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Investing in rural people

Minutes of the seventh meeting of the Working Group on the Performance-Based Allocation System

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

Rome, 11 July 2017

Minutes of the seventh meeting of the Working Group on the Performance-Based Allocation System

1. These minutes reflect the discussions at the seventh meeting of the Working Group on the Performance-Based Allocation System (PBAS) held on 11 July 2017.

Agenda item 1: Opening of the meeting

2. Participants included Working Group members from Angola, China, the Dominican Republic, France, Ireland (via videoconference), Japan, Nigeria (Chair), Sweden (via video conference) and Bolivarian Republic of Venezuela, along with observers from Algeria, Argentina, Canada, Egypt, Ghana, Italy, Switzerland, the United Kingdom, and the United States (via videoconference). The meeting was attended by the Associate Vice-President, Programme Management Department (PMD); the Director and Treasurer, Treasury Services Division; the Chief, Operational Programming and Effectiveness Unit, PMD; the Secretary of IFAD, a.i.; the Director, Independent Office of Evaluation of IFAD (IOE); the Deputy Director, IOE, and other IFAD staff.

Agenda item 2: Adoption of the agenda

3. The provisional agenda, document PBAS 2017/7/W.P.1, contained four items: (i) opening of the meeting; (ii) adoption of the agenda; (iii) PBAS formula enhancements; and (iv) other business.

4. Members adopted the provisional agenda with no amendments. The final agenda will be posted as document PBAS 2017/7/W.P.1/Rev.1.

Agenda item 3: PBAS formula enhancements

5. The Chairperson thanked the Working Group for its work over the past six meetings in discussing the revised PBAS. He thanked Management for the efforts made to address members' concerns during the review process. He also commended Management for preparing frequently asked questions and responses on the PBAS, which were now available to members.

6. The Chairperson reminded members that the purpose of the seventh meeting was to reach consensus on the formula to be presented by Management for approval to the Executive Board at its September session. This would allow Management to take the necessary action to produce the allocations for IFAD11 in 2018. He underlined that a transparent allocation system was essential for the implementation of the financial strategy for IFAD11 discussed at the second session of the Consultation on the Eleventh Replenishment of IFAD's Resources (IFAD11) in June. Moreover, the Chairperson noted that Management had made a clear commitment to review the PBAS should IFAD move forward with market borrowing as a complementary source of resources for IFAD12.

7. Management shared a presentation showing four scenarios out of the 20 tested. All four scenarios were characterized by a stronger focus on country performance than was currently the case under IFAD10. Of the four, scenario 3-D was proposed for approval. Management explained the merits of this proposal, noting that it took into account the comments received at the sixth meeting of the Working Group in March and the Board session in April, and that it was in line with the business model and the financial strategy presented at the second session of the IFAD11 Consultation.

8. Notably, the proposed scenario captured the following aspects:

   (a) Compared to the other three, it reduced the number of countries with minimum allocations, maintaining it at the same level as in IFAD10, that is about 10 per cent of the total;

(b) It provided more balanced elasticity of variables: changes to each variable in the formula would have a sizeable impact on allocations;

(c) It was in line with the proposal made for IFAD11 to increase the focus on the poorest countries: low-income countries (LICs) would get a higher share of allocations (41 per cent), equivalent to a 9 per cent increase, and when combined with lower-middle-income countries (LMICs), would account for 85 per cent of total allocations (an additional 4 per cent with respect to IFAD10). Countries with the most fragile situations would also have an increase of 9 per cent compared to IFAD10, and would therefore obtain a 31 per cent share of allocations.

9. Management informed members that these percentages applied to country income groupings. At the individual country level, changes occurred within each of these groups. These changes were determined by the different elasticities of the variables and by two concepts: macrostability and microsensitivity. These concepts meant that when changes occurred, the formula guaranteed that the percentages at the grouping level were maintained, while at the individual country level, positive or negative changes were likely. Management underlined the importance of these changes at the individual country level, noting that they supported the inherent purpose of the PBAS.

10. Management then shared details of a reality check exercise undertaken to assess whether resources were going to the poorest countries in other ways than those defined by Management and the Working Group within the country needs component of the formula. The analysis showed that the proposed scenario 3-D succeeded in allocating a higher share of resources than was currently the case to countries with the lowest Human Development Index value, lowest share of gross domestic product derived from agricultural activities, highest infant mortality rate and lowest primary school enrolment. In a nutshell, scenario 3-D led to an increase in the resources allocated to the countries with the greatest need.

11. Management undertook a second reality check exercise in order to ensure that the proposed scenario was in line with the four cross-cutting priorities identified for IFAD11: gender, youth, nutrition and climate. Using selected indicators for each of these priorities, the analysis showed that allocations to the countries with the greatest need in these four areas increased by 4 to 9 per cent.

