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Enabling the rural poor
to overcome poverty

Progress report on implementation of the performance-based allocation system

Executive Board — Eighty-ninth Session
Rome, 12-14 December 2006

For: **Approval**

Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

To make the best use of time available at Executive Board sessions, Directors are invited to contact the following focal point with any technical questions about this document before the session:

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Recommendation for approval

The Executive Board is invited to approve the submission of a progress report to the thirtieth session of the Governing Council in 2007 based on this report and its addendum containing the 2006 country scores and 2007 allocations.

Progress report on implementation of the performance-based allocation system

I. Introduction

1. At its twenty-sixth session, held in February 2003, the Governing Council approved the establishment in IFAD of a performance-based allocation system (PBAS), delegating authority to the Executive Board to develop the details of the system's design and implementation.
2. The PBAS is based on annual allocation exercises that operate in the context of three-year cycles. 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 frameworks. The first allocation exercise covered the period 2005-2007. During 2005, the PBAS became fully operational and was extended across the lending programme as a whole to define IFAD loan and country-grant allocations to Member States.
3. The report of the Consultation on the Seventh Replenishment of IFAD's Resources¹ confirmed that 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. At its twenty-ninth session, held in February 2006 the Governing Council approved the Consultation report (resolution 141/XXIX). The Consultation report 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 so warrants.

II. Revisions to the PBAS methodology

4. Pursuant to the discussions of the informal seminar on the PBAS held in March 2006 and the discussions of the Executive Board at its April 2006 session, the Board agreed as follows:
 - (a) In line with the Agreement Establishing IFAD, the resources of the Fund would continue to be used with "due regard to a fair geographic distribution". Moreover, with the application of a uniform system of allocation as from 2007, IFAD would, in line with the decisions reached during the Seventh Replenishment, "continue to direct at least the current percentage share of resources to sub-Saharan Africa, provided that the performance of individual countries warrants it".
 - (b) IFAD would continue to implement the PBAS on the basis of a three-year lending/allocation framework and plan allocations to the list of active borrowers. This would be done in the light of an expanding programme of work, and the Board would be kept informed of country scores, allocations and the changes that occur as these are updated.
 - (c) The weight of 0.45 was regarded as a "point of balance" where population still carried significant influence as a determinant of "needs" in the formula but at the same time allowed performance and gross national income (GNI) per capita to have a strong role. It was therefore agreed that the formula

¹ IFAD's Contribution to Reaching the Millennium Development Goals: Report of the Consultation on the Seventh Replenishment of IFAD's Resources (2007-2009), document GC 29/L.4.

would be modified accordingly to reflect a revised weight of population at 0.45.

- (d) There was broad agreement that, given IFAD's specific focus on rural poverty, the use of rural population would respond better to IFAD's mandate. In this regard it was agreed that the concept of rural population would be applied no later than in the 2008 work programme.
- (e) Having agreed to these principles and decisions, the Board further agreed to the suggestion to convene a working group, as referred to in the Consultation report approved by the Governing Council, to develop a broader understanding of evolving issues in PBAS implementation relating to the data to be used for rural population, the importance of performance, the implementation of the PBAS for concessional and non-concessional borrowers, and other potential indicators of poverty such as nutrition and per capita rural income levels that could affect country scores and be introduced into the overall system.

III. PBAS working group

5. An informal seminar was held on 6 July to review the terms of reference of the working group² and it was agreed that the working group would subsequently nominate a chairperson. The terms of reference were agreed with the aim of:

"Developing a broader understanding of evolving issues in PBAS implementation including:

- modifications of elements of the formula, including performance assessments, and the weights of population and income, while maintaining the overall weight of performance;
- the experience and lessons learned from other agencies implementing PBAS initiatives;
- the data to be used for rural population;
- the implementation of the PBAS for concessional and non-concessional borrowers; and
- other potential indicators of poverty such as nutrition and per capita rural income levels."

A meeting of the working group is expected to take place shortly.

IV. Application of the PBAS in 2006

6. All loans and country-specific grants presented to the Executive Board for approval in 2006 have been in accordance with their PBAS allocations. Allocation management issues have continued to be an issue and are, arguably, unique to IFAD given that the number of eligible borrowing Member States in IFAD is large (with a total, historically, of 115 borrowers). 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/programme loans per year number about 30, well below the number of "active" borrowers. This issue continues to be reviewed, particularly in the context of the proposed 2007-2009 allocation period.

² List A: France, Italy, Sweden and the United States of America
 List B: Nigeria, Venezuela (Bolivarian Republic of)
 Sub-List C1: Mali
 Sub-List C2: India
 Sub-List C3: Mexico

7. In developing the PBAS within IFAD, the Executive Board recognized that there would be situations in which it would not be possible to deliver commitments against ex ante country allocations within the allocation period owing, for example, to a lack of demand for IFAD loans or the absence of opportunities to engage in operations in priority activities as identified through the PBAS performance assessments. In such cases, the unused allocation would be reabsorbed into the allocable resource pool³ for redistribution through the prevailing PBAS allocation system (document EB 2003/79/R.2/Rev.1, paragraph 40).
8. The loans and country grants presented in 2006 to the Board have therefore observed the following approach:
 - The programme of work (both loans and grants) is identified for each of the regions in the allocation period 2005-2007. This takes into account absorptive capacity, i.e. how much a borrower can effectively disburse and use each year. The result is a three-year lending programme framework for actual borrowers corresponding to the programme of work in each of the three years.
 - If any country's allocation is in excess of its requirements for the 2005-2007 fixed allocation period (because the country's requirement for funds is less than the initial allocation), IFAD identifies the excess funds and reallocates them. This is done using the PBAS scores, ensuring the integrity of the performance-based allocation process. For instance, if country X has a three-year allocation of US\$11 million and is felt to be likely to use only US\$7 million, then US\$4 million would be moved to the pool for reallocation.
 - The reallocation is made among countries in the programme of work, and this reallocation, as always, is made in proportion to PBAS scores and ensures the use of all funds available for commitment.

V. The 2007-2009 allocation period

9. During 2006, the regional divisions have been identifying the "active"⁴ countries for 2007-2009. The parameters for these countries are being applied to the revised formula to give provisional country scores and allocations for the allocation period. On this basis, the divisions will be able to confirm the active borrowers so that final country scores and allocations can be made for 2007 and provisional figures for 2008 and 2009 (the figures for 2008 and 2009 will be indicative and subject to changes in annual performance, population, GNI per capita). These allocations are not entitlements. If any country's allocation is in excess of its absorptive capacity or requirements for the allocation period (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.
10. A further refinement beginning in 2007 will be the use of individual country policy and institutional assessment (CPIA) scores as disclosed by the World Bank rather than "quintiles" for which average scores were disclosed. The Board will be informed of the scores in accordance with the procedures agreed for disclosure of PBAS information.

³ The concept of the pool as a source of funds for reallocation was also noted in the section on reallocation of uncommitted resources in document EB 2003/79/C.R.P.3.

⁴ "Active" countries are those Member States where IFAD expects to have lending or country-grant operations in the 2007-2009 allocation period.