

**THE REVIEW OF THE SPECIAL DEVELOPMENT FUND (UNIFIED)  
RESOURCE ALLOCATION SYSTEM AND MANAGEMENT'S RESPONSE THERETO**

**1. BACKGROUND**

1.01 Considerable attention was given during SDF 5 replenishment negotiations to the strategy for allocating the limited concessionary resources that were made available. Contributors drew on the experience of other Multilateral Development Banks (MDBs) and approved a new system to replace the old method of allocating resources by country groups. The objective of the new system is to strengthen development results by targeting needs, placing resources where they are likely to be effective, and giving member countries an incentive to perform well.

1.02 The Caribbean Development Bank (CDB) adopted the performance-based allocation (PBA) system in 2001 at the start of SDF 5. It replaced the previous system of allocation of resources solely by country groups and country need. Since that time, there have been four SDF allocation exercises conducted by the Bank – three in SDF 5 (an initial allocation, a mid-term reallocation and an end-of-period allocation); and one in SDF 6, an initial allocation of funds.

1.03 The Resolution and Report of the Contributors to SDF 6 called for a mid-term review that among other things, would examine the experience with the PBA system for the Special Development Fund Unified [SDF (U)] to date. The objective of the assignment is to consider CDB's experience with the SDF allocation system between 2002 and 2006, and taking account of the evolution of similar systems at other multilateral development institutions, to identify options and possibilities for improvement of CDB's approach.

1.04 On May 29 and 30, 2007, CDB's Board of Directors and Contributors to SDF 6 noted and discussed respectively a draft Review Report on the Special Development Fund Resource Allocation System (RAS). During the discussion, Contributors made several suggestions for consideration by Management and for input into the final document. The main recommendations of the review were that:

- (a) country performance scoring as the basis of the allocations should be undertaken with more senior Management participation;
- (b) the portfolio performance variable in the allocation formula should be reformed; and
- (c) reallocations by formula be more frequent to help avoid ad hoc adjustments.

1.05 This paper sets out Management's response to the recommendations contained in the final Review Report which is attached as Appendix A of this paper. Sixteen of these recommendations require changes to the allocation process and of these, seven have been accepted for implementation prior to the next reallocation exercise. Nine of the recommendations will require further study before a determination is made, and the other three do not require any action by the Bank.

## **2. SOME KEY ISSUES AND RECOMMENDATIONS**

### **The Allocation Formula**

2.01 The Consultants' review of CDB's allocation formula points to its complexity compared with the Inter-American Development Bank's (IDB) and the lack of harmonisation with the major MDBs, particularly on the governance aspect of the formula, which may be critical to the context of policy-based lending products. The review suggests that CDB can change its formula to harmonise with IDB's, leading to the loss of continuity, experience and customisation of the current formula. However, the World Bank/International Development Association (WB/IDA) is currently reviewing their RAS which may result in the use of that system as a standard for other MDBs. As a result, the review recommends that CDB awaits and considers the results of the WB/IDA review before deciding on any changes to its formula.

2.02 Management accepts the recommendation to await the outcome of the WB/IDA review before deciding on any changes to its formula.

### **Reallocation**

2.03 Currently, CDB conducts an allocation exercise at the beginning of the cycle and two reallocation exercises during the cycle, i.e. one at the mid-point of the replenishment and another during the final year. However, CDB has made ad hoc changes to allocations in the face of absorptive capacity constraints in some countries and unmet demand for loans in other countries. This raises a question as to whether a reallocation every two years is sufficiently frequent.

2.04 Most MDBs reallocate their concessionary resources on an annual basis and some do so even more frequently. The Consultant recommends that CDB reallocates resources every two years at a minimum, as is the present practice, or annually if circumstances require.

2.05 Having regard to the demands on a relatively small staff complement, Management has reviewed the outcomes of its various allocation exercises including the scoring of the Poverty Reduction Effectiveness Situation (PRES) and is satisfied that a more frequent application of the system will not yield any different outcomes. In addition, having regard to other demands on a relatively small complement of Economists and Sector or Thematic Specialists, it will be more efficient to conduct the exercise every two years.

## **3. PRES – SCORING PROCEDURES AND RATING TEAMS**

3.01 PRES scores reflect the quality of the country's current policy/institutional performance, i.e. its actual performance with its stated intentions. Currently, PRES is scored by CDB's Country Economist with inputs from functional specialists (environment, gender, social development). If there is a lack of consensus on a performance score for a particular country and criterion, the Director of Economics makes a final determination.

3.02 In this regard, the Consultant recommends that in order to enhance the credibility of the performance ratings:

- (a) a country performance rating team be convened once each year to consider, revise if necessary, and approve the PRES country performance rating. The rating team should comprise the Vice-President (Operations) as Chair; the Director of Economics; the Director of Projects; and the Director, Finance and Corporate Planning;

- (b) the inputs of the Country Economist should be coordinated by the Chief Country Economist who should present the proposed performance scores to the rating team for those criteria most relevant to the expertise of the Economist. The output of the functional specialists should be coordinated and presented by the Division Chief, Project Services Division;
- (c) for each performance criterion, Country Economists in the Economics Department and functional specialists in the Projects Department should prepare worksheets of suggested scores, with supporting text; and
- (d) in order to support policy dialogue and to explain country ranking on the particular criterion, the Bank should select one country performance criterion each year for intensive review (including a cross-country comparative study).

3.03 Management recognises the need to enhance the process to protect the credibility and integrity of the performance ratings. The committee system is designed to bring a broader set of perspectives to the process and enhance the degree of confidence in the ratings and rankings. As a result, Management accepts the recommendations contained in paragraphs 3 (a), (b), (c) and (d).

#### **4. SCORING QUESTIONNAIRE**

4.01 To reduce subjectivity, CDB and other MDBs use a questionnaire to help score the policy and institutional performance. CDB's questionnaire was based on WB's 2000 questionnaire with some customisation. WB's questionnaire has since undergone further development and there has been greater harmonisation with those of other MDBs.

4.02 CDB can continue to develop/customise its performance criteria or it can decide to harmonise more fully with WB and other MDBs. Previously, the harmonisation option was not open because the WB/IDA scoring exercise and resulting scores were not disclosed, except in broad ranges. This has changed, and with full disclosure in 2007, harmonisation and collaboration on the questionnaire and benchmarks is now possible.

4.03 Further development of CDB's own questionnaire would require a great deal of work and past experience suggests that resource limitations would make this a difficult and drawn-out process. The reviewer recommends that CDB adopts the WB/IDA policy and institutional performance questionnaire, while keeping its own weights and applying its own judgement to generate the scores.

4.04 CDB's questionnaire is already very similar to WB's, and a decision to use the WB's updated questionnaire would result in substantial staff time savings and allow for some joint benchmarking of country performance by CDB, WB and other MDB's. Management accepts the recommendations including that of continuing to assign CDB's own weights to the criteria used in the updated questionnaire.

#### **5. GOVERNANCE AS A PERFORMANCE CRITERION**

5.01 The Consultants recommended and Management agrees that no further action needs to be taken in order to emphasise governance in the performance criteria.

## **6. SECTOR SPECIALISTS, THEMATIC STUDIES AND COUNTRY PERFORMANCE SCORES**

6.01 The Consultants found that one of the key challenges to managing CDB's concessionary RAS is finding a way to generate country performance scores for each performance criterion. To date, the Bank has relied on the professional judgement of the Country Economists with some assistance from sector specialists to generate country performance scores for each performance criterion.

6.02 The weakness of this approach is that some of the items in the performance questionnaire are more related to the expertise of sector specialists rather than the Country Economists and the process would benefit substantially from the greater involvement of the former in the process. At the same time, it is recognised that the process would need to be supported by cross-country thematic studies to build expertise and credibility. The Consultants recommend that:

- (a) responsibility for different PRES criteria be divided between the Economics Department and Project Services Division to do the work-up of possible scores for the Rating Committee to consider. A work-up will comprise the suggested score by country for each criterion supported by a short comparative text; and
- (b) the scores and supporting text will involve professional judgement supported by periodic cross-country comparative thematic studies and that commissioning of such thematic studies should be an eligible use of SDF (U) funds.

6.03 CDB's sector specialists already play a significant part in the setting of the country performance scores. However, Management agrees that their role can be further strengthened. The commissioning of cross-country comparative thematic studies is also recognised as one way of facilitating knowledge capture and dissemination, as well as strengthening the Bank's knowledge management process.

## **7. HARMONISATION AND COOPERATION WITH OTHER MDBs**

7.01 One of the principal benefits of harmonisation of some aspects of the RAS with other MDBs is likely to be derived from the joint benchmarking of the detailed performance scores of one or more countries, so that the scorers of other countries' performance will have something against which to judge appropriate scores and ensure consistency with performance scoring across countries (especially common member countries).

7.02 It also opens the possibility for joint benchmarking of common member countries involving CDB, IDB and WB/IDA as well as joint benchmarking of environmental criteria between CDB and the Global Environment Facility (GEF), which also operates a PBA system. The Consultants recommend that CDB explores the possibilities for joint benchmarking with MDBs operating in the Region as well as to participate in the joint MDB country performance benchmarking exercise.

7.03 CDB will proactively pursue the possibility of joint benchmarking with other multilateral development institutions in the Caribbean including IDB and WB/IDA.

## **8. DISCLOSURE, COUNTRY DIALOGUE AND PEER INPUT**

8.01 CDB has been at the forefront of MDBs with regard to the disclosure of all aspects of the performance-based concessionary RAS. Country performance scores disaggregated to the level of individual criteria have been available to the CDB's Board of Directors and to any member country that makes a request. The Consultants believe that it is desirable to take this degree of disclosure to another

level and to involve the Borrowing Member Countries (BMCs) in a dialogue as an input to performance scoring. They further recommend that:

- (a) CDB explore the possibility of an annual discussion with each BMC in its performance rating, perhaps jointly with other multilaterals that now score country performance; and
- (b) to facilitate dialogue with BMCs, each set of scores by country and by criterion be supported by a short written text.

8.02 Further enhancement of current disclosure processes and the improvement of country dialogue are desirable and would increase the effectiveness of CDB's development efforts. Some degree of forward planning would be required to implement the Consultants recommendations, especially with regard to the assignment of additional human resources. Management will need to examine the full implications of pursuing these recommendations before deciding on further action in this regard.

## **9. THE SMALL PORTFOLIO VOLATILITY PROBLEM**

9.01 All of the multilateral institutions that allocate concessionary resources by formula use portfolio performance as a variable in the formula. It is the minor component in assessing country performance. If a country has a small CDB portfolio [say, less than three operations, including technical assistance (TA) projects] then its portfolio performance score might not be a good indicator of its true performance. The performance score might be unstable, changing substantially when a new project enters or a completed project leaves the portfolio. The multiplicative form of CDB's allocation formula exacerbates this instability as it makes the allocation outcome equally sensitive to each and every variable in the formula.

9.02 Since PORT can be quite volatile in an artificial way, and its volatility can lead to major changes in a country's allocation for no better reason than that a single project has moved into or out of the country's small portfolio, this artificial volatility is a serious problem for CDB, particularly because several BMCs have small portfolios of capital investment projects. Hence, in order to ameliorate the small portfolio problem, the Consultant proposes the following:

- (a) that CDB extend its Project Performance Index to include all operatives including TA over a certain size. This requires entering full information into the Portfolio Performance Management System (PPMS) for TA projects as well as capital investment projects;
- (b) the country portfolio performance score should be averaged over all project scores for the previous three years rather than only current projects; and
- (c) where a country still has such a small portfolio and CDB judges that its portfolio performance score is not a reliable measure of its performance, it is recommended that PORT be given zero weight in the calculation of their country's allocations, i.e. country performance would be judged solely by PRES.

9.03 These recommended measures will be subject to further study by simulating the outcomes of various scenarios after the agreed number of TA projects (say, those above \$100,000) have been included in the PPMS system.

## **10. PORTFOLIO PERFORMANCE INDEX (PPI) OR PROJECTS AT RISK**

10.01 CDB does not use projects at risk in its resource allocation formula. It uses a portfolio performance index, which is the average performance of all investment projects active at the time. All other institutions base their portfolio performance on projects at risk. The CDB method of using all its

active projects rather than projects at risk provides a better basis for the portfolio performance variable because it captures information about the quality of all active projects. In any event, CDB has so few projects flagged as at risk that the measure does not distinguish much among BMCs. Hence the recommendation is for CDB to continue to use PPI as the basis for its portfolio performance variable.

## **11. WEIGHT OF PORTFOLIO PERFORMANCE**

11.01 The 30% weight of portfolio performance in the country performance factor of the PBA formula is common among multilateral institutions except WB/IDA which gives it a weight of 20%. In light of the volatility issue and in the interest of harmonisation, the Consultant recommends that CDB reduces its own weighting to 20%. Management proposes to revisit this issue and the recommendation after the completion of the WB/IDA review.

## **12. USE OF THE AVERAGE OF WEIGHTED PROJECT SCORES**

12.01 CDB weights its project performance index by loan approval amounts. At least one MDB uses the undisbursed amount in problem projects. Based on their comparative review of the two methods, the Consultants conclude that CDB's approach is more appropriate and recommends its continued use. They also recommend that the Bank consider other ways to penalise non-completion or extremely late completion of projects. The Bank will explore other approaches to this issue at the earliest possible time.

## **13. THE PORTFOLIO PERFORMANCE SCORING SCALE**

13.01 CDB scores portfolio performance on a scale of 0-10 and other MDBs use 1-6. This has no significant implications since (a) the portfolios are different so there is no reason why a country should receive the same or even similar portfolio scores from different institutions, even if the scoring is on the same scale; and (b) it is relative performance that matters to the allocation so the measurement scale is immaterial. However, if CDB adopts the WB/IDA country performance questionnaire, it would be convenient to adopt the six-point scale at the same time, rather than have to adjust the related scoring guidelines to the CDB scale. The Consultant recommends that CDB adopts the six-point country performance scoring scale.

13.02 Management will make a determination of the suitability of this change after it assesses the impact of the current WB/IDA review on the direction of the harmonisation of the various RASs.

## **14. DEFINING COUNTRY NEED**

14.01 CDB's allocation formula contains three variables related to country need, i.e., population, per capita income and country vulnerability. In general, CDB like other MDBs needs to develop better measures of poverty in its allocation formula. Population and per capita income can be used to indicate relative poverty as long as the distribution of income is the same in the two countries being compared. However, since that will seldom or never be the case, a more direct measure is the number of people (or families) earning less than the poverty threshold.

14.02 The Consultant recommends that CDB study three possibilities with regard to these two poverty variables:

- (a) replace the population and per capita income variables with the logarithm of the population earning less than the poverty threshold;

- (b) replace only the population variable with the population earning less than the poverty threshold; or
- (c) make replacements as in (a) or (b) with extra weight for the level of indigent population.

14.03 CDB's vulnerability index combines vulnerability to natural disasters with vulnerability to economic shocks and the Consultant recommends that this be retained.

14.04 The proposals with respect to the population and per capita income variables will be considered in the context of the ongoing Country Poverty Assessments (CPAs). These CPAs will provide the data for testing the appropriateness of these options.

## **15. NEW BMCs**

15.01 New borrowing members are in a special situation with regard to the RAS because they will not have an established track record on "CDB's portfolio performance". This may not be an immediate problem if early lending volume is low and the new member's allocation is determined largely by a need for TA for governance and institutional strengthening. However, some method needs to be developed to incorporate new members and special cases within the PBA system. The Consultant recommends that:

- (a) affixed country allocation for a new member is appropriate until CDB has enough experience to consider the country's performance along with other BMCs in the normal allocation exercise; and
- (b) for special cases of new members that have serious governance problems, CDB should give a fixed allocation, as recommended above, and offer to increase that allocation according to performance on negotiated criteria that might resemble the post-conflict allocation criteria used by other MDBs in similarly unique cases.

15.02 The Bank already uses a fixed allocation approach for its newest member country and accepts that it needs to gain experience in dealing with all aspects of the new member's situation before attempting to apply the RAS.

## **16. BASIC NEEDS TRUST FUND (BNTF)**

16.01 Among the SDF (U) grant programmes only BNTF is allocated to eligible countries on the basis of the resource allocation formula. The review recommends the continuation of this approach to the initial allocation of resources in each BNTF cycle. Management agrees and will assess the outcomes of this approach during future mid-term reviews of the BNTF programme.



# **SPECIAL DEVELOPMENT FUND**

## **A REVIEW OF THE SDF (U)**

### **RESOURCE ALLOCATION SYSTEM**

**July 2007**

## ABBREVIATIONS

|         |   |   |
|---------|---|---|
| ADB     | - | Asian Development Bank                          |
| AfDB    | - | African Development Bank                        |
| BMC     | - | Borrowing Member Country                        |
| BNTF    | - | Basic Needs Trust Fund                          |
| CDB     | - | Caribbean Development Bank                      |
| CPIA    | - | Country Policy and Institutional Assessment     |
| FSO     | - | Fund for Special Operations                     |
| GEF     | - | Global Environmental Facility                   |
| IDA     | - | International Development Association           |
| IDB     | - | Inter-American Development Bank                 |
| IFAD    | - | International Fund for Agricultural Development |
| MDBs    | - | Multi-lateral Development Banks                 |
| MDGs    | - | Millennium Development Goals                    |
| PBA     | - | performance-based allocation                    |
| PPI     | - | Project Performance Index                       |
| PPMS    | - | Project Portfolio Management System             |
| PRES    | - | Poverty Reduction Effectiveness Situation       |
| SDF (U) | - | Special Development Fund (Unified)              |
| TA      | - | Technical Assistance                            |
| WB      | - | World Bank                                      |

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## 1. INTRODUCTION

### 1.1 The SDF (U) Allocation System

1.1.1 The Caribbean Development Bank (CDB) allocates its single largest source of concessional resources, the Special Development Fund Unified [SDF (U)], among member countries according to a performance-based allocation (PBA) formula that measures country need and country performance. The objective is to strengthen development results by targeting needs, placing resources where they are likely to be effective, and giving member countries an incentive to perform well. Since resources are at stake, PBA is, ideally, a strong form of “policy dialogue” between the Bank and member countries.

