AFRICAN DEVELOPMENT FUND

THE ENHANCED PERFORMANCE-BASED ALLOCATION FRAMEWORK EMERGING ISSUES, CHALLENGES AND PROPOSALS FOR DISCUSSION FOR THE WAY FORWARD

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ACRONYMS

ADF	African Development Fund
AfDB	African Development Bank Group
AsDB	Asian Development Bank
CPA	Country Performance Assessment
CPIA	Country Policy and Institutional Assessment
CPPR	Country Portfolio Performance Rating
CSP	Country Strategy Paper
DFID	Department for International Development, United Kingdom
DSF	Debt Sustainability Framework
GEF	Global Environmental Facility
GF	Governance Factor
GNI	Gross National Income
HDI	Human Development Index
IaDB	Inter-American Development Bank
IDA	International Development Association (IDA), World Bank
IFAD	International Fund for Agricultural Development
MDBs	Multilateral Development Banks
MDRI	Multilateral Debt Relief Initiative
PAR	Projects-at-Risk
PBA	Performance-based Allocation
PCCF	Post Conflict Country Facility
PCEF	Post Conflict Enhancement Factor
RMC	Regional Member Country
SDR	Special Drawing Rights
UA	Unit of Account (UA 1.0 = SDR 1.0)
UNDP	United Nations Development Program

EXECUTIVE SUMMARY

1. The enhanced performance-based allocation (PBA) system, which is being applied during the ADF-X cycle, is an adaptation of IDA's PBA framework, initially introduced in 1999 during the ADF-VIII (1999-2001) period. The system has since evolved with a number of new refinements and enhancements approved by the Board of Directors in December 2002 during the ADF-IX (2002-2004) cycle.

2. This paper presents the key issues and challenges faced regarding implementation of the PBA system, particularly during the current ADF-X period, for discussion and guidance by Deputies during the ADF-XI replenishment consultations. This discussion will also contribute to deepening harmonization and coordination with other partner MDBs on approaches to address some of the common issues and challenges.

3. After presenting the main elements of the enhanced PBA framework, the paper reviews the underlying factors behind the substantial volatility of the 2006 allocations vis-à-vis the 2005 allocations. The paper then examines up to 10 main issues and challenges of the current PBA system for discussion by the Deputies. These include: (i) subjectivity of performance ratings; (ii) predictability of annual country allocations; (iii) the effective weight of governance in the PBA system; (iv) the weight of the population factor and treatment of small performing countries; (v) the process of conducting the annual country portfolio performance assessments; (vi) the post conflict enhancement factor (PCEF) and other alternative measures in support of post conflict and fragile states; (vii) the process of annual allocations and the front and back loading mechanism; (viii) the eligibility criteria for ADF resource reallocations in the final year of the replenishment cycle; (ix) the free rider issue and its implications for the DSF and MDRI; and (x) relative weights of the key variables in the PBA formula.

4. The paper underscores the fact that Management is committed to taking measures through in-house consultations on the PBA system, with strong involvement of country directors and country teams. It also emphasizes that appropriate action will be taken to scale up and enhance consultations and dialogue with RMCs, through sensitization missions and seminars. The paper acknowledges that the enhanced PBA system for ADF-X is not yet perfect and therefore will require continuous refinements, improvements, and possible revisions in close consultation with the Deputies on the one hand, and with partner MDBs and the beneficiary countries, on the other.

5. For the way forward, the key issues and challenges are highlighted for discussion and guidance by Deputies during the forthcoming ADF-XI replenishment consultations.

The Enhanced Performance-Based Allocation Framework: Emerging Issues, Challenges and Proposals for Discussion for the Way Forward

I. Introduction

1.1 The enhanced performance-based allocation (PBA) system, which is being applied during the ADF-X cycle for the allocation of concessional ADF resources, has been inherited from past ADF replenishments. The Fund's PBA system is an adaptation of IDA's PBA framework, initially introduced in 1999 during the ADF-VIII (1999-2001) period. The system has since evolved with a number of new refinements and enhancements first approved for application during the ADF-IX (2002-2004) period.

1.2 The ADF Board of Directors approved the new policy document on *Enhanced Performance-based Allocation Framework* for ADF-IX[1], on 30 December 2002, specifying the new enhancements endorsed earlier by the ADF Deputies during the ADF-IX replenishment consultations. These enhancements included the following:

- Streamlining the PBA formula by removal of the kink (or step function);
- Introduction of the Governance Factor (GF) for the first time as a key component of the PBA formula to ensure greater weighting of governance in overall country rating;
- Introduction of the Post Conflict Enhancement Factor (PCEF) for the first time as another important component of the PBA formula; and
- Raising the minimum country allocation from UA 3 million to UA 5 million.

1.3 Within the context of some degree of dissatisfaction being expressed by some members of the Board of Directors regarding implementation of the PBA system, particularly during the current ADF-X period, the aim of this paper is to present the key issues and challenges being faced for discussion and guidance by Deputies, particularly during the forthcoming ADF-XI replenishment consultations. The discussion will also contribute to deepening harmonization and coordination with other partner MDBs on approaches to address some of the common issues and challenges of the PBA system as agreed during the second MDBs technical meeting on PBA methods held in Tunis in March 2006.[2]

1.4 This paper has five main sections. Following the Introduction, Section II presents the main elements of the enhanced PBA framework. Section III discusses application of the enhanced PBA framework to the 2006 country allocations. Section IV reviews each of the main issues and challenges of the current PBA system for discussion by the Deputies. These include: (i) subjectivity of performance ratings; (ii) predictability of annual country allocations; (iii) the effective weight of governance in the PBA system; (iv) the weight of the population factor and treatment of small performing countries; (v) the process of conducting the annual country portfolio performance assessments; (vi) the PCEF and other alternative measures in support of

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[1] See ref.: ADF/BD/WP/2002/120/Approval, dated 23 December 2002.

[2] See Chairman's Summary, ref.: ADF/BD/IF/2006/39/Add.1, dated 26 April 2006. Besides AfDB, the following multilateral institutions were represented: AsDB, DFID, GEF, IaDB, IDA, and IFAD. This document will be made available to Deputies for information during the aDF-X Mid Term Review meeting. The next MDBs technical meeting on PBA methods will be held in January 2007 at the World Bank Headquarters in Washington DC, USA.

post conflict and fragile states; (vii) the process of annual allocations and the front and back loading mechanism; (viii) the eligibility criteria for ADF resource reallocations in the final year of the replenishment cycle; (ix) the free rider issue and its implications for the DSF loan/grant ranking system and debt relief under the MDRI; and (x) proposals for revision of the relative weights of the key variables in the enhanced PBA formula. Section V presents, for the way forward, highlights of the key issues for discussion and guidance, and the concluding remarks.

II. The Enhanced Performance based Allocation Framework for ADF-X

2.1 The enhanced PBA model being applied to determine country allocations during the current ADF-X period, may be stated as follows[3]:

$$A_i = (GNI/P)_i^{-\lambda} (CPA^*)_i^{\theta} (P)_i \qquad (1)$$

where: $(CPA^*) = (CPA)\,(GF)\,(PCEF);$ (2)

$$(CPA)_i = \alpha\, CPIA_i + \beta\, CPPR_i; \qquad (\alpha + \beta) = 1.0 \qquad (3)$$

and,

- $\mathbf{A_i}$ is the allocation share for country *i*;
- **GNI/P** is gross national income per capita, a proxy for poverty level;
- **P** is the level of population;
- λ is a fixed exponential assigned to the poverty variable ($\lambda = 0.125$); and
- θ is the performance exponential, now fixed at $\theta = 2$[4]

2.2 In the above equations, CPA* denotes the adjusted Country Performance Assessment (CPA); CPIA represents Country Policy and Institutional Assessment; CPPR represents the Country Portfolio Performance Rating; GF represents the Governance Factor; PCEF represents the Post Conflict Enhancement Factor; and α = 70 percent, β = 30 percent, are fixed parameters.

2.3 The essential ingredients of the PBA system are in line with the directives of ADF Deputies and best practices in sister institutions such as IDA and the Asian Development Bank. The PBA system aims at providing a transparent means of allocating concessional ADF resources to eligible borrowers based on performance and need, with a higher premium placed on performance ($\theta = 2$) than on need ($\lambda = 0.125$). The PBA framework is based on the CPA, which is a weighted average of the CPIA and CPPR, accounting for 70 percent and 30 percent respectively. The CPA is further adjusted by the GF and the PCEF to ensure greater weighting of governance in overall country rating, and provide additional resources to post-conflict countries in support of their reconstruction and rehabilitation efforts as they emerge from situations of conflict.

2.4 Among the new enhancements introduced during the ADF-X period are the following 6 elements[5]:

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[3] See Annex 2 for the technical details. For additional information, see ref.: ADF/BD/WP/2005/93/Rev.1, dated 5 July 2006, Section III, pp.4-18.

[4] During the ADF-VIII period, the performance exponential θ was set to 2 for CPA $\geq$3 and 1.75 for CPA<3, thus creating the kink. One of the enhancements approved for ADF-IX removed the kink. See para 1.2 above, first bullet.

[5] For further details, see *Enhanced Performance-based PBA Framework for ADF-X* (Revised), distributed to the

- Refinements in the new CPIA, involving the elimination of redundancies within the previous CPIA Questionnaire by reducing the set of criteria from 20 to 16;
- Deputies' directive for the public disclosure of the CPIA and CPA ratings;
- Integration into the PBA system of the IMF/World Bank Debt Sustainability Framework (DSF) country loan/grant rankings, including the 20 percent discount from grants, and reallocation of the 8 percent incentives-related portion to all ADF-only countries;
- Netting out of the debt relief under the Multilateral Debt Relief Initiative (MDRI) from ADF-X country allocations, and reallocation of the donor replacement resources to all ADF-only RMCs;
- Operational flexibility for front- and back-loading of allocations while enforcing annual allocations within the 3-year PBA envelope, building on replacement of the lending scenarios and triggers by performance benchmarks in the new results-based CSPs; and
- Measures to address the implications of the free-rider problem on the DSF loan/grant country classifications and the MDRI debt relief.

2.5 The above refinements leave intact the basic structure of the enhanced PBA formula, as inherited from ADF-IX, and defined in para 2.1 above. The refinements are made up of additional operational enhancements and their application within the PBA system, as well as their implications on the net PBA resources actually allocated to the ADF-eligible RMCs.

2.6 The refinements are included in the revised enhanced PBA policy document[6], which was distributed to the Boards for consideration and approval.[7] Because of a mix-up of the enhanced PBA policy document, which was for consideration, with the Board document on the *ADF-X Country Resource Allocation for Year 2006*[8],which was only for information, the former is still pending Board approval.

III. Application of the Enhanced PBA Framework to the 2006 Country Allocations

3.1 Annex 1 presents the 2006 performance-based country allocations for ADF-X which showed unusually large swings for individual countries, vis-à-vis the 2005 PBAs. In particular, 10 RMCs faced a decrease in their allocations of over UA 5 million while 9 other countries had an increase in their allocations in excess of UA 5 million. Positive variations in allocation would have been as large as 62.7 percent, and negative variations in allocation as large as 47.8 percent. These unusually large variations raised important concerns regarding cross-country and year-by-year consistency between allocations and underlying performance, as well as their operational implications for both 2006 and 2007.

