

Document: PBAS 2017/7/INF.1
Date: 4 July 2017
Distribution: Public
Original: English

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Investing in rural people

IFAD's performance-based allocation system: Frequently asked questions

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Working Group on the Performance-Based Allocation System —
Seventh Meeting

Rome, 11 July 2017

For: Information

IFAD's performance-based allocation system: Frequently asked questions

Introduction

The Executive Board has played a key role in the introduction of the performance-based allocation system (PBAS) at IFAD and is actively engaged through the PBAS Working Group in the review of the system currently under way. The Board created the Working Group in April 2006 to gain a broader understanding of evolving issues in the PBAS. In February 2009, the Governing Council approved terms of reference for the PBAS Working Group, tasking it to review the practices of other international financial institutions (IFIs) and identify improvements to the system. The PBAS Working Group was mandated to review and assess such improvements, including modifications to elements of the formula, which would subsequently be presented to the Executive Board and the Governing Council for their consideration and approval (EB 2009/97/R.48/Rev.1.) The PBAS Working Group has led Management's work on the review of the formula, which stems from the 2016 corporate-level evaluation on the performance-based allocation system (EB 2016/117/R.5).

Since the start of this process, four meetings of the PBAS Working Group have taken place. Management has also presented the findings of the analysis conducted under the Working Group's guidance at the Executive Board sessions in April 2017 (EB 2017/120/R.2) and December 2016 (EB 2016/119/R.5), and at the Evaluation Committee session in March 2017 (EC 2017/96/W.P.5). In addition, Management has organized two Executive Board informal seminars (November 2015 and April 2017). Management has also engaged in dialogue on the PBAS with the Executive Board at Convenors and Friends meetings, and has held bilateral meetings with Executive Board representatives who showed interest or had concerns.

The purpose of these frequently asked questions and answers is to enhance the understanding of the PBAS formula, and facilitate the decision-making process for approval of an enhanced formula.

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PBAS frequently asked questions

Overview, country selection, country allocations

1. What is the PBAS?

The PBAS is IFAD's system for allocating resources to its recipient Member States. The PBAS determines the volume of financing that IFAD provides to each recipient country during a given replenishment cycle.

The PBAS consists of a mathematical formula made up of two components: a country needs component and a country performance component. The variables included within the formula reflect the best practices of other international financial institutions (IFIs) that use performance-based systems for allocating resources, and also the specificity of IFAD's mandate.

Several other development finance institutions use performance-based allocation systems: 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 (IDA) of the World Bank. All systems assess both performance and needs.

2. Why do we need a PBAS?

The PBAS is a transparent and predictable way of allocating IFAD's resources to its Member States¹ in that it is formula-based and uses standardized sources of information compared to alternative systems. This reduces the level of subjectivity.

3. Which resources are allocated through the PBAS?

IFAD allocates all financing for investment projects (or 95 per cent of its programme of loans and grants [PoLG])² through the PBAS. This includes (i) core resources (Members' contributions through replenishment cycles); (ii) loan reflows; (iii) income from the investment portfolio; and (iv) borrowed resources. According to the 2016 Corporate-level evaluation (CLE) on IFAD's PBAS, the efficiency of IFAD's resource allocation processes has been strengthened by the decision in 2015 to allocate all borrowed funds through the PBAS. This increased the organization's efficiency in managing its programme resources, rather than having parallel processes and systems for allocating borrowed funds.

4. What has the PBAS achieved so far?

The CLE on the PBAS found that the system has succeeded in enhancing the Fund's credibility as an IFI by providing a more transparent, flexible and predictable approach to resource allocation. It also aligned IFAD's resource allocation system with those found in similar organizations.

The CLE found that IFAD's PBAS is a relatively efficient system, especially compared with the resource allocation system previously in place. The system has allowed IFAD to consistently provide approximately 45 per cent of core resources to sub-Saharan Africa (SSA) and close to 50 per cent to Africa.