1.1.2 The allocation guidelines agreed by the Contributors include rules that define access by country group, set-aside resources for special purposes<sup>1</sup>, and state a formula by which each country’s allocation is calculated. The PBA allocations are not entitlements, nor are they absolute limits on the grants and loans that a country can receive. They are indicative planning figures and they may vary depending on circumstances and on the level of effective demand from member countries.

### 1.2 The Allocation Experience

1.2.1 CDB adopted the PBA allocation system in 2001 at the start of SDF 5.<sup>2</sup> It replaced the previous system of allocation of resources solely by country group and country need. Since that time there have been four SDF allocation exercises conducted by the Bank – three in SDF 5 (an initial allocation, a mid-term reallocation and an end-of-period allocation); and one in SDF 6, an initial allocation of funds. Appendix A Table 5 shows the dollar allocations by country at each stage. Appendix B shows an example allocation for the Basic Needs Trust Fund (BNTF).

### 1.3 Purpose of this Paper

1.3.1 SDF contributors asked for a review of the allocation experience at SDF 5 mid-term and at SDF 6 mid-term. A Working Paper was distributed to the CDB Board as part of the SDF 5 Mid-Term Review in April 2003 entitled “*Implementation of the SDF (U) Resource Allocation Strategy*”.<sup>3</sup>

1.3.2 The *Resolution and Report of the Contributors*<sup>4</sup> to SDF 6 called for a mid-term review that, among other things, would examine the experience with the PBA system for SDF (U) to date.<sup>5</sup> This is the report of that review. The CDB *Strategic Plan 2005-2009* similarly commits the Bank to a review of its SDF (U) resource allocation system.

1.3.3 CDB’s objective in commissioning this report was to have an independent reviewer assess the allocation system<sup>6</sup> in light of experience between 2001 and 2006; and in light of the experience of other multilateral development institutions. The report describes the CDB’s experience, identifies possibilities for improvement in the allocation system and presents options for consideration.

## 2. CONCESSIONARY RESOURCE ALLOCATION

### 2.1 Allocation Processes

2.1.1 CDB allocates SDF (U) funds among member countries every two years, at the start and the midpoint of each replenishment cycle, and sets aside some funds for special purposes. All borrowing member countries (BMCs) are eligible for an SDF (U) allocation, but Group 1 countries have access only up to the amount of their own contribution to the Fund and then only for certain purposes, such as crises and projects that contribute to regional “public goods”.<sup>7</sup>

2.1.2 The Corporate Planning Division of the Bank calculates the country allocations, according to a formula, with inputs from other branches of the Bank. In particular, the Country Analysis and Policy Unit of the Economics Department has in the past provided country scores on “policy and institutional performance”.

### 2.2 The Allocation Formula

2.2.1 The allocation formula of CDB’s Special Development Fund, is shown below (See Appendix C for the formulae of other multilateral development banks). The CDB formula is multiplicative. It contains three factors to reflect country need (population, per capita income, and vulnerability) and two factors to reflect country performance (a policy-and-institutional performance score and a portfolio performance score). Each member country receives an allocation in proportion to its allocation score.

$$\begin{aligned} \text{Allocation score} &= (\text{country need}) \times (\text{country performance}) \\ &= (\log\text{POP} \times \text{GNPpc}^{-0.9} \times \text{VUL}^{2.0}) \times (0.7\text{PRES} + 0.3\text{PORT})^{2.0} \end{aligned}$$

Where:

*logPOP* = the logarithm of population

*GNPpc* = gross national product per capita

*VUL* = country vulnerability (according to CDB’s index of member country vulnerability)

*PRES* = country performance on policy and institutions (similar to the World Bank CPIA)

*PORT* = performance of the country’s portfolio of CDB loans

2.2.2 Factors in the formula have two kinds of “weights”. First, the two component factors in “country performance” (PRES and PORT) have arithmetic weights (70% and 30% respectively). Second, three factors are raised to a power (exponent). In general, the larger the absolute value<sup>8</sup> of the exponent the greater the weight of this factor in the formula.

2.2.3 CDB gives greatest weight to country performance and country vulnerability. Average per-capita income receives a lesser, but still substantial, weight. Population does not have an exponent, but rather appears in the formula in logarithmic form. The effect of this is to change the exponential distribution of population data into a linear form. This does not greatly affect the countries with relatively small populations but it strongly moderates the influence of “population” for the largest member countries.

2.2.4 CDB has two main options for its allocation formula in future:

1. CDB could keep its existing allocation formula. The advantages are continuity, experience and customisation to CDB’s own priorities (both in terms of the weights of various factors and by including a “vulnerability” factor). The disadvantages include complexity (compared with the Inter-American Development Bank (IDB) formula, for

example) and some degree of lack of harmonisation with the major Multilateral Development Banks (MDBs), particularly in regard to their treatment of “governance” in the allocation formula. However, while maintaining the existing type and structure, CDB could modify its allocation formula to include a governance factor or, more sensibly, could give the existing governance cluster in the PRES greater visibility and greater weight. The advantages are, first, that this might contribute towards giving governance more importance in CDB’s dialogue with member countries not a bad thing when CDB is considering major policy-based loans; and, second, harmonisation with other MDBs that follow the World Bank/International Development Association (WB/IDA) model would be enhanced.

2. Alternatively, CDB could change its allocation formula to be similar to the IDB formula. The advantages are simplicity and harmonisation within the Americas region. The disadvantages are discontinuity with CDB’s established approach, and the likelihood that, as harmonisation proceeds, the MDBs will take the WB/IDA type of formula as the standard.

**Recommendation 1:**

2.2.5 The WB/IDA, the Asian Development Bank (ADB), and the African Development Bank (AfDB) have harmonised on a single formula (or, at least, very similar formulas). If IDB decides to harmonise with this group, despite the manifest advantages of its own simpler formula, then the case for CDB to do the same would be strong. However, since the WB/IDA intends to review and perhaps change its allocation formula during the IDA 15 negotiations in 2007, we recommend that CDB wait to see the result before deciding on any changes to its own formula (apart from a change in the weight of “portfolio performance” – see recommendations number 13).

**2.3 Reallocations**

2.3.1 CDB conducted one reallocation exercise at the mid-point of the SDF replenishment period and one in the last year of the period. In a reallocation, the funds that are unlikely to be used are placed in a common pool and then reallocated iteratively by formula to countries with unmet demand. (See Table 2.3 for an example.)

**TABLE 2.3: AN EXAMPLE REALLOCATION**

| Country     | Initial allocation | Expected demand | Pot for reallocation | New allocation |
|-------------|--------------------|-----------------|----------------------|----------------|
|             | \$ mn              |                 |                      |                |
| 1           | \$5 mn             | \$12 mn         |                      | \$11           |
| 2           | \$20 mn            | \$19 mn         | \$1 mn               | \$19 mn        |
| 3           | \$10 mn            | \$17 mn         |                      | \$15 mn        |
| 4           | \$10 mn            | \$0             | \$10 mn              | \$0            |
| Sub-totals: | \$45 mn            | \$41 mn         | \$11 mn              | \$45 mn        |

2.3.2 In the example shown in Table 2.3, country 4 has no demand for SDF funds during the period so its initial allocation goes back into the common pot. Similarly, country 2 requires \$1 million less than its initial allocation, so that amount returns to the common pot. The other two countries demand more funds than they were initially allocated and, in total, more funds than are available. Therefore, the funds in the common pool are reallocated by the standard allocation formula to the two countries that have effective unmet demand. How well each does in the reallocation depends on its need and performance scores, as

usual. The important point is that funds that are available for reallocation are reallocated by formula, not ad hoc.

2.3.3 However, CDB has, on occasion, made ad hoc changes to allocations in the face of absorptive capacity constraints in some countries and unmet demand for loans in other countries. This raises the question whether a reallocation every two years is sufficiently frequent. Most MDBs, including WB and ADB, reallocate their concessionary resources annually. Some reallocate even more frequently. The International Fund for Agricultural Development (IFAD), for example, conducts a reallocation immediately after the initial allocation to cope with the fact that it has a large number of small members that are unlikely to borrow during a particular allocation period, and then reallocates annually at a minimum.

2.3.4 More frequent formula-based allocations are preferable to less frequent allocation exercises combined with case-by-case adjustments. However there is no “correct” allocation period. If allocations move too far out of alignment with effective demand, short of the two-year milestone, then a formula-based reallocation is in order.

**Recommendation 2:**

2.3.5 We recommend that CDB reallocate its SDF (U) resources every two years at a minimum, as is present practice, or annually if circumstances require.

**2.4 Other MDB’s Allocation Formulas**

2.4.1 The allocation formulas used by other multilateral development institutions are shown in Appendix C Tables 2 and 3. There are two main types of formula: (1) a complex multiplicative formula with exponent weights as exemplified by WB; and (2) a simpler additive formula with percentage-share weights, as exemplified by IDB.

2.4.2 The CDB formula is similar to the WB/IDA formula, as it existed in 2001 when the CDB adopted a formula approach. However there are some important differences. The CDB formula gives much less weight to population than the WB formula does. In effect this means that the CDB gives relatively more weight to poverty, vulnerability, the environment and country performance.<sup>9</sup> CDB also added a second “needs factor” (vulnerability) that is not part of the WB formula.

2.4.3 In a multiplicative formula, one cannot change the weight of one factor, or add a factor, without changing the relative weights of all the other factors, sometimes quite radically. The interaction between factors is complex. Consequently, some member countries have criticised the allocation formula because it is difficult for a government to understand what are the most important things it needs to do to improve its allocation.

2.4.4 This complexity was magnified when the WB/IDA changed its formula, thereby double counting “governance” and giving the “governance factor” a sub-exponent. That is, the current WB/IDA formula has exponents on exponents. Not surprisingly, simplification is one of the main themes of discussion at present, and WB management has undertaken to place simplification options in front of the IDA Deputies during the IDA 15 replenishment negotiations.

*“... Management proposes that the country performance rating formula be simplified and its outcomes be made less volatile. Simplification of the formula is necessary at a time when IDA is taking steps to be transparent about how its resources are allocated through public disclosure of*

*its country performance assessments. A simpler formula would promote a clearer understanding among partner countries of which factors most influence IDA allocations.”<sup>10</sup>*

2.4.5 In contrast, the allocation formula of IDB<sup>11</sup> is much simpler. (Appendix C Table 2) IDB decides how much weight it wants to give to country need and how much to country performance. It then divides the total money accordingly into two pots and allocates each pot of money separately. For example, suppose IDB has \$100 of Fund for Special Operations (FSO) monies to allocate. If the Bank decides to give 60% weight to country performance then it sets aside \$60 and allocates that amount among member countries strictly according to their performance scores alone. The remainder, \$40, is allocated among the same countries but according to the “country needs criteria” alone. It is a simple system and no econometrics is needed to understand the weight of each factor in the formula. For this reason, the IDB Board is able to understand and control the allocations whereas the WB/IDA Board relies more on expert staff for guidance.

2.4.6 AfDB has adopted a formula that is similar to the WB/IDA formula, except in two aspects: (1) the “governance factor” in its allocation formula does not have a separate exponent and is, therefore, less complex and (2) AfDB adds a “post-conflict enhancement factor” to its formula rather than dealing with post-conflict countries separately, with a separate set of performance criteria, as the WB does.

2.4.7 In 2005, the ADB set out to harmonise its allocation formula with the WB/IDA system. However, it did not like the obvious double counting of “governance”, which in the WB/IDA formula appears both in the “policy and institutional performance” factor and also separately as the “governance factor”. Therefore ADB removed the “governance cluster” from its policy and institutional performance score and had it only as a stand-alone factor in the formula. ADB then chose exponents for each factor in its allocation formula that, together, result in allocations that are identical to those that ADB would obtain if it used its own data and the WB/IDA formula. In summary, ADB has a more elegant, but still complex, formula that produces the same allocation results that the WB/IDA formula would produce if used with ADB data.

2.4.8 IFAD is an interesting case among the small agencies because, like CDB, it took the WB/IDA formula, changed the exponents to fit its own priorities (giving much more weight to relative poverty, for example, and much less weight to population) and added a new factor that reflects its special mandate (a policy and institutional performance score for the rural sector alone). This is similar to what CDB has done with its formula, except that CDB added a vulnerability factor that reflects regional conditions rather than reflecting a particular sector mandate as in the case of IFAD.

### 3. POLICY AND INSTITUTIONAL PERFORMANCE

#### 3.0 Defining “Policy and Institutional Performance”

3.0.1 One of the two measures of country performance in CDB’s allocation formula is called the *Poverty Reduction Effectiveness Situation* (PRES). It is a measure of policy and institutional performance, based on 17 performance criteria. (See Appendix C Table 4). Bank staff assigns a score to each country on each criterion, in light of the information available and professional judgement.

3.0.2 Other MDBs use similar variables<sup>12</sup> for the same purpose.<sup>13</sup> This is partly because most of the allocation formulas were adopted soon after the publication of WB research that indicated that development aid was effective only in the context of good policies and institutions<sup>14</sup> in the recipient country.<sup>15</sup> However, the adoption of this variable also reflects a reluctance to assess country performance by results. It was thought that economic growth, for example, is affected by too many exogenous variables to be a good measure of government performance, at least in the short term.

3.0.3 Each member country receives an allocation in proportion to its allocation score (in addition to its access to any set-asides). The absolute value of the performance variable is used in the allocation formula.<sup>16</sup> However it is not the absolute scores but the relative scores that affect the allocations of funds. This is important because the relative country performance can change from year to year.<sup>17</sup> For example, Dominica improved from 16<sup>th</sup> in 2003 to 10<sup>th</sup> in 2006. (See Table 3.1).

**TABLE 3.1: CDB PRES SCORES AND RANKS, 2001, 2003 AND 2006**

| Country                | 2001 |       | 2003 |       | 2006     |       |
|------------------------|------|-------|------|-------|----------|-------|
|                        | Rank | Score | Rank | Score | Rank     | Score |
| Antigua and Barbuda    | 17   | 2.10  | 17   | 2.15  | 17       | 2.87  |
| Guyana                 | 16   | 2.50  | 13   | 3.13  | 14       | 3.10  |
| Dominica               | 15   | 2.68  | 16   | 2.46  | 10       | 3.39  |
| Belize                 | 14   | 2.82  | 14   | 3.10  | 15       | 3.06  |
| St. Kitts/Nevis        | 13   | 2.89  | 12   | 3.16  | 13/12/11 | 3.30  |
| St. Vincent/Grenadines | 12   | 2.92  | 11   | 3.31  | 13/12/11 | 3.30  |
| Turks and Caicos       | 11   | 2.93  | 07   | 3.58  | 9/8      | 3.40  |
| Grenada                | 10   | 2.94  | 15   | 3.01  | 16       | 3.00  |
| Jamaica                | 09   | 3.12  | 09   | 3.40  | 6/7      | 3.70  |
| St. Lucia              | 08   | 3.22  | 04   | 3.75  | 4/5      | 3.80  |
| British Virgin Islands | 07   | 3.23  | 10   | 3.38  | 9/8      | 3.40  |
| Montserrat             | 06   | 3.25  | 08   | 3.50  | 4/5      | 3.80  |
| Anguilla               | 05   | 3.34  | 02   | 3.98  | 13/12/11 | 3.30  |
| Trinidad and Tobago    | 04   | 3.49  | 06   | 3.65  | 3        | 3.82  |
| Cayman Islands         | 03   | 3.70  | 05   | 3.66  | 6/7      | 3.70  |
| Bahamas                | 02   | 3.84  | 01   | 4.03  | 2/1      | 3.90  |
| Barbados               | 01   | 3.89  | 03   | 3.90  | 2/1      | 3.90  |
| Haiti                  |      |       |      |       |          |       |
| Suriname               |      |       |      |       |          |       |

*Score on Scale 1-5*

*See Appendix A, Table 1, for more details*

### 3.1 CDB Review of the PRES

3.1.1 In 2006, CDB undertook a review of the PRES.<sup>18</sup> The resulting *Discussion Note* concluded that the process is basically sound and largely harmonised with the WB/IDA and other MDBs. The Note recommended two main reforms. First, the scoring process needs improvement<sup>19</sup> and, second, the scoring instrument needs improvement.

3.1.2 The Discussion Note describes when each score (1 to 5) is appropriate for each of the PRES performance criteria. It also makes reference to relevant literature and data series.

3.1.3 However it does not address the matter of scored sub-criteria that has been the key development at the WB during the past three years. The WB/IDA has developed scored sub-criteria (typically three or four for each criterion). That is, it has broken its 16 policy and institutional performance criteria into sub-criteria. It is the sub-criteria that are scored directly. The score on each criterion is the average of the scores on its sub-criteria. The intent is to make the scoring more consistent across countries by scoring at the concrete sub-criterion level rather than at the level of general criteria.

### 3.2 The PRES and the WB Country Policy and Institutional Assessment (CPIA)

3.2.1 CDB's PRES variable is based on the WB/IDA CPIA variable, as it existed in 2001. At that time, there were 20 criteria in the CPIA, each equally weighted (5%). They were arranged in four clusters. CDB took a similar approach, although it gave poverty issues greater visibility. Also, CDB made "environmental sustainability" a fifth "cluster" of criteria, rather than being only one criterion within the "economic management" group. This was to reflect the importance and the fragility of the environment in the Caribbean. Environmental sustainability was given a weight of 10% and, to enable this, the weight of "structural policies" (trade, financial sector, and business environment) was reduced from 25% to 15%. (Appendix A Table 3 shows a comparison between CDB criteria and WB/IDA criteria in 2006).