Boards for consideration, ref.: ADF/BD/WP/2005/93/Rev.1, dated 5 July 2006, sections 3.1 - 3.8.

[6] Ibid. The issues that are new and require Board consideration and approval are: (i) the CPIA disclosure and scaled-up dialogue with RMCs on the PBA; (ii) integration of the Debt Sustainability Framework in the PBA; (iii) netting out of MDRI debt relief from the PBA; (iv) the new policy on annual allocations with front and back loading; and (v) the eligibility criteria for reallocation of unused resources from non-performing RMCs to high performers.

[7] The revised PBA policy document was scheduled for Board discussion first on 20 September 2006, then on 11 October 2006, and further on 18 October 2006.

[8] See ref.: ADF/BD/IF/2006/185, dated 7 August 2006.

3.2 An Informal Board meeting was held on 22 September 2006 during which Management provided the clarifications on the unusually large variations in the 2006 country allocations. Based on intensive sensitivity analysis of the underlying factors, Management confirmed that there was no substantial problem with the CPIA ratings, nor with the ratings of the Governance Factor (GF), which are broadly aligned with the data from sister institutions, particularly IDA's CPIA and GF ratings. The analysis revealed that the wide variations in the allocation were caused by the significant variability of the GNI per capita, Population and CPPR data series.[9] As well, the impact of reallocating the donor replacement resources based on the first time MDRI-related adjustments on country allocations in 2006, as compared to 2005, turned out to be quite sizeable for some RMCs such as Kenya, DRC, Tanzania, Mali and Ghana[10].

3.3 Regarding the GNI per capita and Population series, obtained from the World Bank's *World Development Indicators*, it has been acknowledged by the World Bank's Development Data Group that changes in the 2005 GNI data are driven by three factors: (i) changes in the dollar exchange rate; (ii) large jumps in the GNI of oil exporting states; and (iii) exceptional revisions to the population data series. In particular, it was confirmed that the population estimates have been affected by a review of population estimates in 2005 in order to bring the World Bank's estimates into better alignment with those of the United Nations Population Division. This revision resulted in some large one-time changes relative to the previous published series.

3.4 With respect to the CPPR, the large variations were the result of some weaknesses in the annual CPPR data base. The Bank has not been supervising and rating its entire portfolio for each ADF-eligible RMC every year. As a result not the same projects are supervised from one year to the other. Consequently the CPPR data are not comparable year by year, with the possibility of large variations in country portfolio rating that may not reflect the condition of the entire country portfolio. This defeats the main objective of the CPPR process which assumes that all projects due for supervision are supervised every year.

3.5 Taking into account the factors behind the wide variations in the GNI per capita, Population and CPPR data series, Management has proposed an alternative scenario, which keeps unchanged the inputs CPPR, GNI per capita and Population as applied during the 2005 PBA exercise.. As can be observed in Annex 3, the variations (positive and negative) in country allocations have been reduced to below 10 percent in 17 of the 38 ADF-only countries. All countries for which the CPPR and GNI per capita variations were the main driving force behind the high allocation variations now show reduced allocation volatility of below 10 percent (Senegal, Uganda, Cameroon, and Angola). These revised allocations ensure the fundamental linkage between performance and allocations, which is at the core of the PBA process. In addition, they reduce the impact of variables whose consistency and reliability are questionable. It is important to underscore that these temporary modifications being made in the application of the agreed PBA Framework do not undermine the core purpose and intention of the Framework[11]. In particular, the adjustments do not alter the number of key input variables nor

[9] For further details see ref.: ADF/BD/IF/2006/185/Rev.1/Corr.1, dated 10 October 2006, paras 3.1-3.7.
[10] See Annex 4 attached.

[11] In accordance with the provisions of the Agreement establishing the African Development Fund, the applicable Board of Governors Resolutions authorizing ADF replenishments (notably, Resolution F/BG/2005/01 authorizing

depart from the core objectives of the PBA system, as prescribed by donors in the ADF-X Deputies Report[12].

IV. Emerging Issues and Challenges of the PBA System

4.1 *Subjectivity of Performance Ratings*

4.1.1 There is room for improvement in the determination of the CPIA and CPPR assessments. For the CPIA, country economists assess each RMC with respect to each of the 16 criteria of the CPIA, based on the staff's judgment. The assessment focuses on policy shifts adopted and implemented by the country, but not the results of those policy changes. Based on staff's judgment, each of the criteria is interpreted in terms of what it is meant to measure (gender mainstreaming, good governance, etc.) and the country is rated accordingly. It is required that the ratings by staff be supported by written statements justifying why the specific ratings were given.

4.1.2 After the initial CPIA assessment is determined by staff, the subjectivity element is substantially reduced by a thorough peer review process in three stages. First, the staff ratings are reviewed by inter-departmental country teams made up of staff from Project, Legal, Procurement, and Sustainable Development organizational units. Second, the ratings endorsed by the country teams are next reviewed at a series of inter-departmental working group (IDWG) meetings of all country teams (up to 4 during the 2005 CPIA process). Third, the revised ratings from the IDWG sessions are compared and harmonized with similar ratings from IDA.

4.1.3 Regarding the CPPR, the assessments are determined by staff based on field survey and desk-based supervisions on 18 different criteria, 14 of which assess different elements of project implementation progress (IP) while the remaining 4 elements relate to the project's development objectives (DO). At this stage, staff assessments are reviewed by country teams and managers.

4.1.4 But the methodology of transforming the ratings from project supervision reports into the CPPR ratings involve staff judgment as well, based on a set of criteria by which, among the projects supervised, staff selects the projects at risk (PAR) made up of the sum of problem projects (PP) and the potentially problematic projects (PPP). At this level also, the bias in staff judgment could be significantly reduced when inter-departmental country teams are involved to carry out the assessments.[13]Management is highly committed to enforce this process and align it with the CPIA process to make it more effective.

4.2 *Predictability of Annual Country Allocations*

4.2.1 ADF-eligible countries face the problem of predictability of annual allocations at two levels. First, there is the problem of the predictability of annual resource allocation at the country

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ADF-X) and the directives contained in the ADF-X Deputies Report, Management is entrusted, in practice, with the technical function of computing and making periodic country resource allocations within the context of the overarching policy and legal frameworks of the PBA system and submitting the results to the ADF Board of Directors for information. See ref.: ADF/BD/IF/2006/185/Rev.1/Corr.1, dated 10 October 2006, paras 3.8-3.10

[12] See ref.: ADF/BD/WP/2005/06/Corr.2, dated 1st February 2005, paras 7.3-7.21.

[13] Additional issues identified in the CPPR ratings process are examined in para 3.4 above and under Section 4.5.

level in view of the PBA formula that is sensitive to annual variations in the input variables: CPIA, CPPR, GNI per capita and the Governance Factor (GF)[14]. This is compounded by the new policy on annual allocations, which specifies firm allocations only for the first year, but indicative allocations for each of the two outer years of the ADF cycle. In the face of a decline in the annual PBA envelope, and the corresponding annual allocations, countries in the middle of ongoing negotiations on projects and programs are compelled to make critical choices to either scale down considerably such projects or programs, because of lack of predictability of ADF resources, or look for co-financing opportunities.

4.2.2 Second, there is the problem of predictability of loan/grant eligibility on an annual basis in view of the need to apply the DSF loan/grant rankings year-by-year. Application of the DSF implies reclassification of some RMCs which may receive grants in one period, loans in another period, and loan/grant combinations in some other periods[15]. In the light of this, some RMCs have raised the concern regarding predictability of grant resources for countries which engage in Joint Assistance Strategies or Medium-term Plans to fund their poverty reduction programs. A country now classified to receive 100 percent loans, but engaged in ongoing negotiations on projects prepared and appraised on the basis of grant segments, faces a situation where the financing conditions have changed.

4.2.3 In addition there is a credibility problem for the Fund in its dialogue with some governments which have adopted a debt management strategy that insists on no loan contracts for social sector projects in education, health, and HIV/AIDS, among others. It is emphasized that at appraisal the totality of grant resources for such social sector projects was underscored. These governments put a high premium on predictability of grant resources in preparing their medium-term budgets for implementing public expenditure programs, but the application of the DSF tends to reduce significantly the predictability of grant resources for such RMCs.

4.2.4 The application of the DSF rankings and the annual variations in performance ratings tend to aggravate the difficulty of planning ADF-funded interventions at the country level, and accordingly this is likely to prevent the Fund from meeting one of the main requirements of the Paris Declaration on Aid Effectiveness, which is to promote predictability of aid flows.

4.3 *Effective Weight of Governance in the PBA System*

4.3.1 In the light of the refinements in the revised CPIA for the ADF-X cycle, the effective weight of governance in the overall CPA is now estimated as **59.27 percent** under ADF-X, below the 61.25 percent estimate under ADF-IX. This compares with an estimate of **66.27 percent** under IDA14, and 68 percent under IDA13. The difference in the Fund's effective weight of governance under ADF-X vis-à-vis ADF-IX is attributed to the new 16-criteria CPIA as compared with the previous 20-criteria CPIA , while the relatively lower effective weights of

[14] See Annex 1 attached.

[15] The following are some examples. Cameroon which was classified to receive 100 percent grants during the 2005 PBA process, was re-classified to receive 100 percent loans during the 2006 PBA process. Benin, Uganda, and Zambia which were classified to receive a combination of loans and grants in various proportions during the 2005 PBA process, were re-classified to receive 100 percent loans under the 2006 PBA process. Also, Djibouti and Niger which were classified to receive 100 percent loans under the 2005 PBA process, were re-classified to receive 100 percent grants under the 2006 PBA process.

governance for the Fund as compared to IDA is explained by the higher exponent on the GF for IDA of 1.5, and of 1.0 in the Fund's GF formula[16]

4.3.2 A significant issue related to the effective weight of governance in the PBA system is the problem of double counting of governance in the fourth cluster of the CPIA and also in the GF where the governance elements constitute 5 of the 6 elements in measuring the GF. Thus any small decline in the rating of the fourth cluster of the CPIA magnifies into a major decline in the GF, the adjusted CPA, and the corresponding country allocation. This is vividly illustrated in the implications on the 2006 country allocation envelopes of Burkina Faso, Chad and Ghana[17].

4.3.3 Thus, even with the Fund's definition of GF, where the exponent is 1.0, this double counting causes wide swings in the annual variations in country allocations. An exponent of 1.5 would further increase the volatility in the annual allocations. In this connection, Deputies are invited to provide guidance regarding the elimination of double counting.

4.3.4 One proposal to eliminate the problem of double counting of governance is to simplify the CPIA Questionnaire by limiting the CPIA to only the first three clusters, excluding the fourth cluster. In this proposal, the Governance Factor is maintained to include all 5 elements of the CPIA's fourth cluster, plus the procurement element of the CPPR.

4.4 *Weight of the Population Factor in the PBA System*

4.4.1 The enhanced PBA system is designed to reward countries with higher performance and encourage low performing countries to improve their performance. However, the reward is on per-capita basis, which implies that the higher the adjusted CPA, the higher is the per capita allocation. The population factor in the PBA formula converts the per-capita allocation to total country allocation in absolute terms. This allows for the possibility of relatively low performing countries with relatively higher population to be allocated larger shares of ADF concessional resources, in absolute terms, vis-à-vis the high performing countries.