Furthermore, the PBAS simplified the allocation process through a clear formula for determining country allocations and made allocations more predictable. That predictability allows for better forward planning of investment operations and country grants, and prioritization of the use of IFAD resources. The PBAS has strengthened partnership and dialogue with country authorities. It has also enhanced the leveraging capacity of IFAD resources, given that recipient countries

¹ The Report of the Consultation on the Sixth Replenishment of IFAD's Resources (2004-2006) states: "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."

² The remaining five per cent is assigned to regional and global grants, which are allocated as per the IFAD Policy for Grant Financing.

are able to earmark their own resources earlier as counterpart funding towards IFAD operations.

5. Why do we need changes?

The CLE identified some areas for improvement. To address these, Management is changing the formula by: (i) increasing its rural poverty focus; (ii) aligning it with IFAD's current priorities, as per the Strategic Framework 2016-2025; (iii) rebalancing the country needs and performance components; (iv) addressing data gaps; (v) taking a more corporate approach to resource allocation.

6. What are the proposed changes?

Change	Rationale	Frequency of update
Inclusion of an IFAD Vulnerability Index in the needs component	Complement the needs component of the formula by introducing measures of non-income poverty (vulnerability, climate, food security and nutrition in rural areas).	Every year
Increased absolute value of the gross national income per capita (GNlpc) variable's exponent	Increase the influence of income on the country score: the poorer the country, the higher score.	Every year
Decreased exponent of rural population variable	Reduce the influence of rural population on allocations, as well as allocations variability across countries	Every year
Removal of the Country Policy and Institutional Assessment (CPIA) variable from the performance component	Solve data gap issues within the formula, since the CPIA is disclosed for a subset of IFAD Member States only	N/A
Addition of a disbursement measure to the portfolio-at-risk (PAR) variable, which is now called the portfolio performance and disbursement (PAD) variable	Include a measure that underlines the ability to disburse resources promptly and efficiently to finance project implementation	Every year
Enhancement of rural sector performance (RSP) variable	<ul style="list-style-type: none"> Enhance the objectivity of the questionnaire Revise questions to better reflect current IFAD priorities Incorporate the macro-level questions relevant to the rural sector previously incorporated into the formula through the CPIA Strengthening the RSP quality assurance process 	Every three years
Rebalance the needs and performance components	The CLE found that the current formula balance is 65 per cent to needs and 35 per cent to performance, and therefore is skewed towards needs. Management is adjusting the formula to assign around 55% to the needs component, and 45% to the performance component.	N/A

7. What is the IFAD Vulnerability Index (IVI)?

The IVI was created to capture the multidimensionality of rural poverty in the country needs component of the PBAS formula. In broad terms, the IVI provides an indication of well-being in rural areas, factoring in the effects of climate change. It is an index of 12 equally weighted indicators that measure rural vulnerability in terms of exposure, sensitivity and lack of adaptive capacity to endogenous and exogenous causes and/or events. Each of these can be associated with one or more of the IVI focus areas (food security, nutrition, inequality and climate vulnerability). The index is computed by IFAD, based on internationally recognized data sources. The indicators within the IVI were selected to reflect IFAD's specific focus on poor rural people. The IVI will be produced every year, to feed into the yearly allocation calculations.

