

The Second Multilateral Development Banks Technical Meeting on Performance-Based Allocation (PBA) Methods

**African Development Bank
(Temporary Relocation Agency)
Tunis, Tunisia**

8-9 March, 2006

CHAIRMAN'S SUMMARY

1. Introduction

1.1 On 8 and 9 March 2006, the second Multilateral Development Banks Technical Meeting on Performance-based Allocation (PBA) Methods was hosted by the African Development Bank Group at its Temporary Relocation Agency in Tunis, Tunisia. The meeting was held at the Abou Nawas Hotel in Tunis. Representatives from six multilateral institutions and one bilateral donor agency participated in the meeting¹.

1.2 In his opening statement, Mr. Philibert Afrika, Officer-in-Charge for Planning, Policy and Research Vice presidency (PRVP), African Development Bank, highlighted a number of pressing issues related to the PBA system. These include: (i) country ownership, transparency and disclosure of the CPIA ratings; (ii) the weight of the population factor in the PBA formula; (iii) the lack of provision of concessional resources to Middle Income Countries (MICs) facing daunting development challenges; and (iv) the need to accommodate other risk factors alongside debt ratios in a dynamic forward-looking Debt Sustainability Framework. He also drew the attention of participants to issues related to the country assessment processes which include: (i) the subjectivity of the CPIA process; (ii) the attribution of all weaknesses in the country portfolio rating to the borrower; (iii) the variability of country performance assessments and country allocations; and (iv) the impact of the annual CPIA exercise on member countries' budget planning and resource inflow predictability. The participants took note of the statement, and addressed the issues during their deliberations.

1.3 The meeting proceedings centered around five main areas:

- CPIA Process and Ratings Disclosure Implementation Issues
- Reducing the Volatility of Portfolio Ratings
- Managing Country Allocations and Utilization
- Implementing the Debt Sustainability Framework-based Grants Approach
- Multilateral Debt Relief Initiative (MDRI) Implementation: Implications and Emerging Issues.

¹ The following organizations were represented at the meeting: African Development Bank (AfDB); Asian Development Bank (AsDB); Department for International Development (DFID), UK; Global Environmental Facility (GEF); Inter-American Development Bank (IaDB), International Development Association (IDA), World Bank; and International Fund for Agricultural Development (IFAD).

Below is a summary of the discussions on the five themes.

2. CPIA Process and Ratings Disclosure Implementation Issues

2.1 Participants agreed that differences in country performance ratings among MDBs are inevitable for a number of reasons, including differences in judgment and different cut-off periods. MDBs should be ready to explain these differences, especially in the aftermath of the forthcoming disclosure of the ratings in the public domain. Participants recognized challenges in applying the same rating and assessment system to a very diverse set of countries. While participants agreed that there is a need to avoid “one size fits all” approach, there was also a broad agreement that the current CPIA questionnaire provides substantial flexibility to consider country-specific circumstances, and represents professional judgment.

2.2 Participants discussed the issue related to rating levels of performance versus rating changes in performance. The issue is particularly important for turnaround countries. There was a broad agreement that it continues to be more appropriate to focus on levels of performance rather than changes in performance, since it is the current performance level that is seen to be the determinant of the effectiveness of the use of allocated funds.

2.3 Participants recognized that the performance assessment exercise is staff and resource intensive. Accordingly, some participants called for considering conducting the country performance assessment exercise once during a replenishment period. On the other hand, other participants noted that decreasing frequency of assessments would increase the lag between the changes in performance and corresponding changes in allocations. This would be particularly true for the turnaround countries. One possible compromise is the current system used by AsDB, where assessments of smaller countries are done once in two years, while the assessments for larger countries are done every year. Similarly, at the IaDB, assessments and allocations are made every two years for all countries eligible for concessional resources.

2.4 Participants recognized that stability in the CPIA questionnaire is important. It was underscored that frequent changes in questionnaire may undermine the quality of assessments and policy dialogue with the respective governments. Nevertheless, new insights will contribute to a gradual evolution of the questionnaire. The external panel review of CPIA ratings and methodology for the IDA14 negotiations found unnecessary overlap in some of the criteria and outlined steps to address these methodological and process issues. The current 16-criteria questionnaire adopted by IDA, AsDB and AfDB incorporates the panel’s recommendations. Further possible simplification of the questionnaire can be considered at an appropriate time in the future.