3.2.2 Over time, both CDB and the WB/IDA have modified their formulas, so they are different from five years ago. For example, the WB/IDA has reduced the number of criteria from 20 to 16. Describing the recent changes the WB/IDA staff have said:

*"Measurement has improved... To begin with, the criteria underpinning the ratings have become very explicit. Previously, they were specified only for the top and bottom ratings (for ratings "2" and "5" to be precise) and were not very exhaustive. They now cover all rating levels (from "1" to "6") in detail. In addition, each question is currently made up of two to four sub-ratings, which need to be evaluated separately. Country teams are therefore discouraged from basing their ratings on selected areas in which the country performs particularly well, but have to address all areas ... Moreover, country teams have to provide written explanations that justify their ratings. Finally, the Bank-wide reviews of the regions' (proposed scores) have become more thorough. The networks perform more in-depth quantitative and qualitative analysis, often complemented by external indicators... (Performance scores) also benefit from the advances made by other agencies in improving measurement... Despite these measures, as with other governance indicators, CPIA is still subject to certain measurement errors."*<sup>20</sup>

### 3.3 Scoring Procedures and Rating Team

3.3.1 The PRES for each country is calculated as a weighted average of its criteria scores. The weights are defined in the working paper "Allocation of the Special Development Fund Resources (Fifth Cycle), June 2001". The PRES score reflects the quality of the country's current policy/institutional performance – its actual situation not its stated intentions. Development results (such as growth rates) are taken into

account, but these are influenced by many factors beyond a government's control. The main focus is policies and institutions, which are within its control.

3.3.2 In the past CDB's Country Analysis and Policy Unit of the Economics Department has scored the PRES. Each Country Economist makes the score for his or her assigned countries.<sup>21</sup> Thereafter, a general meeting of all of the Economists in the Unit discusses the performance scores. In 2005, functional specialists in Projects Department (environment, gender, social development) were asked to contribute to the country performance scores in regard to criteria related to their specialties. If there was a lack of consensus on a performance score for a particular country and criterion, the Director of the Economics Department has made a final determination.

3.3.3 There is an alternative approach. The WB separates the analysis of scores (the "work-up") from the scoring itself. Country Economists and functional (network) specialists develop suggested scores and short supporting texts, but a Rating Team of senior managers, chaired by a senior policy advisor to the President, decides the final scores (not the Country Economists). Of course this requires senior managers' time, which is scarce; but it would have many potential benefits both within the Bank and in terms of the external credibility of the performance ratings. We believe that it is worth the senior manager's time once a year to consider the broad range of BMC performances in depth.

**Recommendation 3:**

3.3.4 We recommend that CDB convene a Country Performance Rating Team once each year to consider, revise if necessary and approve the PRES country performance ratings. The Rating Team should comprise a small number of executive managers. One good design would be to have the Vice-President (Operations) as Chair, and, as members, the Director Economics, the Director Projects, and the Director Finance and Corporate Planning. To minimise the time burden, the size of the team should be kept to four.

**Recommendation 4:**

3.3.5 The Rating Team should be supported by the Country Economists and by topic specialists in Projects Department. We recommend that the input of the Country Economists should be coordinated by the Chief Country Economist who should present proposed performance scores to the Rating Team for those criteria most relevant to the Economists' expertise. The input of the functional specialists should be coordinated, and presented, similarly by the Division Chief, Project Services Division. For each performance criterion, Country Economists in Economics Department and functional specialists in Projects Department should prepare worksheets of suggested scores on each criterion, each with a supporting text. The rating meeting should be held in February and the background work for the scoring exercise should be integrated with the development of CDB's *Annual Economic Review*.

**Recommendation 5:**

3.3.6 We believe that the Bank is ready to make wider use of the performance scores in policy dialogue. This should be selective. If, for example, the Bank selected one "country performance criterion" each year for intensive review (including a cross-country comparative study of performance led by Economics or by the Project Services Division) it would be well prepared to present and explain country rankings on that criterion. The *Annual Economic Review* would, in our opinion, be a good venue for such discussion.

### 3.4 The Scoring Questionnaire

3.4.1 To reduce subjectivity, CDB and WB both use a “questionnaire” to help score policy-and-institutional performance.<sup>22</sup> For each performance criteria, the questionnaire describes the circumstances in which it is appropriate to assign a score of 1, 2, 3, 4 or 5.<sup>23</sup> The CDB questionnaire was based on the WB questionnaire in 2000, with some relatively minor customisation.

3.4.2 In the years since two things have happened. First, the pressure to harmonise procedures across the MDBs has increased; and, second, the WB questionnaire has become more sophisticated. Specifically, in the past two years, the WB has added sub-criteria to each main performance criterion. The sub-criteria number 46, about three per main criterion. It is these sub-criteria that are now scored, although the questionnaire has not been fully redeveloped to reflect this. In general the sub-criteria have equal weights and each main criterion score is a simple average of its sub-criteria scores. In two cases the sub-criteria have different weights. Other MDBs take a similar approach with some differences in details.<sup>24</sup>

3.4.3 CDB could continue to develop and customise its performance criteria, adding sub-criteria as the WB has done and developing a more extensive questionnaire for country performance scoring, or, alternatively, CDB could use the WB questionnaire. There is at least one precedent for this since the ADB decided in 2005 to use the WB questionnaire in future. If CDB further develops its own questionnaire, it requires a great deal of work, especially to develop sub-criteria and guidelines for scoring them. Experience in the first five years of CDB’s system indicates that finding staff time to develop the questionnaire and keep it current is not easy. Using the WB questionnaire would result in substantial savings in the economist and sector specialist time that would otherwise be needed to keep a questionnaire up to date. Using the same questionnaire would also facilitate some joint benchmarking of country performance by CDB and WB.

3.4.4 On the other hand, if CDB decided to harmonise fully with the WB questionnaire, it would lose some of the nuances that are possible when one crafts a customised approach. However, the structure of CDB’s questionnaire is already very similar to the WB’s. Its results, in terms of ranking country performance, are probably the same as they would be very similar if the same scorers used the WB questionnaire.

3.4.5 Even if CDB used the WB questionnaire, it could keep its own priorities for country performance. That is, CDB could use the WB questionnaire but assign its own weights to the criteria therein.

3.4.6 In 2001, the full harmonisation option was not open because the WB/IDA scoring exercise and the resulting scores were secret. Scores were not disclosed even to the IDA Deputies, except in broad ranges (quintile groups). This has changed. With full disclosure in 2007, harmonisation and collaboration with CDB on the questionnaire and benchmarks have become viable options.

#### **Recommendation 6:**

3.4.7 We recommend that CDB adopt the WB/IDA policy and institutional performance questionnaire, while keeping its own criteria weights and applying its own judgment to generate scores. The PRES will need minor adjustments to cope with this change in scoring instrument.

### *Governance as a Performance Criterion*

3.4.8 Governance is important to all aspects of development and particularly important in the context of debt problems and policy-based lending. The CDB PRES contains a cluster of criteria called “Governance/Public Sector Management”, which covers the rule of law, anti-corruption and accountability institutions, civil service, revenue mobilisation and budgetary management; and management and efficiency of public expenditures. (See Appendix C Table 5 for a comparative view of the weight of “governance” in the MDBs’ concessionary resource allocation formulas.)

3.4.9 The WB recently published a review of its experience with “governance” in the concessionary resource allocation formula.<sup>25</sup> “Governance” is one of the clusters of criteria in its assessment of policy and institutional performance (CPIA), entitled “Public Sector Management and Institutions”.

3.4.10 The WB cluster contains five criteria: (1) property rights and rule-based governance; (2) quality of budgetary and financial management; (3) efficiency and equity of revenue mobilisation; (4) quality of public administration; and (5) transparency, accountability and corruption in the public sector. In both the CDB and the WB/IDA this cluster of criteria has a weight of 25% in the assessment of country policy and institutional performance.

3.4.11 The WB/IDA has experimented with various ways to emphasise “governance” in its allocation formula, without great success. In its current allocation formula, the WB/IDA has combined this cluster with the “procurement efficiency indicator” from its Annual Review of Portfolio Performance and called the combined variable “governance”. It is, clearly, mainly public sector management rather than governance more broadly defined.<sup>26</sup> The previous approach (a “governance factor” used to discount allocations) was deemed too draconian and the current approach (double counting the public sector management criteria in the allocation formula) does not seem appropriate either.

*“The PBA formula has become more complex. Double counting the CPIA governance cluster and the procurement flag from the ARPP, and introducing an exponential multiplier in the form of the governance factor, has made the calculation and interpretation of the country performance rating more complex. As a result, it is difficult to say how much each component contributes to and weighs within the formula. This complexity of the formula is especially problematic at a time when IDA is taking steps to be transparent about how its resources are allocated through public disclosure of its country performance assessments. Explaining how allocations change at the country level due to changes in underlying country performance is not straightforward and this difficulty has surfaced regularly in conversations with country teams and governments who want to know what impact improvements in certain components or clusters of the CPIA would have on the final country performance rating, and therefore allocation.”<sup>27</sup>*

### **Recommendation 7:**

3.4.12 CDB has selected an appropriate weight for the “governance cluster” of performance criteria in the PRES. Nothing additional is needed to emphasise its importance.

## **3.5 Sector Specialists, Thematic Studies and Country Performance Scores**

3.5.1 One of the key challenges in managing CDB’s concessionary resource allocation system is finding a way to generate country performance scores for each performance criterion. To date the Bank has relied on the professional judgment of the country economists, with some assistance from sector specialists in 2006. One can see the rationale for the economists to do the scoring for those performance criteria closest to the economists’ expertise, including the following items in the performance

questionnaire: Trade Policy, Financial sector efficiency and soundness; Factor and product markets and prices; Revenue mobilisation and budgetary management; Management and efficiency of public expenditures; Fiscal policy, Monetary policy and External financing policies.

3.5.2 However there are other PRES criteria that may be closer to the sector expertise to be found in the new Project Services Division of Projects Department. These include:

- **Social Analysts:**  
Framework for poverty reduction policy. Enhancing the human capital of the poor. Enhancing the economic capital of the poor. Equity and social safety nets
- **Gender Specialist:**  
Gender, empowerment and participation
- **Governance Specialists:**  
Rule of law. Anti-corruption and accountability institutions. Civil service
- **Environmental Specialists:**  
Environmental laws, regulations and institutions. Environmentally damaging subsidies and other damaging practices

3.5.3 Specialists could score these criteria in the same way as the economists presently score them. However, progressively, they need to be supported by cross-country thematic studies to be really well based. Perhaps only one such study could be undertaken each year because they are expensive, but in the long run they are very important to CDB's expertise and credibility.

**Recommendation 8:**

3.5.4 (A) We recommend that responsibility for different PRES criteria be divided between Economics Department and Project Services Division to do the work-up of possible scores for the Rating Committee to consider. A work-up will comprise the suggested scores by country for each criterion supported by a short comparative text.

3.5.5 (B) The scores and supporting text will involve professional judgment supported by periodic cross-country-comparative thematic studies. We recommend that commissioning such thematic studies should be an eligible use of SDF (U) funds.

**3.6 Harmonisation and Cooperation with Other MDBs**

3.6.1 The idea of benchmarking is to assess the performance scores of one or more countries in detail so that the scorers of other countries' performance have something against which to judge appropriate scores. Benchmarks would improve the consistency of scoring within the CDB and, possibly, between the CDB and other multilateral institutions that also score Caribbean countries' performance.

3.6.2 A 'benchmark' borrowing member country may be selected for each performance criterion. The benchmark country could be different for each criterion, if appropriate, or the same for all criteria. The benchmark country is chosen not because it is likely to receive any particular score, but rather because its performance and the appropriate score are likely to be clear. Logistically it is generally easier to have a single benchmark country (although the WB had 20 in 2006 to ensure that each region was represented in the benchmark group).

3.6.3 The WB/IDA relies on benchmarking to ensure consistency of performance scoring across countries and regions. For instance in December 2006 the WB conducted a benchmarking exercise in preparation for the main country performance scoring exercise in March 2007. Twenty<sup>28</sup> countries were scored against the policy and institutional performance criteria. There were two Caribbean countries in the benchmark group – Guyana and Grenada.

3.6.4 One can envisage the possibility of a joint benchmarking exercise involving CDB, IDB and the WB/IDA. Similarly one could envisage joint benchmarking of the environmental criteria between CDB and the Global Environmental Facility (GEF), which also operates a PBA system.

**Recommendation 9:**

3.6.5 We recommend that CDB explore the possibility of joint benchmarking with other multilateral development institutions working in the Caribbean, including the IDB and the WB. CDB should send an economist, one or more sector specialists and an evaluator from the Evaluation and Oversight Division (for general methodology and for the portfolio performance variable) to Washington D.C. each year to participate in the joint MDB “country performance benchmarking exercise”, which is generally in November/December.

**3.7 Disclosure, Country Dialogue and Peer Input**

*Disclosure*

3.7.1 CDB has been in the forefront of MDBs in regard to disclosure of all aspects of the performance-based concessionary resource allocation system. Country performance scores disaggregated to the level of individual criteria have been available to the Board and to any country that wishes to ask. (See Appendix C Table 10 for a comparative table of disclosure practices among MDBs.)

3.7.2 The WB has disclosed less than the CDB. For many years it disclosed only the quintile ranks of country performance (top fifth, bottom fifth, etc.) It now discloses the performance scores of each member country, whether IDA eligible or not, but it does not disclose the actual dollar allocations by country.

3.7.3 Obviously full disclosure is necessary if the PRES is to be a significant part of the CDB’s policy dialogue with member countries. In principle the PRES provides a framework for country dialogue. Written text in support of the PRES scores would be a useful addition. It would be sensible, in most cases, to undertake such a dialogue in conjunction with other MDBs that are also scoring the country’s performance.

*Peer Input to Country Performance Ratings*

3.7.4 In the medium term CDB should engage its BMCs in a dialogue as input to the country performance scores. At some stage in the future it is conceivable that two or three BMCs each year (perhaps on a rotating basis) might be invited to participate in the annual meeting of the CDB’s Country Performance Rating Team, providing a peer perspective on country performance.

*CDB-Country Policy Dialogue*

3.7.5 A third kind of dialogue involves “triggers”. The idea is that a country would receive not a single allocation figure but a range. Thereafter its actual allocation would be high or low in the range depending on its short-term performance on agreed policy and institutional objectives. The WB and ADB tried to

implement “triggers” for some years. In principle the approach may strengthen policy dialogue; but in practice it proved too complex and too demanding of supervision time, and was discontinued.

**Recommendation 10:**

3.7.6 (A) We recommend that CDB explore the possibility of an annual discussion with each BMC on its performance ratings, perhaps jointly with other multilateral institutions that now score country performance (including WB/IDA and IDB).

3.7.7 (B) To facilitate dialogue, we recommend that each set of scores (by country and by criterion) be supported by a short written text<sup>29</sup> (See Appendix D for an example of a WB template for this purpose). This would involve greater disclosure than the WB currently undertakes, since, at present, it discloses the scores but not the supporting text.

3.7.8 Dialogue could also be facilitated by a system that alerts CDB to projects or portfolios at risk. The WB/ADB “red flag” system performs this function (Appendix E).

3.7.9 Some multilateral institutions have found that policy dialogue is more possible, and more productive, when it is related specifically to core aspects of the institution’s mandate. For example, the GEF calculates a country performance index that is only partly portfolio performance (See Section 4.0 following). It contains two other variables explicitly focused on the environmental mission of the GEF (See Appendix F).

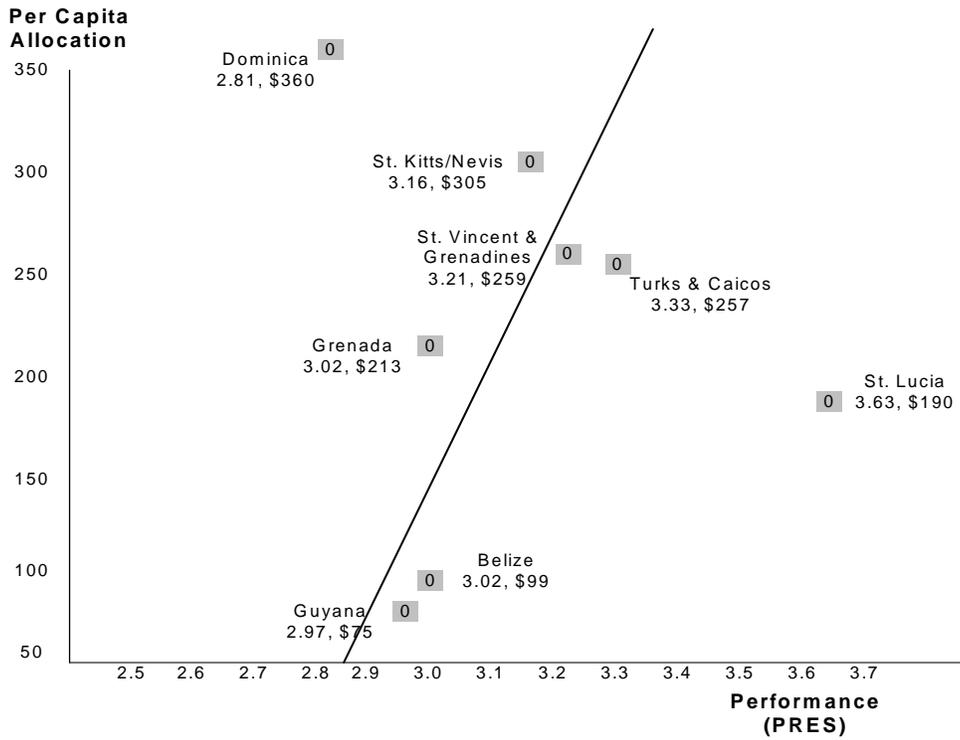
**3.8 The Influence of PRES on the Allocations**

3.8.1 The PRES appears to have had a strong influence on the SDF (U) allocations. For example, consider the performance scores<sup>30</sup> and dollar allocations of six member countries<sup>31</sup>, four of which are in Group 3, one in Group 2 and one in Group 4. These countries display a strong correlation between PRES performance and SDF (U) dollar allocations. (Figure 3.8). The correlation coefficient is approximately 0.76, which is very high. About 57% of the variability of SDF (U) dollar allocations is explained by country performance (PRES), in these cases.<sup>32</sup>

3.8.2 However in some other cases PRES has not been so influential. Dominica, for example, has received a greater allocation per capita than one would expect purely on the basis of its policy and institutional performance score.<sup>33</sup> In contrast, St. Lucia received a per-capita allocation that was less than its PRES performance score alone might have predicted. St. Lucia’s population is more than twice Dominica’s and its per capita income is about 25% higher. On the other hand its portfolio performance score was better and its vulnerability index higher.

