

a

IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board – Eighty-Fifth Session
Rome, 6-8 September 2005

REVIEW OF THE IMPLEMENTATION OF THE
PERFORMANCE-BASED ALLOCATION SYSTEM IN IFAD

TABLE OF CONTENTS

ABBREVIATIONS AND ACRONYMS	iii
I. INTRODUCTION	1
II. OPERATION OF PERFORMANCE-BASED ALLOCATION SYSTEMS AT OTHER MULTILATERAL INSTITUTIONS	2
III. IDENTIFICATION OF ISSUES AT IFAD AND EXPERIENCE TO DATE	2
IV. CONSIDERATION OF THE USE OF RURAL POPULATION AND A CHANGE IN WEIGHT OF POPULATION	3
V. ALLOCATION AND REALLOCATION MANAGEMENT	7
VI. COUNTRY PERFORMANCE SCORING	11
VII. OPERATION OF THE PBAS WITHIN THE FRAMEWORK OF REGIONAL ALLOCATIONS	13
VIII. POST-CONFLICT ALLOCATIONS	14
IX. CONCLUSION AND RECOMMENDATIONS	15
ANNEX	17

ABBREVIATIONS AND ACRONYMS

AsDB	Asian Development Bank
AfDB	African Development Bank
CDB	Caribbean Development Bank
CPIA	Country Policy and Institutional Assessment (World Bank)
GNI	gross national income
IDA	International Development Association
IDB	Inter-American Development Bank
LICUS	low-income countries under stress
MDBs	multilateral development banks
OECD/DAC	Development Assistance Committee of the Organisation for Economic Co-operation and Development
PBAS	performance-based allocation system
PMD	Programme Management Department (IFAD)

REVIEW OF THE IMPLEMENTATION OF THE PERFORMANCE-BASED ALLOCATION SYSTEM IN IFAD

I. INTRODUCTION

1. At its Twenty-Sixth Session in February 2003, the Governing Council approved the establishment in IFAD of a performance-based allocation system (PBAS). Such a system had been previously recommended by the Consultation on the Sixth Replenishment of IFAD's Resources in its report to the Governing Council, *Enabling the Rural Poor to Overcome their Poverty* (document GC 26/L4). The Governing Council further decided to delegate authority to the Executive Board to develop the details of the design and implementation of the PBAS. The structure and operation of the PBAS for IFAD were approved by the Executive Board at its Seventy-Ninth Session in September 2003 (document EB 2003/79/R.2/Rev.1).

2. The PBAS introduces an approach to allocating IFAD's loan and country-grant resources to country programmes on the basis of country performance (the broad policy framework, rural development policy and portfolio performance), population and per capita gross national income (GNI). The annual allocation exercises operate in the context of three-year cycles. In the year immediately preceding the first year of a three-year cycle, an assessment exercise determines *ex ante* allocations to be committed over the following three years. Within each cycle, IFAD reviews the *ex ante* allocations annually to reflect the results of the annual country performance assessments, as these capture significant changes in country needs and/or achievements in the sphere of policy and institutional framework. This allows the Fund to produce concrete performance assessments and allocations by September and December each year. Within the framework of these PBAS allocations, commitments will be made in the context of the annual programmes of work approved by the Executive Board.

3. The first allocation exercise covers the period 2005-07, and the first PBAS performance assessments were produced by the end of the second quarter of 2004. The calculation of *ex ante* allocations was completed in time to allow presentation to the Executive Board in September 2004 of a planned programme of work for 2005 within the framework of the PBAS. The Board subsequently approved the 2005 PBAS-based programme of work at its December 2004 session. The programme of work approved in 2004 for activities in 2005 involved the application of the PBAS within the framework of regional allocations adopted by the Executive Board in 1999.

4. It was also agreed by the Consultation on the Sixth Replenishment that the proposed programme of work for 2006, to be presented to the Executive Board in September 2005, would reflect the experience of applying the PBAS within the system of regional allocations and would extend the PBAS as a uniform system of comparison and allocation across the lending programme as a whole. This would take into account the need both to reflect priorities in terms of regional distribution of development assistance and to maintain at least a two-thirds share of the lending programme on highly concessional terms. The Executive Board would also consider whether the system and its resulting allocations effectively satisfy development goals with regard to regional priorities and whether the operation of the PBAS within the framework of regional allocations should be maintained.

5. The PBAS system remains subject to continuing evolution in the light of experience. Therefore, this report also reflects IFAD's review and recommendations regarding methodological aspects of the PBAS, based on the experience gained in implementing the system for one year and on the lessons learned by other institutions in implementing their PBASs.

II. OPERATION OF PERFORMANCE-BASED ALLOCATION SYSTEMS AT OTHER MULTILATERAL INSTITUTIONS

6. The multilateral development banks (MDBs) and other multilateral institutions have a common interest in improved methods for the allocation of scarce resources, as well as in sharing knowledge and lessons learned. Consequently, the first Multilateral Development Bank Technical Meeting on Performance-Based Allocation Methods took place at the Asian Development Bank (AsDB) headquarters in Manila in January 2005. Participants represented the African Development Bank (AfDB), ADB, International Development Association (IDA)/World Bank Group, IFAD, Caribbean Development Bank (CDB), European Commission and Inter-American Development Bank (IDB). Presentations on the various systems were given and views exchanged, and the dialogue has continued since the meeting.

7. Although each institution's PBAS reflects needs and performance as the main elements of the approach, each may also reflect distinctive institutional mandates, policies, governance structures and client groups. For example, in the CDB system, there is special provision for countries that are vulnerable to natural calamities, such as hurricanes, which are endemic in the region. Participants at the meeting noted that in IFAD's approach, uniquely, there is special provision for rural-sector performance, which is weighted heavily in the overall assessment of country policies and institutions. More generally, participants discussed the rating of country performance, the measurement of portfolio performance and the scope for further sharing of operational experience.