Table 1
Structure and indicators selected for the IFAD Vulnerability Index

<i>Vulnerability element</i>		
<i>Exposure</i>	<i>Sensitivity</i>	<i>(Lack of) adaptive capacity</i>
1. Index of variability of per capita food production <i>Source: FAO, Food security indicators</i>	2. Food price volatility <i>Source: FAO, Food security indicators</i>	3. High child malnutrition measured as wasting (weight to height ratio in children under 5) <i>Source: World Health Organization and FAO, Food security indicators</i>
4. Value of food imports over total merchandise exports (%) <i>Source: World Bank, World Development Indicators</i>	5. Share of food expenditure by poor <i>Source: FAO, Food Security Indicators</i>	6. Low fertilizer use per ha agricultural land <i>Source: World Bank, World Development Indicators</i>
7. Natural hazard and exposure dimension of the Index for Risk Management (INFORM) <i>Source: Inter-Agency Standing Committee (IASC) for Preparedness and Resilience, and European Commission</i>	8. Prevalence of undernourishment <i>Source: FAO, Food security indicators</i>	9. Low growth in the per capita Food Production Index <i>Source: World Bank, World Development Indicators</i>
10. Water – percentage of available internal water withdrawn for agriculture <i>Source: World Bank, World Development Indicators and FAO AQUASTAT</i>	11. Rural/urban divide in access to improved water, sanitation and electricity <i>Source: World Bank, World Development Indicators</i>	12. Infrastructure – little access to all-weather roads in rural areas <i>Source: FAO</i>

8. What is the portfolio performance and disbursement (PAD) variable?

The PAD measures the overall performance of the portfolio by combining two complementary measures: a positive one – disbursements – is used as a proxy for the agility and pace of portfolio implementation; and a negative one – problem projects – measures the percentage of the ongoing portfolio where implementation is unsatisfactory.

9. What does the transition from PAR to PAD change?

The PAD was introduced as a variation of the PAR following the recommendation by the CLE to better capture portfolio performance at country level. As a result, a disbursement ratio was introduced as a further measure in the PAD to give an indication of the entire country programme performance. Another change from the PAR measure is that the PAD excludes potential problem projects (PPPs), so as not to penalize the early identification of potential challenges and to incentivize the mobilization of additional operational support before projects become an actual risk.

10. Rural Sector Performance Assessment (RSPA)

The Rural Sector Performance Assessment is designed to measure the performance of country policy frameworks, specifically, the responsiveness of a country's policies to the needs of poor rural people. This is currently done through a questionnaire containing 19 questions organized around six thematic clusters.

11. Variables in the formula under review and what they measure

Variable	Rural population	GNIpc	RSP	PAR
Description	The rural population of a country	Per capita gross national income (with a negative/minus sign)	Rural Sector Performance score	Portfolio-at-risk rating
What it measures	How many people, out of a country's total population, live in rural areas	Annual per capita income, expressed in United States dollars	The responsiveness of country policies to rural poor needs, measured through a score ranging from 1 to 6	IFAD's country portfolio-level performance, through a score ranging from 1 to 6
Source	World Bank, World Development Indicators	World Bank, World Development Indicators	IFAD	IFAD

12. What is the balance between needs and performance in the formula?

Following the CLE recommendations, the two components of the PBAS formula will be rebalanced in favour of the performance component (which currently has a 35 per cent weight), leading to an approximate distribution of 45 per cent to performance versus 55 per cent to needs.

13. How does the new formula influence country allocations?

The proposed formula slightly increases the overall allocations to low-income countries (LICs) and lower-middle-income countries (LMICs) when compared to the current formula, in line with the strategic direction of IFAD's business model for the Eleventh Replenishment of IFAD's Resources (IFAD11). Within the income groupings, individual country allocations change, with some countries receiving more resources and others less.

To test the robustness of the formula, Management performed a series of sensitivity analyses by shocking selected variables of the formula. The sensitivity analysis demonstrated that when changes to the individual formula variables are applied, the formula remains stable and is therefore robust. In practical terms, this means that regardless of variations to the inputs (for example changes to some or all of the values of the variables), or the presence of outliers (a sharp increase or decrease in the value of an individual variable), the results of the formula remain within a reduced range. This is demonstrated by the fact that the distribution of allocations across income groupings remains relatively constant. A key factor determining this result is the heterogeneity of IFAD Member States. The values of all individual variables for these countries vary significantly. This heterogeneity has a stabilizing effect on allocations distribution across income groups. The sensitivity analysis also showed that while allocations across income groups are stable, the allocations to individual countries change in the different scenarios. Therefore, the macro level (income groups) remains stable, while the micro level (the allocations to individual countries in each income group) varies. This is because countries' allocations are the result of: (i) the value of the individual variables of the formula for each country; and (ii) how the value of the formula variables for each country relates to the value of the variables of each other country included in the PBAS calculations.