4.4.2 To neutralize to some extent the population bias which tends to penalize countries with smaller populations, the minimum UA 5 million allocation for all ADF-eligible RMCs was approved by the Board of Directors in December 2002[18]. The minimum allocation ensures that small countries receive a higher premium on their per capita allocations to compensate for the population bias inherent in the PBA system.

4.4.3 With the minimum allocation applied to all ADF-eligible countries, as shown in Annex 6, Cape Verde, one of the top performing countries (adjusted CPA of 4.22), with a population of 0.5 million, receives a per-capita allocation of UA 20.73, the second highest among all RMCs, but a total allocation of UA 10.26 million. Even so, the bias is not completely eliminated, as by

[16] See Annex 5 for the detailed derivation of the effective weights of governance in the PBA system.
[17] For the 2006 PBA exercise, it was the results of the 2005 CPIA and GF ratings that were applied for all RMCs. For the case of Ghana, the country's 2005 CPIA was 3.83, a 2.2 percent increase over its 2004 CPIA of 3.74. But the reduction in its governance elements of the 2005 CPIA resulted in its 2005 GF rating of 1.0, below its 2004 GF rating of 1.07, which represents a 6.7 percent decrease. The net effect is a 2006 PBA envelope for Ghana of UA 160.32 million, compared with its 2005 PBA envelope of UA 191.22 million, a substantial 16.2 percent decrease.
[18] See the last bullet of para 1.2 above.

comparison, Togo, with about 12 times the population size of Cape Verde, gets almost the same total allocation of UA 10.32 million, even though it is a low performing country (adjusted CPA of 1.51); the country, nevertheless, receives a lower per capita allocation of UA 1.72 as expected.

4.4.4 Some Board members have raised the concern regarding the weight of the population factor in the PBA formula, and called for reducing it to ensure that the strongest performers receive the largest shares. During the second MDBs technical meeting on PBA methods held in Tunis in March 2006[19], the issue was discussed and it was concluded that even though the allocation models used by major MDBs are broadly similar, they do differ in a number of respects in achieving higher per capita allocations for higher performance, with some institutions allocating concessional funds on per capita basis, while others apply variable weights on the population factor. It was 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.

4.4.5 The meeting observed that, while some agencies (IDA, AfDB, GEF) have incorporated minimum country allocations in their PBA formula, others (AsDB, IFAD, DFID) have varying weights on the population factor. Other mechanisms employed include biennial allocations for countries with small populations, additional flexibility in front- and back-loading allocations during the replenishment cycle, as well as through flexible reallocation rules. After extensive discussion, the participants concluded that it is per capita, and <u>not</u> absolute country allocation that should be the criterion for assessing whether higher performance leads to higher allocation for ADF-eligible countries. The positive relationship between per capita allocation and performance is illustrated in Annex 7 attached. Nevertheless, the meeting recognized that the weight of the population factor remains a burning issue that needs to be further examined, in particular during the forthcoming IDA14 and ADF-X Mid-term Review processes.

4.5 *Annual Country Portfolio Performance Ratings Process*

4.5.1 Substantial variability in the CPPR ratings was one of the major factors behind the unusually large variations in the initial 2006 country allocations, vis-à-vis the 2005 allocations (see para 3.4 above). As explained, the large variations were the result of some weaknesses in the annual CPPR data base. Similar to other sister MDBs (e.g., IDA, AsDB), the Fund measures the quality of its portfolio based on the so-called projects-at-risk (PAR) approach. Although the PAR system captures a large range of information about ongoing projects, this approach has some well-known problems.

4.5.2 In particular, assessing the performance of new borrowers, or borrowers that have only a few active or no projects is difficult. Moreover, if only current projects are assessed, cancelling a weak project might result in an improved rating. In addition, the question of whose performance is being measured needs to be resolved. For example, a borrower might fail to meet the Fund's implementation targets, but those targets might sometimes be unrealistic. Evidence also suggests that in some MDBs, project supervisors have rated their projects too optimistically, giving an upward bias to the ratings.

[19] See ref.: ADF/BD/IF/2006/39/Add.1, dated 26 April 2006.

4.5.3 In view of the above and other factors (see para 3.4), resulting in high volatility of portfolio ratings, the observed weaknesses in the CPPR process need to be addressed. First, a thorough cleaning up of the portfolio will be undertaken to remove aged projects (i.e. projects not completed after 8 years, and 5 years for technical assistance operations) and non-performing projects. Second, sufficient budgetary allocation needs to be made to ensure that all projects in a country's portfolio for all RMCs are adequately supervised from one year to the next, by applying the CPPR assessment methodology as spelled out in Annex 8 attached. Third, an important new proposal for consideration is to introduce a technical fix by applying a three-year moving average of the portfolio either for all ADF-eligible countries, or limited to any country that moved from, or moved to, having no project at risk and therefore could experience a sharp change in its CPPR scores.

4.6 ***Post Conflict Enhancement Factor and Other Alternative Measures***

4.6.1 The PBA formula applied for determining ADF-X country allocations includes a built-in post conflict enhancement factor (PCEF). Under ADF-X, in 2006, based on the latest information received from IDA (mid-October 2006), the following 6 countries are now classified as PCEF beneficiaries: Angola, Burundi, Congo DRC, Congo Republic, Eritrea, and Liberia[20]

4.6.2 The essence of the PCEF is that eligible beneficiaries are entitled to receive additional resources by this factor in support of their recovery and in recognition of the period of exceptional need in which they find themselves. Beneficiaries are eligible for a limited period only (up to 6 years), after which they are expected to graduate into normal regional member countries. Underlying the PCEF is a set of 2 questionnaires on the basis of which the selected PCCs are assessed regarding progress they are making in the process of emerging out of conflict.

4.6.3 The first is the Post Conflict Assessment Indicators (PCAI) questionnaire (Annex 9A) which is applied during the first year assessment of a country emerging from conflict. It consists of ten indicators and covers four broad areas: (i) prospects for peace; (ii) country needs; (iii) government's commitment to sustainable development; and (iv) moral hazard concerns. The second is the Post Conflict Progress Indicators (PCPI) questionnaire (Annex 9B), which is applied to assess the degree of progress the country is making after emerging from conflict. This questionnaire has a set of 12 questions, and performance is measured on the basis of the government's record of implementing pro-poor growth policies; it is applied from the second to subsequent years while the country remains a PCEF beneficiary.

4.6.4 Over the 6-year period, while a country benefits from the PCEF, a conscious effort is made in progressively reducing the PCEF ratings. Thus, the ratings assigned to particular PCCs show a declining trend until they graduate out of the PCC status to become regular RMCs. The "phasing down" mechanism is a discount factor applied to the ratings determined from the responses to the PCEF questionnaire.

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[20] In September 2006 when the revised 2006 country allocations were determined, the following 9 PCCs were PCEF beneficiaries: Angola, Central African Republic (CAR), Congo DRC, Congo Republic, Eritrea, Guinea Bissau, Liberia, Sierra Leone, and Sudan. As of this date (mid-October 2006) Sierra Leone has graduated from post conflict status, and the following 3 RMCs are now excluded: CAR, Guinea Bissau, and Sudan.

4.6.5 While the ADF's PCEF is a component of the adjusted CPA, and therefore additional allocations to PCCs are determined within the framework of the PBA exercise, in contrast, additional resources from IDA to the PCCs are determined from a pool of extra resources outside of the PBA system. IDA's pool of resources which is earmarked for PCCs is set aside from the IDA replenishment resources and allocated separately based on alternative criteria but using a set of questionnaires similar to those presented in Annexes 9A and 9B.

4.6.6 One proposal for consideration is to eliminate the PCEF from the Fund's PBA formula in line with IDA's practice. Nevertheless, this would be accompanied simultaneously by setting aside, from the ADF replenishment resources, a larger pool of resources of an enlarged Post Conflict Country Facility (PCCF) into a so-called Fragile States Facility (FSF) designed to cater for the needs of both arrears clearance and reconstruction and rehabilitation in the post conflict and fragile countries[21].

4.7 ***Annual Allocations and the Front and Back Loading Mechanism***

4.7.1 In line with the new policy on annual ADF allocations approved by the Boards of Directors on 29 September 2006[22], the ADF-X resource envelope is allocated over a 3-year lending period, with *firm* amounts for just the first year and *indicative* amounts for the outer years. It is noted that all new Results-based Country Strategy Papers (RB-CSPs) should include an explicit statement that lending is firm for the first year and that the projections are indicative for years 2 and beyond. Further the policy states that during the first and second years of the lending cycle, countries may front load up to 50 percent of the next year's allocation or back load up to 100 percent of the previous year's allocation that was not committed during that year[23]. The front- and back-loading mechanism is illustrated in Annex 10 attached for ease of reference.

4.7.2 The second MDBs technical meeting on PBA methods underscored the importance of balancing predictability in allocations with the ability to respond quickly to the changes in countries' performance. In this connection, all the key MDBs apply the front-and back-loading mechanism which provides some flexibility in managing their allocations. Accordingly, a country that has experienced a shortfall in its allocation envelope in the second year of the 3-year ADF cycle should not be penalized by abruptly stopping ongoing negotiations on projects, cancel, or scale down such projects or programs, because of the temporary shortfall. Through the front and back loading mechanism, the country has the flexibility to maintain its project pipeline while looking for co-financing opportunities, or improving its performance ratings to raise its allocation in the next period, for financing its projects and programs.

[21] See *Proposals for Enhancing Bank Group Assistance to Fragile States in Africa*, ref.: ADF/BD/WP/2006/138, dated 31 October 2006, paras 7.1.1-7.1.8

[22] See *Annotated Format for Bank Group Results-based Country Strategy Papers (RB-CSPs)*, dated 19 September 2006, ref.: ADF/BD/WP/2004/179/Rev.4/Approval, Section 4.6, pp. 17-18. See also *Enhanced Performance-based Allocation Framework for ADF-X*, ref.: ADF/BD/WP/2005/93/Rev.1, dated 5 August 2006, paras 3.7.3 – 3.7.6.

[23] For countries with minimum allocation (i.e., allocation envelopes less than UA 10 million) the country is allowed to have firm allocation of 50 percent of the allocation envelope during the first year, and can front load up to 100 percent of the outer year's allocation. See ref.: ADF/BD/WP/2005/93/Rev.1, para 3.7.3, third bullet.

4.8 *Eligibility Criteria for Reallocation of ADF-X Resources*

4.8.1 As proposed in the policy document on the Enhanced PBA Framework for ADF-X, reallocations are carried out during the third year of the ADF cycle, as the amounts involved are relatively small compared with amounts during annual ADF PBA exercises. The reallocations are based on idle resources from non-performing countries to performing countries which satisfy a set of eligibility criteria. There are 4 key eligibility criteria:

(a) <u>Performance</u>: Eligible countries must have an adjusted CPA ≥ 3.0 and a CPIA ≥ 3.25;
(b) Country must demonstrate high absorptive capacity;
(c) Country's project must conform with ADF strategic priorities and ADF-X lending and financing priorities and guidelines; and
(d) Country must not have accumulated any arrears or be under Bank Group sanctions.

4.8.2 It is noted that the adjusted CPA is a weighted average of CPIA, CPPR, GF, and PCEF, which is a more comprehensive measure of performance than the CPIA. Nevertheless, both the conditions, adjusted CPA ≥ 3.0 and a CPIA ≥ 3.25, must be satisfied simultaneously.