2.5 Participants discussed the approaches used by different MDBs to prepare for the disclosure of the CPIA ratings. They exchanged information on what would be disclosed by each institution and the timing of the disclosure. This could include the composite country performance assessment (CPA) comprising a weighted average of the CPIA rating and portfolio rating. Participants underscored the need for the disclosure of the scores to be accompanied by a set of materials that would clarify, to a wider audience, what CPIA is, its purpose, and the methodology and process used to determine the scores. It was noted that the information

disclosure initiative should address other dimensions as well, including education about the CPIA methodology and process, and should be geared towards a non-technical audience. Participants agreed to share information and lessons learned in the coming months on the forthcoming disclosure.

2.6 Participants agreed that it is important to establish appropriate internal procedures and checks and balances to ensure the integrity of ratings and their institution-wide ownership, especially in preparation for the forthcoming disclosure of country performance ratings in the public domain. They welcomed the information that the IaDB already discloses performance ratings and allocations, and that the AsDB will go ahead with disclosure of its performance rating in March 2006, followed by IDA in May 2006 and the AfDB in June 2006.

3. Reducing the Volatility of Portfolio Ratings

3.1 There was broad interest in three amendments proposed to reduce the country portfolio rating variability, caused by modest changes in projects at risk which result in large rating changes. These were: (i) applying a narrower range conversion table; (ii) using average data for the four quarter ends of the last calendar year; and (iii) providing exceptions in the use of the portfolio rating for countries with portfolios of 3 or less projects, and using their CPIA as a proxy. Participants agreed that these amendments could be implemented without becoming too complex and time-consuming. It was recognized that the approach needed some strong checks and balances.

3.2 It was also noted that alternative systems that might be based on independent project outcome assessments would be more objective but too historical to be a good yardstick of current country performance. Some participants felt alternative ways of measuring portfolio performance needed to be explored, including the possibility of introducing a system which rates all projects using more results-based indicators. There was a general agreement that there is an added value in including a portfolio performance measure in the PBA system. The youth correction, which lowers the portfolio score in cases of less than the average age portfolio, was considered a useful feature.

3.3 There was some discussion of the extent to which weak portfolio performance may be attributed to weak portfolio supervision by the MDB, rather than the recipient country's performance. It was agreed that, in such a case, urgent corrective action would be needed on the part of the MDB, but in the mean time, the low score could be allowed to stand.

4. Managing Country Allocations and Utilization

4.1 Participants agreed that even though the allocation models by major MDBs are broadly similar, they do differ in a number of aspects, including treatment of per capita allocations, with some institutions allocating concessional funds on per capita basis, while others apply a population factor as one of the critical elements. The importance of balancing predictability in allocations with the ability to respond quickly to the changes in countries' performance was underscored. It was noted that all institutions apply front- and back-loading which provide

important flexibility in managing the allocations. It was pointed out, however, that there is the need to ensure that these rules do not undermine the link between performance and allocations.

4.2 Participants agreed that implementing a meaningful operational program in countries with small allocations is difficult, and flexibility is needed in the PBA rules with respect to these countries. This is already being done, to some extent, at the various IFIs. While some agencies (IDA, AfDB, GEF) have incorporated minimum country allocations in their allocation formulas, others (AsDB, IFAD, DFID) have varying weights on the population factor. Other mechanisms include biennial allocations, additional flexibility in front-loading and back-loading allocations during the replenishment cycle, as well as through flexible reallocation rules in the case of these countries. It was nevertheless underscored that it is per capita, and not absolute, country allocation that should be the criterion for assessing whether higher performance leads to higher allocation for small countries.

4.3 The issue of reallocations and the need for transparent rules was discussed in order to guide the allocations without undermining the institutions' ability to effectively utilize concessional resources, while at the same time preserving the performance-based nature of the allocations. Participants also discussed the issue of country-specific triggers. It was noted that a number of institutions had abolished triggers altogether (AsDB, IDA), or had moved towards abolishing trigger-based scenarios in the country strategy and planning documents (AfDB).

4.4 The issue of dealing with natural emergencies was examined. Participants noted that there is the need to distinguish between emergencies that can be anticipated with a certain periodicity, like periodic floods or droughts, and truly unanticipated emergencies like earthquakes or tsunamis. IDA is currently doing research on the merits and feasibility of setting up a separate "shocks facility" out of the replenishment resources to handle the latter type of emergencies. Also, IaDB already has an "unallocated reserve" of US\$ 100 million for natural disasters which was set up and replenished over a number of years with unused allocations.

