ASIAN DEVELOPMENT FUND APPROVALS PRIOR TO PERFORMANCE-BASED ALLOCATIONS

1. During the ADF VII period (1997–2000) allocations were determined in two steps. Based largely on historical considerations and the available ADF commitment authority, resources were first allocated on a regional basis through Management's Planning Directions. In each region, Vice Presidents then decided on country allocations based on the recommendations of, then, Programs' Directors. Programs Directors' recommendations reflected the information provided in "country performance assessments". The format of these assessments differed across countries and regions. Even though in most cases recommended allocations emerging from these assessments included performance considerations, particularly portfolio performance, they were also influenced by "strategic" and operational considerations. Links between performance and allocations do not seem to have been concerted or transparent.

2. Approvals for the ADF VI and ADF VII periods are shown in Table A1.1. Data for 2001, which preceded the PBA are also shown. To control for year-to-year changes in the level of approvals, these data are expressed as shares in ADF. Although there is considerable year-to-year variation in shares only a few countries experienced consistently rising or falling shares. For most countries, ADF shares varied around a more or less stable mean.

3. In looking at the cross-country pattern of historical ADF resource use, two stylized facts emerge. First, by weight of their needs, large countries got larger shares in ADF. Second, consistent with ADB's Charter obligations to small countries, less populous countries got larger per capita allocations.

Table A1.1: Historical Asian Development Fund Approvals, 1992–2000

	ADF VI (%)					ADF VII (%)						(%)
DMCs	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**Mean**	**Cov**
Pacific Group												
Cook Islands	0.0	0.0	0.0	0.0	16.4	1.7	0.0	0.0	0.0	6.3	2.4	217
Federated States of Micronesia	4.9	14.4	17.8	18.9	34.8	39.3	0.0	0.0	13.3	37.1	18.1	82
Kiribati	0.0	0.0	0.0	0.0	0.0	0.0	16.1	0.0	0.0	0.0	1.6	316
Papua New Guinea	73.8	59.7	2.5	0.0	0.0	32.8	0.0	56.7	41.4	16.8	28.4	100
Marshall Islands	0.0	20.3	28.9	58.1	0.0	26.2	0.0	26.2	11.3	22.8	19.4	92
Samoa	21.3	4.4	0.0	0.0	0.0	0.0	11.8	0.0	17.4	17.1	7.2	121
Solomon Islands	0.0	1.1	0.0	0.0	0.0	0.0	40.8	0.0	16.6	0.0	5.8	228
Tonga	0.0	0.0	50.7	23.0	16.1	0.0	0.0	0.0	0.0	0.0	9.0	188
Tuvalu	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.3	0.0	0.0	1.1	316
Vanuatu	0.0	0.0	0.0	0.0	32.8	0.0	31.4	5.7	0.0	0.0	7.0	191
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**		
Group A and B1												
Bhutan	0.0	0.4	0.0	0.6	0.0	0.5	0.7	1.0	1.5	0.6	0.5	89
Cambodia	7.0	0.0	2.8	3.4	7.1	0.0	0.0	9.0	8.2	6.1	4.4	82
Kyrgyz Republic	0.0	0.0	3.9	3.0	5.4	6.0	8.4	7.4	2.7	6.1	4.3	67
Lao People's Democratic Republic	7.3	5.6	6.3	6.9	6.2	6.9	2.6	2.6	4.5	5.3	5.4	31
Maldives	0.0	0.8	0.0	0.0	0.0	0.5	0.8	0.8	0.0	1.4	0.4	119
Mongolia	0.4	5.9	6.3	6.3	4.3	4.2	0.0	5.1	3.1	2.9	3.9	59
Nepal	4.4	3.2	1.3	3.0	17.1	1.8	13.6	5.1	13.0	7.8	7.0	80
Tajikistan	0.0	0.0	0.0	0.0	0.0	0.0	2.6	2.6	4.0	0.3	0.9	160
Bangladesh	26.4	28.4	27.4	16.9	17.3	28.2	23.7	25.6	15.2	13.0	22.2	27
Pakistan	42.2	26.0	25.7	32.2	19.1	16.9	0.0	9.8	19.2	29.7	22.1	54
Sri Lanka	12.3	7.2	12.7	10.4	3.0	10.9	23.9	15.2	14.5	7.0	11.7	49
Vietnam	0.0	22.4	13.7	17.4	20.5	24.2	23.8	15.8	14.1	19.8	17.2	41
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**		