4.8.3 Some Board members have proposed setting a higher performance threshold - preferably at adjusted CPA above 3.5 - to demonstrate that this extra funding from reallocation is really to the top and best performers. The concern is raised regarding the prospect of countries which far exceed the lower threshold being denied an additional allocation only because countries closer to the threshold have projects ready to go.

4.9 *The Free Rider Issue and Implications for the DSF and the MDRI*

4.9.1 The "free riding" issue refers to situations in which non-concessional lenders indirectly obtain financial gain from grants and concessional resources, as well as MDRI debt relief, provided by ADF and IDA, without any costs incurred. Grant recipients and MDRI-eligible countries facing sharply reduced debt burdens are the potential targets for new borrowing from commercial and other non-concessional sources.

4.9.2 The free rider problem is an issue that affects all MDBs together as concessional lenders, and it is therefore not an issue to be addressed independently by ADF alone, but in close consultation and harmonization with all MDBs and IFIs. This calls for adopting a uniform approach to discourage the free riding behavior through sanctions and incentives applied together among all IFIs. In this connection, all IFIs acknowledge that IDA/IMF play the lead role, and ADF is in close consultations with them and other MDBs to adopt such a common approach

4.9.3 One important incentive measure proposed is for all IFIs to adopt a common measure of concessionality, and the DSF has been proposed as that common concessionality measure. Other common strategies being considered by the MDBs community to resolve the issue include: (i) strengthening reporting requirements and grant agreements on planned and new non-concessional borrowing; (ii) creating incentive mechanisms (additional grant discounts, PBA reductions, etc.) to restrain prospects of non-concessional borrowing; and (iii) harmonizing free riding policies among the creditor community. In addition, debt management capacity should be strengthened in borrowing countries to neutralize the adverse impact of free riding behaviour on the DSF and MDRI through: (i) improving debt data collection and reporting to the MDBs; and (ii) providing technical assistance, institutional support and capacity building operations on debt management in borrowing countries.

4.9.4 Management plans to prepare a paper, in liaison with the MDBs community, highlighting the ADF's stance on this issue for discussion during the ADF-XI replenishment consultations.

4.10 *Relative Weights of Key Variables in the Enhanced PBA Formula*

4.10.1 The concerns raised by various stakeholders (Board members, government officials, etc.) with respect to application of the enhanced PBA framework have led some to call for a complete overhall and revision of some of the key elements of the enhanced PBA formula as specified in para 2.1 above. Among these are proposals to revise or change the exponents applied to the key determinants of the PBA model: the poverty index (GNI per capita), the adjusted CPA (CPA*) performance indicator, and the Population factor. Other proposals have focused on the need for revising the relative weights of the CPIA and CPPR in the basic CPA performance indicator.

4.10.2 One of the calls for revision relates to the exponents or relative weights attached to the poverty index, the GNI per capita, vis-à-vis the performance indicator, the adjusted CPA. It is argued that the very low premium accorded to poverty in the PBA formula cannot be defended by the Fund, the primary objective of which is poverty reduction. It is underscored that the relative weight on the poverty index (0.125), compared to the weight on the performance indicator (2.0), represents about 16 times the premium on poverty, seen as disproportionate, and should be revised as appropriate.

4.10.3 In addition, some have argued that the GNI per capita does not adequately reflect the incidence of poverty, as it is a measure of average national income which ignores differences in income distribution. Accordingly, among alternative poverty indicators, the UNDP's Human Development Index (HDI) is noted by some as a relatively better proxy for poverty, reflecting elements of human capital development and income distribution, and thus could be recommended for discussion as the new poverty indicator in a revised PBA formula.

4.10.4 The second concern raised refers to the relative weights the Fund assigns to the CPIA (70 percent) and CPPR (30 percent) in the composite CPA performance measure, by comparison with IDA which assigns weights of 80 and 20 percent respectively for the CPIA and the CPPR in its CPA. It is noted that the Fund's relative weights had been approved by the Boards of Directors and Governors since the ADF-VIII (1999-2001) period. Moreover, the higher 30 percent weight on CPPR reflects the Fund's relatively higher emphasis placed on country portfolio performance within the overall CPA. Nevertheless, in the current environment of high year by year volatility in the CPPR, more caution is warranted regarding the relatively high premium placed on the CPPR within the overall CPA. It is also noted that the weight given to the CPPR is too high relative to the average quality of the ADF portfolio in relation to IDA's African portfolio. Some have therefore called for revising the Fund's PBA formula by defining the weights of the CPIA and CPPR in the CPA, as 80 and 20 percent respectively, as in IDA's PBA formula.

4.10.5 The above proposals on revising the PBA formula are presented here only for discussion during the Mid-term Review of ADF-X, pending their full consideration during the ADF-XI replenishment consultations. These proposals need further study and review, in consultation with other MDBs and stakeholders, within the framework of the annual technical MDBs meetings on PBA methods. The next meeting is scheduled for 17-18 January 2007 in Washington, DC.

V. The Way Forward and Conclusion

The Way Forward

5.1 The enhanced PBA system is an essential framework for the allocation of scarce ADF resources, and needs to be maintained. Nevertheless, this paper clearly shows that the system is not yet perfect, and therefore will require continuous refinements, improvements, and adjustments as necessary, in close consultation with the Deputies on the one hand, and with partner MDBs and the beneficiary countries, on the other.

5.2 Management remains strongly committed to deepen in-house consultations on the PBA system, with a special focus on a strong involvement of country directors and the country teams, including field offices staff. Action will also be taken to scale up and enhance consultations and dialogue with RMCs through sensitization missions and seminars providing clarifications on the CPIA and CPPR processes and the methodology of the PBA system.

5.3 The outstanding issues and challenges of the PBA system examined under Section IV of this paper are complex and require careful review and guidance by Deputies. This is important to assist the Fund come up with proposals for amendments, as appropriate, that could be taken into account during the forthcoming ADF-XI replenishment consultations. The key issues are highlighted below:

(a) The need to reduce volatility in the CPIA and CPPR ratings, and improve predictability of annual allocations. Consideration could be given, among other things:

- To strengthen the internal peer review process, and to better harmonize ADF's assessments with those of IDA, for the purpose of reducing substantially elements of subjectivity, in order that this results in more credible and objective assessments. To better achieve this objective, it is important to recognize the differences in time frame, i.e., calendar year for ADF (Jan-Dec) and fiscal year (July-June) for IDA.

- To conduct CPIA and CPPR assessments, as well as the PBA exercise, only once during the ADF replenishment cycle. This would ensure predictability of allocations, and avoid the annual volatility of performance ratings and allocations; and/or

- To look into the possibility of putting a cap of 20-25 percent on variations in country allocations in the second and third years to reduce the extreme volatility and swings in country allocations.

- To design a technical fix to apply a three-year moving average of the CPPR scores rather than using the current annual CPPR scores; and

- To improve portfolio management and supervision through systematic and thorough cleaning up of ageing and non-performing projects.

(b) The implications of the new DSF on predictability of financing terms (loan/grant resources) and the variability in input ratings resulting from annual assessments. An enhanced policy dialogue with RMCs will be crucial to assist them cope with the problem of predictability of ADF resources.

(c) The need to reduce or eliminate the double counting of governance in the PBA system. Consideration could be given to revising the CPIA Questionnaire by limiting the CPIA to only the first three clusters, while the Governance Factor, which includes all 5 elements of the CPIA's fourth cluster, is maintained (see paras 4.3.2-4.3.4).

(d) The need to reward small performing countries under the enhanced PBA system. Consideration could be given to reducing the weight of the population factor; or to raise the minimum allocation to these countries; or both (see paras 4.4.4-4.4.5).

(e) The need to take into account the special financing requirements of post conflict and fragile states. It could be envisaged to set up a larger pool of resources such as the proposed Fragile States Facility (FSF) to cater for both arrears clearance and reconstruction and rehabilitation in these countries (see para 4.6.6). As a result, the PCEF could be removed from the PBA formula in line with best practices as in IDA.

(f) The criteria for the relocation of unused resources. Consideration could be given to defining clear eligibility criteria for the reallocation of unused resources from non-performing to performing countries. A proposal on setting a higher performance threshold by increasing the adjusted CPA from 3 to 3.5 could be examined (see paras 4.8.1 and 4.8.3).

(g) The revision of the enhanced PBA formula. It could be envisaged to re-examine assigning new relative weights or exponents to the key variables in the enhanced PBA formula. As well, the relative weights assigned to CPIA and CPPR in the CPA formula could be revised, adjusted as appropriate and/or aligned with IDA's CPA formula (see paras 4.10.2 and 4.10.4).

Conclusion

5.4 To better address all the above-mentioned issues and challenges, ADF will continue to scale up and deepen its collaboration and partnership with sister MDBs in order to come up with concrete proposals on the issues of common interest. This will be actively pursued within the framework of the MDBs annual technical meetings on PBA methods, the next meeting of which is scheduled for January 2007. To that end, ADF will continue to seek the advice and guidance of Deputies on the way forward. This will be a key agenda item during the forthcoming ADF-XI replenishment consultations.