8. Several MDBs are currently reviewing their PBASs in order to improve their implementation and, as such, the system is seen as a "living" product, capable of enhancement and improved applicability. For example, in 2004 the AsDB revised the weight of population and the allocation period; IDA has revised its allocation and reallocation methodologies; the AfDB is reviewing its reallocation methodology; and the IDB is reviewing its formula.

III. IDENTIFICATION OF ISSUES AT IFAD AND EXPERIENCE TO DATE

9. During this first year of implementation, the feedback from PBAS implementation has identified positive features as well as areas where further operational experience and/or some modifications would be advantageous. On the positive side, the rural-sector performance assessments have provided the basis and introduction for policy dialogue at the operational level, and have further emphasized the rural and agricultural role and focus of IFAD at the country level. They have also, as noted above, offered an opportunity for learning and sharing with other MDBs implementing such systems. Nevertheless, in comparison with other PBAS practitioners, IFAD faces several specific, additional challenges.

10. First, IFAD has limited resources to allocate over many countries, while facing the same need as other MDBs to develop coherent country programmes that contain projects of at least a minimally efficient size so as to attain the required development goals. Furthermore, IFAD is the only institution to apply the PBAS to ordinary-term borrowers. Several other institutions, e.g. the World Bank, gain flexibility by allocating only concessionary resources by formula, allowing blends, and having multiple sources of non-concessionary funds, including borrowings on capital markets.

11. Second, IFAD's borrowing members vary greatly in population. Under the existing formula, this results in a wide range of allocations, some relatively very large and some very small, together with a significant number (up to 52) of maximum and minimum allocations. Other multilateral institutions face similar problems but generally to a lesser extent than IFAD, owing to the lower number of participating countries.

12. Finally, while the country performance indicators in IFAD are basically sound, individual elements may sometimes be overemphasized, e.g. portfolio scores can be limited when the portfolio is small and loans are made at widely spaced intervals. IFAD has responded to this by following up on the initial one-off investments in performance assessment in 2004 with extensive incremental updating and divisional review, conducted on an annual basis, and further work is under way. In summary, these issues require that IFAD have an allocation management system that is both responsive to the annual programme of work of the institution and follows the basic tenets of PBAS principles. The following sections develop some of these issues and proposals for modification, where appropriate, for consideration by the Executive Board.

IV. CONSIDERATION OF THE USE OF RURAL POPULATION AND A CHANGE IN WEIGHT OF POPULATION

13. At present IFAD uses a combination of population and per capita income variables in the allocation formula to reflect the country's need for development assistance. While per capita income remains the most appropriate proxy for poverty,¹ population is by far the most influential of the "need" variables for two reasons. First, its exponent is three times the weight of the exponent on per capita income and, second, population has a much wider range than per capita income. As introduced in the previous section, two aspects of the population variable in the allocation formula have been reviewed and considered in proposing modifications. These concern the use of rural population in the formula instead of total population and the weight assigned to population in the formula.

14. **The change to rural population.** Currently, the PBAS uses the total population of each eligible borrowing country as an indicator of need. Given IFAD's mandate, however, rural population would be a more appropriate indicator of the need of the rural poor. The source of the data is the same for both population figures, namely the World Development Indicators 2002 database (World Bank). (These data, in turn, are sourced from the Population Division of the Department of Economic and Social Affairs, United Nations). Notwithstanding possible issues with definitional terms, which are arguably minor in comparison with the benefits, this modification would represent a broad improvement in line with IFAD's role and focus.

15. Using rural population would favour those countries that have a high proportion of their population in rural areas, because a country obtains its score *relative* to other scores. If the rural population of a country is proportionally higher than that of other countries, then that country will receive, relatively, a proportionally higher score. The ratio of total population to rural population is not standard throughout IFAD's Member States. Consequently, converting to rural population would change allocations – and focus – to reflect those relative differences.

16. **Variations in the size of rural populations among IFAD Member States.** While the use of total population in the formula to date has influenced the formula away from IFAD's target group, the large variation in population size per se among IFAD's members has made population the most influential variable in the allocation formula. As an immediate corollary, this has made the country performance variables less influential. Two factors have resulted in an IFAD formula that emphasizes population. First, the exponent weight, as originally determined, is relatively high (0.75),² and, second, the variance among population values is much larger than the variance among country performance values. For example, the largest active country (China) is about 8 000 times the size of the smallest active country (Saint Lucia).

¹ This is because it is more readily available for most countries on an annual basis, less subject to serious error, and transparent.

² When the weight given to population is less than one, other things being equal, less populous countries attract more resources in per capita terms.

17. As a result, several countries have received annual allocations that, even in the context of a three-year programme of lending operations, are too small for effective operational impact. Moreover, the variations in population have also resulted in country scores that have introduced the need both to cap allocations at maximums in the case of some countries and, at the other extreme, give minimum allocations to other countries. Up to 52 countries are potentially affected in this way (approximately 38% of eligible borrowers). In these cases, changes in performance have little or no influence on the allocations, and in the case of minimum allocations, as noted above, the allocations may be too small for effective operations.

18. This phenomenon is common to many multilateral institutions: a few countries with very large populations receive a large percentage of the funds to be allocated. Different institutions have taken different approaches to the issue. Some have limited access to funds by the largest member countries (the World Bank, AsDB and CDB). The AsDB has made various ad hoc adjustments, including placing a low weight on population, denying access to concessionary funds to some eligible but large countries, capping the allocation of one large country, and giving the smallest borrowing members (the Pacific Island states) a separate pool of concessionary funds for which they compete only among themselves.

