would not change in the IFAD11 and IFAD12 funding cycles. This means that the formula is stable on aggregate; but variations occur at the country level. Management viewed this result as positive, since members could be reassured that the future distribution of resources among groups of countries would remain relatively stable, while at the same time ensuring variability in country allocations as needs and performances changed.
11. Management then presented four viable scenarios resulting from the extensive work done to assess the balance between the two formula components: country needs and country performance. The aim was to keep the focus on the neediest countries, but with greater consideration of their specific performances on rural issues. The ideal configuration of allocations would be represented by an overlap between the neediest and the best-performing countries as the primary beneficiaries of IFAD resources. The PBAS formula is multiplicative and compares countries to one another. Management stressed that a larger weight for one variable or component did not necessarily mean that countries with better scores on that variable would receive more funding, even if that variable scored higher than any other variable in the formula.
12. The four options presented by Management tend towards increasing the weight of the country performance component relative to its weight in the current balance, in line with the recommendations of the CLE on the PBAS.
13. Management presented each of the four scenarios developed in detail. Each scenario increased the weight of the country performance component by raising its exponent, and adjusting the coefficient of the rural sector performance (RSP) score or the PAD. Management's criteria for assessing each of the scenarios was whether it: (a) balanced country needs and country performance as far as possible; and (b) provided clear incentives to improve performance in terms of poverty reduction and the use of IFAD resources.

14. All four scenarios were viable because they produced a distribution of allocations aligned with IFAD's commitments on providing financing on highly concessional terms and to sub-Saharan Africa. Management indicated its preferred option, however, based on the criteria for assessing each scenario. In its view, scenario 3 displayed the best results, since it provided the best balance between the country needs and country performance components (48 and 52 per cent, respectively) and tended to distribute a larger share of funding to countries that simultaneously had the greatest needs and best performance. Moreover, this scenario produced a considerable increase in the weight of the PAD (0.8, while the weight of the RSP was reduced to 0.2), to become the variable of highest elasticity within the formula. It also involved a doubling of the exponent on the country performance component. This increased the weight of that component as a whole, and provided a clear incentive for country and project teams to improve the performance of the IFAD-financed portfolio.
15. On the reallocation of unused resources earlier in the cycle, as recommended by the CLE on the PBAS, Management explained that this was not a common practice among MDBs; in fact, all MDBs reallocated resources in the last year of the cycle, as IFAD also currently did. However, Management agreed in principle that this was a desirable step that could facilitate pipeline development and make for smoother delivery. Several methodologies to implement early reallocation had been tested. The proposed option entailed an additional step after updating variables and running the PBAS on the total number of active countries in year two. This second step consisted of eliminating the countries indicated by regional divisions as being unable to absorb their allocations, so as to build a reallocation pot that would be redistributed as an additional allocation to each of the other countries only. By doing so, the potential variation in annual allocations based on updated variables would remain, but it would not be further affected by the early reallocation process.
16. Some members of the Working Group argued that the revised PBAS was not yet ready for approval at the 120<sup>th</sup> session of the Executive Board, as had previously been anticipated, citing the need for members to gain a clearer understanding of the formula. Management noted that a delay in the agreed schedule to approve the revised PBAS formula would make it difficult to implement the formula and process adjustments in IFAD11. Management would need time to mainstream the new processes arising from the review (such as the quality assurance associated with the enhanced RSP) into existing business processes; and this, in turn, would foster implementation of the holistic approach. Once the final formula had been agreed upon, a significant amount of work would have to be done to implement the proposed changes, because specific guidelines and systems would need to be developed to apply it in IFAD11.
17. The Working Group noted that Management's proposed adjustments to enhance the PBAS responded to the recommendations of the CLE on the PBAS. Members thanked Management for the work done by the technical team, and especially for the clear presentation which had helped them understand the scenarios better. Members highlighted the importance of all Executive Board representatives having the same clarity regarding the PBAS. List-A members of the Working Group reiterated that, while comprehensive work had been done and results had been achieved, more time needed to be devoted to creating awareness and clarity on the proposed changes among members and the Executive Board. They strongly urged Management to present the document to the April Board for review only, rather than for approval as had been planned, to allow more time for discussions, and postpone its approval to the September 2017 Board session. This would help raise the necessary awareness and understanding of the topic and issues among Working Group members and Executive Board representatives, thus enabling them to make an informed decision on this important subject.