Annex 1

2005 and 2006 ADF-X Allocations & Inputs - Initial Country Allocations

	Beneficiairy countries	Total Allocation		% change	Population		% change	GNI/Cap		% change	CPIA		% change	CPPR		% change	GF		% change	CPA Adjusted		% change
		2005	2006	(2006/2005)	2005	2006	(2006/2005)	2005	2006	(2006/2005)	2005	2006	(2006/2005)	2005	2006	(2006/2005)	2005	2006	(2006/2005)	2005	2006	(2006/2005)
1	Cape Verde	9.85	10.05	2.0%	0.47	0.50	5.4%	1440	1770	22.9%	3.98	4.21	5.6%	2.50	3.00	20.0%	1.12	1.14	2.1%	3.96	4.40	11.0%
2	Senegal	120.01	74.14	-38.2%	10.24	11.39	11.2%	540	670	24.1%	3.95	4.01	1.5%	4.00	2.00	-50.0%	1.10	1.10	0.0%	4.34	3.73	-14.1%
3	Uganda	205.59	246.93	20.1%	25.28	27.82	10.0%	250	270	8.0%	3.84	3.88	1.0%	3.00	4.50	50.0%	1.02	1.00	-2.3%	3.67	4.07	10.7%
4	Tanzania	283.95	283.59	-0.1%	35.89	37.63	4.8%	300	330	10.0%	3.80	3.93	3.5%	2.50	3.00	20.0%	1.02	1.04	1.6%	3.49	3.80	8.9%
5	Burkina Faso	112.96	75.48	-33.2%	12.11	12.82	5.9%	300	360	20.0%	3.79	3.77	-0.7%	2.50	2.00	-20.0%	1.10	1.02	-6.5%	3.73	3.31	-11.1%
6	Ghana	191.22	140.17	-26.7%	20.67	21.66	4.8%	320	380	18.8%	3.74	3.83	2.2%	3.00	3.00	0.0%	1.07	1.00	-6.7%	3.77	3.58	-5.1%
7	Mali	124.30	80.21	-35.5%	11.65	13.12	12.6%	290	360	24.1%	3.73	3.74	0.4%	4.00	2.50	-37.5%	1.05	1.02	-2.3%	3.99	3.45	-13.5%
8	Benin	52.54	57.28	9.0%	6.72	8.18	21.7%	440	530	20.5%	3.72	3.72	0.0%	2.00	2.50	25.0%	1.12	1.10	-2.1%	3.58	3.67	2.5%
9	Kenya	178.28	222.14	24.6%	31.92	33.47	4.9%	400	460	15.0%	3.71	3.73	0.4%	2.00	3.00	50.0%	0.93	1.02	10.3%	2.97	3.59	21.0%
10	Rwanda	56.59	67.48	19.2%	8.40	8.88	5.8%	220	220	0.0%	3.68	3.58	-2.9%	2.50	4.00	60.0%	1.02	1.10	7.0%	3.41	4.06	19.0%
11	Mozambique	179.85	138.62	-22.9%	18.79	19.42	3.4%	210	250	19.0%	3.62	3.58	-0.9%	4.00	4.00	0.0%	1.00	0.98	-2.4%	3.73	3.62	-3.0%
12	Cameroon	99.27	74.51	-24.9%	16.09	16.04	-0.3%	630	800	27.0%	3.61	3.45	-4.5%	4.00	3.00	-25.0%	0.95	0.93	-2.5%	3.55	3.08	-13.3%
13	Lesotho	16.44	15.25	-7.2%	1.79	1.80	0.3%	610	740	21.3%	3.61	3.66	1.4%	3.00	4.00	33.3%	1.00	0.95	-4.8%	3.43	3.58	4.6%
14	Mauritania	20.47	17.66	-13.8%	2.85	2.98	4.6%	400	420	5.0%	3.48	3.40	-2.2%	2.50	4.00	60.0%	0.90	0.86	-5.3%	2.88	3.07	6.6%
15	Niger	69.76	73.83	5.8%	11.76	13.50	14.8%	200	230	15.0%	3.43	3.48	1.7%	2.50	4.00	60.0%	0.90	0.95	5.3%	2.85	3.47	21.7%
16	Ethiopia	284.48	267.79	-5.9%	68.61	75.60	10.2%	90	110	22.2%	3.43	3.46	1.0%	4.00	4.00	0.0%	0.98	1.07	9.8%	3.51	3.88	10.5%
17	Chad	47.08	24.60	-47.8%	8.58	9.45	10.1%	240	260	8.3%	3.43	3.01	-12.2%	3.00	3.00	0.0%	0.93	0.79	-15.4%	3.06	2.36	-22.9%
18	Djibouti	8.87	7.12	-19.7%	0.71	0.78	10.5%	910	1030	13.2%	3.43	3.32	-3.2%	2.00	2.00	0.0%	0.90	0.98	7.9%	2.71	2.85	5.2%
19	Madagascar	102.15	89.21	-12.7%	16.89	18.11	7.2%	290	300	3.4%	3.41	3.46	1.5%	2.50	2.50	0.0%	0.95	0.95	0.0%	2.99	3.02	1.1%
20	Gambia	10.76	10.32	-4.1%	1.42	1.48	4.0%	270	290	7.4%	3.31	3.29	-0.5%	2.50	4.00	60.0%	0.93	0.90	-2.6%	2.85	3.17	11.4%
21	Zambia	46.68	64.01	37.1%	10.40	11.48	10.3%	380	450	18.4%	3.26	3.48	6.9%	2.50	2.50	0.0%	0.88	1.02	16.2%	2.67	3.26	22.3%
22	Malawi	47.01	76.48	62.7%	10.96	12.61	15.0%	160	170	6.3%	3.21	3.26	1.6%	2.50	4.00	60.0%	0.88	0.98	10.8%	2.64	3.40	28.8%
23	Congo, Rep. of	18.77	20.15	7.4%	3.76	3.88	3.4%	650	770	18.5%	3.19	2.88	-9.7%	1.00	2.50	150.0%	0.86	0.81	-5.6%	2.66	3.03	14.3%
24	Sao Tome & Principe	5.33	4.37	-18.1%	0.16	0.15	-2.6%	300	370	23.3%	3.10	3.05	-1.6%	2.50	2.50	0.0%	0.88	0.88	0.0%	2.57	2.54	-1.2%
25	Burundi	28.29	38.18	34.9%	7.21	7.28	1.1%	90	90	0.0%	3.00	3.11	3.6%	1.00	2.00	100.0%	0.79	0.86	9.1%	2.21	2.89	30.6%
26	Guinea	32.94	25.01	-24.1%	7.91	9.20	16.3%	430	460	7.0%	2.98	3.13	5.0%	3.00	2.50	-16.7%	0.90	0.86	-5.3%	2.70	2.52	-6.7%
27	Sierra Leone	29.68	29.55	-0.5%	5.34	5.34	0.0%	150	200	33.3%	2.83	3.03	7.1%	3.00	3.00	0.0%	0.81	0.79	-2.9%	2.73	3.16	15.5%
28	Congo DRC	182.30	252.93	38.7%	53.15	55.85	5.1%	100	120	20.0%	2.80	2.83	1.2%	3.00	4.00	33.3%	0.79	0.86	9.1%	2.28	2.92	28.3%
29	Angola	36.57	44.12	20.6%	13.52	15.49	14.6%	740	1030	39.2%	2.79	2.73	-2.4%	2.00	3.50	75.0%	0.74	0.69	-6.5%	2.15	2.41	12.2%
30	Central African Repub	10.18	9.15	-10.1%	3.88	3.99	2.7%	260	310	19.2%	2.77	2.47	-10.8%	1.00	1.00	0.0%	0.73	0.62	-15.2%	1.63	1.44	-11.5%
31	Togo	11.03	12.19	10.6%	4.86	5.99	23.2%	310	380	22.6%	2.64	2.59	-1.9%	1.00	2.00	100.0%	0.74	0.71	-3.2%	1.59	1.72	8.7%
32	Cote D'Ivoire	19.44	18.69	-3.9%	16.84	17.87	6.2%	660	770	16.7%	2.62	2.58	-1.6%	1.00	2.00	100.0%	0.64	0.60	-7.4%	1.37	1.43	4.4%
33	Sudan	35.32	43.30	22.6%	33.55	35.52	5.9%	460	530	15.2%	2.62	2.62	0.0%	1.00	1.00	0.0%	0.64	0.64	0.0%	1.37	1.57	14.4%
34	Eritrea	20.10	17.20	-14.4%	4.39	4.23	-3.6%	190	180	-5.3%	2.50	2.54	1.7%	4.00	3.50	-12.5%	0.74	0.76	3.2%	2.38	2.38	-0.3%
35	Comoros	5.14	5.31	3.3%	0.60	0.78	29.5%	450	530	17.8%	2.26	2.42	7.0%	1.00	1.00	0.0%	0.57	0.64	12.5%	1.07	1.28	19.1%
36	Guinea-Bissau	5.80	7.39	27.5%	1.49	1.54	3.4%	140	160	14.3%	2.23	2.83	27.0%	1.00	2.00	100.0%	0.59	0.74	26.0%	1.09	1.91	74.8%
37	Liberia	6.97	8.68	24.5%	3.37	3.24	-4.0%	110	110	0.0%	2.04	2.54	24.5%	1.00	1.00	0.0%	0.61	0.60	-2.3%	1.05	1.41	33.4%
38	Somalia	5.27	5.12	-2.7%	9.63	7.96	-17.3%	90	90	0.0%	1.00	1.00	0.0%	1.00	1.00	0.0%	0.29	0.29	0.0%	0.29	0.29	0.0%
39	Nigeria	138.04	138.44	0.3%	136.46	128.71	-5.7%	350	350	0.0%	2.85	3.18	11.4%	1.00	2.00	100.0%	0.81	0.81	0.0%	1.86	2.28	23.0%
40	Zimbabwe	12.52	8.13	-35.1%	13.10	12.94	-1.3%	480	480	0.0%	2.38	1.90	-20.3%	1.00	1.00	0.0%	0.69	0.57	-17.2%	1.36	0.93	-31.5%
	Total	**2,871.79**	**2,804.77**		**651.41**	**678.68**	4.2%	**14,850**	**17,330**		**125.73**	**126.65**		**92.50**	**108.00**		**34.57**	**34.61**		**106.14**	**112.52**	

Annex 2

Technical Details of the ADF-X Country Resource Allocation Model

The ADF-X Country Resource Allocation Model reflects the allocation of scarce concessional resources on the basis of performance and need. Country performance assessment (CPA) is derived from a weighted average of country policy and institutional assessment (CPIA) and country portfolio performance rating (CPPR):

$$CPA_i = \alpha\, CPIA_i + \beta\, CPPR_i \quad (1)$$

$$GF_i = (GR/3.5)_i \quad (2)$$

$$PCEF_j = (1 + k_j); \quad k_j = \text{constant for 6 PCCs, and zero otherwise} \quad (3)$$

$$(CPA^*)_i = [(CPA)_i\,(GF)_i\,(PCEF)_j\,] \quad (4)$$

where $\alpha = 0.7$; and $\beta = 0.3$ are fixed policy parameters determined by Management; GF is the governance factor; GR is the governance rating derived from 6 criteria, 5 of which are from the CPIA and the 6^{th} from the procurement criterion of the CPPR; PCEF is the post conflict enhancement factor, with k_j capped at 50% and applied to only the 6 post conflict countries, hence PCEF=1 for all countries except post conflict; $(CPA^*)_i$ is designated as the adjusted CPA.

The Model

The model, which allocates ADF concessional resources per country, is given by:

$$A_i = (GNI/P)_i^{-\lambda}\,(CPA^*)_i^{\theta}\,(P)_i \quad (5)$$

$$\text{and } \lambda = 0.125; \quad \theta = 2$$

where A_i is the allocation share for country i, GNI is gross national income; P is population; $(-\lambda)$ is a fixed inverse exponential representing need; θ is the performance exponential applied to the CPA, and all other variables are as already defined.

The total allocation for all countries (A) is given by:

$$A = \sum A_i \quad (6)$$

The share of country i in the total allocation for all countries is derived as:

$$bi = (A_i)/(\sum A_i), \quad \sum bi = 1 \quad (7)$$

Thus, the PBA formula for determining actual country allocations follows:

$$Z_i = [b_i * (X - (\eta + \Sigma\delta))] + \delta \quad (8)$$

where Z_i is country i's share of available resources for allocation; X represents total resources or the total replenishment available; η is the sum of special allocations set aside (e.g. for HIPC, regional projects, policy-based loans, research institutions, project preparation facility, etc.); and δ is a fixed, predetermined minimum allocation for each country.