19. In response to this situation, there are at least three ways to moderate the influence of population in the allocation formula:

- place caps or ceilings on the allocations of the largest countries, in absolute or in per capita terms, and have a minimum annual allocation no matter how small the country;
- use an algebraic transformation of population, like the logarithmic value, which retains a systematic relationship among populations but produces less extreme values; and
- lessen the exponential weight of population.

20. The use of maximum and minimum allocations has already been applied at IFAD and, as noted above, has resulted in many countries effectively being outside the system. In theory, the second approach, the use of logarithmic values, has potential advantages. The CDB uses such values of population in its formula. The extreme “outliers” at the top of the range, which tend to be created by exponential weights, are much less prominent when population is expressed in logarithmic form. However, in the recent simulations carried out by IFAD, the effects of using logarithmic values of population (instead of a weighted population) significantly reduced the allocations to larger countries.

21. The final alternative is to decrease the exponential weight of population. Other multilateral institutions originally used exponents ranging from 0.75 to 1.0, but the AsDB has recently reduced the population weight from 0.75 to 0.6.³ IFAD has carried out several allocation simulations to test various weights for population. Using population weights from 0.6 to 0.75 still results in many outliers (i.e. maximum/minimum allocations). Thus IFAD would have to continue to impose arbitrary maximums or minimums on countries’ allocations fairly frequently. Alternatively, allocations with weights from 0.1 to 0.5 resulted in fewer outliers and less frequent imposition of arbitrary constraints. A weight of 0.3, in particular, resulted in allocations to the largest borrowers that were below the arbitrary ceilings (5% of IFAD’s resources), but not as far below as they would be if IFAD used logarithmic values of population. However, such allocations are likely to be below the absorptive capacity and demand of these borrowers.

³ However it is difficult to compare these individual exponents of other institutions with the 0.75 initially used by IFAD. The effective importance of a weight in the allocation formula depends on other variables in the formula, the variance of values on each factor, and the exponents of those other factors as well. In a multiplicative formula, it is the *relative* weights that matter, *not the absolute* exponent values.

22. To further analyse these issues, several different simulations have been carried out on a specific range of weights that address the following parameters:

- reduction in number of maximum/minimum allocations;
- allocations to larger countries that remain responsive to needs;
- allocations to smaller countries that provide the basis for loan or grant sizes that enable effective levels of intervention; and
- allowing performance an increasing influence in allocations.

23. Table 1 gives examples of such simulations for five indicative countries, using different weights of *rural* population, that illustrate the range of changes in allocation and, at the same time, indicate the effect of improvements in performance resulting from a change in population weights. The five countries selected are from different regions, and it is not intended that the individual countries be compared. For countries A, D and E, the current allocations (column 5) increase from between USD 0.9 million and USD 2.2 million per year when the weight of population is lowered from 0.75. This has several positive effects. Firstly, it would allow a reduction in the number of countries previously “outside” the system, e.g. country D, and bring those countries within the parameters of the allocation system. Secondly, the increases in allocation would also allow the development of more appropriate lending programmes. For example, country D, once allocated only a minimum amount, would now receive a significantly increased amount due to its proportionally high rural population. In a three-year lending programme, this amount would give an adequate loan size.

24. With regard to the influence of such changes on performance, under the current formula and approach, if the performance of countries A and E were to increase by 10%, it would increase the allocations by about USD 800 000 and USD 300 000 respectively. With a revision in the allocation formula to use rural population and a weight of 0.45, these premiums would increase to USD 1.0 million and USD 600 000 respectively. That is, the reduction in the influence of population in the formula creates a comparative increase in the influence of performance and provides individual countries with good incentives to increase allocations through improved performance.

25. Countries B and C, both having large populations and high existing allocations, would still receive large allocations, which confirms the continued role of population as a significant need determinant. Country B would have a slightly reduced allocation (the balance going to other countries in the region) but still retain an adequate annual allocation of USD 16.3-18.6 million, levels sufficient for effective IFAD interventions. Moreover, as columns 10-12 indicate, the allocation would be responsive to improvements in performance.

26. On the basis of these extensive simulations, therefore, it is management’s proposal to amend the current formula to reflect both the use of rural population and a weight of 0.45 for population. This addresses many of the issues raised: the number of maximum and minimum allocations is reduced from 40 to 25 (using the list of countries disclosed in January 2005); allocations to countries with relatively smaller populations increase to a size that becomes operationally efficient; and allocations become more related to performance, yet the needs of Member States, as measured by rural population, remain a significant contributor to allocation levels. Analysis has shown that with a weight of population set at 0.45, the ten largest current IFAD borrowers could still receive up to 27% of IFAD’s annual resources (currently, under the existing formula, the figure is 37%). If approved, this modification to the allocation formula would be applied to the allocation process for the 2006 programme of work to be presented to the Executive Board in December 2005.

Table 1. Sensitivity of Annual Allocation to Changes in the Weight of Population and the Performance Rating

1. Country	2. Rural population 2002 (million)	3. Total population 2002 (million)	4. Country performance rating	Annual Allocation (USD million)				Revised Annual Allocation with 10% Performance Improvement (USD million)			
				5. Current approved allocation	6. Allocation using rural population with weight of 0.40	7. Allocation using rural population with weight of 0.45	8. Allocation using rural population with weight of 0.50	9. Using current approved allocation	10. Allocation using rural population with weight of 0.40	11. Allocation using rural population with weight of 0.45	12. Allocation using rural population with weight of 0.50
A	3.68	6.55	4.25	4.13	5.45	5.25	5.03	4.94	6.51	6.27	6.01
B	56.30	67.20	4.25	22.11	16.26	17.43	18.55	23.75	18.92	20.20	21.42
C	797.72	1 280.40	4.18	23.75	21.63	23.75	23.75	23.75	23.75	23.75	23.75
D	4.41	5.53	3.96	1.00	3.22	2.81	2.48	1.48	3.80	3.38	2.99
E	2.31	4.11	4.66	1.60	2.90	2.73	2.56	1.92	3.48	3.28	3.08

