



**IFAD**  
**INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT**  
**Executive Board – Eighty-seventh Session**  
Rome, 19-20 April 2006

**PROPOSED MODIFICATIONS TO THE  
IFAD PERFORMANCE-BASED ALLOCATION SYSTEM (PBAS)**

**Overview of the Development of the PBAS in IFAD**

1. The report of the Consultation on the Sixth Replenishment of IFAD's Resources, adopted by the Governing Council at its twenty-fifth anniversary session, stipulated that the Fund should design and implement an explicit, transparent performance-based allocation system (PBAS) as one of the new internal processes developed and implemented by IFAD to enhance its development effectiveness. "In pursuing the objective of maximizing the impact of its resources on rural poverty, IFAD will further its practice of focusing resources on the best opportunities for accelerated and sustained rural poverty reduction through design and implementation of an explicit, transparent PBAS."<sup>1</sup> The report also stated that "The IFAD PBAS should draw upon the experience and general approach of other IFIs (notably the African Development Fund, AsDF and IDA) in developing their PBASs, but it should also clearly reflect the specificity of IFAD's mandate, its mechanisms of assistance, and its financial and governance structure."<sup>2</sup>

2. The Consultation on the Sixth Replenishment also reaffirmed that, as agreed during the Fifth Replenishment, at least 67% of IFAD's loan resources would be allocated to countries that borrow on highly concessional terms and conditions. In accordance with the Agreement Establishing IFAD, the resources of the Fund are to be used with "due regard to a fair geographic distribution" of such resources.<sup>3</sup> The Consultation on the Sixth Replenishment also agreed that the proposed programme of work would extend the PBAS as a uniform system of comparison and allocation across the lending programme as a whole, taking into account the need to reflect priorities with regard to the regional distribution of development assistance and to maintain at least a two-thirds share of the lending programme on highly concessional terms.

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<sup>1</sup> Enabling the Rural Poor to Overcome their Poverty: Report of the Consultation on the Sixth Replenishment of IFAD's Resources (2004-2006). GC 26/L.4 (paragraphs 41 and 42).

<sup>2</sup> The Asian Development Bank tabled a comparative overview of all PBAS approaches, including IFAD's, at the High-level Forum on Aid Effectiveness, Paris, March 2005.

<sup>3</sup> Agreement Establishing IFAD, Article 7, Section 1(d).



3. Subsequently, the Executive Board, at its seventy-ninth session, reviewed and approved the “structure and operation” of the PBAS for IFAD as developed in consultation with Member States. This process included an Informal Panel of Members designated by the Governing Council. It was also noted that the PBAS would continue to evolve to reflect operational experience. The initial design would be a starting point for an ongoing process of refinement relative to the methodology of assessment and the weighting of the separate factors of the formula.

4. In September 2005, the eighty-fifth session of the Executive Board reviewed PBAS implementation at IFAD,<sup>4</sup> including recommendations for changes in some methodological aspects of the PBAS, based on experience gained in implementing the system in 2004-2005 and on lessons learned by other international financial institutions (IFIs) in implementing their own PBASs.

5. A series of technical issues were identified that limited the effective implementation of the system. Firstly, the large variations in population between IFAD’s Member States had resulted in large differences in country scores, making it necessary to introduce maximum and minimum allocations for up to 52 countries, thus reducing the system’s responsiveness to changes in performance indicators. Secondly, rural population rather than total population was considered to be a more appropriate indicator of the needs of the rural poor in line with IFAD’s role and focus. Finally, changes to the allocation methodology were considered in order to facilitate annual changes in countries’ performance scores, changes in the list of active borrowers annually, and changes in the scheduling of loans and planned loan amounts (i.e. the pipeline). In considering the report, the Board requested: further analysis with respect to the issue of regional allocations; further simulations on the weights used in the formula and the use of other components in the formula; and that this be brought to the Board at a future session.

6. An information note on the PBAS was tabled at the fifth session of the Seventh Replenishment Consultation.<sup>5</sup> The session discussed the implementation of the PBAS and made proposals as contained in a conference room paper drawn up during the Consultation,<sup>6</sup> and in a supplementary report, both submitted by a working group that comprised representatives from all Lists. Both documents form part of the Report of the Consultation on the Seventh Replenishment of IFAD’s Resources (2007-2009).<sup>7</sup> The Governing Council at its twenty-ninth session in February 2006 in Resolution 141/XXIX approved the Consultation report. The Consultation report confirmed that the implementation of the uniform system of allocation across the IFAD lending programme as a whole would become effective in the 2007 programme of work (i.e. the first year of the Seventh Replenishment period), and that fixed regional allocations would no longer apply. It also confirmed that the uniform system would need to reflect priorities in terms of the regional distribution of development assistance and maintain at least a two thirds share for Africa and other highly concessional borrowers. In this regard, IFAD would continue to direct at least the current percentage share of resources to sub-Saharan Africa, provided that the performance of individual countries warrants it.