18. Working Group members asked for several clarifications, for instance on the RSP assessment and the distribution of allocations. Management noted that about 25 per cent of the questions on the enhanced RSP assessment were macro-level issues arising from the CPIA. Regarding the distribution of allocations, Management made clear that existing commitments reflected the provisions contained in the Policies and Criteria for IFAD Financing on highly concessional terms, and IFAD9 commitments regarding financing to sub-Saharan Africa. In relation to the RSP assessment, members advised Management to build external assessment elements into the quality assurance process that was being developed.
19. Some members asked for further discussion on the variables, in particular how the GNIpc and the IVI for the country needs component were reflected in the formula. There was consensus that the GNIpc variable would remain within the country needs component, as discussed at previous meetings. One member called for further discussion on what exponent should be associated with that variable, particularly since GNIpc was now accompanied by the IVI in the country needs component. One member asked for further information on what the IVI measures and the variables within it. Management referred the member to the detailed description of the IVI presented in the "Approach to the review of the PBAS" paper, which had been discussed and approved at the Board in December 2016.
20. Further clarification was also requested on the new PAD variable. The inclusion of a disbursement measure within the PAR was generally welcomed as a way of facilitating the absorption of resources by countries that were in a position to use them, in order to enhance IFAD's effectiveness. Some members pointed out that fast disbursement might not be a positive outcome in all cases, and urged caution on this assumption. Regarding scenario 3 and the proposed increased weight for the PAD, relative to the RSP score, one member noted that this was a rather important policy decision to make, as it would shift the formula's attention from the country-policy environment to IFAD operations. This shift merited further discussion, also taking into account broader issues within the replenishment debate. Another member saw this as a welcome shift, because influencing country institutional processes was itself a lengthy process. So, if the shift was towards a greater focus on disbursements, efforts should be targeted on enhancing IFAD's institutional performance in this regard. Some members of the Working Group mentioned that scenario 2 might be their preferred option, since it seemed to produce a more even distribution of resources. Management clarified that, based on the median, 50 per cent of the countries received above and 50 per cent received below in every scenario, which meant resources were not being concentrated in fewer countries.
21. Responding to one member's request for clarification, Management provided further information on the exclusion of the potential problem projects measure from the new PAD variable, explaining that the rationale for this decision was to give country teams incentives to identify potential problem projects as early as possible. To achieve this outcome, the proposal aimed to separate the operational early-warning system from resource allocation.
22. Clarification was sought regarding the rationale for the exponent proposed for the rural population variable (0.40), and the preference expressed for scenario 3. Management explained that the proposed exponent was what best aligned the lowest and highest allocations resulting from the calculations to the current minimum and maximum allocations, which therefore did not need to be imposed. This would simplify the calculation process and make it more efficient. Management clarified that scenario 3 did not concentrate resources in fewer countries, and reiterated that one reason for preferring this scenario was that it provided incentives for performance at the portfolio level, rather than at a higher policy level.

23. Some members asked for more details on the sensitivity analysis and the underlying methodology. A risk analysis was also suggested, to anticipate possible changes arising from predictable risk factors that might change the distribution of allocations among country groupings. Management replied that the sensitivity analysis was in fact being used for risk analysis, as it included an evaluation of the impact that extreme shocks to the variables had on allocations. The stability of the formula at the aggregate level was confirmed by all tests. Management had consulted on this issue with colleagues from the Strategy and Knowledge Department and with other partners; and there was consensus that this was due to the wide diversity of countries included in the calculation, which resulted in volatility at the individual country level being cancelled out when considering country groupings.
24. Members stressed that it would be important for them to be able to compare the allocations that resulted from the four scenarios presented with the current ones, as this would help them reach a decision. One member renewed the request for data disclosure and again offered to work with the technical team to conduct further analysis. Management welcomed the offer and confirmed that all the necessary input data would be shared in a format that would make it easy for members to undertake their own analysis. The technical team informed members that it would remain available for further bilateral discussions as requested.
25. Some members argued that the discussion around the PBAS in the Working Group should align with decisions and discussions in the replenishment negotiations. One member noted that IFAD was the only MDB that used the PBAS for a single financing window. The same member also noted that as IFAD had moved toward market borrowing, consideration should be given to the possibility of a two-window approach, as there might be an impact on the Fund's credit rating. Furthermore, the work on the PBAS needed to fit into the discussion on the holistic approach. This would include country-selectivity considerations to reassure members about which countries would receive financing within a replenishment period, and avoid fluctuations within countries entering the cycle and those that actually make use of the resources.
26. There was consensus among members to hold an informal Executive Board seminar on the proposed changes to enhance the PBAS formula, prior to the April session. The seminar would aim to strengthen understanding and clarity on the different scenarios; and it would also provide an opportunity for further discussion of scenario 3, the option recommended by Management. The informal seminar would be held on 5 April 2017 in the afternoon. Members also welcomed the opportunity to participate in the Evaluation Committee on 23 March 2017, as a further opportunity to gain a deeper understanding of the proposed scenarios. The Working Group also:
- (a) Took note of the four scenarios presented and Management's recommendation that scenario 3 be approved, as the option that provided the best balance between the needs and performance components and tended to concentrate the allocations in the countries that needed them most and performed best;
  - (b) Took note of Management's confirmation that all scenarios were in line with commitments to provide financing on highly concessional terms and to sub-Saharan Africa, and that they focused more strongly on performance while at the same time reflecting the balance between the country needs and country performance components; and
  - (c) Announced that the document would be presented to the Board at its 120<sup>th</sup> session, to authorize presentation of the final conclusions and recommendations to the Executive Board for approval at the 121<sup>st</sup> session.

Agenda item 4: Other business

27. Members considered and approved document PBAS 2017/6/W.P.3, the revision to the draft minutes of the fifth meeting of the Working Group, amended to include comments received from a member.
28. There being no further business, the Chairperson thanked all members, observers, and Management for their contributions to the discussion. He also thanked the interpreters, messengers and other staff who had worked hard to make the meeting successful. He then declared the meeting closed.