3.8.3 In summary, a country’s PRES performance is, in general, a strong influence on its SDF (U) allocation, but there are four other factors in the allocation formula, each of which can be influential in a particular case.

**FIGURE 3.8: PRES PERFORMANCE AND PER-CAPITA SDF (U) ALLOCATIONS, SELECTED COUNTRIES, 2002-2006**



Notes:

“Per capita allocation” is for SDF 4, 5 and 6 taken together. See Appendix A, Table 5.  
 “PRES Performance” is the average of four PRES exercises, 2001 to 2006, See Appendix A, Table 1

## 4. COUNTRY PORTFOLIO PERFORMANCE

4.0.1 All of the multilateral institutions that allocate concessionary resources by formula use “portfolio performance” as one variable in the formula. It is the minor component in assessing country performance. (“Policy and institutional performance” is the major component, in all instances.)

4.0.2 The CDB gives the performance of the country’s CDB loan<sup>34</sup> portfolio a weight of 30% and it gives policy/institutional performance (PRES<sup>35</sup>) a weight of 70%. These weights are similar to those of other institutions, although both the WB/IDA and the ADB give portfolio performance a somewhat smaller weight, 15%-18% in the case of ADB. (See Appendix G); and 20% in the case of IDA (See Appendix C Table 3 and Appendix H).

### 4.1 Defining Portfolio Performance

4.1.1 Most MDBs use a “red flag” system to measure project performance. However they vary in the way in which “red flags” are converted to a performance score. The WB uses a simple measure of percentage of projects at risk. IDB, in contrast, does not convert raw percentages of problem/alert projects to a 1-6 scale using an arbitrary equivalence table. Instead the IDB measures a country’s portfolio performance as the undisbursed amount in problem or on-alert projects compared with the total amount undisbursed from all current projects in the country (expressed as a percentage).<sup>36</sup> (See Appendix I). The AfDB goes a step further and includes potentially problematic projects as well. (See Appendix J)

4.1.2 CDB keeps a *Project Performance Index* (PPI),<sup>37</sup> which reports project performance scores based on the Bank’s PPES. The project performance criteria<sup>38</sup> are strategic relevance, poverty relevance, efficacy, economic efficiency, institutional development impact, and sustainability.<sup>39</sup> A country’s *portfolio performance score* is the average performance score of all current investment projects.

4.1.3 This is a distinctive system that meets standards of good practice among the MDBs. The performance index number captures a good deal of information. Its strength is that it is based on the performance of all active investment loans, not only on the percentage of “projects at risk” as other MDBs do. However the system needs to be up-dated and extended to cover technical assistance (TA) operations (at least over a certain size) as well as investment operations.

### 4.2 The Small Portfolio Volatility Problem

4.2.1 If a country has a small CDB portfolio (say, less than three operations, including TA projects) then its portfolio performance score might not be a good indicator of its true performance. The performance score might be unstable, changing substantially when a new project enters or a completed project leaves the portfolio.

4.2.2 The form of the allocation formula exacerbates this instability. CDB’s allocation formula is a multiplicative one. Therefore the allocation outcome is equally sensitive to each and every variable in the formula (putting aside for the moment the issue of different weights for different variables). To make the point another way, a 25% change in “vulnerability” has the same effect on the allocation outcome as a 25% change in country performance.

4.2.3 However, as a practical matter, the values of some variables do not change much from year to year (population, per capita income, and vulnerability, for example) and, in contrast, the values of some variables can change a lot. Therefore it is this second set of variables (PRES and PORT) that tend to result in changes in allocations from year to year.

4.2.4 This is fine if the changes in the variable values are meaningful. Unfortunately this is sometimes not the case. For example, PORT is quite volatile in an artificial way, and its volatility can lead to major changes in a country's allocation for no better reason than a single project has moved into or out of the country's small portfolio.

4.2.5 Consider a country with two projects current in year 1. The better project has a PPI of 7.5 and the worse project a PPI of 2.0. Imagine that in Year 2 this country has only one project still active. If it is the better project then the country PPI in Year 2 will be 7.5 and if it is the worse project that is still active then the country PPI will be 2.0. Imagine further that the country's PRES is 3.0. In the first case the country performance factor will be  $(0.7*3.0 + 0.3*7.5)^2 = 18.9$ , and in the second case the country performance factor will be  $(0.7*3.0 + 0.3*2.0) = 7.29$ . To put it another way, this country's allocation could be more than twice as large in the second year if the worse project is terminated in Year 1.

4.2.6 This artificial volatility is a serious problem for CDB because several BMCs have small portfolios of capital investment projects. In 2005, for instance, at the time the PPI was calculated for reporting to the Board, nine BMCs had two or fewer active capital investment projects. Eight other countries each had seven or more projects each. The PPI is an unstable measure for the first set of countries and a much more stable measure for the second set.

### **Recommendation 11:**

4.2.7 We recommend three things to ameliorate the small-portfolio problem in the PORT variable: (1) CDB should extend its PPI to include all operations, including technical assistance over a certain size and this requires entering full information into the Portfolio Performance Management System for TA projects as well as capital investment projects; (2) the country portfolio performance score should be averaged<sup>40</sup> over all project scores for the previous three years, rather than only current projects; and (3) where a country still has such a small portfolio that CDB judges that its portfolio performance score is not a reliable measure of its performance, we recommend that PORT be given zero weight in the calculation of these countries' allocations (that is, country performance would be judged solely by PRES).

## **4.3 Portfolio Performance Issues**

### ***Capital Projects or All Operations?***

4.3.1 Most institutions base their portfolio performance scores on all operations. CDB does not presently score TA operations, so the PPI is based only on investment projects. A recent evaluation of CDB's TA operations found no bar to extending performance scoring to all operations.<sup>41</sup> If this were done then the PPI could be based on all CDB operations, which is desirable in itself and would harmonise the CDB's approach with other multilateral institutions.

### ***Should "portfolio performance" be based on the PPI or on "projects at risk"?***

4.3.2 All other institutions base their "portfolio performance" scores on "projects at risk" which, in turn, is based on a system of "red flags" (See Appendix E for a comparative table). In 2002, CDB stated its intention at some time in the future to consider a 'projects at risk' variable in its allocation formula for concessionary resources. It does have such a variable in its PPMS.<sup>42</sup> The CDB project-rating form that is completed after each supervision milestone indicates that the project is 'at risk' if more than one 'red flag' is up.<sup>43</sup>

4.3.3 However CDB does not currently use "projects at risk" in its resource allocation formula. It uses a ***Portfolio Performance Index***, which is the average performance score of all investment projects active

at the time. Therefore CDB is the only MDB to use all its project evaluation data (not only data for “projects at risk”) as the basis for a ‘portfolio performance’ variable in the resource allocation formula. This should provide a better basis for the ‘portfolio performance’ variable than projects-at-risk, because it captures information about the quality of all active projects rather than only the small group of projects at risk. It also helps avoid or lessen<sup>44</sup> certain traps inherent in the at-risk calculation, notably that terminating a non-performing project (and thereby removing it from the at-risk category) can artificially and counter-intuitively sharply improve the country’s portfolio performance score. Also, at a practical level, CDB has so few projects flagged as “at risk” that the measure does not distinguish much among BMCs.<sup>45</sup>

**Recommendation 12:**

4.3.4 We recommend that CDB continue to use the PPI (rather than the percentage of projects-at-risk) as the basis for its “portfolio performance” variable.

*The weight of portfolio performance in the allocation formula.*

4.3.5 The 30% weight of “portfolio performance” in the “country performance” factor in the PBA formula is common among multilateral institutions, although the WB/IDA gives it less weight (20%).

**Recommendation 13:**

4.3.6 We recommend that CDB change the weight of PORT in the country performance factor in the allocation formula to 20%. This harmonises with the WB/IDA and seems a reasonable weight. When the volatility problems of the variable are remedied, CDB might wish to consider a weight of 30% again. At the same time CDB should engage with other MDBs to agree on a consensus weight for “portfolio performance”.

*Should portfolio performance be the average of weighted project scores?*

4.3.7 The IDB uses of the undisbursed amount in problem/on alert projects (rather than the simple number of problem/on-alert projects). In effect this weights the performance scores by project size. A very small project that goes on alert, or a project that goes on alert late in its life, will affect the country’s portfolio performance score less than large projects and early alerts. CDB does something similar with its project performance scores, weighting the PPI by loan approval amounts.

4.3.8 On balance the CDB approach seems better. If one weights by the undisbursed balance of the loan, then a loan project that remains bad throughout its life will gradually influence the country PPI less and less as its budget gets disbursed.

**Recommendation 14:**

4.3.9 (A) We recommend that CDB continue to weight its PPI by project size (approved budgets). This will avoid small operations being overly influential in the country portfolio performance score, balancing our recommendation that TA operations (which tend to be small) should be included in the base on which country portfolio performance is calculated. At the same time, weighting by approved budget avoids the problem encountered by the IDB that a good (or bad) project declines in influence on the country average PPI as it gradually disburses its monies.

4.3.10 (B) The focus on the current state of the portfolio (rather than a longer view) can lead to volatility in scores.<sup>46</sup> For instance the failure and closure of a weak project can result in an improved country performance score without anything else happening to the portfolio. CDB should count

the score of a project terminated incomplete in calculating the country's portfolio performance score in that year; and should consider other ways to penalise non-completion or extremely late completion of projects.<sup>47</sup>

*Adjustment for the age of the portfolio*

4.3.11 New portfolios tend to have an over-optimistic performance score because problems have not yet had time to emerge. It is difficult to assess the performance of new borrowers [or a new government of an established borrower, or a country that has several new loans] until sufficient time has elapsed to expose problems.

4.3.12 Because managers in charge of projects have historically underestimated the number of 'projects at risk',<sup>48</sup> the WB adjusts the estimate to take into account the average 'net disconnect'<sup>49</sup> observed in the past between managers' assessments and actual outcomes.<sup>50</sup> If the 'net disconnect' for a country during the most recent WB fiscal year was 20% or more, or if net commitments associated with unsatisfactory projects, as rated by the WB Operations Evaluation Department, represent more than 40% of commitments for completed projects over the past five years, then this raises a red flag.

4.3.13 CDB could prepare an exploratory paper on the disconnect (if any) between early-year PPI scores and scores on completion. If a significant disconnect is found, CDB could consider an adjustment factor to each country's average PPI linked to the average age of the projects in the country portfolio. This is not a high priority but could be investigated after other reforms to the project performance variable are complete.

*The Scoring Scale*

4.3.14 CDB scores portfolio performance on a scale 0-10 and other MDBs use 1-6. This has no significant implications since (1) the portfolios are different so there is no reason why a country should receive the same or even similar portfolio scores from different institutions, even if the scoring is on the same scale; and (2) it is relative performance that matters to the allocation so the measurement scale is immaterial. However if CDB adopts the WB/IDA country performance questionnaire it would be convenient to adopt the six-point scale at the same time, rather than have to adjust the related scoring guidelines to a five-point scale.

**Recommendation 15:**

4.3.15 We recommend that CDB adopt the six-point country performance scoring scale.

## 5. COUNTRY NEED

### 5.1 Defining Country Need

5.1.1 The SDF (U) allocation formula contains three variables related to country need. These are population, per capita income<sup>51</sup> and country vulnerability. Together these variables are a reasonable surrogate for country poverty, although individually they leave much to be desired as measures of poverty. In general, CDB, like all other MDBs, needs better measures of poverty in its allocation formula. IFAD has made some interesting efforts in this regard, using rural population (not total population) and considering the addition of UN measures of the incidence of malnutrition.

5.1.2 Population and per capita income can be used to indicate relative poverty as long as the distribution of income is the same in the two countries being compared. However, since that will seldom or never be the case, a more direct measure of the number of poor people would be preferable – say the number of people (or families) earning less than the poverty threshold.

#### **Recommendation 16:**

5.1.3 We recommend that CDB study three possibilities in regard to the “poverty” variables in the allocation formula: (1) replace the population and per capita income variables with the logarithm of the population earning less than the poverty threshold. This would involve changing the weights of variables in the allocation formula, since the variables themselves would change; (2) replace only the population variable with the population earning less than the poverty threshold; Or (3) make replacements as in (1) or (2) with extra weight for the level of the indigent population.

#### **Recommendation 17:**

5.1.4 The third needs variable is “vulnerability” based on CDB’s Vulnerability Index (2002).<sup>52</sup> This index combines vulnerability to natural disasters with vulnerability to economic shocks. We recommend that CDB continue to use this variable.

### 5.2 Fragile States

5.2.1 MDBs have recognised that certain “fragile” states should be treated differently with regard to concessional resource allocation. In post-disaster, post-conflict or turn-around situations, CDB may need to be more involved with a particular borrower than the standard resource allocation formula would indicate. CDB’s *Natural Disaster Strategy and Operational Guidelines*<sup>53</sup> were amended in February 2000 to provide further flexibility for an early response during the initial phase of recovery when dislocations affecting the poor are greatest. However, loans granted in an emergency situation may not be fully disbursed, and need to be returned to the fixed allocation ‘pot’ as promptly as possible. At some stage the residual, if any, needs to be reallocated for other purposes, if it appears that not all the allocation will be needed for disaster response.

5.2.2 As well, there may be a need for some flexibility in ‘turn-around’ situations – that is, if a country is undertaking important and difficult reforms, the Bank may need to be supportive sooner than would be possible if it waits for results to show themselves clearly. In the case of countries that have had poor policies but have reformed, increased technical cooperation may be warranted as well as, or prior to, increased lending.

5.2.3 New members are in a special situation because they do not have an established track record on ‘CDB portfolio performance’, which is an important factor in the standard allocation formula. This may

not be an immediate problem if early lending volume is low and the new member's allocation is determined largely by a need for technical assistance for governance and institutional strengthening, and BNTF-type projects, as is the case with Haiti. However some method needs to be developed to incorporate new members and special cases within the performance-based allocation system.

**Recommendation 18:**

5.2.4 (A) A fixed country allocation for a new member is appropriate until the CDB has enough experience to consider the country's performance along with other borrowing members in the normal allocation exercise.

5.2.5 (B) For special cases of new members that have serious governance problems CDB should give a fixed allocation, as recommended above, and offer to increase that allocation according to performance on negotiated criteria that might resemble the post-conflict allocation criteria<sup>54</sup> used by other multilateral development banks in similarly unique cases.

**5.3 Volatility of Allocations**

5.3.1 Some have criticised concessionary resource allocation systems because the allocations are volatile. A country's allocation may vary substantially from one period to the next. The volatility of the allocation depends on its sensitivity to changes in the values of variables in the allocation formula.

5.3.2 In the multiplicative formula, used by the CDB and modeled on the WB/IDA type of formula, volatility in any factor has the same effect on the allocation as volatility in any other factor. That is, a 20% change in population of a country will have exactly the same effect on its allocation as a 20% change in its per capita income or a 20% change in its country performance score. If one is multiplying several factors together it does not matter which one increases by 20% because the number resulting from the whole multiplication of all factors (which determines the allocation share) will be 20% larger whichever factor actually increases.

5.3.3 However, of course, the factors in the allocation formula are not typically equally volatile. Low volatility factors include population, per capita income, and (in the CDB formula) vulnerability. That is, the "country needs" factors do not tend to be volatile. In contrast, the country performance factors can be very volatile. The relative scores of a country in regard to policy-and-institutional performance, portfolio performance or governance can change markedly from one period to the next. The most volatile factor tends to be "portfolio performance" especially when the country has a small portfolio of CDB loans. One good or bad loan can make a large difference to the country's performance score.

5.3.4 In practical terms the volatility of a country's allocation is determined by its relative scores on each factor in the formula, and the propensity for its scores to change.<sup>55</sup> If there is little difference among country scores on a particular factor then this factor will make little difference to the allocation outcome. Similarly, if the relative scores of the member countries in regard to a particular factor in the formula do not change much over time, then this factor will contribute little to volatility. The term "relative" is important. If eligible member countries were subject to a lot of volatility in, say, their "vulnerability" scores, but these scores always moved up or down together, then this factor would have little influence on the resource allocations. It is change in the relative scores that affects allocations. Therefore the type of volatility that matters is the volatility of relative scores.

5.3.5 On average CDB scores of country policy and institutional performance, made four times between 2001 and 2005, varied by 0.44 between the low and the high score (Appendix A, Table 1). Eight countries out of 17 had differences between low and high scores that were greater than 0.5. The country

whose scores varied the most was Dominica and the country whose scores varied the least was Barbados. The average score across all member countries rose each time the scoring was undertaken, increasing from 3.11 in 2001 to 3.45 in 2005. Therefore some of the apparent volatility may be a result of “grade inflation”. The alternative explanation is that policy and institutional performance has in fact improved significantly in the Caribbean from 2001 to 2005. Only one country, Anguilla, received a lower score in 2005 than in 2001.

5.3.6 The WB/IDA Deputies have identified volatility of allocations as one of two themes (along with complexity) for discussion during the forthcoming IDA 15 negotiations.