7. In addition, the Consultation report further stated that an informal seminar should be held to consider modifications to the current PBAS formula, with reference made to the PBAS paper presented to the Executive Board in September 2005. This could include changing the population indicator from total to rural population and using alternative weightings for key factors (e.g. population), which would have the effect of enhancing the impact of performance. It was further agreed that the Executive Board would decide on revisions to the system at its April 2006 session. In this connection, an informal seminar was held at IFAD on 31 March; the related technical note is posted on the restricted IFAD website.

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<sup>4</sup> Review of the Implementation of the Performance-Based Allocation System in IFAD (EB 2005/85/R.3).

<sup>5</sup> Performance-Based Allocation System: Information Note (REPL. VII/5/INF.3), 14 December 2005.

<sup>6</sup> Performance Based Allocation System (REPL.VII/5/C.R.P.7/Rev.1).

<sup>7</sup> IFAD’s Contribution to Reaching the Millennium Development Goals: Report of the Consultation on the Seventh Replenishment of IFAD’s Resources (2007-2009). GC 29/L.4.

## Current PBAS Issues at IFAD

8. The 31 March informal seminar discussed (as requested by the Replenishment Consultation) modifications to the formula reflecting IFAD's own implementation experience and the issues raised in September 2005. These issues included:

- (a) source and weight of population; and
- (b) allocation management.

9. These issues were first raised during the initial design of IFAD's PBAS in 2003 and were highlighted in the conference room paper<sup>8</sup> prepared in conjunction with the paper submitted to the September 2003 session of the Executive Board. Both issues were raised again at the Executive Board session in September 2005 as IFAD's implementation experience with the PBAS was reviewed.

10. **Source and weight of population.** Large country populations cause the population factor to become the dominant factor in the allocation formula at the expense of performance indicators and, to a lesser extent, GNI per capita. Moreover, the large variance in relative population levels across IFAD's wide membership causes many countries:

- (a) to be assigned overly small allocations from the perspective of effective project/programme operations;
- (b) to be classified with minimum or maximum allocations effectively placing them outside a performance/poverty-based system; and,
- (c) to ultimately receive allocations based on significant reallocations from countries with unused allocations.

11. IFAD has carried out numerous allocation simulations to test various weights for population. Using population weights from 0.6 to 0.75 continues to result in many countries remaining outside the system (i.e. countries with maximum/minimum allocations). Alternatively, allocations with weights from 0.1 to 0.5 resulted in fewer such instances, and a weight of 0.3, in particular, resulted in allocations to the largest borrowers below the ceiling of 5% of IFAD's resources. At this level of population weight, however, the factor of "needs" becomes less important and the resulting allocations are likely to be below the absorptive capacity and demand of larger borrowers. In conclusion, the weight of 0.45 is regarded as a "point of balance" where population still carries significant influence as a determinant of "needs" in the formula but at the same time allows performance and GNI per capita to have a strong role. It is therefore proposed that the formula be modified accordingly to reflect a revised weight of population at 0.45.

12. Rural population was agreed in principle, subject to the availability of appropriate data, during the initial design phase of the PBAS as it would favour those countries that have a high proportion of their population in rural areas inasmuch as a country obtains its PBAS score **relative** to other scores. The ratio of total population to rural population is not standard throughout IFAD's Member States. 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. Given IFAD's mandate, rural population would be a more appropriate indicator of the needs 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). However, it has been pointed out that the definition of rural population, for technical reasons, varies among IFAD Member States.

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<sup>8</sup> EB 2003/79/C.R.P. 3.

13. **Allocation management.** The dimensions of the allocation management issue are, arguably, unique to IFAD given that the number of eligible borrowing Member States in IFAD is large (with a total, historically, of 115 recipient borrowers<sup>9</sup>). Currently, active borrowers in IFAD number about 65. This number is high compared with most other institutions operating a PBAS, but the Fund's resources are relatively small. With their higher resource levels available for commitment, other institutions can establish reasonable lending volumes and programmes for all eligible countries virtually every year and allow performance to determine annual revisions of allocations. However, in IFAD's case, project loans per year number about 30-35, far below the number of "active" borrowers. In fact, to address this issue, consideration was given at the initial design stage to an extended allocation methodology before a three-year period was initiated with carry-forward, front-loading and reallocations. Such allocation systems, as all PBAS practitioners can testify, require careful management and regular readjustment; the Asian Development Bank, for example, has now instituted a two-year allocation period.

14. With the experience of implementation in mind, IFAD proposed at the September 2005 session of the Executive Board revisions in the allocation methodology that would allow IFAD to meaningfully include:

- (a) annual changes in countries' performance scores leading to changes in the overall country scores;
- (b) changes in the list of countries expected to be actual borrowers in a given period; and
- (c) changes in the loan amount required by each actual borrower and in the scheduling of these loans.