14. How does the new balance between needs and performance impact IFAD's mandate to invest in poor rural people?

The increased weight of the performance component within the PBAS formula will be somewhat compensated by the increase of the GNIpc exponent and the inclusion of the IVI, for the benefit of those countries with the most vulnerable and fragile situations. There is no correlation between income level and performance.

This can be observed for each income grouping. All good performers, across all income categories, benefit from an increase in the weight of the PBAS country performance component. Similarly, countries that perform less well see their resources decrease across all income levels.

15. Will countries that perform poorly because of their weak capacity receive lower allocations?

The new proposed formula increases the allocation to LICs and LMICs with respect to the current one. Countries compete for allocations mainly within their own income group (micro variability), and only to a minor extent across income groups (macro stability).

16. How are countries currently selected for inclusion in a PBAS cycle? What are the criteria?

Recipient countries are currently selected on a demand basis. All countries willing to borrow from IFAD are then included in the allocation list.

17. What is changing in country selection?

In order to spread delivery of the PoLG more evenly along the PBAS cycle, and following the CLE recommendations, the IFAD11 business model proposes that countries be selected on the basis of:

- Their readiness to use IFAD lending within an approved country strategy (strategic focus);
- Their performance in using the resources allocated in previous cycles (absorptive capacity); and
- The willingness of their governments to engage with IFAD (ownership)

These criteria will be applied with a degree of flexibility to ensure that all LICs remain eligible.

18. What are the criteria for making reallocations and when do they happen in a given PBAS cycle?

In alignment with other IFIs, under the current system reallocations were originally made in the third year, that is the last year of the cycle. Following the CLE recommendations, Management has introduced earlier reallocations. These take place in the second year of the cycle. In practical terms, the resources allocated to countries that have exited the cycle, and allocations that are highly unlikely to materialize into investment projects, are redistributed among countries identified as being able to absorb additional resources to expand an ongoing project, to broaden the scope of a project under design, or to fill an existing financing gap. This redistribution is conducted in line with the PBAS criteria, based on countries' country scores. The overall aim is to ensure that all IFAD resources are delivered by the end of each financing cycle.

19. Will IFAD allocate funds obtained through the Sovereign Borrowing Framework and other sources through the PBAS?

Yes. IFAD will continue to allocate all resources through the PBAS over the IFAD11 period.

The feature of macro stability provides an assurance that the policy statements made in the IFAD11 business model paper (IFAD11/2/R/3) with regard to allocations to LICs and LMICs on the one hand, and upper-middle-income countries (UMICs) on the other, will be honoured. In practice, it is equivalent to running the PBAS formula twice, on two separate groups of countries (divided either by lending terms or by income group). However, if Management were to adopt such a practice, the process of refining the PBAS formula would have to be reinitiated, including the search for meaningful variables. The main reason for this is the fact that, as explained above, the formula is stable because of the heterogeneity of the

countries involved. Running the PBAS twice would separate countries into two, more homogeneous, groups, each needing a revised formula.

As IFAD prepares itself to access market borrowing, possibly in IFAD12, the PBAS will need to be revisited. Allocating resources that have been obtained through capital markets requires careful consideration of risk and debt management, and the matching of allocations with specific lending terms: considerations that are not guaranteed in the current PBAS system. As has been the experience at other IFIs, it is likely that IFAD's PBAS will eventually be limited to the allocation of concessional resources, and separate allocation procedures will need to be established for ordinary lending. One important lesson from other multilateral development banks is that given the centrality of PBAS for advancing their institutions' goals and priorities, continuous adjustments should be considered in successive replenishment cycles.