*“Another possible area for modification (of the allocation formula) to reduce volatility relates to the portfolio performance ratings. If this would be of interest to the Deputies, management will explore options for simplifying the formula for discussion during the IDA15 replenishment deliberations.”<sup>56</sup>*

5.3.7 The discomfort with volatility is partly fed by the related discomfort with complexity. That is, volatility is less acceptable if it is difficult to understand the reasons for it. To some degree volatility is inevitable in a system that distributes a fixed amount of money according to relative scores. Sometimes a country’s allocation will go up without any absolute improvement on its part (other countries’ scores decline) and sometimes its allocation will go down although its performance improves (other countries’ scores improve more). On the other hand, some of the opacity is the result of the WB’s choice of a particularly complex allocation formula. To a lesser extent one can say the same thing about the CDB formula.

5.3.8 The allocation system of the IDB is, in practice, less volatile. This is because it treats needs and performance separately; and the “country needs” factors, as mentioned above, are not volatile. Countries tend to keep their relative positions in regard to population, per capita income and vulnerability. Therefore the pot of money allocated solely according to country needs (typically about 40% of FSO funds) tends to be shared among member countries in much the same proportions from one period to the next. In contrast, the 60% of FSO funds allocated according to country performance is subject to the same high volatility as shown by the multiplicative-formula allocations (WB/IDA, ADB, AfDB, and CDB). To summarise, a country’s total allocation from IDB has one volatile component and one stable component – so, overall, it tends to be less volatile than the fully multiplicative systems. The result is somewhat analogous to investing some money in stable bonds and some in volatile growth stocks.

### ***A Volatility Problem?***

5.3.9 Is volatility of allocations, then, a problem or not? It is a problem if the volatility of some factors in the formula is more apparent than real. For example, a country’s score on portfolio performance may be volatile for no better reason than the inherent lumpiness of a small portfolio or an unreasonably short timeframe over which portfolio performance is measured. The classic problem has been a small portfolio in which a badly performing project is terminated thereby cleaning it up and resulting in a better portfolio performance score. This problem can be alleviated to some degree by lengthening the measured performance period, using a “rolling” measure instead of a current snapshot of performance; and by instituting some kind of demerit for projects terminated incomplete. If these reforms were instituted, then “portfolio performance” would become more like “policy and institutional performance” – that is, still volatile but largely in a meaningful way.

5.3.10 Policy and institutional performance (and the related “governance” factor in the formulas of the WB/IDA, ADB and AFDB) tend to be somewhat volatile. This is because the effective range of scores on country performance is from about 2.5 to about 4.0 on the scale 1 to 6 (WB/IDA), or about 2.0 to 3.5

on the scale 1 to 5 (CDB). That is, the scores are compressed within a small range. Therefore a small change in score, say from 2.0 to 2.5, can have a large effect on the relative score, and it is the relative score that counts. Consider a simple illustration of an allocation between two countries that, in one allocation period, score 2.0 and 3.0 on country performance. If everything else is equal, Agroland will have an allocation score of 4A and Upland will have an allocation score of 9A, since country performance has an exponent of 2.0 (the score is squared). Therefore Agroland will receive an allocation of 4/13 of the whole amount of money available for allocation. Out of \$100 it will receive an allocation of \$30.77.

5.3.11 Suppose now that Agroland increases its country performance score from 2.0 to 2.5, not a major step although a significant one. Its allocation number is now  $(2.5)^2 = 6.25$ , and it will receive an allocation of  $6.25/(6.25+9)*100 = \$41$ . Its allocation has increased by a little more than one third in response to the minimum possible change<sup>57</sup> in its country performance score. The question is this – is a change in a country’s performance score from 2.0 to 2.5 important enough to justify an increase of one third in its total allocation? Is the allocation appropriately sensitive to country performance or is it over-sensitive?

5.3.12 Policy and institutional performance can change substantially in a short period, for better or for worse, sometimes with a change of government regime. To the extent that the change is real and permanent it is appropriate that it be reflected in the country’s dollar allocation. However if a country has a record of erratic performance one might not want to penalise it or reward it in quite the same way as if the deterioration or improvement were smooth and continuous. This kind of volatility of country performance, which is a form of country risk, should be penalised, but there is no way to do this within the existing formulas.

5.3.13 Measuring country performance over a longer period, rather than taking a current snapshot each year, would stabilise the scores. However this would be a superficial solution. It would make country performance look more stable than it really is.

5.3.14 This report has made recommendations (above) in regard to reducing the artificial volatility caused by small portfolios. CDB could investigate the possibility of a more sophisticated approach to country risk (volatility of country performance scores). It could consider whether a BMC’s allocation should be lessened by adding a risk premium/demerit to the country performance score based upon past volatility of performance. If this proves practical, it is an area in which CDB could lead MDB practice. This is not a high priority but perhaps worth commissioning an exploratory paper.

## 6. SET ASIDES

6.0.1 CDB has a considerable amount in set-asides for special purposes that are untied to particular countries. These include set asides for disasters including HIV/AIDS, for regional projects, for project management training, for the programme entitled Caribbean Technical Consulting Services (CTCS), and monitoring the Millennium Development Goals (MDGs), and for economic research.

6.0.2 There is a case for decreasing the set-asides over time, and having something closer to a single pot of concessionary funds indicatively allocated to a particular country. However, in that case, CDB would need a general reserve of funds to maintain reasonable flexibility, as, for example, IDB has.

### 6.1 Grants

6.1.1 SDF (U) funds are disbursed as loans and grants. The proportion of grants has increased over time and exceeded 50% of new contributions to SDF 5.<sup>58</sup> The recipient BMC benefits from a grant but there are costs to CDB, including substantial time costs in providing and administering technical assistance and some costs of lost interest and capital re-flows. There may also be other costs such as potential loss of ownership, commitment and financial discipline by the BMCs. These costs are mentioned in CDB's recent (2007) evaluation of its TA operations.<sup>59</sup> Their practical implication is that many TA projects are closed incomplete.

6.1.2 CDB has agreed with the SDF 6 contributors that grants shall not exceed 35% of approved project budgets. As well CDB has made so-far-unsuccessful proposals to contributors for compensation similar to that provided to other MDBs.<sup>60</sup>

*“Contributors undertook a review of the issues associated with grant financing, including the extent to which grants reduce SDF income and future re-flows and, therefore, the contribution of internally-generated resources to future replenishments. They noted that the share of grants, as a percentage of new contributions, had risen sharply in recent SDF cycles. They also noted, however, SDF had traditionally included grants, as particularly appropriate for certain types of activity, such as BNTF and TA, and they concluded that grants continued to be important for these purposes and for certain other purposes reflected in the special allocations referred to above. They underscored, however, the need to maintain an appropriate balance, and agreed that the share of grant funding allocations in the base programme level for SDF 6 should be no higher than 35%.”<sup>61</sup>*

6.1.3 The important point for this paper is that, with the partial exception of the Basic Needs Trust Fund (BNTF), SDF (U) grants are not allocated among countries by formula.

### 6.2 BNTF

6.2.1 Among the SDF (U) grant instruments, only the BNTF is allocated by country, using the standard SDF (U) allocation formula. The other set-asides for grants are in single pools of funds, organised by topic (regional projects, disaster assistance, BMC capability enhancement, MDGs etc and any eligible entity (country or regional or sub-regional organisation) may apply for a grant of any amount. The initial allocation of BNTF funds is made according to the SDF (U) allocation formula. The incentive allocation will be made by criteria to be decided upon.

**Recommendation 19:**

6.2.2 CDB should continue to use the PBA formula to make an initial allocation of BNTF funds. CDB should continue to have special criteria for allocation of the incentive portion of BNTF that relate mainly to specific performance on BNTF projects but which may, in part, also relate to country improvement on the general PBA performance criteria.

**6.3 BMC Capacity Building TA**

6.3.1 In 2006 CDB has commissioned an evaluation of its TA operations. When the recommendations of that evaluation are available CDB should consider their implications for SDF (U) resource allocation processes, particularly in regard to the “portfolio performance” variable in the allocation formula.

## **7. FINDINGS AND RECOMMENDATIONS**

### **7.1 Strengths and Weaknesses of the Present System**

7.1.1 CDB has successfully implemented a performance based allocation system for SDF (U) and operated it for five years, through a whole SDF cycle. The Bank has customised the allocation formula to its needs but, at the same time, has maintained a high degree of harmonisation with other MDBs and an admirable degree of openness and transparency.

7.1.2 However, on the basis of experience over the past five years, CDB has opportunities to enhance its allocation system to target it more precisely to the Bank's poverty reduction mission, to make it even more systematic and transparent and less subject to ad hoc changes, to make allocations more predictable and less volatile, and to strengthen the resource allocation system as a vehicle for policy dialogue.

### **7.2 Summary of Recommendations**

#### **Recommendation 1:**

7.2.1 The WB/IDA, the ADB, and the AfDB have harmonised on a single formula (or, at least, very similar formulas). If IDB decides to harmonise with this group, despite the manifest advantages of its own simpler formula, then the case for CDB to do the same would be strong. However since the WB/IDA intends to review and perhaps change its allocation formula during the IDA 15 negotiations in 2007, we recommend that CDB wait to see the result before deciding on any changes to its own formula (apart from a change in the weight of "portfolio performance" – see recommendation number 12).

#### **Recommendation 2:**

7.2.2 We recommend that CDB reallocate its SDF (U) resources every two years at a minimum, as is present practice, or annually if circumstances require.

#### **Recommendation 3:**

7.2.3 We recommend that CDB convene a Country Performance Rating Team once each year to consider, revise, if necessary, and approve the PRES country performance ratings. The Rating Team should comprise a small number of executive managers. One good design would be to have the Vice-President (Operations) as Chair, and, as members, the Director, Economics, the Director, Projects, and the Director, Finance and Corporate Planning. To minimise the time burden, the size of the team should be kept to four.

#### **Recommendation 4:**

7.2.4 The Rating Team should be supported by the country economists and by topic specialists in Projects Department. We recommend that the input of the country economists should be coordinated by the Chief Country Economist who should present proposed performance scores to the Rating Team for those criteria most relevant to the economists' expertise. The input of the functional specialists should be coordinated, and presented, similarly by the Division Chief, Project Services Division. For each performance criterion, country economists in Economics Department and functional specialists in Projects Department should prepare worksheets of suggested scores on each criterion, each with a supporting text. The rating meeting should be held in February and the background work for the scoring exercise should be integrated with the development of CDB's *Annual Economic Review*.

**Recommendation 5:**

7.2.5 We believe that the Bank is ready to make wider use of the performance scores in policy dialogue. This should be selective. If, for example, the Bank selected one “country performance criterion” each year for intensive review (including a cross-country comparative study of performance led by Economics or by Project Services Division) it would be well prepared to present and explain country rankings on that criterion. The *Annual Economic Review* would, in our opinion, be a good venue for such discussion.

**Recommendation 6:**

7.2.6 We recommend that CDB adopt the WB/IDA policy and institutional performance questionnaire, while keeping its own criteria weights and applying its own judgment to generate scores. The PRES will need minor adjustments to cope with this change in scoring instrument.

**Recommendation 7:**

7.2.7 CDB has selected an appropriate weight for the “governance cluster” of performance criteria in the PRES. Nothing additional is needed to emphasise its importance.

**Recommendation 8:**

7.2.8 (A) We recommend that responsibility for different PRES criteria be divided between Economics Department and Project Services Division to do the work-up of possible scores for the Rating Committee to consider. A work-up will comprise the suggested scores by country for each criterion supported by a short comparative text.

7.2.9 (B) The scores and supporting text will involve professional judgment supported by periodic cross-country-comparative thematic studies. We recommend that commissioning such thematic studies should be an eligible use of SDF (U) funds.

**Recommendation 9:**

7.2.10 We recommend that CDB explore the possibility of joint benchmarking with other multilateral development institutions working in the Caribbean, including the IDB and the WB. CDB should send an economist, one or more sector specialists and an evaluator from the Evaluation and Oversight Division (for general methodology and for the portfolio performance variable) to Washington D.C. each year to participate in the joint MDB “country performance benchmarking exercise”, which is generally in November/December.

**Recommendation 10:**

7.2.11 (A) We recommend that CDB explore the possibility of an annual discussion with each BMC on its performance ratings, perhaps jointly with other multilateral institutions that now score country performance (including WB/IDA and IDB).

7.2.12 (B) To facilitate dialogue, we recommend that each set of scores (by country and by criterion) be supported by a short written text<sup>62</sup> (See Appendix D for an example of a WB template for this purpose). This would involve greater disclosure than the WB currently undertakes, since, at present, it discloses the scores but not the supporting text.

**Recommendation 11:**

7.2.13 We recommend that three things be done to ameliorate the small-portfolio problem in the PORT variable: (1) CDB should extend its PPI to include all operations, including technical assistance over a certain size; (2) the country portfolio performance score should be averaged<sup>63</sup> over all project scores for the previous three years, rather than only current projects; and (3) where a country still has such a small portfolio that CDB judges that its portfolio performance score is not a reliable measure of its performance, we recommend that PORT be given zero weight in the calculation of these countries' allocations (that is, country performance would be judged solely by PRES).

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7.2.16 (A) We recommend that CDB continue to weight its PPI by project size (approved budgets). This will avoid small operations being overly influential in the country portfolio performance score, balancing our recommendation that TA operations (which tend to be small) should be included in the base on which country portfolio performance is calculated. At the same time, weighting by approved budget avoids the problem encountered by the IDB that a good (or bad) project declines in influence on the country average PPI as it gradually disburses its monies.

7.2.17 (B) The focus on the current state of the portfolio (rather than a longer view) can lead to volatility in scores.<sup>64</sup> For instance the failure and closure of a weak project can result in an improved country performance score without anything else happening to the portfolio. CDB should count the score of a project terminated incomplete in calculating the country's portfolio performance score in that year; and should consider other ways to penalize non-completion or extremely late completion of projects.<sup>65</sup>

**Recommendation 15:**

7.2.18 We recommend that CDB adopt the six-point country performance scoring scale.

**Recommendation 16:**

7.2.19 We recommend that CDB study three possibilities in regard to the "poverty" variables in the allocation formula: (1) replace the population and per capita income variables with the logarithm of the population earning less than the poverty threshold. This would involve changing the weights of variables in the allocation formula, since the variables themselves would change; (2) replace only the population variable with the population earning less than the poverty threshold; Or (3) make replacements as in (1) or (2) with extra weight for the level of the indigent population.

**Recommendation 17:**

7.2.20 The third “needs variable” is “vulnerability” based on CDB’s Vulnerability Index (2002).<sup>66</sup> This index combines vulnerability to natural disasters with vulnerability to economic shocks. We recommend that CDB continue to use this variable.

**Recommendation 18:**

7.2.21 (A) A fixed country allocation for a new member is appropriate until the CDB has enough experience to consider the country’s performance along with other borrowing members in the normal allocation exercise.

7.2.22 (B) For special cases of new members that have serious governance problems CDB should give a fixed allocation, as recommended above, and offer to increase that allocation according to performance on negotiated criteria that might resemble the post-conflict allocation criteria used by other multilateral development banks in similarly unique cases.

**Recommendation 19:**

7.2.23 CDB should continue to use the PBA formula to make an initial allocation of BNTF funds. The Bank should also continue to have special criteria for allocation of the incentive portion of BNTF that relate mainly to specific performance on BNTF projects but which may, in part, also relate to country improvement on the general PBA performance criteria.

