

a

IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Consultation on the Seventh Replenishment of IFAD's Resources – Fifth Session

Rome, 14-15 December 2005

PERFORMANCE-BASED ALLOCATION SYSTEM

INFORMATION NOTE

1. **Introduction.** The Consultation on the Sixth Replenishment of IFAD's Resources recommended – in its report to the Governing Council, entitled “Enabling the Rural Poor to Overcome their Poverty” (document GC 26/L4) – the establishment in IFAD of a performance-based allocation system (PBAS). The objective of the system is to ensure that countries receive ex ante allocations of IFAD resources in line with their demonstrated ability to use such resources effectively. The resource allocations should be generated by an appropriate combination of performance and needs assessments so as to ensure that IFAD's engagement in the poorest countries is properly reflected. The Governing Council delegated authority to the Executive Board to elaborate the details of the design and implementation of the PBAS. An informal panel, chaired by IFAD and including representatives from each List, assisted in this task. The structure and operation of the PBAS for IFAD were subsequently approved by the Executive Board at its Seventy-Ninth Session in September 2003 (document EB 2003/79/R.2/Rev.1).

2. During 2005, the PBAS became fully operational and was extended across the lending programme as a whole, regulating IFAD loan and country-grant allocations to Member States. The PBAS has introduced 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). At the same time the rural-sector performance assessments have provided the platform and introduction for policy dialogue at the programming and operational level, and have further emphasized the rural and agricultural role and focus of IFAD at the country level.

3. The Agreement Establishing IFAD and the Lending Policies and Criteria have established that at least 67% of IFAD's loan resources would be allocated to countries on highly concessional terms and conditions. In accordance with the Agreement Establishing IFAD, the resources of the Fund are used with "due regard to a fair geographic distribution" of such resources.¹ Allocations to the respective regions have been determined by the Executive Board, the last such exercise being endorsed by the Executive Board in September 1999 (EB 99/67/R.10) based on the work of the Ad Hoc Committee on Regional Allocations of the Executive Board. In terms of total resources allocated to countries borrowing on highly concessional terms, IFAD has, in 2004 and 2005, provided up to 82% of its resources² on highly concessional terms.

4. The Consultation on the Sixth Replenishment also noted that the proposed programme of work for 2006 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 with regard to the regional distribution of development assistance and to maintain at least a two-thirds share of its lending programme on highly concessional terms. At the same time, however, the Executive Board was also to consider whether the system and its resulting allocations effectively satisfied development goals with regard to regional priorities and whether the operation of the PBAS within the framework of regional allocations should be maintained.

5. In September 2005, the Executive Board considered a report on IFAD's review and recommendations regarding the methodological aspects of the PBAS, based on the experience gained in implementing the system in 2004-2005 and on the lessons learned by other international financial institutions (IFIs) in implementing their own PBASs. In this connection, a series of technical issues had arisen that had affected 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 and thus eliminating the system's responsiveness, in terms of allocations, to changes in performance indicators. Secondly, rural 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, a rolling – as opposed to a fixed – allocation period would facilitate changes in countries' performance scores, changes in the list of actual borrowers over time, and changes in the scheduling of loans and planned loan amounts.

6. The report also presented an initial review of applying the PBAS both within the system of regional allocations and across a system of world allocations. The following section further examines the technical aspects and impact of world allocations on the lending framework.

7. **World allocations.** In order to assess the effects of applying a PBAS approach utilizing world rather than regional allocations to the lending framework, a series of simulations based on 2005-2007 PBAS allocations have been prepared to reflect different scenarios for the system's key determinants. These simulations are presented in the attached tables, with each table showing the current regional allocations as approved by the Executive Board in September 1999.

8. The simulations are intended to show how a system of PBAS-determined world allocations meets IFAD's development goals, including the focus on sub-Saharan Africa, the effect on the broader geographical distribution of resources among the membership and the emphasis on highly concessional lending.

9. Table 1 gives the present (2005) lending level for each region, based on the long list of countries, and a number of allocation scenarios using rural population and various weights for population. Column 1 represents the current situation, with allocations as agreed by the Executive

¹ Agreement Establishing IFAD, Article 7, Section 1(d).

² Excluding lending for tsunami-related initiatives.

Board in 1999. As an immediate comparison, column 2 shows the allocation for each region if each country received 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 is reduced by 10 percentage points (USD 47.2 million) from the agreed 36.8% of total IFAD resources to 26.8%. This change is due to the fact that the high variance of population among IFAD countries, formerly confined within regions, would now influence the overall allocations, so Asia – with 75% of world rural population – naturally would receive a higher proportional world allocation. Additionally, as countries move from the regional allocation framework to the world allocation framework, more countries would require a minimum allocation due to the effect of the increasing variance in population figures. The influence of regions with high relative populations will also be evident in the reallocation process.