V. ALLOCATION AND REALLOCATION MANAGEMENT

27. **Three-year rolling allocation system.** IFAD currently operates an allocation system that could be described as a fixed-period system. It is based on a three-year allocation period administered within a six-year time frame. Several other PBAS practitioners have also adopted a rolling allocation approach, e.g. IDA. The key concept in such a system is that the allocations are recalculated each year (i.e. zero-based) for the following three years (one firm and two indicative allocations). The rolling allocation approach is important, because it enables IFAD to cope with several types of changes:

- changes in countries' performance scores;
- changes in the list of countries expected to be actual borrowers in a given three-year period;
- changes in the loan amount required by each actual borrower, and in the scheduling of these loans; and
- changes in IFAD's programme of work and resources available for commitment.

28. Table 2 shows an example of a country's three-year rolling allocation. In the example, country A's three-year share of total regional funds varies from USD 9 to 9.6 million, depending at what point it enters the three-year period. In the three-year period 2005-07 (first row) the allocation is USD 9.0 million. In the period 2006-08, following the annual revision, the allocation could, theoretically, increase to USD 9.6 million. In the subsequent three-year period (2007-09), however, it could fall slightly to USD 9.1 million due to, potentially, a change in the annual allocation.

Table 2. Example of a Three-Year Rolling Allocation to Country A (USD million)

	2005	2006	2007	2008	2009	2010
Zero-based allocation period for 2005-07 (USD 9 million)	3 (firm)	3 (indicative)	3 (indicative)			
Zero-based allocation period for 2006-08 (USD 9.6 million)		3.2 (firm)	3.2 (indicative)	3.2 (indicative)		
Zero-based allocation period for 2007-09 (USD 9.1 million)			3.033 (firm)	3.033 (indicative)	3.033 (indicative)	
Zero-based allocation period for 2008-10 (USD 9 million)				3 (firm)	3 (indicative)	3 (indicative)

29. The essential characteristics of the system are:

- Country scores, leading to provisional country allocations, are calculated annually.
- Each annual exercise allocates funds for each country for the following three years, but only the first year's allocation is firm and the subsequent two years' allocations are indicative.
- The annual allocation exercise is based on new data (new performance scores, a new shortlist of potential borrowers, and, possibly, a new annual programme of work level). If circumstances have changed since the previous zero-based allocation, then the allocations change correspondingly.
- All procedures for allocations and reallocations use the PBAS methodologies.

30. **Annual zero-based allocation exercise.** The zero-based allocation exercise is conducted for all borrowing Member States in all regions. The annual allocation exercise proceeds in several stages:

- (a) The needs and performance of *all* IFAD members entitled to borrow (the “long list”) are taken into account to calculate the current PBAS scores for *all* countries in the region.
- (b) Provisional country amounts are determined relative to the regional allocations in proportion to their PBAS scores. This is the long list of all potential borrowing Member States and, as such, will include countries that are not regular borrowers and/or are not expected to be loan or grant recipients during the coming three years.
- (c) The programme of work (both loans and grants) is identified for each of the regions in the coming three years.
- (d) This list of countries is, in effect, the “shortlist” of countries that are expected to be actual borrowers or grantees during the forthcoming three-year period. This takes into account the absorptive capacity, i.e. how much a borrower can effectively disburse and use each year. Any limits on a country’s allocation because of previous front-loading are taken into account (see paragraph 36 below).
- (e) If any country’s allocation from the long list is clearly in excess of its requirements for the period (either because there is no intention to borrow at all or because its requirement for funds is less than the initial allocation), then, rather than allow the funds to lay unused, IFAD identifies the excess funds (the “pool”⁴) and reallocates them. This is done using the PBAS formula, thus preserving the integrity of the performance-based allocation process.
- (f) The result is a three-year allocation for a shortlist of actual, active borrowers corresponding to the programme of work in any one year.⁵

31. **Process of reallocation.** As discussed above, reallocation involves only the excess funds placed in the pool, *not* the whole resource envelope. Several other PBAS practitioners apply reallocation procedures in their systems. Reallocation comprises the following steps:

- (a) Identification of a “pool” comprising funds that are unlikely to be used. If, for example, country X has a three-year allocation of USD 11 million (one year firm, two indicative) and is judged likely to use only USD 7 million, then USD 4 million would be moved to the pool for reallocation.
- (b) The pool of funds is allocated among those countries in the short list whose demand was not satisfied by their initial allocation. This reallocation, as always, is made in proportion to PBAS scores.

32. A reallocation is generally relatively minor, because it affects only the marginal funds from the initial allocation that are in the pool. Exploratory simulations in June 2005 indicated that, under current conditions, IFAD’s pool would be only about 16-20% of total regional allocations. Therefore, IFAD should be able to establish an operational limit on the pool of 20% of three-year regional allocation levels. That should be the maximum amount that can be reallocated under the PBAS at any one time. This would ensure that the reallocation process maintains a balance between the demands of the programme of work and the requirement to follow the performance and need parameters of the

⁴ The concept of the pool as a source of funds for reallocation was noted in documents EB 2003/79/R.2/Rev.1 (paragraph 40) and EB 2003/79/C.R.P.3 in the relevant sections on the reallocation of uncommitted resources.

⁵ The shortlist allocation is normally prepared in September/October for consideration by the Executive Board in December. It is refined six to nine months later if circumstances have changed.

PBAS. Amounts in the pool above 20% would in themselves indicate that there is maybe a need to revise anticipated loan sizes or actual number of loans within the regional lending programme.