20. What happens to countries that are dropped or do not enter a given cycle?

They continue to implement ongoing projects and are supported in designing projects for the next cycle.

21. How are countries that transition from one level to another (e.g. evolving from low-income to lower-middle-income country) treated under the PBAS?

There is currently no transition procedure under the PBAS exercise.

The IFAD11 business model proposes the development of a clear transition framework, to be presented for the approval of the Governing Council in 2018. The proposed framework will move away from yearly adjustments to fixed lending terms per cycle and introduce phasing-out/phasing-in periods on the basis of objective criteria that take into account a country's need for concessional funds.

Technical aspects of the PBAS

22. What does the current PBAS formula look like?

$$\underbrace{(Rural\ Population^{0.45} \times GNI_{pc}^{-0.25})}_{\text{Country needs component}} \times \underbrace{(0.20CPIA + 0.45RSP + 0.35PAR)^2}_{\text{Country performance component}}$$

23. How does the calculation work?

The PBAS formula is a multiplication of the formula variables, and produces a number. This number is called the country score. For example:

Rural population ^{0.45}	GNI per capita ^{-0.25}	CPIA	PAR	Rural sector performance	Country score
4 136 120 ^{+0.45}	X 1 130 ^{-0.25}	X [(0.2 x 3.36) + (0.35 x 1.9) + (0.45 x 3.59)] ^{+2.0}			= 1 427

Once all country scores have been calculated, they are added up to produce a total. Using this total country score as reference, the share of each country's individual score is calculated. This share is then applied to the three-year PoLG amount, so that each country gets an allocation that equals its country score share out of the total country score. To simplify:

Percentage share of country score out of total country scores = percentage share of allocation for a given country out of the total PoLG

The actual calculation works as follows:

$$\frac{3\ \text{years}\ \text{PoLG}}{\text{sum of all country scores}} \times \text{single country score} = \text{country allocation}$$

24. How is the revised formula different from the old formula?

Old formula:

$$\underbrace{(Rural\ Population^{0.45} \times GNI_{pc}^{-0.25})}_{\text{Country needs component}} \times \underbrace{(0.20CPIA + 0.45RSP + 0.35PAR)^2}_{\text{Country performance component}}$$

Revised formula recommended for approval by the Board in September 2017:

$$[RurPop^{0.4} \times GNI_{pc}^{-0.3} \times IVI^{1.5}] \times (0.25RSP + 0.75PAD)^1$$

25. How often is the PBAS formula run?

The PBAS is a three-year process, aligned with IFAD's replenishment cycle. This facilitates better pipeline planning and allows the Fund to develop its programme of loans and grants based on a clearer idea of its total resource availability. The three-year allocations are updated annually to take into account updates to the

formula variables, and hence year-on-year changes in countries' needs and performance.

26. Is there a regional allocation?

The allocation system prior to the PBAS was based on regional allocations. With the PBAS, IFAD introduced allocations by country. Allocations through the PBAS are made at country level, since they are based on the country score calculated through the PBAS formula. The PBAS is applied to 95 per cent of IFAD's financing during each replenishment cycle.

A portion equivalent to 5 per cent of IFAD's financing is allocated to global/regional grants, outside the PBAS, on a competitive basis and in line with the IFAD Policy on Grant Financing.

27. How do the 45 per cent allocation to sub-Saharan Africa and 50 per cent allocation to Africa come about? Are these percentage allocations predetermined or are they determined through the PBAS? If so, how?

The share of allocations to sub-Saharan Africa and Africa are determined through the PBAS, they are not pre-determined. This has been the case since the PBAS was first implemented at IFAD. When the PBAS was introduced, an effort was made when developing the formula to maintain the historical share of allocations that was provided to Africa.³ Therefore, the coefficients and exponents associated with the variables were developed in such a way as to ensure that, given the PoLG size and the countries borrowing on highly concessional terms at the time, about 50 per cent of all highly concessional lending was allocated to Africa.