Annex 3

	2005 and 2006 ADF-X Allocations					
			Final ADF-X Allocations			
	ADF-eligible countries		Total Allocations - UA million		Allocation % change	Adj. CPA % change
			2005 PBA	2006 PBA		
1	Cape Verde		9.85	10.26	4.2%	6.7%
2	Senegal		120.01	111.76	-6.9%	1.0%
3	Uganda		205.59	209.96	2.1%	-1.6%
4	Tanzania		283.95	294.82	3.8%	4.4%
5	Burkina Faso		112.96	92.85	-17.8%	-7.0%
6	Ghana		191.22	160.32	-16.2%	-5.1%
7	Mali		124.30	110.27	-11.3%	-2.0%
8	Benin		52.54	51.80	-1.4%	-2.1%
9	Kenya		178.28	211.44	18.6%	10.7%
10	Rwanda		56.59	57.98	2.5%	4.5%
11	Mozambique		179.85	160.36	-10.8%	-3.0%
12	Cameroon		99.27	105.72	6.5%	-5.5%
13	Lesotho		16.44	15.37	-6.5%	-3.8%
14	Mauritania		20.47	15.68	-23.4%	-6.8%
15	Niger		69.76	59.28	-15.0%	6.6%
16	Ethiopia		284.48	274.68	-3.4%	10.5%
17	Chad		47.08	26.29	-44.2%	-22.9%
18	Djibouti		8.87	7.30	-17.7%	5.2%
19	Madagascar		102.15	97.67	-4.4%	1.1%
20	Gambia		10.76	9.44	-12.3%	-2.9%
21	Zambia		46.68	69.18	48.2%	22.3%
22	Malawi		47.01	59.88	27.4%	12.1%
23	Congo, Rep. of		18.77	17.35	-7.6%	-4.3%
24	Sao Tome & Principe		5.33	4.46	-16.3%	-1.2%
25	Burundi		28.29	35.59	25.8%	16.5%
26	Guinea		32.94	27.86	-15.4%	-1.9%
27	Sierra Leone		29.68	35.15	18.4%	15.5%
28	Congo DRC		182.30	237.66	30.4%	16.2%
29	Angola		36.57	35.11	-4.0%	-4.8%
30	Central African Republic		10.18	9.80	-3.8%	-11.5%
31	Togo		11.03	10.32	-6.4%	-4.8%
32	Cote D'Ivoire		19.44	16.76	-13.8%	-8.7%
33	Sudan		35.32	48.07	36.1%	14.4%
34	Eritrea		20.10	21.22	5.6%	5.0%
35	Comoros		5.14	5.27	2.6%	19.1%
36	Guinea-Bissau		5.80	7.13	23.0%	54.5%
37	Liberia		6.97	9.42	35.2%	33.4%
38	Somalia		5.27	5.26	-0.2%	0.0%
39	Nigeria		138.04	141.96	2.8%	9.9%
40	Zimbabwe		12.52	8.61	-31.2%	-31.5%
	Total		**2,871.79**	**2,889.31**		

Annex 4

Netting Out MDRI Debt Relief from ADF-X Country Allocation
(UA million)

HIPC Status	2006	2007	MDRI Debt Relief during ADF-X Cycle	Relloc. of Debt Relief Cost*	ADF-X Resource Allocation			Netting out Debt Relief	ADF-X net Allocation	ADF-X Allocation after MDRI Relief		
					Loans	Grants	Total			Loans	Grants	Total
Completion point countries												
Benin	1.45	1.49	2.94	1.53	53.20	-	53.20	50.27	51.80	51.80		51.80
Burkina Faso	1.58	1.65	3.22	2.84	93.24	-	93.24	90.02	92.85	92.85		92.85
Ethiopia	3.94	4.19	8.13	8.48	152.22	122.11	274.33	266.20	274.68	152.22	122.46	274.68
Ghana	3.93	4.12	8.05	5.11	163.25	-	163.25	155.20	160.32	160.32		160.32
Madagascar	1.99	2.07	4.06	3.01	98.72	-	98.72	94.66	97.67	97.67		97.67
Mali	3.22	3.21	6.43	3.49	113.21	-	113.21	106.78	110.27	110.27		110.27
Mauritania	1.22	1.34	2.56	0.39	17.85	-	17.85	15.29	15.68	15.68		15.68
Mozambique	2.29	2.66	4.95	5.02	160.30	-	160.30	155.35	160.36	160.36		160.36
Niger	1.30	1.31	2.61	2.22	-	59.67	59.67	57.06	59.28		59.28	59.28
Rwanda	1.10	1.14	2.24	2.16	-	58.06	58.06	55.82	57.98		57.98	57.98
Senegal	3.02	4.54	7.56	3.57	115.75	-	115.75	108.19	111.76	111.76		111.76
Tanzania	2.71	2.72	5.43	8.48	291.77	-	291.77	286.34	294.82	294.82		294.82
Uganda	2.58	2.84	5.42	6.59	208.79	-	208.79	203.37	209.96	209.96		209.96
Zambia	1.65	1.76	3.42	2.10	70.49	-	70.49	67.08	69.18	69.18		69.18
Sub Total	**31.97**	**35.04**	**67.01**	**54.99**	**1,538.80**	**239.83**	**1,778.63**	**1,711.62**	**1,766.62**	1,526.89	239.72	1,766.62
Decision point countries												
Burundi	-	0.20	0.20	1.09	-	34.70	34.70	34.50	35.59		35.59	35.59
Cameroon	0.83	1.68	2.51	3.22	105.01	-	105.01	102.50	105.72	105.72		105.72
Chad	0.97	2.17	3.14	0.96	-	28.47	28.47	25.33	26.29		26.29	26.29
Congo DRC	-	1.31	1.31	8.48	-	230.49	230.49	229.18	237.66		237.66	237.66
Gambia	-	0.86	0.86	0.21	-	10.09	10.09	9.23	9.44		9.44	9.44
Guinea	-	3.43	3.43	1.03	-	30.27	30.27	26.83	27.86		27.86	27.86
Guinea-Bissau	-	-	-	0.09	-	7.04	7.04	7.04	7.13		7.13	7.13
Malawi	1.17	2.44	3.61	2.02	34.10	27.36	61.46	57.85	59.88	34.10	25.77	59.88
Sao Tome & Princ	0.28	0.57	0.85	0.02	-	5.29	5.29	4.44	4.46		4.46	4.46
Sierra Leone	0.64	1.28	1.91	1.13	-	35.93	35.93	34.02	35.15		35.15	35.15
Sub Total	**3.89**	**13.93**	**17.81**	**18.26**	**139.11**	**409.63**	**548.74**	**530.92**	**549.18**	139.82	409.36	549.18
Pre-Decision point countries										-		-
Central African R	-	-	-	0.16	-	9.63	9.63	9.63	9.80		9.80	9.80
Comoros	-	-	-	0.02	-	5.25	5.25	5.25	5.27		5.27	5.27
Congo, Rep. Of	-	-	-	0.43	-	16.92	16.92	16.92	17.35		17.35	17.35
Cote d'Ivoire	-	-	-	0.47	-	16.29	16.29	16.29	16.76		16.76	16.76
Liberia	-	-	-	0.15	-	9.28	9.28	9.28	9.42		9.42	9.42
Somalia	-	-	-	0.02	-	5.24	5.24	5.24	5.26		5.26	5.26
Sudan	-	-	-	1.52	-	46.55	46.55	46.55	48.07		48.07	48.07
Togo	-	-	-	0.22	-	10.11	10.11	10.11	10.32		10.32	10.32
Sub Total	-	-	-	**2.98**	-	**119.27**	**119.27**	**119.27**	**122.24**	-	**122.24**	**122.24**
Sunset Clause												
Eritrea				0.57	-	20.66	20.66	20.66	21.22		21.22	21.22
Remaining RMCs							-		-			
Angola				0.98	18.14	15.98	34.12	34.12	35.11	18.14	16.97	35.11
Cape Verde				0.13	10.13	-	10.13	10.13	10.26	10.26		10.26
Djibouti				0.10	-	7.20	7.20	7.20	7.30		7.30	7.30
Kenya				6.47	204.97	-	204.97	204.97	211.44	211.44		211.44
Lesotho				0.35	8.34	6.69	15.03	15.03	15.37	8.34	7.03	15.37
Nigeria				-	141.96	-	141.96	141.96	141.96	141.96		141.96
Zimbabwe				-	8.61	-	8.61	8.61	8.61	8.61		8.61
Sub Total	-	-	-	**8.03**	**392.15**	**29.87**	**422.02**	**422.02**	**430.05**	**398.75**	**31.30**	**430.05**
Total	**35.86**	**48.97**	**84.82**	**84.82**	**2,070.06**	**819.26**	**2,889.31**	**2,804.49**	**2,889.31**	**2,065.47**	**823.84**	**2,889.31**

* Allocation similation is based on PBA system

<u>Annex 5</u>

Effective Weight of Governance in the Overall CPA

1. *Introduction*

The estimate of the Effective Governance Weight (EGW) in the overall CPA for the African Development Fund (ADF) over the ADF-X period (2005-2007), is different from what it was for the ADF-IX period (2002-2004). One of the main reasons is the fact that the CPIA for the ADF-X period has been revised and consolidated into **16 criteria** from the previous **20 criteria** for the ADF-IX period.

In the analysis below, the Fund's original estimate of the EGW for ADF-IX is illustrated first; this is then followed by the revised EGW estimate for the current ADF-X period.

2. *ADF's Original EGW Estimate for ADF-IX*

Based on IDA's formula for the Effective Weight of the Governance Factor (IDA-EGW) during IDA13, the following equation was applied:

IDA - EGW = 0.8*((6*7)/(6*7+14*1)) + 0.2*(1*7/(1*7+10*1)) = **0.68**

As the ADF Governance Factor during ADF-IX also contains 7 elements, from the above, the formula for EGW may be interpreted as follows:

EGW = á * (relative weight of 6 CPIA elements/ total weighted CPIA elements)
+ â * (relative weight of 1 CPPR element/ total weighted CPPR elements) ...(1)

where á is the share of CPIA in the overall CPA, and â is the share of the CPPR in the overall CPA[24]. In IDA the shares are 80% and 20% respectively, whereas in ADF the shares are 70% and 30% respectively. The Governance Factor itself (GF) under ADF-IX is a weighted average of 7 elements, 6 of which are the same as the 6 elements in the governance cluster of the CPIA, while the seventh element is the procurement factor in the CPPR. In IDA there are 11 elements in the CPPR, while in AfDB there are 18 elements.

Thus, based on the IDA formula (1) above, the ADF's EGW is estimated as follows:

ADF - EGW = 0.7*((6*7)/(6*7)+(14* 1)) + 0.3*((1*7)/(1*7)+17*1)
= 0.7 * 0.75 + 0.3 * 0.291667
= **0.6125**

Thus, for the ADF-IX period, the Effective Weight of the Governance Factor is **61.25%.** This is the estimate of the EGW that the Fund reported to the ADF Deputies during the first ADF-X replenishment consultative meeting in Geneva in February 2004.

[24] CPIA = Country Policy and Institutional Assessment; CPPR = Country Portfolio Performance Rating; and CPA = overall Country Performance Assessment.

3. *ADF's Revised EGW Estimate for ADF-X*

As noted earlier, in the light of the refinements in the revised CPIA for the ADF-X period, the Effective Weight of the Governance is estimated by a different formula as proposed by IDA for the IDA14 period. This is given by:

IDA – EGW = (0.8* ((5*z)/(5*z)+(11*1)) + 0.2*((1*z/(1*z) +(10*1))) ……. (2)

A key element in the new formula is the parameter (**z)**, representing the average ratio between the impact on CPA of an increase in a governance criterion over the impact on CPA of an increase in a non-governance criterion. Thus, on average, changes in governance criteria have **z** times as much impact on the overall CPA as changes in non-governance criteria. The average ratio (**z**) is estimated as 6.07 in this revised formula for the EGW.[25]

Accordingly, the Effective Governance Weight for the IDA14 period is calculated as 66.27 percent, as follows:

IDA – EGW = (0.8* ((5*z)/(5*z)+(11*1))+ 0.2*((1*z/(1*z) +(10*1))) = **0.66273**

The **EGW for the African Development Fund** during the ADF-X period applies the same IDA formula but makes provision for the salient differences that exist between the IDA14 and the ADF-X Performance-based Allocation (PBA) formulas. These include the following: (i) IDA applies an exponent of 1.5 on its definition of the Governance Factor, but the ADF applies an exponent of 1.0; (ii) the weights of the CPIA and CPPR in the IDA14 PBA formulas are 80/20% respectively, as compared with the ADF's weights of 70/30% respectively; and (iii) there is one governance criterion among 11 in IDA's CPPR, whereas there is one governance criterion among 18 in ADF's CPPR.