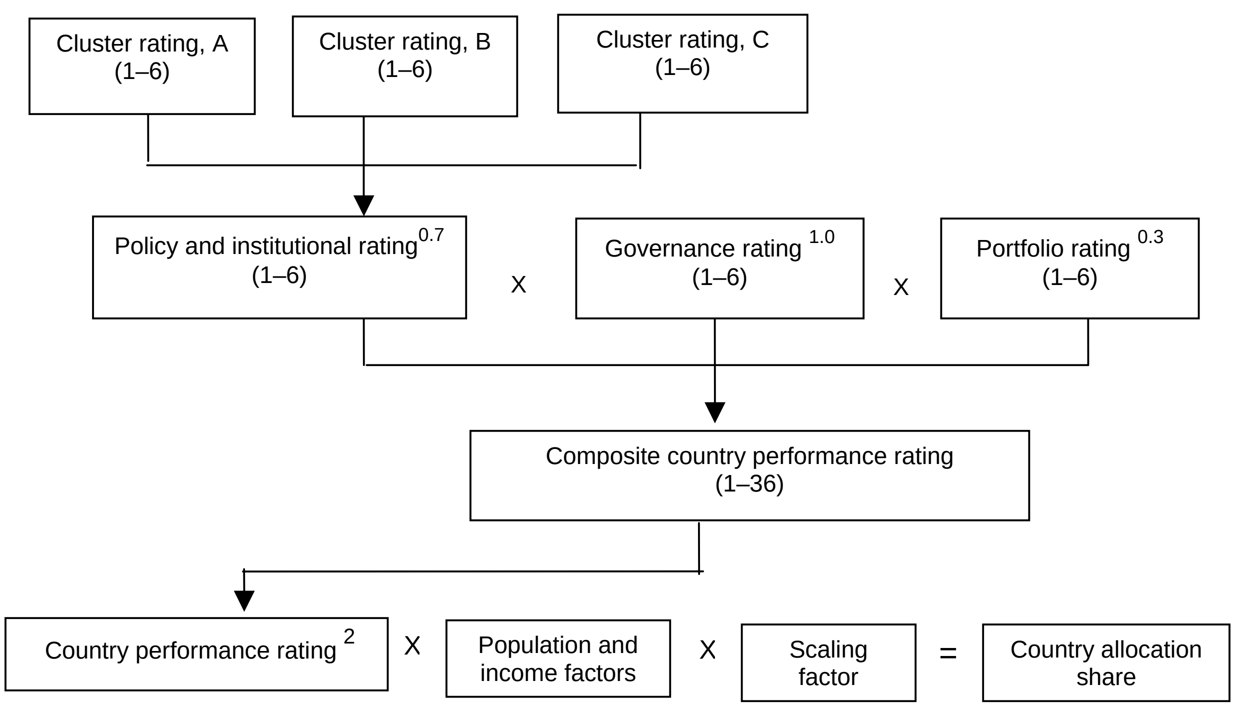
ADF = Asian Development Fund, Cov = coefficient of variation, DMCs = developing member countries
Note: The coefficient of variation of lending is defined as the standard deviation as a percentage of the mean over the sample period. The larger the number, the more volatile lending has been over the period.
Source: Project Coordination and Procurement Division loan, technical assistance, and equity approvals.

THE REVISED COUNTRY PERFORMANCE ASSESSMENT SYSTEM AND ALLOCATION FORMULA

1. The allocation formula presented in Box 6 can be constructed using an overall country performance rating. Figure A2.1 illustrates how this overall country performance rating is constructed. The scale on which ratings are recorded at each step is identified in parenthesis. The allocation shares that would result from the use of the framework of Figure A2.1 are identical to those generated by the modified formula of Box 6 and as such are “observationally equivalent”.