12. While more resources would be allocated to the neediest countries under scenario 3-D, Management recalled that the PBAS was a performance-based system and therefore aimed to reward the best performers. Management demonstrated that the share of allocations going to countries that were not only the neediest but also the best performers increased with scenario 3-D when compared to IFAD10. Scenario 3-D allocated 45 per cent of resources to the countries falling within the area where greatest need and highest performance overlapped, as opposed to 31 per cent to such countries in IFAD10. This outcome was consistent with the fact that the proposed scenario foresaw an enhanced balance between the weights of the components in favour of the performance side: from 65 per cent to needs and 35 per cent to performance within the current formula, to 55 per cent and 45 per cent under scenario 3-D respectively.

13. Management explained the work done on the elasticity of individual variables within the formula. Within the needs component, the importance of the rural population variable had been slightly reduced, the importance of the gross national income per capita had been increased, and the new variable – the IFAD Vulnerability Index (IVI) – had been given the highest elasticity. Within the performance component, the elasticity of the rural sector performance (RSP) variable had been reduced, while that of the portfolio performance and disbursement (PAD) variable had been increased. The rationale for this was that the PAD was the variable over which countries had more control: if IFAD resources were used well, and good

implementation and disbursement performance was evident, the PAD increased, contributing to higher allocations.

14. Regarding the impact on the formula of the IFAD11 Consultation, Management recalled that:

    (a) The PBAS formula was stable at the macro level, implying that the selectivity criteria proposed under the Consultation would not affect the shares allocated to country groupings;

    (b) The commitment to allocate 90 per cent of official development assistance (ODA) resources to LICs and LMICs and the remaining 10 per cent to upper-middle-income countries (UMICs) was related to the source of the funds and would not impact the formula;

    (c) The proposed scenarios related to the size of the programme of loans and grants would not affect the overall distribution of allocations, as shown by the results of the sensitivity analysis.

15. Management then addressed a key question: what would happen in the event that IFAD accessed market borrowing in IFAD12? Management reminded the Working Group that IFAD was the only international financial institution that used the PBAS to allocate both concessional and non-concessional resources. It did so through a formula that focused on country needs and performance, with no link to the actual demand that countries might have. Should IFAD move forward with market borrowing, demand considerations would need to become explicit and better accounted for. Management clarified that two key parameters needed to be taken into account when allocating non-concessional resources: single borrower concentration and the borrower's credit rating. These parameters ensured that resources were provided in a financially sustainable manner. This could not be assured with the PBAS formula, hence the need for a separate resource allocation system for borrowed resources.

16. In practical terms, should IFAD borrow from the market, Member States borrowing on ordinary terms would no longer be part of the PBAS exercise. As the countries included in the PBAS would be fewer and would be limited to the lowest income levels, some checks might be needed on the PBAS formula to ensure that it allocated ODA resources in a way that was acceptable to Members.

17. Management also presented the roadmap for IFAD11 and IFAD12, which was interrelated with the one proposed for the financial strategy. As per the allocation process, the timeline was quite strict. Several actions needed to be taken in order to operationalize the proposed formula: (i) operationalization of the rural sector performance assessment (RSPA), including testing; (ii) development of an ICT system for the PBAS, which would enable the automatization of the allocations process and automatize the calculation of certain variables; and (iii) possible application of the country selectivity criteria. Management explained that it was important that countries know their allocations within a time frame that allowed for the design and presentation of operations for approval at the first Board session of the IFAD11 period, in April 2019. Since the average design time was 18 months, Management acknowledged that this would be challenging.

18. IOE shared its comments and informed members that the proposed 3-D scenario responded to the recommendations of the corporate-level evaluation (CLE) on the PBAS. In particular, it welcomed:

    (a) The removal of the Country Policy and Institutional Assessment (CPIA) variable from the formula, since this score was not available for 30 to 38 per cent of active countries;

    (b) The inclusion of the IVI in the formula to better reflect the multidimensionality of poverty;

(c) The reduction in the variability of allocations over time;

(d) The transition from the portfolio-at-risk (PAR) variable to the PAD variable through the inclusion of a disbursement measure, and the way in which this was calculated as it reduced the bias linked to the age and size of portfolio;

(e) The gains in efficiency achieved by undertaking the RSPA once per cycle;

(f) Overall, the more corporate approach taken during the whole review process.

19. However, IOE highlighted that the balance between the needs and the performance components resulting from the logarithmic decomposition of the formula was different from that shown by Management (which used a different calculation method, i.e. logarithmic regression). The results of the analysis carried out by IOE showed that allocations were determined by the needs component to an extent of 77.7 per cent.