**SDF (U) ALLOCATIONS TABLE****TABLE 1: COUNTRY POLICY AND INSTITUTIONAL PERFORMANCE SCORES, 2001-2005**

| Countries                 | Year        |             |             |             | Average<br>2001-<br>2005 | Range               | Difference<br>(low to<br>high) |
|---------------------------|-------------|-------------|-------------|-------------|--------------------------|---------------------|--------------------------------|
|                           | 2001        | 2003        | 2004        | 2005        |                          |                     |                                |
| Dominica                  | 2.68        | 2.46        | 2.71        | 3.39        | <b>2.81</b>              | 2.46 to 3.39        | 0.93                           |
| Antigua and Barbuda       | 2.10        | 2.15        | 2.60        | 2.87        | <b>2.43</b>              | 2.10 to 2.87        | 0.77                           |
| Anguilla                  | 3.34        | 3.98        | 3.81        | 3.30        | <b>3.61</b>              | 3.30 to 3.98        | 0.68                           |
| Turks and Caicos Islands  | 2.93        | 3.58        | 3.39        | 3.40        | <b>3.33</b>              | 2.93 to 3.58        | 0.65                           |
| Guyana                    | 2.50        | 3.13        | 3.13        | 3.10        | <b>2.97</b>              | 2.50 to 3.13        | 0.63                           |
| Jamaica                   | 3.12        | 3.40        | 3.53        | 3.70        | <b>3.44</b>              | 3.12 to 3.70        | 0.58                           |
| St. Lucia                 | 3.22        | 3.75        | 3.75        | 3.80        | <b>3.63</b>              | 3.22 to 3.80        | 0.58                           |
| Montserrat                | 3.25        | 3.50        | 3.50        | 3.80        | <b>3.51</b>              | 3.25 to 3.80        | 0.55                           |
| St. Kitts and Nevis       | 2.89        | 3.16        | 3.29        | 3.30        | <b>3.16</b>              | 2.89 to 3.30        | 0.41                           |
| St Vincent and Grenadines | 2.92        | 3.31        | 3.31        | 3.30        | <b>3.21</b>              | 2.92 to 3.31        | 0.39                           |
| Trinidad and Tobago       | 3.49        | 3.65        | 3.65        | 3.82        | <b>3.65</b>              | 3.49 to 3.82        | 0.33                           |
| Belize                    | 2.82        | 3.10        | 3.10        | 3.06        | <b>3.02</b>              | 2.82 to 3.10        | 0.28                           |
| British Virgin Islands    | 3.23        | 3.38        | 3.44        | 3.40        | <b>3.36</b>              | 3.23 to 3.40        | 0.21                           |
| Grenada                   | 2.94        | 3.01        | 3.14        | 3.00        | <b>3.02</b>              | 2.94 to 3.14        | 0.20                           |
| Bahamas                   | 3.84        | 4.03        | 3.89        | 3.90        | <b>3.92</b>              | 3.84 to 4.03        | 0.19                           |
| Cayman Islands            | 3.70        | 3.66        | 3.66        | 3.70        | <b>3.68</b>              | 3.66 to 3.70        | 0.04                           |
| Barbados                  | 3.89        | 3.90        | 3.90        | 3.90        | <b>3.90</b>              | 3.89 to 3.90        | 0.01                           |
| Haiti                     |             |             |             |             |                          |                     |                                |
| Suriname                  |             |             |             |             |                          |                     |                                |
| <b>Average:</b>           | <b>3.11</b> | <b>3.36</b> | <b>3.40</b> | <b>3.45</b> | <b>3.33</b>              | <b>3.11 to 3.45</b> | <b>0.44</b>                    |

**Notes:**

Scores are weighted averages of policy and institutional performance scores as described in "Allocation of SDF V Resources", (Working Paper, April 2001)

Raw Scores are on a 1 to 5 scale: 1.Very Poor 2.Poor 3.Satisfactory 4.Good 5.Excellent

Average weighted scores: 1-2 Very Poor; 2-3 Poor; 3-4 Satisfactory; 4-5 Good to Excellent

**APPENDIX A**

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**TABLE 1A: SCORES ON PRES 2006 AND IFAD RURAL CPIA 2004 COMPARED**

| <b>Countries</b>          | <b>2006 PRES<br/>(CDB)</b> | <b>2006 PRES (standardised<br/>for IFAD comparability)</b> | <b>2004 IFAD<br/>(Rural<br/>CPIA)</b> |
|---------------------------|----------------------------|--|---------------------------------------|
| Dominica                  | 3.39                       | 4.02   | 4.13                                  |
| Antigua and Barbuda       | 2.87                       | 3.40   | 4.13                                  |
| Anguilla                  | 3.30                       |  |                                       |
| Turks and Caicos Islands  | 3.40                       |  |                                       |
| Guyana                    | 3.10                       | 3.68   | 3.73                                  |
| Jamaica                   | 3.70                       | 4.39   | 4.13                                  |
| St Lucia                  | 3.80                       | 4.51   | 4.17                                  |
| Montserrat                | 3.80                       |  |                                       |
| St Kitts and Nevis        | 3.30                       | 3.92   | 4.17                                  |
| St Vincent and Grenadines | 3.30                       | 3.92   | 4.13                                  |
| Trinidad and Tobago       | 3.82                       | 4.53   | 4.17                                  |
| Belize                    | 3.06                       | 3.63   | 3.63                                  |
| British Virgin Islands    | 3.40                       |  |                                       |
| Grenada                   | 3.00                       | 3.56   | 4.13                                  |
| Bahamas                   | 3.90                       |  |                                       |
| Cayman Islands            | 3.70                       |  |                                       |
| Barbados                  | 3.90                       | 4.63   | 4.59                                  |
| Haiti                     |                            |  |                                       |
| Suriname                  |                            |  |                                       |
| <b>Average:</b>           | <b>3.45</b>                |  | <b>4.10</b>                           |

**TABLE 2: CDB AND IDA SCORES FOR COUNTRY POLICY AND INSTITUTIONAL PERFORMANCE, 2005**

| <b>Countries</b>          | <b>CDB Scores by Year</b> |             |             |             |
|---------------------------|---------------------------|-------------|-------------|-------------|
|                           | <b>2001</b>               | <b>2003</b> | <b>2004</b> | <b>2005</b> |
| Dominica                  | 2.680                     | 2.460       | 2.71        | 3.39        |
| Guyana                    | 2.500                     | 3.130       | 3.13        | 3.10        |
| Grenada                   | 2.940                     | 3.010       | 3.14        | 3.00        |
| St Vincent and Grenadines | 2.920                     | 3.310       | 3.31        | 3.30        |
| St. Lucia                 | 3.220                     | 3.750       | 3.75        | 3.80        |
| Haiti                     |                           |             |             |             |
| <b>Average:</b>           | <b>2.85</b>               | <b>3.13</b> | <b>3.21</b> | <b>3.32</b> |

| <b>Countries</b>          | <b>IDA and (adjusted) CDB Scores 2005</b> |                     |                 |             | <b>IDA Rank</b> |
|---------------------------|---|---------------------|-----------------|-------------|-----------------|
|                           | <b>CDB 2005</b>                           | <b>CDB Adjusted</b> | <b>CDB Rank</b> | <b>IDA</b>  |                 |
| Dominica                  | 3.39                                      | 4.06                | 2               | 3.80        | 3               |
| Guyana                    | 3.10                                      | 3.72                | 4               | 3.40        | 5               |
| Grenada                   | 3.00                                      | 3.60                | 5               | 3.70        | 4               |
| St Vincent and Grenadines | 3.30                                      | 3.96                | 3               | 3.90        | 2               |
| St Lucia                  | 3.80                                      | 4.56                | 1               | 4.00        | 1               |
| Haiti                     |   |                     |                 | 2.80        | 6               |
| <b>Average:</b>           | <b>3.32</b>                               | <b>3.98</b>         |                 | <b>3.76</b> |                 |

**Notes:**

*CDB Scores are weighted averages of performance scores on criteria set out in "Allocation of SDF V Resources", (Working Paper, April 2001)*

*CDB raw scores are on a 1 to 5 scale. CDB adjusted scores are on a scale 1 to 6 to be comparable with IDA.*

**TABLE 3: COUNTRY PERFORMANCE CRITERIA OF THE CDB COMPARED WITH THE WORLD BANK/IDA AND ADB**

| Caribbean Development Bank Criteria  |     |  | World Bank (IDA) and ADB Criteria         |     |  |
|--------------------------------------|-----|--|---|-----|--|
| Socially–inclusive development       | 25% | Framework for Poverty Reduction Policy<br>Enhancing the Economic Capital of the Poor<br>Developing the Human Capital of the Poor<br>Equity and Social Safety Nets<br>Gender, Empowerment and Participation | Policies for social inclusion/equity      | 25% |  |
|                                      |     |  |   |     | Equity of public resource use                                    |
|                                      |     |  |   |     | Building human resources   |
|                                      |     |  |   |     | Social protection and labour                                     |
|                                      |     |  |   |     | Gender equality  |
| Structural policies                  | 15% | Trade Policy<br>Financial sector efficiency and soundness<br>Factor and product markets and prices<br>Enabling Environment for Private Sector Development  | Structural Policies                       | 25% | Trade policies   |
|                                      |     |  |   |     | Financial sector policies  |
|                                      |     |  |   |     |  |
|                                      |     |  |   |     | Business regulatory environment                                  |
| Governance, public sector management | 25% | Rule of Law<br>Anticorruption and Accountability Institutions<br>Civil Service<br>Revenue mobilisation and budgetary management<br>Management and efficiency of public expenditures                        | Public sector management and institutions | 25% | Property rights and rules-based governance                       |
|                                      |     |  |   |     | Transparency, accountability and corruption in the public sector |
|                                      |     |  |   |     | Quality of public administration                                 |
|                                      |     |  |   |     | Efficiency of revenue mobilisation                               |
|                                      |     |  |   |     | Quality of budgetary and financial management                    |
| Macroeconomic management             | 25% | Fiscal Policy<br>Monetary Policy<br>External financing policies  | Economic Management                       | 25% | Fiscal policy  |
|                                      |     |  |   |     | Macroeconomic management   |
|                                      |     |  |   |     | Debt policy  |
| Environmental sustainability         | 10% | Environmental Laws, regulations and institutions   |   |     | Policies and institutions for environmental sustainability       |
|                                      |     | Environmentally damaging subsidies and other damaging practices  |   |     |  |

Source: CDB Social and Economic Research Unit, Economics Department, Caribbean Development Bank

Source: World Bank, Operations Policy and Country Services, CPIA 2005 Assessment Questionnaire, Dec. 20, 2005

**TABLE 4: CDB'S (COUNTRY POLICIES AND INSTITUTIONS) PERFORMANCE CRITERIA COMPARED WITH THE IDB CRITERIA**

| Caribbean Development Bank Criteria  |     |   | Inter-American Development Bank |  |  |
|--------------------------------------|-----|---|---------------------------------|--|--|
| Socially-inclusive development       | 25% | Framework for Poverty Reduction Policy                          |                                 |  |  |
|                                      |     | Enhancing the Economic Capital of the Poor                      |                                 |  |  |
|                                      |     | Developing the Human Capital of the Poor                        |                                 |  |  |
|                                      |     | Equity and Social Safety Nets                                   |                                 |  |  |
|                                      |     | Gender, Empowerment and Participation                           |                                 |  |  |
| Structural policies                  | 15% | Trade Policy  |                                 |  |  |
|                                      |     | Financial sector efficiency and soundness                       |                                 |  |  |
|                                      |     | Factor and product markets and prices                           |                                 |  |  |
|                                      |     | Enabling Environment for Private Sector Development             |                                 |  |  |
|                                      |     |   |                                 |  |  |
| Governance, public sector management | 25% | Rule of Law   |                                 |  |  |
|                                      |     | Anticorruption and Accountability Institutions                  |                                 |  |  |
|                                      |     | Civil Service   |                                 |  |  |
|                                      |     | Revenue mobilisation and budgetary management                   |                                 |  |  |
|                                      |     | Management and efficiency of public expenditures                |                                 |  |  |
| Macroeconomic management             | 25% | Fiscal Policy   |                                 |  |  |
|                                      |     | Monetary Policy   |                                 |  |  |
|                                      |     | External financing policies                                     |                                 |  |  |
| Environmental sustainability         | 10% | Environmental Laws, regulations and institutions                |                                 |  |  |
|                                      |     | Environmentally damaging subsidies and other damaging practices |                                 |  |  |

Source: CDB Social and Economic Research Unit, Economics Department, Caribbean Development Bank

Source: IDB

**APPENDIX A**

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**TABLE 5: SDF ALLOCATIONS - SDF IV, V AND VI**

| Loans and Grants Categories                       | Allocation of SDF Monies (\$US000) |                          |                          |                         | Total Initial Allocations (SDF 4, 5 and 6) |
|---|------------------------------------|--------------------------|--------------------------|-------------------------|--|
|   | SDF 4 Initial Allocation           | SDF 5 Initial Allocation | SDF 5 Revised Allocation | SDF6 Initial Allocation |  |
| <b>Loans</b>                                      |                                    |                          |                          |                         |  |
| Anguilla (Grp 2)                                  | 2000                               | 5010                     | 2742                     | 3,460                   | 10,470                                     |
| Antigua and Barbuda (Grp 2)                       | 4000                               | 2480                     | 1760                     | 2,262                   | 8,742                                      |
| Barbados (SDF 4 Grp 1, SDF 5 & 6 Grp 2)           | 1000                               | 3420                     | 1000                     |                         | 4,420                                      |
| Bahamas (Grp 1)                                   | 1000                               | 0                        | 0                        |                         | 1,000                                      |
| Belize (Grp 3)                                    | 10000                              | 10810                    | 6100                     | 7,256                   | 28,066                                     |
| British Virgin Islands (SDF 4 Grp 2, SDF 5 Grp 1) | 2000                               | 0                        | 0                        |                         | 2,000                                      |
| Cayman Islands (Grp 1)                            | 300                                | 0                        | 0                        |                         | 300  |
| Dominica (Grp 3)                                  | 11000                              | 5970                     | 8760                     | 8,404                   | 25,374                                     |
| Grenada (Grp 3)                                   | 11000                              | 5610                     | 7841                     | 5,716                   | 22,326                                     |
| Guyana (Grp 4)                                    | 12000                              | 21540                    | 25378                    | 22,906                  | 56,446                                     |
| Haiti [Financial Intermediaries/Microcredit]      |                                    |                          |                          | 6,000                   | 6,000                                      |
| Jamaica (Grp 3)                                   | 19200                              | 12300                    | 8274                     | 13,393                  | 44,893                                     |
| Montserrat (Grp 3)                                | 6200                               | 3480                     | 3480                     | 2,507                   | 12,187                                     |
| St. Kitts and Nevis (Grp 3)                       | 7400                               | 3660                     | 7400                     | 3,562                   | 14,622                                     |
| St. Lucia (Grp 3)                                 | 11000                              | 9130                     | 10035                    | 10,841                  | 30,971                                     |
| St. Vincent/Grenadines (Grp 3)                    | 11000                              | 7300                     | 6500                     | 7,810                   | 26,110                                     |
| Trinidad and Tobago (SDF 4 Grp 1, SDF 5 Grp 2)    | 1700                               | 3770                     | 1000                     |                         | 5,470                                      |
| Turks and Caicos (Grp 2)                          | 3200                               | 2440                     | 1430                     | 1,451                   | 7,091                                      |
| <b>Total Country Allocations for Loans</b>        | <b>114,000</b>                     | <b>96,920</b>            | <b>91,700</b>            | <b>95,568</b>           | <b>306,488</b>                             |
| Unallocated                                       | 12000                              |                          |                          |                         | 12,000                                     |
| Loans - Disaster Mitigation & Fiscal Distress     |                                    | 15000                    | 18000                    | 45,000                  | 60,000                                     |
| Regional Projects                                 | 4000                               | 5000                     |                          |                         | 9,000                                      |
| <b>Total Allocations for Loans</b>                | <b>130,000</b>                     | <b>116,920</b>           | <b>109,700</b>           | <b>140,568</b>          | <b>387,488</b>                             |
| <b>Grants</b>                                     |                                    |                          |                          |                         |  |
| Haiti (including in SDF6 \$19M BNTF, \$2M TA)     |                                    | 10000                    | 5000                     | 21000                   | 31000                                      |
| BNTF (Excluding Haiti)                            | 18000                              | 32000                    | 32000                    | 32000                   | 82000                                      |
| BMC Capacity Building TA (Excluding Haiti)        | 9000                               | 12000                    | 15000                    | 10000                   | 31000                                      |
| Natural Disasters, HIV/AIDS etc                   |                                    |                          |                          | 8000                    | 8000                                       |
| Regional Projects                                 |                                    |                          | 4000                     | 10000                   | 10000                                      |
| Project Training                                  | 1000                               |                          |                          | 2000                    | 3000                                       |
| Caribbean Technological Consultancy Services      | 1000                               |                          |                          | 4000                    | 5000                                       |
| Economic Research                                 | 1000                               |                          |                          |                         | 1000                                       |
| Millennium Development Goals                      |                                    |                          |                          | 4000                    | 4000                                       |
| <b>Total Allocations for Grants</b>               | <b>30,000</b>                      | <b>54,000</b>            | <b>56,000</b>            | <b>91,000</b>           | <b>175,000</b>                             |
| Total Funding                                     | 160000                             | 170920                   | 165700                   | 231568                  | 562,488                                    |
| Structural gap                                    |                                    |                          |                          | 25,932                  |  |
| <b>Total Programme</b>                            | <b>160,000</b>                     | <b>170,920</b>           | <b>165,700</b>           | <b>257,500</b>          | <b>562,488</b>                             |

Source: CDB, Corporate Planning Division, Dec. 2006

TABLE 6: SDF V ALLOCATIONS AND APPROVALS

| Loans and Grants Categories                       | SDF 5<br>Initial<br>Allocation | SDF 5<br>Revised<br>Allocation | SDF5<br>Approvals<br>2001-2004 | Approvals<br>as % of<br>Initial<br>Allocation | Approvals<br>as % of<br>Revised<br>Allocation |
|---|--------------------------------|--------------------------------|--------------------------------|---|---|
| <b>Loans</b>                                      |                                |                                |                                |   |   |
| Anguilla (Grp 2)                                  | 5010                           | 2742                           | 0                              | 0%  | 0%  |
| Antigua and Barbuda (Grp 2)                       | 2480                           | 1760                           | 395                            | 16%   | 22%   |
| Barbados (SDF 4 Grp 1, SDF 5 & 6 Grp 2)           | 3420                           | 1000                           | 0                              | 0%  | 0%  |
| Bahamas (Grp 1)                                   | 0                              | 0                              | 0                              |   |   |
| Belize (Grp 3)                                    | 10810                          | 6100                           | 3,615                          | 33%   | 59%   |
| British Virgin Islands (SDF 4 Grp 2, SDF 5 Grp 1) | 0                              | 0                              | 0                              |   |   |
| Cayman Islands (Grp 1)                            | 0                              | 0                              | 0                              |   |   |
| Dominica (Grp 3)                                  | 5970                           | 8760                           | 6,108                          | 102%  | 70%   |
| Grenada (Grp 3)                                   | 5610                           | 7841                           | 18,280                         | 326%  | 233%  |
| Guyana (Grp 4)                                    | 21540                          | 25378                          | 28,936                         | 134%  | 114%  |
| Haiti   | 0                              | 0                              | 0                              |   |   |
| Jamaica (Grp 3)                                   | 12300                          | 8274                           | 12,465                         | 101%  | 151%  |
| Montserrat (Grp 3)                                | 3480                           | 3480                           | 0                              | 0%  | 0%  |
| St. Kitts and Nevis (Grp 3)                       | 3660                           | 7400                           | 10,042                         | 274%  | 136%  |
| St. Lucia (Grp 3)                                 | 9130                           | 10035                          | 10,271                         | 112%  | 102%  |
| St. Vincent and the Grenadines (Grp 3)            | 7300                           | 6500                           | 6,348                          | 87%   | 98%   |
| Trinidad and Tobago (SDF 4 Grp 1, SDF 5 Grp 2)    | 3770                           | 1000                           | 1000                           | 27%   | 100%  |
| Turks and Caicos (Grp 2)                          | 2440                           | 1430                           | 372                            | 15%   | 26%   |
| <b>Total Country Allocations for Loans</b>        | <b>96,920</b>                  | <b>91,700</b>                  | <b>97,832</b>                  | <b>101%</b>                                   | <b>107%</b>                                   |
| Unallocated                                       |                                |                                |                                |   |   |
| Loans - Disaster Mitigation and Fiscal Distress   | 15000                          | 18000                          | 14,050                         | 94%   | 78%   |
| Regional Projects                                 | 5000                           | 0                              | 0                              | 0%  |   |
| <b>Total Allocations for Loans</b>                | <b>116,920</b>                 | <b>109,700</b>                 | <b>111,882</b>                 | <b>96%</b>                                    | <b>102%</b>                                   |
| <b>Grants</b>                                     |                                |                                |                                |   |   |
| Haiti (including in SDF6 \$19 mn BNTF, \$2 mn TA) | 10000                          | 5000                           | 0                              | 0%  | 0%  |
| BNTF (Excluding Haiti)                            | 32000                          | 32000                          | 32000                          | 100%  | 100%  |
| BMC Capacity Building TA (Excluding Haiti)        | 12000                          | 15000                          | 11442                          | 95%   | 76%   |
| Disaster Response                                 | 0                              | 0                              | 0                              |   |   |
| Regional Projects                                 |                                | 4000                           | 903                            |   | 23%   |
| Project Training                                  | 0                              | 0                              | 0                              |   |   |
| Caribbean Technological Consultancy Services      | 0                              | 0                              | 0                              |   |   |
| Economic Research                                 | 0                              | 0                              | 0                              |   |   |
| Millennium Development Goals                      | 0                              | 0                              | 0                              |   |   |
| <b>Total Allocations for Grants</b>               | <b>54,000</b>                  | <b>56,000</b>                  | <b>44,345</b>                  | <b>82%</b>                                    | <b>79%</b>                                    |
| Total Funding                                     | 170920                         | 165700                         | 156,227                        | 91%   | 94%   |
| Structural gap                                    |                                |                                |                                |   |   |
| <b>Total Programme</b>                            | <b>170,920</b>                 | <b>165,700</b>                 | <b>156,227</b>                 | <b>91%</b>                                    | <b>94%</b>                                    |