33. IFAD would normally undertake reallocations at two times. The first would be immediately following each zero-based allocation exercise, as noted above, and is the process of going from a long-list allocation to a shortlist allocation, taking into account demand and absorptive capacity. A second reallocation *may* take place in the middle of the following year to enable adjustments if the “firm” funds for the year are not being taken up in some cases, or for unexpected changes in the lending programme. A similar process, in line with PBAS parameters, will be carried out in the last quarter of 2005 to assess whether any allocations are likely to remain unutilized.

34. In addition, managers should have discretion to reallocate some funds from the pool for strategic or operational purposes. This might include a new component in a loan project during appraisal or the need for a country grant in support of partnership or knowledge-sharing initiatives. It is therefore suggested that if the pool were limited to 20% of total regional allocations, as noted above, then a *maximum* of 4% of the total regional allocations (e.g. up to USD 3.5 million in the case of each of the principal Africa regions, i.e. 20% of 20%) would be available for reallocation at the discretion of the regional directors, subject to approval by the Assistant President, Programme Management Department (PMD).

35. **Allocation period.** IFAD has already established a three-year allocation period. The three years relate to the replenishment cycle and to practical limitations on planning a lending and grant programme into the future. However, IFAD has many small Member States⁶ (several of which are island states) that borrow only occasionally, but that need to design a project of an efficient minimum size when they do borrow. To illustrate, a state that receives a USD 3 million allocation over three years would have to combine two full cycles of allocations to obtain access to USD 6 million, which is, by and large, the *minimum* efficient project size, with respect both to borrower requirements and to IFAD operational parameters. IFAD currently responds to this eventuality by allowing a full carry-over from one allocation period to the next.

36. **Front-loading within the current allocation period.** Front-loading enables a country to use its firm resources for the current year and to draw upon indicative resources for the next two years to achieve an efficient project size. Most institutions generally allow front-loading, but with specific rules; however, the needs in those institutions are less, given the size of annual allocations. Front-loading is an important modality for IFAD in the light of its scale of annual lending and number of potential borrowers. Transparent rules are needed for front-loading, particularly in an allocation system that has rolling periods. Therefore, a country must “repay” front-loaded funds from its future allocations and cannot front-load again until previous front-loading has been repaid.

37. Table 3 shows the funds that would be available to country A each year if it decided to front-load some of its indicative allocations as compared with a base (i.e. no front-loading) scenario.

⁶ Defined as a member of the Small States Forum, with a population of less than 1.5 million.

Table 3. Front-Loading Example (USD million)

Possible Borrowing Patterns for Country A under Front-Loading Rule					
Rule: A borrower can front-load any amount of its indicative allocations (to add to its firm allocation in the current year), but all front-loadings are deducted from otherwise firm allocations in subsequent years until "repaid".					
	USD million				
	2005	2006	2007	2008	2009
Scenario 1: Country A does no front-loading	3.0	2.8	4.0	3.9	4.0
Scenario 2: Country A front-loads USD 1.8 million in 2005, repays the front-load from its allocation in 2006, then front-loads again in 2007, etc.	4.8	1.0	11.9	0.0	0.0

38. Thus, the suggested rule is that front-loading should be allowed at any time and in any amount equal to or less than the indicative allocations for the following two years, but all front-loadings would be deducted from the zero-based allocations in subsequent years until repaid. For example, if a country front-loaded USD 4 million, then, when the zero-based allocation was redone the following year, its allocation would be reduced until the USD 4 million was fully repaid. Front-loading would not be allowed again until all previous front-loading had been repaid.

39. For those small islands or small states with minimum allocations, front-loading could be allowed up to twice their indicative allocations, with the same repayment provisions. Given the small size of their potential requirements, such an allowance is unlikely to result in a cash-flow problem for IFAD.

40. **Carry-over of unused funds.** Under carry-over arrangements, a country that does not use its allocation in a given period can carry some or all of it forward into the next allocation period. Many multilateral institutions only allow very limited carry-over of funds, typically only from one prior year and only if the funds are used within a few months of the start of the new allocation period. The reason is that carry-over can be difficult to manage in a PBAS system that uses reallocation to transfer unused funds to other countries with higher requirements. Carry-over also implicitly endorses the idea that an allocation is actually an entitlement, which, in principle, is not what it is supposed to be. There is no carry-over available to IFAD members at present because there was no allocation period preceding the current one. Countries would have to wait until early 2008 to be able to "combine" allocations from two full allocation periods (2005-07 and 2008-10). As from 2006, however, carry-over of "unused" funds from 2005 will become a possibility.

41. Whether there is a need to allow carry-over depends on whether sufficient flexibility has been achieved by adjustments to the PBAS formula, to the length of the allocation period (it may mean, for example, that a three-year period is too short and that IFAD needs a four-year rolling allocation period) and to front-loading provisions. Therefore it is proposed to allow the use of a one-year carry-over on a case-by-case basis (after review of the specific allocation, COSOP and proposed lending programme) subject to approval by the Assistant President, PMD, and to continue monitoring the process until at least September 2007, when IFAD's evolving experience with the PBAS will be clearer on a number of interrelated issues.

VI. COUNTRY PERFORMANCE SCORING

42. **Scoring rural-sector policy and institutional performance.** IFAD uses three performance variables in its allocation formula:

- (a) rural-sector policy and institutional performance, to which IFAD gives 45% weight in assessing country performance;
- (b) portfolio performance, to which IFAD gives 35% weight; and
- (c) national policy and institutional performance (World Bank Country Policy and Institutional Assessment [CPIA] scores), to which IFAD gives 20% weight.

