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Enabling poor rural people
to overcome poverty

Report of the Working Group on the Performance-based Allocation System

Executive Board — Ninety-third Session
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For: **Information**

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This document is submitted for the information of the Executive Board.

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Report of the Working Group on the Performance-based Allocation System

I. Introduction

1. In April 2006, acting on a suggestion made in the Report of the Consultation on the Seventh Replenishment of IFAD's Resources approved by the Governing Council, the Executive Board agreed to convene a working group on the performance-based allocation system (PBAS).
2. The Working Group¹ is chaired by a member of the Executive Board. Its terms of reference are to develop "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."
3. The Executive Board reviewed the 2007 implementation report of the PBAS in December 2007 and invited the Working Group to report on its progress at the April 2008 session of the Board.

II. Meetings of the Working Group

4. The Working Group met in February, April and September 2007 and in February 2008, using video-conferencing where required. The minutes of these meetings are attached as annexes I and II. Following a suggestion made by the Executive Board in December 2007, Member States who wished to attend Working Group meetings were invited to do so as observers. Five Member States attended the February 2008 meeting.² At each Working Group meeting, the secretariat has made an initial presentation on the PBAS giving an overall summary of the system, both technical and methodological, and providing more details of specific aspects for discussion in the respective agenda.

A. Topics discussed by the Working Group and issues raised

The Debt Sustainability Framework

5. The Working Group reviewed the Debt Sustainability Framework (DSF) and its application in IFAD, including the methodology used for classifying countries and the allocations available for "active" countries. IFAD is in regular contact with the World Bank and the African Development Bank to ensure alignment with their country classifications and approaches. Moreover, each country's classification is reviewed annually following the debt sustainability analysis undertaken by the World Bank and the International Monetary Fund. The regional development banks are now joining these DSF missions in their respective regions.

¹ 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

² Argentina, Brazil, Cameroon, Ecuador and Guatemala.

The introduction of rural population into the PBAS formula in place of total population

6. The effect of introducing rural population into the PBAS formula was the topic of several Working Group meetings, with one meeting dedicated exclusively to this topic. The Working Group reviewed various definitions of rural population and the data sources used by IFAD, and looked into concerns about the lack of comparable rural income data. It concluded that sufficient data were available to apply rural population to the PBAS formula. The Group also reviewed changes in "active" country allocations, both increases and decreases. Members and observers from Latin America and the Caribbean expressed concern about the reduced allocations to that region. In this regard, the importance of maintaining a strong pipeline of projects and programmes for IFAD financing in the region was emphasized.

Links with other international financial institutions implementing the PBAS

7. At each of its meetings, the Working Group has been brought up-to-date on PBAS implementation in other international financial institutions, including the African Development Bank, the Asian Development Bank, the Caribbean Development Bank, the Global Environment Facility, the Inter-American Development Bank and the International Development Association. These institutions meet annually and IFAD is hosting the April 2008 meeting (a summary of the meeting is attached as annex III). Informal contacts are also maintained with the other institutions concerning improvements and adjustments in the methodology. A key aspect of this has been the need for both transparency and simplification.

B. Topics under consideration for future discussion

8. The Working Group is expected to continue its work in 2008 and beyond, examining several other topics and issues more closely. The Group has agreed to meet again after a proposed workshop to be hosted by the Regional Unit for Technical Assistance (RUTA) in Costa Rica. RUTA has been carrying out much of the analysis for the rural sector performance assessment (one of the performance criteria in the PBAS formula) in Central America, and it now has good experience at country level of this aspect of the PBAS application. IFAD and RUTA are therefore planning to hold a 2-3-day workshop to review how RUTA has been operationalizing the surveys in-country, and to discuss any findings and issues that have arisen. The workshop will also provide an opportunity to present the PBAS to a wider audience in the region and to broaden understanding of the system's purpose and methodology. The findings and conclusions of the workshop will be discussed at the next meeting of the Working Group.
9. In parallel to this, the secretariat will continue to work with the World Bank and the United Nations to ensure that the best estimates of rural population are used in the PBAS formula. This will include specific country-level studies such as the World Bank study being carried out by the Universidad Nacional de La Plata in Argentina.

PBAS Executive Board Working Group Minutes of 2007 meetings

1. Executive Board PBAS Working Group: Minutes of the first meeting, 27 February 2007, IFAD Rome

Members: India - Ramalingam Parasuram, Chairperson; Mexico - Vladimir Lara; Sweden - Ann Uustalu; France - Vincent Perrin; United States - Carol Kramer-LeBlanc. Absent: Italy, Nigeria, Mali and Venezuela.