2. Although this representation of the modified allocation framework is similar to that of the original policy, a critical difference is the scale on which the country performance rating is measured. In this representation of the allocation formula, the country performance rating is measured in a range of 1 to 36. In the original allocation formula, the country performance rating is measured in a range of 1 to 6. The exponential weight on the composite country performance rating is 2 in the new formula and 1.8 in the old formula. Therefore, other things equal, the ratio of maximum to minimum performance related allocations under the new policy is $36^2 \div 1^2 = 1296$ to 1, which compares with $6^{1.8} \div 1^{1.8} = 25$ to 1 (approximately) under the old policy. The revised scoring system and formula weight is equivalent to applying an exponential weight of 4 to ratings measured in a range of 1 to 6, as this, too, would generate a ratio of maximum to minimum allocations of 1296 ($=6^4$) to 1 ($=1^4$). For IDA’s country performance ratings, see Figure 3 and Box 4, the corresponding ratio is about 6 times larger, specifically: $13.46^2 \div 0.153^2 = 7776$ to 1. The ratio using the AfDF’s rating system, which has a linear governance factor is, $10.286^2 \div 0.286^2 = 1296$ to 1, which is the same as the proposed modified allocation system

Figure A2.1: Composite Country Performance Rating and Allocations



3. Performance impacts in the revised allocation system are summarized in Table A2.1. For ease of comparison, the criteria used follow those presented in Table 2, p4 of IDA (2004).[1] The modified system is compared with the earlier ADF system (a governance weight of 30% and no governance factor), and the results reported by IDA for non-linear (1.5) and linear (1) governance factors. All calculations are based on the weights shown in Figure A2.1. Note identical results would be obtained from the allocation model of Box 6.

4. The results of Table A2.1 confirm that governance ratings exert a substantially greater pull on ADF resource allocation in the proposed allocation system than under current arrangements. The theoretical weight of governance is 50%, but because of the distribution of actual performance ratings its empirical weight is 53%, compared with 30% in the current system. The "impact ratio" [2] (shown in the fourth row of the table) also shows a strengthened governance link. The impact of a unit reduction in a governance criterion rating on allocations is substantially larger than in the present system (shown in the fifth row of the table). The modified system also substantially stretches the gap between allocations for the best and worst performers. Using 2004 performance data, which are still based on the old CPA criteria, and holding other factors equal, the best performer would receive a per capita allocation 10.6 times as large as that of the worst performer, compared with just 2.8 times in the current system.

Table A2.1: The Impact of the Revised Country Performance Assessment and Allocation Formula

	Existing System	Modified PBA System	IDA with Governance Factor = 1.5	IDA with Linear Governance Factor = 1
Double Counting of Governance	—	No	Yes	Yes
Nominal Weight of each Governance Criterion in CPA/CPIA (%)	6	—	5	5
"Effective" Weight of Governance (%)	30	53	68	60
Governance to Non-Governance Impact Ratio	1.5	4.0	6.2	4.5
Allocation Reduction from a One-Point Reduction in Governance (%)	4	10[3]	13.8	10

— = not applicable

CPIA = country policy and institutional assessment, CPA = country performance assessment, IDA = International Development Association, PBA = performance-based allocation

Note: The calculations pre-date proposed revisions to IDA's PBA. Since only a marginal reduction in the effective weight of governance is implied by IDA's current proposals, results would be substantially the same.

Source: IDA. 2004. IDA's Performance-Based Allocation System: Update on Outstanding Issues. Washington, DC (Table 2, p4).

5. Compared with the IDA allocation system, the revised approach has a more modest effective weight for governance (53% compared with 68%), and changes in governance have more modest impacts on allocations. If the exponential weight on the IDA governance factor

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[1] IDA. 2004. IDA's Performance-Based Allocation System: Update on Outstanding Issues. Discussion Paper presented at IDA 14 replenishment meeting. Paris. Table 2, p4.