43. **Rural-sector performance criteria.** IFAD has adopted five clusters of rural-sector performance criteria. These clusters are based on the *Strategic Framework for IFAD 2002-2006*. Within these clusters, IFAD has identified 12 criteria to be scored, each with equal weight. The clusters and their respective criteria are:

- (a) Strengthening the capacity of the rural poor and their organizations
 - policy and legal framework for rural organizations
 - dialogue between government and rural organizations
- (b) Improving equitable access to productive natural resources and technology
 - access to land
 - access to water for agriculture
 - access to agricultural research and extension services
- (c) Increasing access to financial services and markets
 - enabling conditions for rural financial services development
 - investment climate for rural businesses
 - access to agricultural input and produce markets
- (d) Gender issues
 - access to education in rural areas
 - representation
- (e) Public resource management and accountability
 - allocation and management of public resources for rural development
 - accountability, transparency and corruption in rural areas

44. In 2004, the 12 performance criteria were disaggregated into 59 subcriteria, each to be scored separately. The subcriteria scores are averaged to produce the 12 criteria scores. In turn, the 12 criteria scores are averaged to produce the overall rural-sector performance score. Most organizations that operate a PBAS now apply weights at the cluster level. IFAD is currently assessing one possible way to simplify performance scoring through assigning weights and scores only at the cluster level. The criteria and subcriteria would be treated as guideposts and worksheets but not scored or weighted individually. If only the clusters were weighted and scored, a clear narrative would need to be added describing the rationale for each score.

45. The 2004 round of rural-sector performance scoring was conducted within the regional divisions with intraregional benchmarking. In the 2005 round, IFAD has initiated a cross-regional coordination process to help achieve IFAD-wide consistency in scoring (and as a lesson-learning experience), but the primary responsibility will remain with the regions and regional directors. The

scoring process for rural-sector policy and institutional performance is an important occasion for policy dialogue with national governments and other in-country stakeholders. The first round of scoring was carried out in May/June 2004. Given many Member States' potential resource constraints for conducting consultations, it is considered practical to schedule such consultations at reasonable intervals, perhaps once every two to three years (depending on the size and nature of IFAD operations in each country), rather than attempting to do so every year. In alternate years, the country's performance scores would be updated by a desk exercise and the scores would continue to be an input into the annual country scoring process.

46. **Portfolio performance scoring.** One of the three "country performance" variables in IFAD's allocation formula is portfolio performance. This variable relies on staff and regional division assessments of how well each current IFAD project is performing. The assessments are based on whether the project is "at risk" or a "problem project". IFAD has adopted IDA's red flag approach to defining projects at risk, but uses a set of flags that is different in some respects from those used by the World Bank/IDA.

47. The emphasis on "failed or failing projects" in the existing portfolio performance system needs to be balanced with consideration of how projects not at risk are performing. In other words, a system that measures portfolio performance solely by the proportion of projects that are at risk or problematic fails to capture information on the performance of projects that are not at risk but are performing barely adequately – or excellently. IFAD has recognized and begun to address this with its revision of its Portfolio Review Guidelines. This is particularly important to IFAD because it has many country portfolios that contain only one or two projects. Therefore its portfolio performance scores are lumpy and unstable. They can easily be 100% (all projects at risk/problem projects) or 0% (no projects at risk/problem projects), and can change from one extreme to the other suddenly.

48. **Improvements under ongoing review.** IFAD is reviewing several ways in which it could improve its use of portfolio performance measures in the PBAS formula. These include, but are not limited to:

- broaden the sample of projects whose performance is scored by including projects over a longer time frame, rather than only projects that are currently active, as well as those that have recently closed. This would result in performance scores that are more continuous on the scale, rather than bimodal;
- continue to learn from the experience of other multilateral institutions. For example, the CDB has adopted a system of portfolio performance scoring that, when fully functional, will track project performance through all stages of a project's development, according to seven criteria of performance agreed on by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD/DAC);
- devise a set of project performance criteria that apply to all projects, rather than, or in addition to, only problem projects and projects at risk. This might require a change in project supervision practices; and
- examine project risk (and sometimes volatility in performance scores) as well as the absolute level of scores. These could be measured, perhaps, by the standard deviation of scores over time.⁷

⁷ If this measure proved useful it would be a separate portfolio performance variable in the allocation formula, with the result that there would be two portfolio performance variables and two policy-and-institutional performance variables in the allocation formula, creating a very IFAD-unique approach.

VII. OPERATION OF THE PBAS WITHIN THE FRAMEWORK OF REGIONAL ALLOCATIONS

49. As noted in section I, the Executive Board has requested that IFAD reflect on the experience of applying the PBAS within the system of regional allocations and on whether the system and its resulting allocations effectively satisfy development goals with regard to regional priorities. Table 4 gives the present (2005) situation for each region and revised allocations under two different scenarios. Column 1 represents the current situation, with allocations as amended and agreed by the Executive Board in 1999 (EB 67/1999/R.10). As an immediate comparison, column 2 shows the allocations to each region if each country were to receive its allocation without having had any prior regional allocation, according to the PBAS formula currently in place. In this scenario, the allocation for the two principal Africa regions drops USD 47.2 million (10 percentage points) from the agreed 36.8% of total IFAD resources to 26.8%. This reaffirms the conclusion made earlier that, given the emphasis of population within the current PBAS formula, those regions with higher populations receive proportionally higher allocations.