20. Members and observers thanked Management for their tireless efforts to refine scenario 3 and propose the four variations to this scenario (scenarios 3-A through 3-D), and for the clear presentation. They all acknowledged the progress made in focusing on the multidimensional nature of poverty and in allocating more resources to countries with the most fragile situations.

21. Working Group members did not reach consensus on scenario 3-D. List A members and some observers supported it and were pleased to see their feedback reflected in the scenario. They welcomed the sharpened focus on the poorest countries and most fragile situations. Many members underlined the need to continue the discussion on the allocation system in tandem with IFAD's evolution in the coming years, notably in the event of market borrowing.

22. Working Group members falling within the UMIC category opposed the proposal, stating that fewer resources would be allocated to them. A member noted that UMICs were able to ensure higher cofinancing rates and better loan repayments and that they were also potential donors. Moreover, many UMICs still had vast pockets of poverty and thus should not receive less support from IFAD. The observers in this category also opposed the proposal. One observer noted that although scenario 3-D meant a sizeable reduction in allocations to UMICs, countries with specific concerns should work with Management on refining the scenario supported by the majority.

23. Other List C members and observers supported scenario 3-D, noting that it was the scenario best suited to allocating resources to countries that had the greatest need and at the same time to countries that performed well. Members acknowledged Management's difficulties in accommodating the differing views of members and the challenge this posed to the process.

24. Management responded to questions on the reduction of allocations to UMICs as a result of scenario 3-D by recalling the first conversation with the Working Group at the beginning of the review process, when it was explained that any change to the PBAS formula would imply that some countries would receive more resources and others less. Management had anticipated these variations would be within a 5 per cent range. With the proposed scenario, UMICs would experience a 4 to 5 per cent reduction in their share of allocations when compared to IFAD10, thus remaining within this range.

25. Management explained that one reason why UMICs received a lower level of allocations under the revised formula was the introduction of the PAD as a variation of the PAR variable in order to include a disbursement measure. Although it was commonly held that better performance was linked to higher levels of income, data proved that this was not the case for the disbursement ratio. Indeed, data showed that the performance of IFAD operations was less satisfactory in UMICs than in LICs and LMICs, leading to lower allocations.

26. In relation to the overall balance between the needs and performance components, Management recalled that the statistical tool used to calculate this was logarithmic linear regression. This analysis found that scenario 3-D actually increased the weight of the performance component by 10 per cent in the direction agreed in previous discussions.

27. In response to a request for clarification, Management provided further information regarding the potential impact of the revised RSP variable on allocations: the analysis, which was carried out assigning mock RSP scores for new questions that had been incorporated, showed that repetition between indicators was reduced and that the new RSP scores were only slightly lower, with an average reduction of 3 per cent. This exercise had reassured Management that, as anticipated, the new RSP scores would not be radically different from those used in the simulations conducted so far.

28. Management also clarified that the reduction in allocations to specific regions could not be addressed through the PBAS formula and this had never been the aim. Broadly speaking, fluctuations in allocations were mainly due to the changes in value of the variables included: notably for UMICs, 10 countries out of the 30 active in IFAD10 increased their allocations under scenario 3-D, mainly as a result of their good performance.

29. Regarding the governance of the variables included, Management reassured members about the transparency and efficiency of the process. In particular, the calculation of the PAD would be aligned with reallocations, so that every change in performance would be promptly accounted for.

30. As per the 90:10 per cent distribution of allocations between LICs and LMICs, and UMICs respectively, which was discussed during the IFAD11 Consultation discussions, Management clarified that there was no contradiction inherent in the 15 per cent share allocated to UMICs by scenario 3-D. The discrepancy was due to the fact that the allocations referred to different pools of funds: the former percentage refers to ODA resources, while the latter referred to total resources.

31. Management took note of members' views and the need to engage in further dialogue. The importance of finalizing the PBAS review process in order to have the system ready for implementation in IFAD11 was underlined.

32. The Chairperson emphasized the need to reach consensus before the September session of the Executive Board, and encouraged members to promote further dialogue between capitals and IFAD Management in this direction. He thanked IOE for their independent and constructive role in the process.

33. Given that the PBAS Working Group was a subsidiary body of the Executive Board and did not have decision-making powers, it was noted that the differing views expressed by members and observers would be reflected in the minutes, and shared with the Executive Board.

Agenda item 4: Other business

34. There were no issues raised under other business. The Chairperson thanked all members and Management for their contributions. He also thanked the observers for their interest in the discussion, their contributions and their support. The Chairperson then closed the meeting.