1. The members were welcomed by the Chairman who outlined the purpose of the meeting, to discuss and understand the basics of the PBAS, to identify outstanding issues and to establish a timeframe for the group's work and meeting modalities.
2. Members agreed that they would use the group to understand and inform themselves (and colleagues) on PBAS issues, both technical and political and to straighten out concerns. Some issues may need referring back to the Executive Board, others may remain within the group and, finally, some issues may have a longer time frame and be linked to issues being discussed by other IFIs. It was discussed and agreed that if there were issues to be raised to the EB it would be likely that this would initially be reviewed in September for discussion in December when it could be considered as part of the PBAS annual review, which the Secretariat is required to present annually.
3. The Secretariat (represented by Mr Baldwin) presented an overview of the PBAS implementation to date, the current status, the issues being discussed and reviewed with other PBAS practitioners and the current IFAD issues that needed to be further examined. In particular, this concerned the issue of the adoption of rural population where initial discussions with the World Bank indicate that the comparability and definition of rural population data may pose issues for its inclusion in the formula as previously recommended. It was also pointed out that ongoing Replenishment discussions at IDA and AfDB will raise issues of simplification of the system, reducing excessive variability in portfolio assessments and how to address fragile states.
4. In the subsequent discussion it was confirmed that none of the other IFIs intend to use rural population in the formula and that, as a technical issue, this topic would need the technical support of the Secretariat for the working group to have a substantive discussion. The Secretariat will continue its investigation on this and keep the group informed. Several technical questions were raised and answered by the Secretariat. The members agreed that the group could not deal with all questions and that the issues should be categorised into issues that were technical and which required technical support from the Secretariat (including the use of other indicators) and those issues which would have a slightly longer time frame & be linked to the discussions in other IFIs.
5. In conclusion the Chairperson requested that members engage with their Lists to identify other issues that the group should consider. As a next step, the group would meet in the morning of Thursday, 19 April, after the Executive Board, to review all issues received from Lists, categorise them and establish a time frame for action, where needed, by the group. To the extent possible, the Secretariat would provide further feedback on the issue of rural population.

2. Executive Board PBAS Working Group: Minutes of the second meeting, 19 April 2007, IFAD Rome

Members: India – Ramalingam Parasuram, Chairperson; Mexico – Vladimir Hernandez Lara, Víctor Daniel Flores Fuentes; Sweden – Ann Uustalu; United States – Liza Morris, Carol Kramer-LeBlanc; Italy – Augusto Zodda; Nigeria – Yaya O. Olaniran; Mali – Modibo Mahamane Touré; and Venezuela – Mariella Mancini. Absent: France (Vincent Perrin).
Observers: Brazil – Felipe Haddock Lobo Goulart; Guatemala – Ileana Rivera De Angotti;

1. The members were welcomed by the Chairman to the second meeting of the Working Group (minutes of first meeting attached) and requested the Secretariat to give a short overview of the PBAS in IFAD as there were several members of the Group who had not seen the presentation that was made at the first meeting. The Chairman also noted that, while lists had been requested to identify specific issues, none had been received so the meeting was an opportunity to consider suggestions and ideas for further review.
2. The Secretariat (represented by Mr Baldwin) presented a PowerPoint/overview of the:
 - PBAS implementation to date;
 - The current status;
 - The amendments being introduced as a result of the approval of the Debt Sustainability Framework (DSF) by the Executive Board;
 - The issues being discussed and reviewed with other PBAS practitioners; and
 - The current IFAD issues that needed to be further examined.
3. The working group initiated a discussion during the presentation concerning the methodology used for the DSF and the classification of red, yellow and green countries, and the alignment of approaches with the other practitioners of the DSF. The Secretariat confirmed that IFAD was in regular contact with both the World Bank and African Development Bank concerning alignment of country classifications and the approaches used. The Working Group also discussed how the change in the weight of population (approved by the Board in December 2006) had the intention to reduce the variations in country allocations due to size of population but, nevertheless, still retain the importance of this criteria as a 'need' factor. The Secretariat also gave a résumé of how the 'post-conflict' countries were treated under the PBAS and explained that IFAD followed the World Bank guidelines in this respect and provided increased allocations to such countries. The examples of Eritrea at the December 2006 Board and Sierra Leone at the April 2007 Board were given of how this approach was being applied by IFAD.
4. To further aid the working group in the understanding of the PBAS methodology, as reviewed in the initial presentation, the analysis of country level applications, based on the information already provided to the Executive Board (and subsequently disclosed), is attached for information.
5. The Working Group had a substantive discussion concerning the issues raised on the possible adoption of rural population rather than the, current, total population. The Secretariat had summarised discussions with the World Bank which indicated that the comparability and definition of rural population data may pose issues for its inclusion in the formula as previously recommended. The Working Group acknowledged the validity of using rural population (and if possible rural income) but also recognised the potential limitations imposed by data availability, accuracy and comparability.
6. The Working Group agreed together with the Secretariat that the Secretariat would further review the issues concerning rural population, including:

- Discussions with the World Bank and the UN regarding definitional terms;
 - Actual sources of rural population and the issues of available censuses to see whether or not those censuses give the sort of information required; and
 - Provide various scenarios concerning rural population (and also the overall weight of total population and per capita income and the impact of the ceilings on several Asian countries).
7. The Working Group would, on the basis of information to be provided by the Secretariat, would next meet (possibly late June or July) to take this issue further with a view to presenting the Group's conclusions as part of the Annual Report on PBAS to be presented to the EB in December.

3. Executive Board PBAS Working Group: Minutes of the third meeting, 13 September 2007, IFAD Rome

Members: Present: India – Ramalingam Parasuram, Chairperson; France – Marc Trouyet; United States – Liza Morris, Andrew Velthaus; Nigeria – Yaya O. Olaniran; and Mali – Modibo Mahamane Touré. Absent: Mexico; Italy; Sweden; Venezuela. Observers: Brazil – Felipe Haddock Lobo Goulart;

1. The members were welcomed by the Chairman to the third meeting of the Working Group. The Chair raised the issues of the intended duration of the Working Group and at what point the Group would report back to the Executive Board. He then introduced the agenda item: the discussion and review of the use of rural population in the formula.
2. The Secretariat (represented by Mr Baldwin and Ms Rice PMD/PD) presented a Power Point presentation: "Review of the use of Rural Population in the PBAS formula". This included a review of data sources: their comprehensiveness, timeliness and comparability; the methodological issues concerning the definition of 'rural'; and, the effect of application on country scores & allocation.
3. The group then discussed the issues surrounding the use of rural population in the PBAS formula, its importance in the mandate of IFAD. While there was an appreciation of the methodological issues and concerns there was nevertheless sufficient data, available from the World Bank, to apply rural population to the formula.
4. It was also noted that the Executive Board had agreed at its April 2007 session to apply rural population to the formula and that the role of the Working Group had been to review the data sources and methodological implications. The Secretariat informed the Working Group that the 2007 revision of scores and 2008 allocations (and 2009 indicative allocations) would be based on the use of rural population. The Working Group agreed that it would not be appropriate to apply this to the 2007 allocations or for projects already approved by the Board or to be approved in December 2007.
5. It was agreed that a Report on the meetings of the Working Group would be contained in the regular annual report to be presented to the December Executive Board. The Secretariat informed the Working Group that the minutes and presentations provided to the Group would be available on a restricted access part of the PBAS section of IFAD's website: www.ifad.org/operations/pbas.

Executive Board PBAS Working Group: Minutes of the fourth meeting, 28 February 2008, IFAD Rome

Members:

Present: India- Ramalingam Parasuram, Chairperson; France- Clarisse Paolini; United States – Liza Morris, Andrew Velthaus; Nigeria- Yaya O. Olaniran; Mali- Mohammed Al Moustapha Cissé; Mexico- Diego Alonso Simancas Gutierrez; Italy- Augusto Zodda.

Observers:

Brazil- José Antonio Marcondes De Carvalho; Felipe Haddock Lobo Goulart; Argentina- María del Carmen Squeff; Guatemala- Ileana Rivera De Angotti ; Ecuador-Geoconda Galán Castelo; Cameroon- Médi MOUNGUI

Secretariat:

B.Baldwin; T.Rice; E. Murguia; U. Demirag

Absent:

Sweden; Venezuela

1. The Chairperson welcomed both the members of the Working Group (WG) and the observers. The Chair, following agreement on the agenda noted that there had been some good meetings in 2007 following the initiation of the WG by the Board in April 2006 and that these meetings had been reported to the Board in December 2007. The Chair noted that the Board had observed that the WG should continue to meet with the same objectives of improvement of understanding of the issues surrounding the PBAS in IFAD.
2. The Secretariat presented a Power Point presentation outlining the key features of the PBAS in IFAD and the decisions taken since the inception of the approach. The WG then had a discussion concerning the presentation and the PBAS in general.
3. During the course of the discussion, several of the WG reiterated that the mandate of the WG was 'fact finding' and a broader understanding of PBAS, in keeping with the terms of reference given by the Board. Issues concerning evaluation of the PBAS would need to be tabled to the Evaluation Committee of the Board and proposals to modify the PBAS would need to be brought by the members themselves to the Board, rather than the WG.
4. The WG discussed the introduction of rural population into the PBAS formula (after the Executive Board of April 2006) and reviewed the effect on allocations at country level. Several members and observers expressed concern that the allocations to countries in Latin America and the Caribbean (LAC) had been reduced since the introduction of rural population. The WG also discussed the issues concerning definition of rural population, income distribution and the data sources used by IFAD. It was discussed that rural population is usually calculated at country level in conjunction with the overall population analysis and the determination of urban populations. The World Bank use their in-country staff to review and where necessary validate total population (as it is central to IDA lending terms) and subsequently publish rural populations. IFAD uses the data as provided by the World Bank. The need for continued study was emphasised and it was explained that the Universidad Nacional de La Plata in Argentina was carrying out a World Bank funded study (World Bank's LAC poverty group) into the issues of rural population and rural income. The Secretariat will follow up with the University.
5. The changes in country allocations in LAC and the overall lending to the region were discussed. Allocations for LAC have varied with the introduction of rural population, some have increased but several have decreased, if only marginally. A review of regional lending, in the context of a growing overall IFAD lending programme,

presented by the Secretariat noted the need to continue to develop a strong pipeline of projects & programmes for funding in LAC. The need to consider reallocation within regions was also raised and it was noted that, with the decisions taken by the Governing Council, regional allocations were no longer applied beginning with the 2007 work programme.

6. WG noted the continued collaboration with other IFIs, in the spirit of the Paris Declaration, in the implementation of PBAS and the proposal for IFAD to host the MDB/IFI annual technical meeting in early April; to which the members of the WG would be invited as observers. The WG noted the use by the Millennium Challenge Corporation (MCC) of indicators that were part of the rural sector performance assessment. Much of the analysis done in relation to the rural sector performance assessment in Central America is done by the Regional Unit for Technical Assistance (RUTA), based in Costa Rica. In this regard the Secretariat informed the WG that it intended to hold a 2-3 day workshop with RUTA to review how RUTA had been operationalising the surveys in –country and discuss the findings and issues arising. It was also proposed to use such a workshop to give an overview of the design and implementation of the PBAS in the region, in Spanish, to a wider, operational audience. It was intended to include both Central American countries but also other countries from LAC. The Secretariat would give further details of the workshop (proposed for late June 2008) at a later date.
7. The WG agreed that the next meeting of the WG would be after that workshop and would include a report of the event and the issues raised.
8. The WG discussed the request by the Executive Board in December 2007 for a progress report by the WG to be tabled to the April 2008 Executive Board. This would be an ‘information’ item and will give a report on the meetings of the WG in 2007 and 2008 (to date), the issues raised and the views expressed. This will also include a summary of the MDB/IFI technical meeting.
9. In closing the meeting the Chair confirmed that the next meeting would be after the Costa Rica workshop. He also expressed the intent for moving ahead in the discussions. This can be achieved by reducing the need to ask and review some of the basic issues which have been deliberated upon in earlier meetings. From the next meeting onwards it would be desirable to discuss specific issues. The chair also requested members to notify him & the Secretariat of issues they wish to be tabled for discussion by the WG.
10. The Secretariat informed the Working Group that the minutes and presentations provided to the Group would be available on a restricted access part of the PBAS section of IFAD’s website: www.ifad.org/operations/pbas.

Summary of the fourth MDB/MFI technical meeting on performance-based allocation systems, 3-4 April 2008, IFAD Rome

1. Introduction

On 3rd and 4th of April 2008, the fourth MDB/MFI Technical Meeting on Performance-Based Allocation Systems was hosted by the International Fund for Agricultural Development (IFAD). Representatives from the following seven multilateral institutions¹ participated in the meeting: African Development Bank (AfDB), Asian Development Bank (AsDB), Caribbean Development Bank (CDB), Global Environmental Facility (GEF), Inter-American Development Bank (IADB), World Bank (IDA), and IFAD. Observers from Italy, Guatemala, the World Bank and the United Kingdom attended.