In estimating the ADF's EGW, once again, the relative importance of governance in the overall CPA rating has to reflect the fact that governance appears in: (i) 5 of the 16 criteria in the revised new CPIA (cluster D); (ii) one of the 18 criteria of the CPPR; (iii) and the governance factor (derived from the average of these 5 CPIA governance criteria plus the one procurement criterion in the CPPR).

Based on the above inputs, the ADF's EGW is estimated as follows:

ADF – EGW = (0.7* ((5*z)/(5*z)+(11*1)) + 0.3*((1*z/(1*z) +(17*1)))
= 0.7 * 0.51378 + 0.3 * 0.07893
= **0.59272**

Thus, the Effective Weight of the Governance Factor will be **59.27%** as applied during the ADF-X period (2005-2007).

[25] See IDA-14: IDA's Performance-based Allocation System: IDA Rating Disclosure and Fine-tuning the Governance Factor, September 2004, Table 3, p.8.

Annex 6

2006 ADF-X Country Allocations - with Per Capita Allocations

	Countries	2005 CPIA	2005 CPA adjusted	DSF Traffic Light Ranking			2006 ADF-X Allocation after MDRI Relief (UA millions)			2006 ADF-X Alloc Per capita (UA)	
				AfDB	FL-DSA	Final	Loans	Grants	Total	Pop (mill.)	Alloc/pc
Strong policy: CPIA >= 3.75											
1	Cape Verde	4.21	4.22	Green		Green	10.26	-	**10.26**	0.50	**20.73**
2	Senegal	4.01	4.39	Green		Green	111.76	-	**111.76**	11.39	**9.82**
3	Tanzania	3.93	3.65	Green	Green	Green	294.82	-	**294.82**	37.63	**7.84**
4	Uganda	3.88	3.62	Yellow	Green	Green	209.96	-	**209.96**	27.82	**7.55**
5	Ghana	3.83	3.58	Green		Green	160.32	-	**160.32**	21.66	**7.40**
6	Burkina Faso	3.77	3.47	Green	Green	Green	92.85	-	**92.85**	12.82	**7.24**
Medium policy : 3.25 < CPIA < 3.75											
1	Mali	3.74	3.91	Green	Green	Green	110.27	-	**110.27**	13.12	**8.40**
2	Kenya	3.73	3.28	Green		Green	211.44	-	**211.44**	33.47	**6.32**
3	Benin	3.72	3.51	Green	Green	Green	51.80	-	**51.80**	8.18	**6.33**
4	Lesotho	3.66	3.30	Green	Yellow	Yellow	8.34	7.03	**15.37**	1.80	**8.55**
5	Rwanda	3.58	3.56	Green	Red	Red	-	57.98	**57.98**	8.88	**6.53**
6	Mozambique	3.58	3.62	Green		Green	160.36	-	**160.36**	19.42	**8.26**
7	Niger	3.48	3.04	Green	Red	Red	-	59.28	**59.28**	13.50	**4.39**
8	Zambia	3.48	3.26	Red	Green	Green	69.18	-	**69.18**	11.48	**6.03**
9	Ethiopia	3.46	3.88	Green	Yellow	Yellow	152.22	122.46	**274.68**	75.60	**3.63**
10	Madagascar	3.46	3.02	Yellow	Green	Green	97.67	-	**97.67**	18.11	**5.39**
11	Cameroon	3.45	3.36	Green	Green	Green	105.72	-	**105.72**	16.04	**6.59**
12	Mauritania	3.40	2.68	Red	Green	Green	15.68	-	**15.68**	2.98	**5.26**
13	Djibouti	3.32	2.85	Red		Red	-	7.30	**7.30**	0.78	**9.37**
14	Gambia	3.29	2.76	Red		Red	-	9.44	**9.44**	1.48	**6.39**
15	Malawi	3.26	2.96	Red	Yellow	Yellow	34.10	25.77	**59.88**	12.61	**4.75**
Poor Policy : CPIA < 3.25											
1	Guinea	3.13	2.65	Red	Red	Red	-	27.86	**27.86**	9.20	**3.03**
2	Burundi	3.11	2.58	Red	Red	Red	-	35.59	**35.59**	7.28	**4.89**
3	Sao Tome & Principe	3.05	2.54	Red		Red	-	4.46	**4.46**	0.15	**29.17**
4	Sierra Leone	3.03	3.16	Red		Red	-	35.15	**35.15**	5.34	**6.59**
5	Chad	3.01	2.36	Green	Red	Red	-	26.29	**26.29**	9.45	**2.78**
6	Congo, Rep. Of	2.88	2.54	Red		Red	-	17.35	**17.35**	3.88	**4.47**
7	Congo DRC	2.83	2.64	Red		Red	-	237.66	**237.66**	55.85	**4.26**
8	Guinea-Bissau	2.83	1.69	Red		Red	-	7.13	**7.13**	1.54	**4.63**
9	Angola	2.73	2.05	Red	Yellow	Yellow	18.14	16.97	**35.11**	15.49	**2.27**
10	Sudan	2.62	1.57	Red		Red	-	48.07	**48.07**	35.52	**1.35**
11	Togo	2.59	1.51	Red		Red	-	10.32	**10.32**	5.99	**1.72**
12	Cote d'Ivoire	2.58	1.25	Red		Red	-	16.76	**16.76**	17.87	**0.94**
13	Eritrea	2.54	2.50	Red		Red	-	21.22	**21.22**	4.23	**5.02**
14	Liberia	2.54	1.41	Red		Red	-	9.42	**9.42**	3.24	**2.91**
15	Central African Repul	2.47	1.44	Red	Red	Red	-	9.80	**9.80**	3.99	**2.46**
16	Comoros	2.42	1.28	Red		Red	-	5.27	**5.27**	0.78	**6.78**
17	Somalia	1.00	0.29	Red		Red	-	5.26	**5.26**	7.96	**0.66**
Blend Countries											
1	Nigeria	3.18	2.04			Green	141.96	-	**141.96**	128.71	**1.10**
2	Zimbabwe	1.90	0.93			Green	8.61	-	**8.61**	12.94	**0.67**
	Total						**2,065.47**	**823.84**	**2,889.31**		
Overall Share of Grants								**28.35%**			

Annex 7

Relationship between Per Capita Allocation and Adjusted CPA

Figure 1A: Performance relationship for all 38 ADF-only RMCs

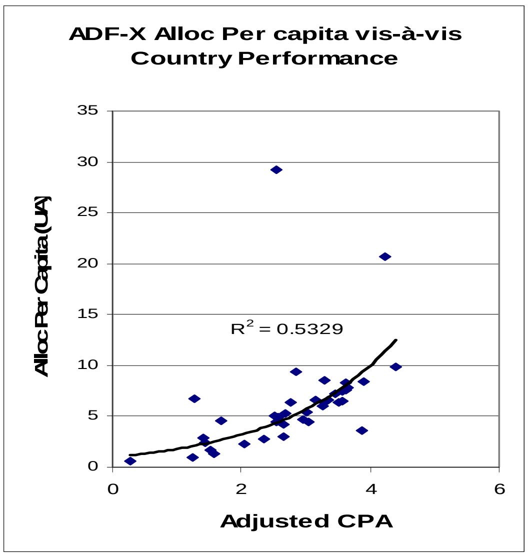
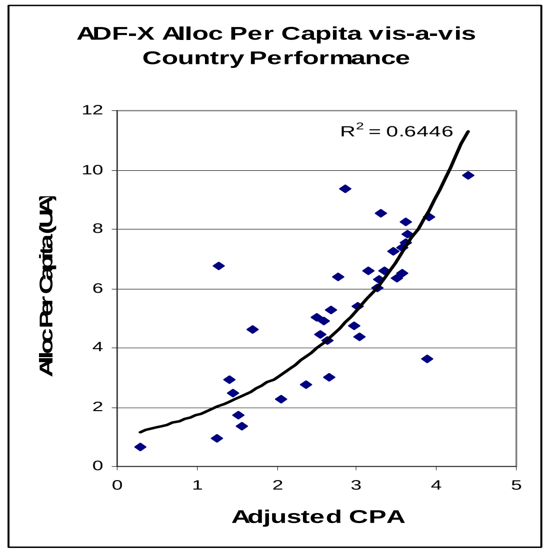


Figure 1B: Performance relationship for ADF-only RMCs, excluding Cape Verde and Sao Tome & Principe



The positive relationship between per capita allocation and performance is illustrated in Figures 1A and 1B above. The graphs are based on the 2006 country allocations data base provided in Annex 5.

For all 38 ADF-only countries, it is shown in Figure 1A that the goodness of fit (R^2 = 53.3 percent) is relatively small, but this is because of the two outliers, Cape Verde and Sao Tome & Principe, with their per capita allocations of UA20.73 and UA 29.17 respectively, while all the other 36 ADF-only RMCs have less than UA 10.0 as their indicative per capita allocations. In Figure 1B, the two outliers are excluded, and this improves the goodness of fit (R^2 = 64.5 percent) for the positive relationship between per capita allocation and performance.

<u>Annex 8</u>

Country Portfolio Performance Rating (CPPR) Methodology

Overview

1. The assessment of the overall country portfolio performance begins with an assessment of the project performance and results for each project into a series of ratings that cover various aspects of project implementation. The assessments are determined by staff based on field survey and desk-based supervisions, but are subject to review by Country Teams and Managers. Two separate scores for each individual project are calculated from the ratings, as described below.

2. The first score, Implementation Progress (IP), attempts to measure relative satisfaction achieved in project execution at a given point in time. This score is based on the average of 14 separately rated indicators for elements such as project management, procurement and fulfillment of loan conditions. The second score measures the likelihood that the project will achieve its development objectives (DO), and is based on the average of 4 indicators, such as the contribution to institutional capacity and the longer-term impact of the project on the beneficiary group. Each of the 18 indicators is rated on a four point scale (0,1,2,3)

3. The 14 IP indicators and 4 DO indicators are averaged separately. An average score of less than 1.5 constitutes a problematic rating. This threshold is consistently applied to all ratings. For a project to be considered problematic, it must possess either an IP <u>*or*</u> a DO score with a value less than 1.5. Thus, it is not necessary for the project to have both an IP and DO less than 1.5 to be considered problematic.