Table 4. Regional Distribution of Resources under Fixed Allocation, PBAS Allocation and Modified Formula (USD million)

	1		2		3	
Region	Current Regional Allocation as fixed by 1999 Executive Board Decision		Allocation Using Current PBAS Formula		PBAS Allocation Using Rural Population Weighted at 0.45	
Western and Central Africa	87.3	(18.4%)	53.0	(11.2%)	64.0	(13.5%)
Eastern and Southern Africa	87.3	(18.4%)	74.4	(15.6%)	89.8	(18.9%)
Asia and the Pacific	147.3	(31.0%)	194.3	(40.9%)	182.5	(38.4%)
Latin America and the Caribbean	80.9	(17.0%)	87.4	(18.4%)	67.2	(14.2%)
Near East and North Africa	72.2	(15.2%)	65.9	(13.9%)	71.4	(15.0%)
TOTAL (2005)	475	(100%)	475	(100%)	475	(100%)

50. In order to assess the impact (on allocations) of redefining the population variable in the PBAS formula, the last column shows the possible changes in the allocations to regions. This has been achieved by simulating the use of rural rather than total population and altering the influence or weight of population in the formula. The subsequent calculations show that, when the weight of the rural population variable of IFAD borrowing Member States is reduced to 0.45 (column 3), regional allocations without any prior entitlements still show major fluctuations from current levels. Noticeably, Western and Central Africa would receive 25% less than its current allocation, while Eastern and Southern Africa would receive 3% more, owing not only to the slightly lower total rural population but also to the lower average country performance rating of countries in Western and Central Africa compared with those in Eastern and Southern Africa.

51. Because the allocation formula also includes other aspects of need and performance, these have also been simulated to identify to what extent changes in their levels may influence regional allocations. Variations in both performance and GNI per capita have been simulated, but neither type

of variation mirrors the difference that population makes in allocations or provides a consistent level of responses and allocations across regions.

52. In this regard, moving to a uniform system of comparison and allocation would entail major requirements in terms of interregional performance assessment and the need for consistent performance scoring across divisions. After one year of regional performance assessments and with the second-year review under way, IFAD would need to adapt, develop and test new processes to support a move to a uniform system, with the concomitant, incremental operational costs. Specifically, to facilitate a cross-regional scoring process, the following would be required:

- provide scorers with worldwide country rankings based on published data (partly because it is inefficient for each scorer to have to find and analyse comparative data worldwide);
- provide benchmark country performance scores in each region to help scorers situate the relative performance of countries; and
- have a PBAS performance scoring coordinator convene interregional working discussions during the annual scoring process in order to facilitate consistency in scoring across regions.⁸

53. Further simulations have been undertaken to assess the effect of capping allocations for the two principal Africa regions and allocating the balance of funds to the other regions according to the PBAS formula. The simulations indicate that the subsequent allocations would continue to be significantly different from current levels, even with varying “weights” of population.

54. This review concludes that, in the short term, the fixed allocations to the principal Africa regions, the allocations to the remaining African countries within the Near East and North Africa allocation, and the allocations to the other regions continue to maintain the required focus on IFAD’s development goals and resources throughout its global operations and specifically in Africa. The application of the PBAS has begun – and will continue – to ensure that IFAD’s scarce resources are allocated according to both need and performance. IFAD’s experience in implementing the system will increase substantially in the future. Improved intraregional performance assessment and scoring should lay the basis over the next two years for a reassessment of uniform resource allocations in 2007.

VIII. POST-CONFLICT ALLOCATIONS

55. In line with the previous Executive Board discussion on allocations to countries in post-conflict situations,⁹ IFAD, like the AsDB, has developed procedures reflecting the post-conflict allocation guidelines adopted as part of IDA’s Thirteenth Replenishment. (These have been updated in the light of IDA 14.) Countries eligible for post-conflict allocations¹⁰ will receive a normal PBAS-generated allocation and, in addition, an amount of 30-100% of their normal PBAS allocation. The percentage of incremental increase will be in proportion to the country’s post-conflict performance score as

⁸ As long as competition for resources is only among countries within regions, then quality control and consistency control can only be within regions as well. If, however, IFAD decided to allocate resources among countries in a single pool worldwide, then some central coordinating group would probably be necessary. All the MDBs and other funds that allocate resources to all countries in a single worldwide pool have such a group.

⁹ Document EB 2003/79/C.R.P.3.

¹⁰ At this time, nine IDA countries are eligible for special post-conflict allocations: Afghanistan, Angola, Burundi, the Congo, Côte d’Ivoire, the Democratic Republic of the Congo, Eritrea, Sierra Leone and Timor-Leste (Liberia and the Sudan are expected to qualify in the near future).

calculated by IDA. Further operational arrangements would be developed by IFAD following the approval of its post-conflict policy. Countries recovering from natural disaster would continue to receive financial support outside the PBAS allocations (as practised by IDA), and countries assessed as low-income countries under stress (LICUS) would continue to receive allocations according to PBAS country scores.

56. The IDA 14 agreements modified the time periods for the enhanced allocation so that eligible countries may now receive the special post-conflict allocation for up to four years, followed by up to three years of transition to the normal PBAS allocation. This approach gives regional divisions greater flexibility in phasing commitments appropriately to support country programmes and in ensuring that implementation capacity reflects resource flows in post-conflict countries. Sustaining peace-building efforts and improving aid productivity in these countries require adjusting the pattern of aid flows to take account of capacity improvements. This helps solidify peace and jumpstart stabilization and reconstruction. It also improves the predictability of resource flows, provides a basis for judging resource needs, and ensures equity of treatment across countries and regions. Furthermore, the procedures incorporate a set of performance indicators adapted from IDA 13/14 that are specifically tailored to the circumstances of conflict-affected countries, emphasizing areas that are most relevant, such as security and reconciliation.

IX. CONCLUSION AND RECOMMENDATIONS

57. The report provides an overview of the progress made in implementing the PBAS at IFAD and has highlighted areas where modifications could be made that would enhance the system's operation and effectiveness. It is envisaged that the experience gained in the coming years, both from IFAD's application of the PBAS and lessons learned from other institutions, will lead to further refinements of the system. The Executive Board would be fully consulted before any steps were taken to adopt these or other changes, and a further review based on experience in the near term will be presented to the Executive Board in September 2007.