10. The need for reallocations, however minimal, arises in situations in which it is not possible to deliver commitments against ex ante country allocations within the allocation period owing, for example, to the 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 system. Without a regional framework to guide reallocations within regions, all such reallocations would be made in proportion to PBAS scores, correctly, but with the implication – at the level of world allocations – that unused funds would move from countries in one region to countries in other regions. The consequence could be lower-than-anticipated allocations to certain regions.

11. Given the influence of population variation on allocations, Table 1 also shows the effect of varying the weight of population in the formula which: as the weight of population is reduced, the formula brings the allocations somewhat closer to existing levels, particularly for Eastern and Southern Africa. The trend is evident as the population weight is reduced from the current level of 0.75 through a series of scenarios to 0.40. The number of countries requiring a maximum or minimum allocation is also reduced as population weight is reduced, i.e. more countries become responsive to the coefficients of the formula, including performance. Nevertheless, several issues remain, the allocations to Western and Central Africa and to Latin America and the Caribbean remain below current levels, even with changes in the weight of population.

12. As the weight of population is reduced in the PBAS formula so the effect of other aspects of the formula are increased in influence, including performance. Positive changes in performance in a given country can lead to increases in country allocations, the actual amount depending on the level of performance change and the relative changes of other country's performance scores – i.e. uniform increases or decreases in performance scores by all countries in a region (as with a change in any of the PBAS coefficients) do not lead to overall allocation changes; this requires a variation in the performance rating over and above 'competing' countries.

13. An increased programme of work as proposed by IFAD management addresses some of the concerns by increasing absolute resource levels available for allocation. But as Table 2 shows, the relative situation remains unaltered.

14. To address the variations in resource allocation to sub-Saharan Africa, Table 3 shows the effect of **retaining** the existing regional allocations for the two principal Africa regions and allocating the remaining resources to the other regions on a world allocation basis. While the allocation to Africa therefore remains protected, the influence of Asia's rural population dynamic is still strong, even when reducing the weight of the population factor. The result is that the remaining two regions (Latin

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.

America and the Caribbean, and Near East and North Africa), with rural populations relatively smaller than Asia's, receive lower allocations, depending on the population source and the weight used.

15. Apart from population levels, the other determinant of "needs" within the PBAS is the level of per capita income. Bearing in mind IFAD's specific focus on rural poverty, it is appropriate that this factor be emphasized by increasing its weight by 20%. In order to consider the implications of increasing this factor (i.e. increasing the influence of poverty), Table 4 reflects an increase in the weight of per capita income by 45%. This has the effect, as shown in column 3, of bringing Eastern and Southern Africa's allocation – without changing the population coefficient of the formula – to a level comparable to the current allocation under the regional scenario. Given the lower incomes per capita in much of sub-Saharan Africa, and all other aspects of the PBAS formula being constant, this is a predictable consequence.

16. The simulation also points out a further issue, evident in previous simulations, which is the reduced allocation that Western and Central Africa receives, even with the increased emphasis of per capita income. This is due to the lower-than-average performance scores registered by countries in the region which are not obviated by either changes in population weight or per capita income. In itself, it illustrates the influence that performance rightly has over the final allocations; but also, as a corollary, it indicates that once performance scoring moves outside the basic regional scenario, a cross-regional benchmarking process is required to support the scoring methodology. The experience from other IFIs implementing PBAS approaches is helpful in comparing country scores to facilitate consistency in scoring across regions and provide benchmark country performance scores in each region to help scorers assess the relative performance of countries.

17. The change in the emphasis of income per capita, while increasing the allocation of those regions where there is a predominance of countries with low per capita income, does not necessarily produce the same effect in regions with a mix of different income levels. This is particularly evident in the context of Latin America and the Caribbean, where allocations drop to 10-12% of total IFAD resources. In order to review the effect of variations in per capita income levels (and hence lending terms and conditions), Tables 5 and 6 show the effect of creating two separate pools of IFAD resources, one for highly concessionary borrowers and the other for intermediate and ordinary-term borrowers. The allocation to the respective pools is based on a 75%/25% ratio which is greater than the two-thirds/one-third minimum allocation, but which reflects, as noted above, the actual lending programme. The tables indicate that, while Latin America and the Caribbean is the dominant region within the intermediate and ordinary-term borrowers (Table 6), the overall allocations to Latin America (and indeed to each of the other regions) remain similar to the allocations when all lending terms are grouped together (Table 1).