15. While no changes in allocation methodology were made following the September 2005 session of the Executive Board, IFAD has continued to consider ways to address these operational issues, which still remain critical. An approach was proposed at the 31 March informal seminar.

### **Proposed Allocation Methodology**

16. The proposed use of an annual allocation period within a three-year lending framework was presented and discussed at the informal seminar, and the comments received have been incorporated in the proposed approach. The essential characteristics of the modified system are as follows:

- (a) Country scores, leading to provisional country allocations, are calculated annually.
- (b) Within the three-year lending framework, each annual exercise allocates funds for countries in the lending programme. The first year's allocation is firm but the subsequent two years' allocations are indicative for planning purposes.
- (c) Each annual allocation exercise is based on new performance scores and new data on population, income and the list of borrowers. If circumstances (e.g. performance) have changed since the previous country scoring allocation, then the scores and allocations change correspondingly.
- (d) All procedures for country scores and allocations use the PBAS.

17. The annual allocation exercise would proceed in several stages, based on the existing procedures for pipeline development but with the important proviso that all steps are subject to the PBAS:

- (a) The needs and performance of all IFAD Member States entitled to borrow are taken into account to calculate, annually, the current PBAS scores for all countries.
- (b) Based on the PBAS scores, the list of "active borrowers", country strategic opportunities papers (COSOPs), and the project development cycle, regional divisions identify countries

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<sup>9</sup> IFAD 2004 Annual Report, Table 5.



- for potential inclusion in the annual lending programme. Country allocations are then determined, based on the lending programme, in proportion to their PBAS scores.
- (c) Inception memorandums are, as at present, prepared for each potential project/programme and, subject to quality-at-entry criteria, are formally included in the annual pipeline with, subsequently, the confirmation of a firm country allocation on which the project/programme processing can proceed.
  - (d) In order to establish the tentative allocations programme over a three-year period (in line with the replenishment period), the regional divisions repeat the procedure outlined above for the subsequent two years to give indicative scores and country allocations.
  - (e) These allocations are not entitlements. If any country's allocation is in excess of its absorptive capacity or requirements for a given year (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 and reallocates them to other countries in the lending programme in line with their PBAS country scores, thus ensuring the role of performance-based allocation throughout the process. The volume of these reallocations would be limited in proportion to the overall lending programme.
  - (f) The result is a PBAS three-year allocation to actual, active borrowers.

These allocation management procedures for the countries in the lending programme would require neither front-loading nor carry-forwards and would entail a much less intensive allocation and reallocation process.

18. Within the three-year lending framework, drawn from the total list of “active” borrowers in the Seventh Replenishment period, the list of borrowing countries for the next year would be finalized. Resource allocation to the lending programme countries would be done each year according fully to the PBAS and be sensitive to changes in performance. The application of a uniform PBAS on the basis of countries in the lending programme with allocations driven by annual changes in country performance and needs would respect and respond to the basic PBAS principles and also be more aligned with other PBAS practitioners.

19. **Continuation of the current system.** It should be noted that if no changes are approved to the system as currently implemented then the existing weights in the formula will continue to be applied to determine the lending programme for the 2007 programme of work. The application of the current PBAS methodology under global allocations will intensify the issues already listed, e.g. low country allocations, limited response to performance changes and countries categorized as outside the system. The Board will be kept informed as to the effect on the lending programme but unless the formula is adjusted, it may, according to preliminary scenarios, require either an increase in the total number of projects/programmes (in order to respond to low levels of allocations to many countries) or substantial levels of reallocations from countries with unused allocations. In this context, several participants at the informal seminar suggested that a working group be set up to review these issues and advise on possible future modifications.

### **Conclusions and Recommendations**

20. The presentations and discussions at the informal Board seminar focused on issues and proposed modifications that IFAD has been considering throughout the implementation of the PBAS since its approval by the Executive Board in 2003. Population source and weight and the need for an allocation management methodology that is adjusted to IFAD's membership and resource structure have, to date, been identified as the issues which limit the overall effectiveness of the system. Further work is required, together with other PBAS practitioners, to: review the use of GNI per capita as the most appropriate indicator for poverty; make improvements in performance scoring and analysis; and review



the use of minimum and maximum allocations. A working group of the Board could facilitate these tasks.

21. In preparation for the 2007 programme of work and subsequent lending programmes within the Seventh Replenishment period, management recommends that the Executive Board approve the proposal that IFAD should:

- (a) continue to use total population and per capita income as indicators of need, but decrease the weight assigned to population from 0.75 to 0.45;
- (b) introduce the use of rural population as the basis for calculation for the 2008 lending programme, following validation of the rural population data to be used; and
- (c) within the three-year allocation framework, utilize an annual allocation approach with scores calculated for each year for all eligible borrowing Member States according to the agreed formula.

22. Furthermore, the Board is requested to consider the establishment of a Board working group to consider PBAS issues and possible future modifications and changes in the formula.