58. The areas in which IFAD will continue to improve the effectiveness of the existing system and its parameters include:

- improvement in performance and portfolio assessment at both the inter- and intraregional level;
- pragmatic administration of the minimum allocation to countries receiving such an allocation or those with extremely small populations; and
- sharing of knowledge and lessons with other financial institutions implementing similar PBAS approaches, emphasizing the ways in which IFAD addresses rural poverty reduction within the system.

59. Management recommends that the Executive Board approve the proposal that IFAD should:

- (a) continue to use population and per capita income as indicators of need but use rural population as the basis for the calculation, and decrease the weight assigned to population from 0.75 to 0.45;
- (b) (adopt a three-year rolling allocation period with annual scores calculated for all eligible borrowing Member States according to the agreed formula;

- (c) apply the previously agreed approach of reallocation of unutilized funds according to the agreed performance-based formula, including an amount of not more than 4% of an annual regional allocation to be allocated at the discretion of management for strategic and operational considerations;
- (d) maintain regional allocations according to previously agreed shares; and
- (e) present a review of the implementation experience of PBAS to the Executive Board in September 2007.

Table 1: Multilateral Concessional Funds that Use a Performance-Based Allocation System

Institution	Fund	Year of Establishment	Phase	Year PBAS Adopted	Country Eligibility Criteria
African Development Bank	African Development Fund	1973	AfDF X	1999	AfDB Credit Policy (1995). AfDB uses IDA's country classification for Africa.
Asian Development Bank	Asian Development Fund	1973	AsDF IX	2001	AsDB's Graduation Policy (1998)
Caribbean Development Bank	Special Development Fund	1984	SDF 6	2000	All member countries (Group 1 has limited access)
Inter-American Development Bank	Fund for Special Operations	1961	Agreement of 1998	2002	Five countries (Group D-2): Bolivia, Guyana, Haiti, the Honduras and Nicaragua (plus a small amount to the CDB)
Inter-American Development Bank	Intermediate Financing Facility	1982	Agreement of 1998	2002	Five countries (Groups C and D1) (<USD 2 150 GDP per capita in 2000 dollars): Ecuador, El Salvador, Guatemala, Paraguay, Suriname
IFAD	IFAD	1977	IFAD VI	2005	All developing Member States
World Bank Group	International Development Association (IDA)	1961	IDA 13	1977	Countries with GNP per capita (in 2003 dollars) less than USD 895

Table 2: Allocation Formulae

Institution	Formula				Other Factors			
	Need Factors		Performance Factors		Result	MIN	MAX	Volume Discount
African Development Bank (AfDF IX, 2002-2004)	POP x GNPpc ^{-0.125}	x	$[(0.7CPIA+0.3PORT) \times (GOV/3.5) \times PCEF]^{2.0} \times SCALE$	=	Allocation share	SDR 5.0 million per country		Each allocation discounted depending on % in grants. ADF-X (2005-07)
Asian Dev. Bank (2005)	POP ^{0.6} x GNPpc ^{-0.25}	x	$[(ES_CPIA^{0.7} \times PORT^{0.3}) \times GOV]^{2.0} \times SCALE$	=	Allocation share			
Caribbean Development Bank	log POP x GNPpc ^{-0.9} x VUL ^{2.0}	x	$[0.7CPIA+0.3PORT]^{2.0} \times SCALE$	=	Allocation share			
Inter-American Development Bank (IFF)	$[(0.133Fund)(POP/\Sigma POP)] + [(0.133Fund)(1/GDPpc)/\Sigma(1/GDPpc)] + [(0.133Fund)(DEBT/\Sigma DEBT)]$	+	$[(0.6Fund) \times (0.7CIPE+0.3PORT)] / [\Sigma(0.7CIPE+0.3PORT)]$ (CIPE is similar to the CPIA)	=	Dollar allocation			
Inter-American Development Bank (FSO)	$[(0.22Fund)(POP/\Sigma POP)] + [(0.18Fund)[(1/GNIpc)/\Sigma(1/GNIpc)]]$	+	$[(0.6Fund) \times (0.7CIPE+0.3PORT)] / [\Sigma(0.7CIPE+0.3PORT)]$	=	Dollar allocation			
IFAD	POP ^{0.75} x GNPpc ^{-0.25}	x	$[0.2CPIA+0.35PORT+0.45RuralCPIA]^{2.0} \times SCALE$	=	Allocation share	USD 1.0 million		
World Bank (IDA)	POP x GNPpc ^{-0.125}	x	$[(0.8CPIA + 0.2PORT) \times (GOV/3.5)^{1.5}]^{2.0} \times SCALE$	=	Allocation share	SDR 3.3 million per country (IDA 14)	USD 20 per capita per annum	Each allocation discounted depending on % in grants

CIPE = country institutional and policy evaluation (Inter-American Development Bank); CPIA = country policy and institutional assessment; DEBT = official debt-service ratio; ES_CPIA = economic and social performance criteria in the CPIA; Fund = size of IFF or FSO envelope; GDP/GNP/GNIpc = GDP per capita or GNP per capita or GNI per capita; GOV = for ADF, the average of the five criteria in the “public-sector management” cluster; for AfDF, the average of the six criteria in the Governance and Public-Sector Performance plus a three-year moving average for the “procurement flag” on portfolio performance; for IDA, the average of the five criteria in the public-sector management cluster plus a three-year moving average of the procurement flag on portfolio performance; HDI = Human Development Index; log = logarithm; PBA = performance-based allocation; PCEF = post-conflict enhancement factor (1.13 to 1.30, maximum 1.5); POP = population; PORT = portfolio performance; RuralCPIA = IFAD’s performance rating on policies and institutions for rural development; SCALE = scaling factor that ensures that shares sum to 1.0; SDR = IMF special drawing rights; VUL = country vulnerability.