18. **Conclusion.** The simulations and sensitivity analyses carried out and summarized above are intended to identify and, where necessary, address issues arising from the adoption of a world allocation framework within the PBAS as operationalized by IFAD. The conclusions of this technical assessment are:

- allocations to sub-Saharan Africa under world allocation procedures are lower than current regional allocations unless both population and per capita income variables in the formula are adjusted (although Western and Central Africa remains about 10% lower);
- population type and weight remain a key dynamic for effective operation of the PBAS;
- performance assessment at the level of world allocations requires adequate benchmarking to ensure cross-regional comparisons;
- the reallocation process, if and when required, should not lead to reduced allocations to priority regions; and

- dividing the resources available for commitment into separate allocation pools according to lending terms and conditions does not have major implications for allocations.

19. Further analysis will be carried out in order to address these issues, and the results will be presented to the Executive Board in September 2006 prior to implementation of the revised PBAS in 2007.

Table 1

Comparison of Approved Regional Allocations and Regional Shares Under World Allocation Scenarios														
Simulations for Different Population Types and Weights (USD million)														
	1		2		3		4		5		6		7	
Regional Division	Current Regional Allocation (as approved by the Board in 1999)		Total Population (0.75)		Rural Population (0.75)		Rural Population (0.60)		Rural Population (0.50)		Rural Population (0.45)		Rural Population (0.40)	
Western and Central Africa	87.30	18.4%	53.02	11.2%	58.10	12.2%	60.69	12.8%	62.98	13.3%	64.05	13.5%	65.45	13.8%
Eastern and Southern Africa	87.30	18.4%	74.34	15.6%	89.85	18.9%	90.91	19.1%	90.26	19.0%	89.84	18.9%	89.78	18.9%
Asia and the Pacific	147.30	31.0%	194.23	40.9%	209.72	44.2%	196.22	41.3%	186.94	39.4%	182.47	38.4%	176.94	37.3%
Latin America and the Caribbean	80.90	17.0%	87.33	18.4%	55.32	11.6%	60.92	12.8%	65.11	13.7%	67.24	14.2%	69.48	14.6%
Near East and North Africa	72.20	15.2%	66.08	13.9%	62.02	13.1%	66.26	13.9%	69.71	14.7%	71.41	15.0%	73.35	15.4%
World	475	100.0%	475	100.0%	475	100.0%	475	100.0%	475	100.0%	475	100.0%	475	100.0%
No. of excluded countries	54		58		67		48		46		41		36	

Table 2

Comparison of Approved Regional Allocations and Regional Shares Under World Allocation Scenarios with a 10% Increase in the Programme of Work														
Simulations for Different Population Types and Weights (USD million)														
	1		2		3		4		5		6		7	
Regional Division	Current Regional Allocation (as approved by the Board in 1999)		Total Population (0.75)		Rural Population (0.75)		Rural Population (0.60)		Rural Population (0.50)		Rural Population (0.45)		Rural Population (0.40)	
Western and Central Africa	87.30	18.4%	58.08	11.2%	64.59	12.4%	66.98	12.9%	69.44	13.4%	70.75	13.6%	72.10	13.9%
Eastern and Southern Africa	87.30	18.4%	82.33	15.8%	98.04	18.9%	100.48	19.3%	100.25	19.3%	99.91	19.2%	99.45	19.1%
Asia and the Pacific	147.30	31.0%	210.60	40.5%	227.82	43.8%	213.03	41.0%	202.40	38.9%	197.22	37.9%	192.07	36.9%
Latin America and the Caribbean	80.90	17.0%	96.15	18.5%	60.75	11.7%	66.41	12.8%	71.07	13.7%	73.37	14.1%	75.73	14.6%
Near East and North Africa	72.20	15.2%	72.84	14.0%	68.79	13.2%	73.10	14.1%	76.84	14.8%	78.75	15.1%	80.65	15.5%
World	475	100.0%	520	100.0%	520	100.0%	520	100.0%	520	100.0%	520	100.0%	520	100.0%
No. of excluded countries	54		57		66		49		42		37		35	