Determination of Projects-at-Risk (PAR)

4. The next step in the assessment is to determine which projects have the *potential* of becoming problematic. This classification signifies that although the project is performing satisfactorily in terms of both IP and DO, there are other indicators, which suggest that the project *may* become problematic in the future. For a project to be classified as *potentially* problematic, it must meet <u>at least 2</u> of the following criteria:

- Elapsed time between approval and effectiveness is greater than 12 months. This applies to all operations: projects, structural adjustment loans, and technical assistance activities.
- Conditions precedent (item A1 of the project rating form) is rated at less than 1.5.
- Procurement of goods and services (B.2) is rated at less than 1.5.
- Project management (D.4) is rated at less than 1.5.
- Counterpart funds (C.2) is rated at less than 1.5.
- Country has a record of high rate of project failure (PPAR/PCR failure rate of 50% in a weak country in terms of macro-economic criteria).
- IP <u>or</u> DO ratings indicate unsatisfactory ratings two years in a row.

5. The above definitions were in use from 1997 through 2001. In the 2002 and 2003 Annual Portfolio Performance Review (APPR), the definition of a *potentially* problematic project was revised in order to apply new, more stringent criteria. The changes included adding the following new criteria to the definition:

- **Refinement of the definition of Projects at Risk:** Additional indicators or risk flags were included in the potentially problematic operations list:
  - less than 10 percent of the loan for a specific operation has been disbursed two years after loan effectiveness, or less than 50 percent of the loan has been disbursed 5 years after loan effectiveness;
  - projects are not completed after 8 years (5 years for TAF) from the date of approval;
  - TAF/Grant-financed capacity building operations have less than 50 percent of the resources disbursed after 3 years from approval; and,
  - a loan- or grant-funded operation is not yet declared effective 12 months after signature.

6. By combining potentially problematic projects with actual problem projects (PP), the criterion "projects-at-risk" (PAR) is obtained. The projects-at-risk indicator mitigates possible underestimation of problem projects by being based on a more comprehensive assessment of the portfolio status. In studies conducted at sister institutions, it has been found that some project officers feel the ratings of operations reflect on them personally – giving rise to a tendency to rate projects better than they actually are. Caution, however, should be applied in the interpretation of the PAR figure, since PAR includes projects that *may* become problematic as well as those which *are* problematic. Note that PAR does *not* predict a negative outcome, but instead draws attention to those projects where additional focus may be needed.

7. The final step involves converting the number of PARs into percentages and assigning the CPPR score. This is done by dividing the actual number of PARs by the number of rated operations for each country. Thus, a country that has ten active, rated projects of which 2 are "at -risk", would have a PAR rate of 20%, and a score of 4.0 as indicated in Box 2 below. The new six point scale, as shown below, has been applied since the beginning of 2002. As observed, through the introduction of 0.5 gradients in 2004, the new conversion scale during ADF-IX "rewards" RMCs for smaller increments in portfolio improvement as compared to the previous scale under ADF-VIII.

Box 2 : Projects at Risk Conversion Table

% Projects at Risk per Country (X)	Rating
X = 0% for 3 or more years	6.0
$0<X\leq5\%$	5.0
$5<X\leq15$ %	4.5
$15<X\leq30$ %	4.0
$30<X\leq35$ %	3.5
$35<X\leq45$ %	3.0
$45<X\leq65$ %	2.5
X > 65%	2.0
X > 65% for 3 or more years	1.0

8. Because of the application of these more rigorous criteria, the overall rate of projects-at-risk increased by about ten percentage points as compared to the previous rating system. The anticipated impact of this change in methodology is that the CPPR rating for several countries will be lower under the new rating system compared to the previous rating system.

Annex 9A

POST CONFLICT ASSESSMENT INDICATORS

Dimensions	Questions
Prospects of Peace	**1. Reconciliation:** Is a peace treaty in place? Have all the major parties signed it? Are insurgent groups still carrying out activities? Which accompanying efforts have been carried out to safeguard the peace treaty or cease fire agreement? Is a mediation process in place and how effective is it?
	2. Domestic Security: Have there been shootings over the past six months? is movement of goods and people around the territory unhindered. to what extent does the security situation allow the preparation, implementation and supervision of projects?
	3. Impact of neighboring conflict: To what extent does conflict in neighboring countries affect the internal conflict dynamics? How would stabilization impact the country's neighbors?
Needs	**4. Damage assessment:** What is the extent of destruction of social and economic infrastructure? What are the needs of conflict-affected groups? What is the estimated cost of a 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? What are the main constraints to absorb development assistance?
	6. Adequacy of available resources: Is there a substantial unmet resource need in light of available government and donor resources? Are other donors making a substantial effort to ensure that the recovery program is fully funded? Would the Fund engagement help mobilize donor resources? If the Fund has a portfolio in the country, what level of resources can be redirected to support the recovery program?
Government Commitment to Sustainable Development	**7. Social and economic reform program:** Is the government intending to pursue social and economic policies that would contribute to sustainable and broad-based economic growth and poverty reduction? Which constraints could impede the implementation of the reform program?
	8. Economic management: Is the government putting in place adequate economic management functions, including fiduciary safeguards? Is the government committed to normalizing relations with donors and creditors, and has it encouraged official creditors to participate in an orderly arrears clearance process?
Moral Hazard Concerns	**9. Signaling impact of Fund involvement**: Could a resumption of Fund assistance undermine the domestic or regional commitment to peace? What role did the incumbent government play in the conflict? Could Fund assistance be perceived to "reward" one or more parties to the conflict?
	10. Probability of misuse of Fund assistance: Could the Fund assistance fuel the conflict? To what degree should the fungibility of resources be considered a concern, either in the country or regionally?

Annex 9B

POST-CONFLICT PROGRESS INDICATORS

A. Security and Reconciliation	
1. Public Security • Effectiveness of civilian policing and efforts to reduce crime • Security for war-affected populations	These indicators underscore the importance of a sustainable peace in post-conflict countries. They assess the authorities' efforts to reduce the probability of renewed conflict and to provide security to the population. They are measures of actions taken by the government to improve the environment for sustainable peace. For several of these indicators, the Fund will need to rely on information provided by UN and bilateral agencies.
2. Reconciliation • Government legitimacy • Progress of mediation process • Integration of parties to the conflict	
3. Demobilization and Disarmament • Effectiveness of D&D program • Effectiveness of efforts to integrate ex-combatants	
B. Economic Recovery	
4. Management of Inflation, External Debt; Adequacy of Budget • Composition of budget • Progress on structural reforms and IMF program • Management of fiscal deficit and debt	This cluster measures the extent to which policies have been implemented to spur economic recovery.
5. Trade policy, Foreign Exchange, and Price Regimes • Functioning of customs authorities • Efficiency of foreign exchange regimes	
6. Management and Sustainability of the Development Program • Soundness of reform program • Progress on implementation • Use of participatory processes	
C. Social Inclusion and Social Sector Development	
7. Reintegration of Displaced population • Government efforts to assist displaced people and returnees.	This cluster assesses if immediate social needs are addressed and focuses on the distribution of assets, income and services among the groups affected by the conflict, and on government policies to reintegrate the displaced population and its provision of the most crucial services in education and health.
8. Education • Efforts to address urgent needs in particular primary education • Efforts to address disparities among individuals or groups affected by conflict	
9. Health • Urgent health care needs, particularly in war affected areas • Disparities among individuals or groups affected by conflict	
D. Public Sector Management and Institutions	
10. Budget Formulation and Efficiency of Revenue Mobilization • Budget formulation and implementation • Effectiveness of revenue collection and tax administration • Effectiveness of public auditing	This cluster evaluates the quality of governance by focusing on the government's efforts to effectively manage the public sector, and on the state of its institutions.
11. Reestablishing the Administration and Rule-based Governance • Functioning of civil administration • Payment of government salaries • Enforcement of contracts • Number of ministries	
12. Transparency, Accountability and Corruption in the Public Sector • Level of government accountability • Extent of corruption and government commitment to reduce	

Annex 10

Annual Country Allocations with Front- and Back-Loading

The policy on annual ADF-X allocations, with front- and back-loading of ADF resources, is illustrated below in Table 1. Two Scenarios are considered.

Scenario 1

1. In this Scenario, it is assumed that the first year's PBA resulted in UA 150 million allocation envelope for country X over the 3-year period. The policy requires firm annual allocation (50 percent) for Year 1, followed by indicative allocations (25 percent) for each of the two outer years. Accordingly, annual allocations of UA 75 million, UA 37.5 million and UA 37.5 million are programmed for the 3-year replenishment cycle.

Table 1
Annual Country Allocations with Front- & Back-Loading
Numerical Examples (UA million)

	Scenario 1: Frontloading Yr3 indicative allocation				
	PBA exercise		**Yr1 alloc**	**Yr2 alloc**	**Yr3 alloc**
	(UA mill)		50%	25%	25%
Year 1	150.0		**75.0**	37.5	37.5
Year 2 (avail alloc)	120.0		60.0 **75.0**	30.0 **30.0**	30.0 15.0
Year 3 (avail alloc)	180.0		90.0 **75.0**	45.0 **30.0**	45.0 **75 + realloc**

	Scenario 2: Frontloading Yr2 & Yr3 indicative allocations				
	PBA exercise		Yr1 alloc	Yr2 alloc	Yr3 alloc
	(UA mill)		50%	25%	25%
Year 1 (avail alloc)	150.0		75.0 **93.75**	37.5 **18.75**	37.5 37.5
Year 2 (avail alloc)	120.0		60.0 **93.75**	30.0 **11.25**	30.0 15.0
Year 3 (avail alloc)	180.0		90.0 **93.75**	45.0 **11.25**	45.0 **75 + realloc**

2. In the second year, it is assumed that the PBA envelope falls to UA 120 million, equivalent to a 20 percent reduction. This could be the result of a change in the country's DSF loan/grant terms from 100 percent loan to 100 percent grant. This could also be the result of external negative shocks (drought, other weather hazards), diminished performance relative to other ADF recipients, the result of other factors such as GNI per capita, or some combination of these factors.

3. Based on the new policy, the annual allocations are programmed as UA 60 million, UA 30 million, and UA 30 million for the first, second, and third year respectively. It is assumed the country has utilized the full UA 75 million allocated for the first year. With the Year 1 allocation dropping to UA 60 million, effectively this means that Year 1 programming has front-loaded UA 15 million of the Year 2 indicative allocation into Year 1. What remains is UA 15 million of the second year's allocation, but the country can front-load up to 50 percent of the third year's UA 30 million indicative allocation, to be committed in the second year if necessary. It is assumed that this amount is in fact committed for new projects or programs during this second year.

4. For the third year, it is assumed that the country improves its performance by taking measures related specifically to the weaknesses identified in its CPIA and CPPR, resulting in a UA 180 million PBA envelope. Again, based on the new policy, this new allocation is programmed over the 3-year period as follows: UA 90 million, UA 45 million, and UA 45 million for the first, second and third year's allocation respectively. The country has already absorbed UA 75 million in the first year and UA 30 million in the second year, a total of UA 105 million over 2 years. From the third and final PBA envelope of UA 180 million, UA 75 million would remain available for the country in the third year. In addition, as the country is a high performer, it is eligible for reallocation of resources transferred from non-performers up to 50 percent of its average annual allocation, which is an additional UA 30 million. Thus, altogether, this country could have available a total of UA 105 million available for commitment in the last year of the replenishment cycle.

Scenario 2

5. For the second Scenario in Table 1above, the only modification added is that this country takes advantage of front-loading even in the first year. The analysis of front/back-loading, committing resources for current projects and programs, and prospects for reallocation follow a similar pattern as described for Scenario 1.