[2] This is defined as the ratio of the impact on country ratings of a one-point drop in a governance rating (e.g., 3.5 to 2.5) compared to a one-point drop in a rating on economic and social policy criteria.

[3] This is an average impact. Actual impacts vary by country and the distribution of policy, governance and portfolio ratings. The maximum impact for any country is over 13% and the smallest impact close to 8%.

were reduced from 1.5 to 1, as in AfDF, the impact of changes in governance ratings would be similar. The larger “effective” weight for governance with a linear governance factor stems from the double counting of governance ratings in the IDA system.

THE INTERNATIONAL DEVELOPMENT ASSOCIATION'S APPROACH TO ALLOCATING RESOURCES TO POSTCONFLICT COUNTRIES

1. The International Development Association (IDA) management has developed and tested a methodology that seeks to provide staff and management with a more systematic basis for calibrating IDA's response to the different phases of the postconflict period. The following outlines the key steps of IDA's methodology[1]:

2. **Step 1-Determining Eligibility**

(i) The engagement of a country affected by conflict will be assessed by Bank staff and management, in consultation with other international partners.
(ii) Re-engagement opportunities will be specified in a Transitional Support Strategy, which sets out IDA's assistance program for the immediate postconflict period. The strategy also outlines the process of ascertaining if a country qualifies for exceptional allocations, and the size of the allocation.
(iii) After a decision on initial engagement has been made, staff shall evaluate the country's eligibility for access to exceptional postconflict allocations. Eligible candidates are defined as:
  (a) a country that has suffered from a severe and long-lasting conflict which has led to the inactivity of the borrower for an extended period, or at least a substantial decline in the level of external assistance, including from IDA;
  (b) a country that has experienced a short but highly intensive conflict leading to a disruption of IDA involvement; and
  (c) a newly sovereign state that has emerged through the violent break-up of a former sovereign entity.
(iv) Generally, the eligible countries will be those that have experienced highly intensive conflicts. The degree of exceptional assistance depends on the intensity of the conflict, which is assessed on three key dimensions.
  (a) the extent of human casualties directly or indirectly caused by the conflict;
  (b) the proportion of the population that is either internally displaced, or in exile; and
  (c) the extent of physical destruction.
(v) Staff evaluation will rely mainly on qualitative judgment supplemented by quantitative evidence where available.

3. **Step 2-Determining the Initial Allocation**

(i) Upon confirmation of country eligibility, staff shall initiate a consultative process to find the best possible match between the size of the initial allocation and country needs and circumstances, and the prospects for strong performance on a social and economic recovery program. This process shall assess the following four sets of issues that could have a bearing on the size of the initial allocation:
  (a) the prospects of peace;
  (b) country needs, capacity, and resources;
  (c) Government commitment to sustainable development; and

[1] IDA. 2001. Adapting IDA's Performance-Based Allocations to Postconflict Countries. Discussion paper presented at the IDA 13 Replenishment meeting. An abridged version is available at http://siteresources.worldbank.org/IDA/Resources/Annex2postconflict.pdf

(d) moral hazard considerations.

(ii) An indicative list of ten sets of questions has been developed to guide the assessment (see Table A3.1), which should be summarized in the Transitional Support Strategy. Staff evaluation will rely mainly on qualitative judgment supplemented by quantitative evidence where available.