The agenda of the meeting centred around the following topics: (i) recent PBA issues, particularly at the policy level; (ii) issues related to implementation, particularly allocation adjustments; (iii) implementation of the Debt Sustainability Framework (DSF) grants framework; and, (iv) emerging issues, including the impact of the Multi-level Debt Relief Initiative (MDRI) on future country allocations.

2. PBAS Policy: Recent PBAS Issues

Brief introductory statements on the status of their respective PBA systems were made by participants. Several common themes were raised and subsequent discussion centred on these points:

- (a) **Performance volatility.** While this topic mainly focused on portfolio issues, AfDB noted that it had sought to reduce the potential volatility of allocations due to fluctuations in population and GNI/capita by adjusting population figures every three year basis and using a moving average for GNI. All three institutions use only 'actual' problem projects in calculating PAR values. IDA also makes adjustments to PAR based on the age of the portfolio.
- (b) **Formula.** Both IDA and AfDB have moved to an additive formula rather than a geometric formula so that the formula is easier to understand and the primary factors determining changes in allocations are clearer and can be more easily analysed. Nevertheless, apart from these points, participants noted that the formula remained basically the same; including the country performance assessments and that any 'opening up' of the formula was not being considered.
- (c) **Small states vulnerability.** Several participants noted the issues of small states and islands (Pacific and Caribbean), including pool allocations in response to these countries' greater vulnerability to economic events and natural disasters. IDA has increased the base allocation to SDR 1.5 million for all countries; AsDB has a pool for Pacific states.
- (d) **Vulnerability and natural disasters.** In response to natural disasters, only CDB has earmarks for natural disaster. Participants noted the possibility of cancelling projects/components in affected countries and re-cycling those funds separate from the PBA allocation to finance new projects. IDA has been making efforts to involve the private sector in offering insurance to enable the immediate release of funds in cases of natural disaster. CDB uses the Caribbean Catastrophic Risk Facility for immediate pay-outs in disaster situations. Premiums on the facility in many cases are paid through concessionary financing. Participants agreed that PBA is poverty rather than

¹ Both the IMF and Islamic Development Bank expressed their regrets in being unable to attend.

vulnerability based, and that there is a concern of diluting the poverty focus by including vulnerability in the formula.

- (e) **Allocations for multi-country (regional) projects.** Participants discussed the modality of multi-country allocations in PBA approaches and the modifications introduced at IDA and AfDB. The different approaches and criteria would be outlined in the summary tables on PBA systems that participants agreed to update.
- (f) **Post-conflict and fragile states.** Participants examined the different approaches and definitions used in allocating funds to post-conflict and fragile states. Both IDA and IFAD have used the post-conflict approach, as recently modified under IDA 15. The AfDB has introduced the Fragile States Facility as a development from the earlier Post-Conflict Country Facility, which incorporates arrears clearance. Participants noted the use of 'exceptional re-engagement allocations' as a further way to address such needs. Participants also discussed recent analysis that showed a positive correlation between project success and low IRAI scores as an indication of the trade-offs that could occur with greater funding for post-conflict/fragile states.

3. Implementation: Allocation adjustments

Participants discussed how each institution used front and back loading to both address issues of volatility of annual allocations and ensure full utilisation of funds. Varying rates of front and back loading are used within the three year allocation periods (noting that AsDB has two, two year allocation periods within its 4 year Replenishment period). Reallocations are usually made in the third year from countries unable to use their allocations but in full accordance with PBA methodology.

4. Implementation of the Debt Sustainability Framework

Participants discussed the application of the DSF in their respective institutions, their participation in DSF missions led by the World Bank and IMF and subsequent use of the traffic lights to guide allocations to countries. It was emphasised in the discussions that the DSF was both an integral part of maintaining debt sustainability in recipient countries and ensuring a medium term debt management plan. The DSF analysis is the starting point for countries to borrow prudently and establishes the basis for more sustainable economic growth. It was recognised by participants that there needs to be a continued good level of information flows both as country cases were identified and the specific responses developed.

5. Emerging issues

One of the first topics the meeting addressed in respect of emerging issues was the impact of MDRI (and the netting out effect) on country level allocations. It was recognised that there needs to be equity between countries with similar debt ratios but who were not necessarily part of the HIPC-DI (and hence MDRI). There were concerns expressed that the netting out could, in the medium rather than short term, cause significant reductions in new resource allocations, hence a potential shortfall in development finance. Participants recognised that this would require close contact over the forthcoming year as the scenarios were further developed. Participants agreed to update the tables previously circulated that explained the respective institutions approaches to PBA and agreed that this would be a product of the meeting.