Source: CDB, Corporate Planning Division, Dec. 2006

TABLE 7: SDF V APPROVALS BY COUNTRY (2001-2004)

| Loans and Grants Categories                       | SDF5<br>Loans<br>2001-<br>2004 | Loans:<br>Disaster<br>& Fiscal<br>Stress | Total<br>Loans | New<br>Member<br>Grants | BNTF<br>Grants | Capacity<br>Building<br>TA | Regional<br>Projects<br>Grants | Total<br>Grants |
|---|--------------------------------|--|----------------|-------------------------|----------------|----------------------------|--------------------------------|-----------------|
| <b>Loans</b>                                      |                                |  |                |                         |                |                            |                                |                 |
| Anguilla (Grp 2)                                  | 0                              | 0  |                |                         |                | 74                         |                                | 74              |
| Antigua and Barbuda (Grp 2)                       | 395                            | 0  | 395            |                         |                | 31                         |                                | 31              |
| Barbados (SDF 4 Grp 1, SDF 5 & 6 Grp 2)           | 0                              | 0  | 0              |                         |                | 85                         |                                | 85              |
| Bahamas (Grp 1)                                   | 0                              | 0  | 0              |                         |                | 196                        |                                | 196             |
| Belize (Grp 3)                                    | 3,615                          | 500                                      | 4,115          |                         | 3,255          | 380                        |                                | 3635            |
| British Virgin Islands (SDF 4 Grp 2, SDF 5 Grp 1) | 0                              | 0  | 0              |                         |                | 0                          |                                | 0               |
| Cayman Islands (Grp 1)                            | 0                              | 0  | 0              |                         |                | 0                          |                                | 0               |
| Dominica (Grp 3)                                  | 6,108                          | 0  | 6,108          |                         | 1,785          | 590                        |                                | 2375            |
| Grenada (Grp 3)                                   | 14,830                         | 4,450                                    | 19,280         |                         | 1,680          | 1023                       |                                | 2703            |
| Guyana (Grp 4)                                    | 28,924                         | 0  | 28,924         |                         | 6,468          | 908                        |                                | 7376            |
| Haiti   | 0                              | 0  | 0              | 0                       |                | 0                          |                                | 0               |
| Jamaica (Grp 3)                                   | 12,465                         | 9,000                                    | 21,465         |                         |                | 1432                       |                                | 1432            |
| Montserrat (Grp 3)                                | 0                              | 0  | 0              |                         | 1,050          | 145                        |                                | 1195            |
| St. Kitts and Nevis (Grp 3)                       | 10,042                         | 0  | 10,042         |                         | 1,092          | 371                        |                                | 1463            |
| St. Lucia (Grp 3)                                 | 10,271                         | 3,050                                    | 13,321         |                         | 2,751          | 497                        |                                | 3248            |
| St. Vincent and the Grenadines (Grp 3)            | 6,348                          | 500                                      | 6,848          |                         | 2,184          | 1110                       |                                | 3294            |
| Trinidad and Tobago (SDF 4 Grp 1, SDF 5 Grp 2)    | 1000                           | 0  | 1,000          |                         |                | 68                         |                                | 68              |
| Turks and Caicos Islands (Grp 2)                  | 372                            | 0  | 372            |                         | 735            | 16                         |                                | 751             |
| Regional Projects                                 | 0                              | 0  | 0              |                         | 11,000         | 4344                       | 903                            | 16247           |
| <b>Totals:</b>                                    | <b>94,370</b>                  | <b>17,500</b>                            | <b>111,870</b> | <b>0</b>                | <b>32,000</b>  | <b>11,270</b>              | <b>903</b>                     | <b>44,173</b>   |

Source: CDB, Corporate Planning Division, Dec. 2006

**TABLE 8: POPULATION, PERFORMANCE SCORES, ALLOCATIONS AND APPROVALS AND APPROVALS**

| <b>Loans and Grants Categories</b>                | <b>Population<br/>(2004)</b> | <b>Average<br/>Performance<br/>Score 2001-<br/>2005**</b> | <b>Total Loans<br/>and Grants<br/>Approved<br/>(2001-2004)*</b> | <b>\$ Approved<br/>per capita</b> | <b>Total initial<br/>allocations<br/>(SDF<br/>4+5+6)***</b> | <b>\$ Allocated<br/>per capita<br/>(SDF 4+5+6)</b> |
|---|------------------------------|---|---|-----------------------------------|---|--|
| <b>Countries</b>                                  |                              |   |   |                                   |   |  |
| Bahamas (Grp 1)                                   | 320,700                      | 3.92  | \$196,000   | \$0.61                            | \$1,000,000   | \$3.12   |
| British Virgin Islands (SDF 4 Grp 2, SDF 5 Grp 1) | 21,700                       | 3.36  | \$0   | \$0.00                            | \$2,000,000   | \$92.17  |
| Cayman Islands (Grp 1)                            | 42,400                       | 3.68  | \$0   | \$0.00                            | \$300,000   | \$7.08   |
| Anguilla (Grp 2)                                  | 12500                        | 3.61  | \$74,000  | \$5.92                            | \$10,470,000  | \$837.60   |
| Antigua and Barbuda (Grp 2)                       | 80100                        | 2.43  | \$426,000   | \$5.32                            | \$8,742,000   | \$109.14   |
| Barbados (SDF 4 Grp 1, SDF 5 & 6 Grp 2)           | 272400                       | 3.90  | \$85,000  | \$0.31                            | \$4,420,000   | \$16.23  |
| Trinidad and Tobago (SDF 4 Grp 1, SDF 5 Grp 2)    | 1,290,600                    | 3.65  | \$1,068,000   | \$0.83                            | \$5,470,000   | \$4.24   |
| Turks and Caicos Islands (Grp 2)                  | 27,500                       | 3.33  | \$1,123,000   | \$40.84                           | \$7,091,000   | \$257.85   |
| Belize (Grp 3)                                    | 282,600                      | 3.02  | \$7,750,000   | \$27.42                           | \$28,066,000  | \$99.31  |
| Dominica (Grp 3)                                  | 70,400                       | 2.81  | \$8,483,000   | \$120.50                          | \$25,374,000  | \$360.43   |
| Grenada (Grp 3)                                   | 104,500                      | 3.02  | \$21,983,000  | \$210.36                          | \$22,326,000  | \$213.65   |
| Guyana (Grp 4)                                    | 751,400                      | 2.97  | \$36,300,000  | \$48.31                           | \$56,446,000  | \$75.12  |
| Jamaica (Grp 3)                                   | 2,644,600                    | 3.44  | \$22,897,000  | \$8.66                            | \$44,893,000  | \$16.98  |
| Montserrat (Grp 3)                                | 4,700                        | 3.51  | \$1,195,000   | \$254.26                          | \$12,187,000  | \$2,592.98   |
| St. Kitts and Nevis (Grp 3)                       | 47,900                       | 3.16  | \$11,505,000  | \$240.19                          | \$14,622,000  | \$305.26   |
| St. Lucia (Grp 3)                                 | 162,400                      | 3.63  | \$16,569,000  | \$102.03                          | \$30,971,000  | \$190.71   |
| St. Vincent and the Grenadines (Grp 3)            | 100,600                      | 3.21  | \$10,142,000  | \$100.82                          | \$26,110,000  | \$259.54   |
| Haiti   | 8,600,000                    |   | \$0   | \$0.00                            |   |  |
| Regional Projects                                 |                              |   | \$16,247,000  |                                   |   |  |
| <b>Totals:</b>                                    | <b>14,837,000</b>            |   | <b>\$156,043,000</b>  |                                   | <b>\$300,488,000</b>  |  |

\* See Table 7 for more detail on SDF loans and grants by country.

\*\* See Table 1 for details of the policy and institutional performance scores, 2001-2005

\*\*\* See Table 5 for details of the initial allocations, SDF 4, 5 and 6

Source: CDB, Corporate Planning Division, Dec. 2006



**BNTF ALLOCATIONS TABLES**

**ALLOCATION OF RESOURCES - BNTF 5**

| <b>Item</b>                    | <b>\$'000</b> | <b>%</b>     |
|--------------------------------|---------------|--------------|
| <b>Country</b>                 |               |              |
| Belize                         | 3,254         | 10.2         |
| Dominica                       | 1,786         | 5.6          |
| Grenada                        | 1,680         | 5.3          |
| Guyana                         | 6,468         | 20.2         |
| Montserrat                     | 1,050         | 3.3          |
| St. Kitts and Nevis            | 1,093         | 3.4          |
| St. Lucia                      | 2,750         | 8.6          |
| St. Vincent and the Grenadines | 2,184         | 6.8          |
| Turks and Caicos Islands       | 735           | 2.3          |
| <b>Sub-Total : Country</b>     | <b>21,000</b> | <b>65.6</b>  |
| Regional Coordination          | 6,000         | 18.8         |
| Unallocated Incentive          | 5,000         | 15.6         |
| <b>Total</b>                   | <b>32,000</b> | <b>100.0</b> |



# ALLOCATION FORMULAE AND CRITERIA USED BY MULTILATERAL INSTITUTIONS

**TABLE 1: MULTILATERAL CONCESSIONARY FUNDS THAT USE A PERFORMANCE-BASED ALLOCATION SYSTEM**

| Institution  | Fund  | Started | Current Phase  | Started PBA | Country Eligibility Criterion   |
|--|---|---------|----------------|-------------|---|
| Caribbean Development Bank (CDB)                       | Special Development Fund (SDF)              | 1984    | SDF 6          | 2000        | All member countries (Group 1 has limited access)   |
| African Development Bank (AfDB)                        | African Development Fund (AfDF)             | 1973    | AfDF X         | 1999        | AfDB Credit Policy, 1995. The AfDB uses IDA's country classification in Africa  |
| Asian Development Bank (ADB)                           | Asian Development Fund (ADF)                | 1973    | ADF IX         | 2001        | ADB's Graduation Policy, 1998   |
| Inter-American Development Bank (IDB)                  | Fund for Special Operations (FSO)           | 1961    | Agreement 1998 | 2002        | Five countries (Group D-2). Bolivia, Guyana, Haiti, Honduras and Nicaragua (+ small amount to the Caribbean Development Bank) |
| Inter-American Development Bank (IDB)                  | Intermediate Financing Facility (IFF)       | 1982    | Agreement 1998 | 2002        | Five countries (Groups C&D1), <\$2150 GDP per capita 2000\$). Suriname, Ecuador, El Salvador, Guatemala, Paraguay             |
| International Fund for Agricultural Development (IFAD) | IFAD  |         | First          | 2005        | All member countries.   |
| World Bank Group                                       | International Development Association (IDA) | 1961    | IDA 14         | 1977        | Countries with GNP pc less than \$1025 as of July 1, 2006   |

| Institution/Fund                                | Phase          | Approximate Annual Envelope <sup>1</sup>       |              |                   | Number of Countries Eligible/with Access <sup>2</sup>                                       |                    |       |
|---|----------------|--|--------------|-------------------|---|--------------------|-------|
|   |                | Loans  |              | Grants            | Concessionary Only  | Blend <sup>3</sup> | Total |
|   |                | US\$ million                                   | US\$ million | % Grants          |   |                    |       |
| CDB, Special Development Fund                   | SDF VI         | 36   | 21           | 35%               | 1   | 18 <sup>4</sup>    | 19    |
| African Development Fund                        | AfDF IX        | 750  | 248          | 18-21%            | 38  | 2                  | 40    |
| Asian Development Fund                          | ADF IX         | 1700 <sup>5</sup>                              |              | Up to 18%         | 15  | 12                 | 27    |
| IDB, Fund for Special Operations                | 1998 agreement | 400 (Board is considering an increase to 500.) |              | Zero <sup>6</sup> | 5   |                    | 5     |
| IDB, Intermediate Financing Facility            | 1998 agreement | 250  |              | Zero              |   | 5                  | 5     |
| International Fund for Agricultural Development |                | 450  | 25           | Up to 10%         | Highly concessional, intermediate and ordinary terms. Terms are independent of allocations. |                    | 121   |
| World Bank (IDA)                                | IDA 14         |  |              |                   | 66  | 15                 | 81    |

<sup>1</sup> Most recent complete fiscal year.

<sup>2</sup> In some funds, there are countries that are technically eligible but in practice do not have borrowing access to resources.

<sup>3</sup> Blend borrowers can access both concessional funds and ordinary capital resources in the one loan.

<sup>4</sup> Group 4 countries (Guyana and, in future, Haiti) are eligible for SDF only, but in practice have accessed ordinary capital resources within the HIPC guidelines for loan concessional element. At the other end of the income spectrum, Group 1 countries are eligible for concessional funds, for narrowly defined purposes, but in practice do not access these funds.

<sup>5</sup> Transfers from ADF IX to the Technical Assistance Special Fund (3% of ADF IX) are not included in this figure.

<sup>6</sup> \$30 million of FSO net income is used to finance non-reimbursable technical cooperation. IDB is studying a proposal to disburse part of the FSO as grants.

**TABLE 2: ALLOCATION FORMULAE**

| Institution/Fund                            | Formula  |   |   |                             | Other Factors     |                                      |                           |  |
|---|--|---|---|-----------------------------|-------------------|--------------------------------------|---------------------------|--|
|   | Needs Factors  |   | Performance Factors   | Scaling Factor <sup>7</sup> | Result =          | MIN                                  | MAX                       | Volume Discount  |
| Caribbean Development Bank (SDF)            | $\log \text{POP} \times \text{GNPpc}^{-0.9} \times \text{VUL}^{2.0}$   | x | $[(0.7\text{CPIA}+0.3\text{PORT})]^{2.0}$   | Yes                         | Allocation share  |                                      |                           |  |
| African Development Fund (2002-2004 period) | $\text{POP} \times \text{GNPpc}^{-0.125}$  | x | $[(0.7\text{CPIA}+0.3\text{PORT}) \times (\text{GOV}/3.5) \times \text{PCEF}]^{2.0}$  | Yes                         | Allocation share  | SDR 5.0 million per country          |                           | In ADF X, allocations will be discounted depending on the % in grants. |
| Asian Development Fund (2004)               | $\text{POP}^{0.6} \times \text{GNPpc}^{-0.25}$   | x | $[(\text{ES\_CPIA}^{0.7} \times \text{PORT}^{0.3}) \times \text{GOV}]^{2.0}$  | Yes                         | Allocation share  |                                      |                           |  |
| Asian Development Fund (2006)               | $\text{POP}^{0.6} \times \text{GNPpc}^{-0.25}$   | x | $(\text{CPIA without GOV})^{1.4} \times \text{GOV}^{2.0} \times \text{PORT}^{0.6}$  | Yes                         | Allocation share  |                                      |                           |  |
| IDB (IFF)                                   | $[(0.133\text{Fund})(\text{POP}/\sum\text{POP})] + [(0.133\text{Fund})[(1/\text{GNPpc})/\sum(1/\text{GNPpc})] + [(0.133\text{Fund})(\text{DEBT}/\sum\text{DEBT})]$ | + | $[(0.6\text{Fund})\times(0.7\text{CIPE}+0.3\text{PORT})]/[\sum(0.7\text{CIPE}+0.3\text{PORT})]$<br><i>(CIPE is similar to the CPIA)</i> | No                          | Dollar allocation |                                      |                           |  |
| IDB (FSO)                                   | $[(0.22\text{Fund})(\text{POP}/\sum\text{POP})] + [(0.18\text{Fund})[(1/\text{GNPpc})/\sum(1/\text{GNPpc})]]$  | + | $[(0.6\text{Fund})\times(0.7\text{CIPE}+0.3\text{PORT})]/[\sum(0.7\text{CIPE}+0.3\text{PORT})]$   | No                          | Dollar allocation |                                      |                           |  |
| IFAD  | $\text{POP}^{0.45} \times \text{GNPpc}^{-0.25}$  | x | $[0.2\text{CPIA}+0.35\text{PORT}+0.45\text{RuralCPIA}]^{2.0}$   | Yes                         | Allocation share  | \$1 million                          |                           |  |
| IDA   | $\text{POP} \times \text{GNPpc}^{-0.125}$  | x | $[(0.8\text{CPIA} + 0.2\text{PORT}) \times (\text{GOV}/3.5)^{1.5}]^{2.0}$   | Yes                         | Allocation share  | SDR 3.3 million per country (IDA 14) | \$20 per capita per annum | In IDA 14, allocations were discounted depending on % in grants        |

CIPE= country institutional and policy evaluation (the Inter-American Development Bank terminology equivalent to the World Bank CPIA, Country Policy and Institutional Performance); CPIA = country policy and institutional performance assessment; official debt service ratio; ES\_CPIA = economic and social performance criteria in the CPIA; Fund = Size of IFF or FSO envelope; FSO = Fund for Special Operations (IDB) GNPpc = GNP per capita or GNI per capita; GOV = for ADF, the average of the five criteria in the “public sector management” cluster (see Table 4); for AfDF, the average of the six criteria in the Governance and Public Sector Performance (see Table 4) plus a three-years moving average for the ‘procurement flag’ on portfolio performance; for IDA, the average of the five criteria in the public sector management cluster (see Table 4) plus a three-years moving average of the procurement flag on portfolio performance; HDI = Human Development Index; log = logarithm; IDB = Inter American Development Bank; IFAD = International Fund for Agricultural Development, IFF = Intermediate Financing Facility, PBA = performance-based allocation; PCEF is a post-conflict enhancement factor (1.13 to 1.30, maximum 1.5); POP = population; PORT = portfolio performance; RuralCPIA = IFAD’s performance rating on policies and institutions for rural development; SDF = Special Development Fund (Caribbean Development Bank) ; SDR = IMF Special Drawing Rights; VUL = country vulnerability.