Table A3.1: Considerations for the Initial Allocation

Dimensions	**Guide Questions**[a]
Prospects of Peace	1. Reconciliation**:** Is a peace treaty in place? Which accompanying efforts have been carried out to safeguard the peace treaty or ceasefire agreement? Is a mediation process in place and how effective is it? 2. Domestic security*:* Have there been shootings over the past 6 months? Is movement around the territory unhindered? To what extent does security situation allow preparation, implementation and supervision of projects? 3. Impact of neighboring conflict*:* To what extent does conflict in neighboring countries affect internal conflict dynamics? How would stabilization impact its neighbors?
Needs	4. Damage assessment: What is the extent of destruction of social and economic infrastructures? Needs of conflict-affected groups? Estimated cost of comprehensive emergency recovery/reconstruction program? 5. Absorptive Capacity: what level of government and donor resources can be effectively absorbed? If low, can capacity be quickly augmented? Main constraints to absorb development assistance? 6. Adequacy of available resources: Is there a substantial unmet need given the available government and donor resources? Are other donors making substantial effort to ensure full funding of recovery program? If IDA has a portfolio in the country, what level of resources can be directed to support recovery program?
Government Commitment to Sustainable Development	7. Social and economic reform program: Does government intend to pursue social and economic policies that would contribute to sustainable/broad-based economic growth and poverty reduction? Identify constraints that impede implementation. 8. Economic management*.* Is the government putting in place adequate economic management functions, including fiduciary safeguards? Is it committed to normalizing relations with donors/creditors? Has it encouraged official creditors to participate in an orderly arrears clearance process?
Moral Hazard Concerns	9. Signaling impact of IDA involvement: Could a resumption of IDA assistance undermine the domestic or regional commitment to peace? What role did the incumbent government play in the conflict? Could IDA assistance be perceived to “reward” one or more parties to the conflict? 10. Probability of misuse of IDA assistance: Could IDA assistance fuel the conflict? To what degree should the fungibility of resources be considered a concern, either in the country or regionally?

[a]Condensed from source.

(iii) To avoid over allocation of resources, special attention should be given to assessing the absorptive capacity of countries with large populations. Higher allocations could be considered if warranted by special circumstances, e.g. where government capacity to implement recovery program has remained strong.

(iv) The country team shall also undertake a “shadow” rating of country performance using a set of indicators (refer to Step 3). The main function of the rating results is to provide a benchmark against which future ratings can be compared.

4. **Step 3-Determining the Subsequent Allocations**

(i) Allocation norms for the second and subsequent years are based on systematic performance measurement using postconflict performance indicators tailored to postconflict circumstances (Box A3.1). Performance is measured on the basis of the government's record of implementing pro-poor measures. The rating scale for postconflict performance indicators has been narrowed to 2 to 5, compared with 1 to 6 for the country policy and institutional assessment. The postconflict performance indicators should be updated at least once a year given the volatility of postconflict situations and the short-term horizon of the allocation mechanism. Where available, the portfolio rating shall be included, with a 20 percent weight, to form the postconflict performance rating.

(ii) The postconflict performance rating is the basis for calculation of indicative postconflict allocation norms, which, in turn, shall be the basis for determining assistance levels for the program set out in the strategy for each country. The norms will increase or decrease depending on country performance. If the initial allocation were set at the high end, continued strong performance would be necessary to sustain that level for a second year.

(iii) The scores on the postconflict performance rating are translated into indicative allocation norms using guidelines for maximum per capita per annum allocations. For instance, the upper bound for countries rated close to 5.0 has been set at $20 while those rated close to 2.0, the upper bound is at $4.

(iv) Exceptional postconflict allocations are limited in duration, which is normally limited to 3 years. After which, the allocation is again determined by IDA's regular performance rating-based allocation norm. In some cases, it may be necessary to consider continuing exceptional assistance for an extension of 1 year, or at most 2 years. By the third year of postconflict allocation, the overall country policy and institutional assessment measure for the country is consulted to determine actual allocation with a view to phasing postconflict allocations back to a normal level.

Box A3.1: Postconflict Progress Indicators

A. Security and Reconciliation
   1. Public Security
   2. Reconciliation
   3. Demobilization and Disarmament

B. Economic Recovery
   4. Management of Inflation, External Debt; Adequacy of Budget
   5. Trade policy, Foreign Exchange, and Price Regimes
   6. Management and Sustainability of the Development Program

C. Social Inclusion and Social Sector Development
   7. Reintegration of Displaced population
   8. Education
   9. Health

D. Public Sector Management and Institutions
   10. Budget Formulation and Efficiency of Revenue Mobilization
   11. Reestablishing the Administration and Rule-based Governance
   12. Transparency, Accountability and Corruption in the Pubic Sector