Similarly, during the current review of the PBAS, when assessing options for adjusting the formula, Management ran scenarios to test the share of core resources that the formula would allocate to Africa, in order to ensure that the proposed formula is in line with the commitment made. The formulas that Management presented to the Board in April 2017, including the one recommended for approval, all allocate 50 per cent of core resources to Africa.

28. How is the needs aspect reflected in the PBAS formula?

The needs aspect is reflected through the country needs component of the formula, which incorporates three variables: GNIPc, rural population and the IVI. The GNIPc variable provides an average indication of country's poverty levels. The rural population variable provides a measure of the magnitude of the potential IFAD target group within the country. Rural population affects allocations positively, while the level of GNIPc is negatively related to the allocation. In other words, the higher the rural population, the higher the allocation; and the higher the GNIPc, the lower the allocation.

The IVI, developed during the PBAS review, complements these two elements by incorporating into the formula other elements of the multidimensional nature of poverty, such as food security, nutrition, climate vulnerability and inequality. The IVI influences the allocations positively; therefore the most vulnerable countries receive higher allocations.

29. How is the performance component in the formula determined?

The country performance component of the PBAS formula currently comprises three variables: the World Bank's Country Policy and Institutional Assessment (CPIA) score, the rural sector performance (RSP) score, and the portfolio-at-risk (PAR) rating. The CPIA provides an overview of a country's broader policy and institutional performance at the national level, as assessed by the World Bank. The RSP score is a measure developed by IFAD to assess country performance in establishing a policy and institutional framework conducive to sustained rural poverty reduction, thus capturing IFAD's focus and mandate in the allocation

³ During the IFAD5 period.

process. As in the case of the IDA Resource Allocation Index (IRAI), whose scores are the remit of IDA staff, countries' RSP scores are assigned by IFAD staff. The PAR is a measure of the performance of IFAD's portfolio in a given country, based on scoring by IFAD staff.

In the proposed formula, and in line with the recommendations of the CLE, the CPIA score is no longer part of the performance component. In addition, the PAR has been modified to include a measure that underlines the ability to disburse resources promptly and efficiently to finance project implementation, as a predictor of project success: the PAD.

30. How does the IFAD Vulnerability Index address cross-cutting issues such as climate change, gender and nutrition?

The IVI includes twelve indicators related to climate vulnerability, food security, nutrition and inequality (see table 1).

31. How are special status countries like small island developing states (SIDS) and most fragile situations (MFS) addressed?

Unlike other IFIs, IFAD does not have special windows to address the needs of SIDS and countries with fragile situations, but these dimensions are taken into account in the proposed new PBAS formula. SIDS, most of which receive minimum allocations under the current PBAS formula, will benefit from an increased amount of allocations through the higher minimum allocation threshold. Indeed, minimum allocations have been increased from US\$3.0 million per cycle to US\$4.5 million.

As regards countries with most fragile situations, because there is a partial overlap between these countries and the most vulnerable countries identified by the IVI, the inclusion of the IVI within the formula leads to an overall increase in allocations to MFS.

32. What are the findings of the sensitivity analysis, and what do they imply?

The analysis of the sensitivity of the PBAS formula aims to assess the impact of the changes made to the formula on country allocations. In other words, it answers the question "what if?". The sensitivity analysis conducted on the proposed PBAS formula shows that there are no significant allocation variations at country group level (LICs, LMICs, MFS, sub-Saharan Africa) when shocks are applied to individual variables. This means that the formula is stable. However, variations in country-level allocations, when compared to the allocations calculated with the current formula, do arise. Appendix II in the paper "PBAS formula and procedures" presented in April 2017 (EB 2017/120/R.2) shows the allocations resulting from the use of the four proposed formulas, by country.