4.5 There was a lengthy discussion on the issue of allocations to the fragile states. Some participants noted that purely performance-derived allocations tend to narrow the opportunities for engagement in such states, and questioned whether the PBA system is appropriate for such states. However, there was broad consensus that performance-based allocation is appropriate for fragile states as well, as the allocations to fragile states should also be guided by the goal of using the scarce resources in an efficient manner. It was noted that the LICUS approach used by IDA, under which a (modestly-sized) dedicated trust fund is established to provide some assistance to the fragile states, when IDA cannot do so, constitutes a good model for consideration.

5. Implementing the Debt Sustainability Framework-based Grants Approach

5.1 Participants acknowledged that the eligibility for grants, formerly determined on the basis of special-purpose sectoral priorities, is now determined by the new Debt Sustainability Framework (DSF) which ranks countries in terms of their degree of debt distress, and allocates grants to the highly and moderately risky borrowers. It was noted, however, that the current DSF system which sets indicative policy-dependent debt burden thresholds against static actual debt

ratios will be giving way to country rankings in terms of forward-looking dynamic Debt Sustainability Analysis (DSA) based on future performance prospects.

5.2 Participants agreed that the goal of the new MDBs grants system is to ensure debt sustainability for countries in high or medium risk of debt distress by providing their concessional allocations in grants to help them make progress towards achieving the MDGs. They noted, nevertheless, that under the new grants system, the economic space opened up by grants could allow the re-accumulation of non-concessional debt, raising the “free riding” moral hazard issue, as non-concessional lenders indirectly gain from grants received by borrowers from concessional lenders. The use of judgment-based approach in determining a minimum concessionality measure when any given loan is an instance of “free riding” was underscored.

5.3 As the new MDRI will lower the debt ratios of all eligible beneficiaries, the issue was raised if the new DSF rankings would classify MDRI beneficiaries “green” and hence eligible for credits only, leading to further accumulation of debt. Participants noted, however, that after MDRI assistance, HIPC countries would have relatively low debt ratios, and they would have capacity to borrow, particularly concessional loans. MDBs providing credits might help to prevent free riding by other creditors. And this would need to be complemented by concerted efforts to strengthen debt management capacity in borrowing countries. It was noted that concerns for further debt accumulation should be allayed as the migration to a forward-looking system progresses, insofar as debt-distress risk ratings generated by DSAs would take into account countries’ projected path of debt accumulation. The impact and implications of the MDRI on the DSF is one of the items to be considered during the forthcoming IDA/AfDF mid-term reviews in 2006, 4th Quarter.

5.4 Participants agreed that there is the need for the BWIs to involve respective MDBs in forward-looking DSAs in their regional member countries in the form of participation in joint DSA field missions and/or contributing to the preparation of the DSAs. It was noted that this would facilitate the DSF country rankings and the PBA process in MDBs as well as ensure increased ownership of DSF across MDBs and improved dialogue by the MDBs with the countries concerned.

6. MDRI Implementation: Implications and Emerging Issues

6.1 Four main outcomes emerged from the discussion on the MDRI. First, there was a general agreement that interpretation of the MDRI according to debt relief and financing of forgone credit, is an interdependent package. This highlights the importance of the development impact on the recipient countries and the preservation of the financial strength of the IFIs.

6.2 Second, it was agreed that, post MDRI, there is the need for enhanced harmonization and coordination among multilateral creditors, particularly in the following areas: (i) classifying countries according to their risk of debt distress in post-debt relief contexts; (ii) establishing the appropriate concessionality of assistance for low-income countries, both for grant-recipient and MDRI-recipient countries, using the Debt Sustainability Framework as the coordination platform; and (iii) dealing with instances of “free riding”.

6.3 Third, there was a broad agreement on the need for a collective communication strategy, in order to facilitate a wider understanding of the mechanisms for delivering debt relief, and to help recipient countries get a clearer view of the benefits and impact of the MDRI.

6.4 Fourth, it was emphasized that actions at the country level would be needed to help ensure success of the MDRI and restrain "free riding". These include (i) strengthening countries' debt management capacity; and (ii) improving debt data quality as well as debt data reporting to the IFIs. It was agreed that technical assistance, institutional support and capacity building programs on debt management from multilateral creditors on these areas would be in order.

Hosting of the Next Meeting

The World Bank/IDA and the IaDB proposed to jointly host the next PBA technical meeting in Washington, D.C. in March 2007.