Table 3

A comparison of the approved regional allocations with regional shares developed with scenarios of world allocation (PA & PF Regional Allocation) - (PI + PL + PN World Allocation)																
Simulation of different sources and weights of population (USD millions)																
	1		2		3		4		5		6		7		8	
Regional Division	1999 E.B. Approved Regional Allocation		TOTAL POP (0.75)		RURAL POP (0.75)		TOTAL POP (0.60)		RURAL POP (0.60)		RURAL POP (0.50)		RURAL POP (0.45)		RURAL POP (0.40)	
Western and Central Africa	87.30	18.4%	87.30	18.4%	87.30	18.40%	87.30	18.4%	87.30	18.4%	87.30	18.4%	87.30	18.4%	87.30	18.4%
Eastern and Southern Africa	87.30	18.4%	87.30	18.4%	87.30	18.40%	87.30	18.4%	87.30	18.4%	87.30	18.4%	87.30	18.4%	87.30	18.4%
Asia and the Pacific	147.30	31.0%	170.00	35.8%	194.60	41.00%	163.61	34.4%	182.90	38.5%	175.40	36.9%	171.60	36.1%	166.30	35.0%
Latin America and the Caribbean	80.90	17.0%	74.50	15.7%	49.90	10.50%	75.81	16.0%	56.60	11.9%	60.60	12.8%	62.70	13.2%	65.50	13.8%
Near East and North Africa	72.20	15.2%	55.90	11.8%	55.90	11.80%	60.92	12.8%	60.80	12.8%	64.40	13.6%	66.00	13.9%	68.50	14.4%
WORLD	475	100.0%	475	100.0%	475	100%	475	100.0%	475	100.0%	475	100.0%	475	100.0%	475	100.0%
No. of excluded countries	54		58		46		58		48		43		40		35	

Table 4

World Allocations by Region, with Variations in GNI and Population Weight										
Simulations for Different Population Types and Weights (USD million)										
	1		2		3		4		5	
Regional Division	Current Regional Allocation (as approved by the Board in 1999)		GNI/-0.25 Total Population (0.75) World		GNI/-0.45 Total Population (0.75) World		GNI/-0.45 Rural Population (0.60) World		GNI/-0.45 Rural Population (0.40) World	
Western and Central Africa	87.30	18.4%	53.02	11.2%	60.30	12.7%	67.26	14.2%	73.41	15.5%
Eastern and Southern Africa	87.30	18.4%	74.34	15.6%	89.12	18.8%	105.39	22.2%	103.30	21.7%
Asia and the Pacific	147.30	31.0%	194.23	40.9%	195.40	41.1%	192.98	40.6%	175.79	37.0%
Latin America and the Caribbean	80.90	17.0%	87.33	18.4%	69.44	14.6%	49.38	10.4%	56.00	11.8%
Near East and North Africa	72.20	15.2%	66.08	13.9%	60.74	12.8%	59.99	12.6%	66.50	14.0%
World	475	100.0%	475	100.0%	475	100.0%	475	100.0%	475	100%

Table 5

Comparison of Approved Regional Allocations and Regional Shares Under World Allocation Scenarios: Highly Concessional Borrowers (75% Total Funds)										
Simulations for Different Population Types and Weights (USD million)										
	1		2		3		4		5	
Regional Division	Current Regional Allocation (as approved by the Board in 1999)		Total Population (0.75)		Rural Population (0.75)		Rural Population (0.60)		Rural Population (0.40)	
Western and Central Africa	87.33	18.4%	57.22	16.1%	55.56	15.6%	59.33	16.7%	65.35	18.3%
Eastern and Southern Africa	87.33	18.4%	72.47	20.3%	80.39	22.6%	81.77	23.0%	81.21	22.8%
Asia and the Pacific	147.30	31.0%	186.60	52.4%	186.39	52.3%	174.27	48.9%	159.30	44.7%
Latin America and the Caribbean	80.89	17.0%	11.36	3.2%	7.66	2.1%	10.45	2.9%	14.18	4.0%
Near East and North Africa	72.15	15.2%	28.60	8.0%	26.26	7.4%	30.42	8.5%	36.21	10.2%
World	475	100.0%	356.25	100.0%	356.25	100.0%	356.25	100.0%	356.25	100.0%

Table 6

INTERMEDIATE AND ORDINARY BORROWERS (25% TOTAL FUNDS) - A comparison of approved regional allocations with regional shares developed with scenarios of world allocation										
Simulations for Different Population Types and Weights (USD million)										
	1		2		3		4		5	
Regional Division	Current Regional Allocation (as approved by the Board in 1999)		Total Population (0.75)		Rural Population (0.75)		Rural Population (0.60)		Rural Population (0.40)	
Western and Central Africa	87.33	18.4%	1.00	0.8%	1.00	0.8%	1.00	0.8%	1.00	0.8%
Eastern and Southern Africa	87.33	18.4%	8.14	6.9%	8.51	7.2%	8.70	7.3%	9.40	7.9%
Asia and the Pacific	147.30	31.0%	16.84	14.2%	23.45	19.7%	21.54	18.1%	18.73	15.8%
Latin America and the Caribbean	80.89	17.0%	61.20	51.5%	49.32	41.5%	51.21	43.1%	53.51	45.1%
Near East and North Africa	72.15	15.2%	31.57	26.6%	36.47	30.7%	36.30	30.6%	36.12	30.4%
World	475	100.0%	118.75	100.0%	118.75	100.0%	118.75	100.0%	118.75	100.0%