<sup>7</sup> Indicates whether a scaling factor is applied to ensure that allocation shares add to one. The scaling factor is the sum over all countries of the product of the needs and performance factors shown in the preceding columns.

**TABLE 3: THE WEIGHTS OF FACTORS IN THE ALLOCATION FORMULAE**

**Type 1 Formula: Allocation by a geometric, multiplicative formula (containing factors with exponents)**

| Institution/Fund                                | Exponents <sup>8</sup> on Needs Variables |        |     | Exponents on Performance Factor                         |  |
|---|---|--------|-----|---|--|
|   | POP                                       | GNPpc  | VUL | Country Performance Factor                              | Exponent on the Country Performance Factor |
| Caribbean Development Bank (SDF)                | LogPOP                                    | -0.90  | 2.0 | [0.7CPIA+0.3PORT]                                       | 2.0  |
| African Development Fund                        | 1.00                                      | -0.125 |     | [(0.7CPIA+0.3PORT) x (GOV/3.5)x PCEF]                   | 2.0  |
| Asian Development Fund                          | 0.60                                      | -0.25  |     | [(ES_CPIA <sup>0.7</sup> x PORT <sup>0.3</sup> ) x GOV] | 2.0  |
| International Fund for Agricultural Development | 0.45                                      | -0.25  |     | [0.2CPIA+0.35PORT+0.45RuralCPIA]                        | 2.0  |
| World Bank, IDA                                 | 1.00                                      | -0.125 |     | [(0.8CPIA + 0.2PORT) x (GOV/3.5) <sup>1.5</sup> ]       | 2.0  |

**Type 2 Formula: Allocation by an additive, linear formula (each variable allocates a fixed % of the fund)**

| Institution/Fund                      | Effective Weight of Needs Variables in the \$ Allocation |       |                             | Effective Weight of Performance Variables in the \$ Allocation |
|---------------------------------------|--|-------|-----------------------------|--|
|                                       | POP  | GNPpc | DEBT                        | Country Performance (0.7CPIE + 0.3PORT)                        |
| Inter-American Development Bank (FSO) | 22%  | 18%   |                             | 60%  |
| Inter-American Development Bank (IFF) | 13%  | 13%   | 13% proposal to discontinue | 60%  |

CIPE = country institutional and policy evaluation; CPIA = country policy and institutional performance assessment; DEBT = official debt service ratio; ES\_CPIA = country performance on economic and social criteria; FSO = Fund for Special Operations (Inter-American Development Bank); GNPpc = Gross National Product or Gross National Income per capita; GOV = for ADF, the average of the five criteria in the “public sector management” cluster (see Table 4); for AfDF, the average of the six criteria in the Governance and Public Sector Performance (see Table 4) plus a three-years moving average for the ‘procurement flag’ on portfolio performance; for IDA, the average of the five criteria in the public sector management cluster (see Table 4) plus a three-years moving average of the procurement flag on portfolio performance; IFF = Intermediate Financing Facility (Inter American Development Bank); POP = population; PORT = portfolio performance; SDF = Special Development Fund (Caribbean Development Bank); VUL = country vulnerability index

<sup>8</sup> The Caribbean Development Bank uses the logarithmic value of POP rather than applying an exponent.

**TABLE 4: POLICY AND INSTITUTIONAL PERFORMANCE CRITERIA, AND CLUSTER WEIGHTS (MDBs, EXCLUDING IFAD<sup>9</sup>)**

| <b>Caribbean Development Bank (SDF)</b>  | <b>African Development Fund<sup>10</sup></b>   | <b>Inter American Development Bank (FSO/IFF)<sup>11</sup></b>   | <b>World Bank, IDA and Asian Development Fund<sup>12</sup></b>  | <b>Range</b>             |
|--|--|---|---|--------------------------|
| <p><b>Macroeconomic management 25%</b></p> <ul style="list-style-type: none"> <li>Fiscal policy</li> <li>Monetary policy</li> <li>External financing policies</li> </ul>   | <p><b>Macroeconomic policies 15%</b></p> <ul style="list-style-type: none"> <li>Fiscal policy</li> <li>General macroeconomic performance</li> <li>Macroeconomic and external debt management capacity</li> </ul>   | <p><b>Economic Management 15%</b></p> <ul style="list-style-type: none"> <li>Macroeconomic imbalances (fiscal and monetary policies)</li> <li>Management of external debt</li> </ul>  | <p><b>Economic Management 25%</b></p> <ul style="list-style-type: none"> <li>Monetary and exchange rate policies</li> <li>Fiscal policy</li> <li>Debt management</li> </ul>   | <p><b>15% to 25%</b></p> |
| <p><b>Structural Policies 15% (25% with environment)</b></p> <ul style="list-style-type: none"> <li>Trade policy</li> <li>Financial sector efficiency and soundness</li> <li>Factor and product markets and prices</li> <li>Enabling environment for private sector development</li> <li>Environment (10%) (A) environmental laws, regulations and institutions (B) environmentally damaging subsidies and other damaging practices</li> </ul> | <p><b>Structural Policies 25%</b></p> <ul style="list-style-type: none"> <li>Trade policy and foreign exchange regime</li> <li>Financial stability and depth</li> <li>Competitive environment for the private sector</li> <li>Policies for reducing public sector burden</li> <li>Policies and institutions for regional integration</li> <li>Environmental policies and regulations.</li> </ul> | <p><b>Structural policies 20%</b></p> <ul style="list-style-type: none"> <li>Trade and commercial policy</li> <li>Banking and financial sector stability</li> <li>Policies and institutions for environmental stability.</li> </ul>                                     | <p><b>Structural Policies 25%</b></p> <ul style="list-style-type: none"> <li>External trade</li> <li>Financial sector</li> <li>Business environment</li> </ul>  | <p><b>20% to 25%</b></p> |
| <p><b>Socially-inclusive development 25%</b></p> <ul style="list-style-type: none"> <li>Framework for poverty reduction policy</li> <li>Enhancing economic capital of poor</li> <li>Enhancing human capital of poor</li> <li>Equity and social safety nets</li> <li>Gender, empowerment and participation</li> </ul>   | <p><b>Policies for Growth + Equity and Poverty Reduction 30%</b></p> <ul style="list-style-type: none"> <li>Gender equality &amp; social inclusion</li> <li>Policies towards labour intensive activities</li> <li>Building human capital</li> <li>Pro-poor targeting programs/invest.</li> <li>Poverty monitoring and analysis</li> </ul>  | <p><b>Policies for social inclusion and equity 35%</b></p> <ul style="list-style-type: none"> <li>Gender equality, indigenous and other minorities inclusion</li> <li>Building human resources and social protection</li> <li>Monitoring/analysis of poverty</li> </ul> | <p><b>Social Inclusion Policies 25%</b></p> <ul style="list-style-type: none"> <li>Gender</li> <li>Equity of public expenditures</li> <li>Building human resources</li> <li>Social protection and labour</li> <li>Policies and institutions for environmental sustainability</li> </ul> | <p><b>25% to 30%</b></p> |
| <p><b>Governance and public sector management 25%</b></p> <ul style="list-style-type: none"> <li>Rule of law</li> <li>Anti-corruption and accountability institutions</li> <li>Civil service</li> </ul>  | <p><b>Governance and Public Sector Performance 30%</b></p> <ul style="list-style-type: none"> <li>Property rights and rule-based governance</li> <li>Quality of budget and public</li> </ul>   | <p><b>Public sector management and institutions 30%</b></p> <ul style="list-style-type: none"> <li>Property rights, governance and private sector development</li> </ul>  | <p><b>Public Sector Management and Institutions 25%</b></p> <ul style="list-style-type: none"> <li>Property rights and rule-based governance</li> <li>Quality of budgetary and</li> </ul>   | <p><b>25% to 30%</b></p> |

<sup>9</sup> IFAD uses the IDA performance ratings for the general country performance factor in its allocation formula. It also does its own scoring of a separate performance factor for rural-sector performance. Its criteria for that factor are as follows: policy and legal framework for rural organizations; dialogue between government and rural organizations; access to land; access to water for agriculture; access to agricultural research and extension services; enabling conditions for rural financial services development; investment climate for rural businesses; access to agricultural input and produce markets; access to education in rural areas; representation; allocation and management of public resources for rural development; accountability, transparency and corruption in rural areas.

<sup>10</sup> The 20-criteria CPIA was applicable during the AfDF-IX period. For AfDF-X (2005-2007) a 16-criteria CPIA, similar to IDA's but retaining the ADF-IX cluster weights, was adopted.

<sup>11</sup> The original proposal was for equal cluster weights. These weights were decided by the Board.

<sup>12</sup> ADF gives equal weight to the first three clusters, as IDA does, but separates the governance cluster (public sector management and institutions) and gives it a separate weight in the allocation formula.

| <b>Caribbean Development Bank (SDF)</b>   | <b>African Development Fund<sup>10</sup></b>  | <b>Inter American Development Bank (FSO/IFF)<sup>11</sup></b>  | <b>World Bank, IDA and Asian Development Fund<sup>12</sup></b>  | <b>Range</b> |
|---|---|--|---|--------------|
| <ul style="list-style-type: none"> <li>• Revenue mobilisation and budgetary management</li> <li>• Management and efficiency of public expenditures</li> </ul> | <ul style="list-style-type: none"> <li>• investment process</li> <li>• Revenue mobilisation efforts and rationalization of public expenditures</li> <li>• Accountability/transparency of the public service</li> <li>• Anti-corruption policies and practices</li> <li>• Political stability</li> </ul> | <ul style="list-style-type: none"> <li>• Transparency and accountability in the public sector</li> </ul> | <ul style="list-style-type: none"> <li>• financial management</li> <li>• Efficiency and equity of revenue mobilisation</li> <li>• Quality of public administration</li> <li>• Transparency, accountability &amp; corruption in the public sector</li> </ul> |              |

FSO = Fund for Special Operations (Inter-American Development Bank); IDA = International Development Association; IFF = Intermediate Financing Facility (Inter-American Development Bank); SDF = Special Development Fund (Caribbean Development Bank)

TABLE 5: WEIGHT OF “GOVERNANCE”<sup>13</sup> IN THE COUNTRY PERFORMANCE FACTOR

| Institution/Fund                                       | Emphasis Given to Governance as Part of Country Performance Assessment   | Effective weight <sup>14</sup> in the Performance Factor               |
|--|--|--|
| <b>Caribbean Development Bank (SDF)</b>                | Governance receives the weight of the Governance and Public Sector Management cluster (25% of the CPIA) relative to the weight of all performance variables (that is CPIA and PORT).   | 17.5%  |
| <b>African Development Fund</b>                        | The allocation formula includes a governance factor. The exponential weight of the governance factor is 1.0 compared with 1.5 in IDA’s model. The governance factor takes into account the six criteria in the “Governance and Public Sector Performance” cluster of CPIA plus the procurement element in the Country Portfolio Performance Rating (CPPR). Revisions may be made in 2005.  | 61.25%<br>(in AfDF IX)   |
| <b>Asian Development Fund</b>                          | Until 2004, governance received the weight of the governance cluster of criteria (public sector management and institutions) in the CPIA (30%). In 2005, the allocation formula separates the governance criteria (the IDA cluster “Public Sector Management and Institutions”) from the CPIA into a separate factor, and gives extra weight to that factor that will result in governance having a much larger impact on the performance factor than previously (effective weight 53% compared with 30% in 2004). | 53%  |
| <b>Inter-American Dev. Bank (FSO/IFF)</b>              | Governance receives the weight of the Public Sector Management and Institutions cluster (30% of the CIPE) compared with all performance variables (that is, CIPE and PORT).  | 21%  |
| <b>International Fund for Agricultural Development</b> | IFAD uses the IDA scores for country and policy and institutional performance (including the governance cluster criteria) and also assesses rural sector performance (including performance against some governance related criteria).   | Not directly comparable because of the rural sector performance factor |
| <b>World Bank, IDA</b>                                 | In 1998 IDA applied a governance discount. In 2001 this was changed to a governance factor. In 2005 the governance factor has been slightly modified. That is, “management and sustainability of the development program” has been removed from the governance criteria and the procurement efficiency criterion has been slightly modified to become a three-year moving average.   | 66%<br>(IDA 14)  |

AfDF = African Development Fund; CIPE = Country Institutional and Policy Evaluation (Inter American Development Bank); CPIA = Country Policy and Institutional Assessment; FSO = Fund for Special Operations (Inter-American Development Bank); IFAD = International Fund for Agricultural Development; IFF = Intermediate Financing Facility (Inter American Development Bank); IDA = International Development Association (World Bank Group); PORT = Portfolio rating

<sup>13</sup> “Governance” in this context is defined by the fourth cluster in the country performance assessment criteria (See Table 4 above) and in some cases it also takes into account the country’s performance on procurement related to its borrowing from the particular multilateral development bank.

<sup>14</sup> The “effective weight” is a relative measure of how much a change in “governance score” affects the “country performance factor.”

**TABLE 6: PORTFOLIO PERFORMANCE MEASURES**

| Institution/Fund  | Basis of Portfolio Performance Score  |
|---|---|
| <b>Caribbean Development Bank (SDF)</b>   | Performance scores for all active projects (not only projects at risk), based on OECD/Development Assistance Committee’s project performance criteria <sup>15</sup> |
| <b>African Development Fund</b>   | Projects at risk  |
| <b>Asian Development Fund</b>   | Problem projects, projects on alert   |
| <b>Inter-American Development Bank, Fund for Special Operations (FSO) and Intermediate Financing Facility (IFF)</b> | Problem projects and projects on alert [Based on the Annual Report on Portfolio Execution (ARPE) and the Project Alert Identification System (PAIS)]                |
| <b>International Fund for Agricultural Development (2005)</b>   | Actual problem projects <sup>16</sup> and projects at risk (3 of 11 flags <sup>17</sup> up)   |
| <b>World Bank IDA</b>   | Projects at risk (3 of 12 flags <sup>18</sup> up)   |

**Converting “% Projects at Risk” into a “Portfolio Performance Rating”**

| Rating | AfDF IX & X                | ADB 2004                 | ADB 2006 <sup>67</sup> | CDB (SDF) Rating Scale 1-5 | Inter American Development Bank (FSO and IFF)   | IFAD (For countries with three or more projects <sup>19</sup> ) | World Bank, IDA (% projects at risk) |
|--------|----------------------------|--------------------------|------------------------|----------------------------|---|---|--------------------------------------|
| 6.0    | 0% for three years or more | 0% for two years or more | 0-2%                   |                            | Ratio of undisbursed funds in problematic or on-alert projects as percentage of total undisbursed funds in all current projects under execution in the country. | 0% for two or more years  | 0%                                   |
| 5.5    |                            |                          | 3-7%                   |                            |   |   | 1%                                   |
| 5.0    | 0- 5%                      | 0-10%                    | 8-12%                  | 0-19%                      |   | 0%  | 2%                                   |
| 4.5    | 5- 15%                     |                          | 13-17%                 |                            |   |   | 3-4%                                 |
| 4.0    | 15- 30%                    | 15-34%                   | 18-22%                 | 20-39%                     |   | 0% to 34%   | 5-6%                                 |
| 3.5    | 30- 35%                    |                          | 23-27%                 |                            |   |   | 7-10%                                |
| 3.0    | 35- 45%                    | 35-40%                   | 28-32%                 | 40-59%                     |   | 35% to 67%  | 11-15%                               |
| 2.5    | 45- 65%                    |                          | 33-37%                 |                            |   |   | 16-32%                               |
| 2.0    | >65%                       | 41-70%                   | 38-42%                 | 60-79%                     |   | 68% to 100%   | 33-60%                               |
| 1.5    |                            |                          | 43-47%                 |                            |   |   | 61-99%                               |
| 1.0    | >65% for 3 years or more   | 100% for 2 or more years | 48-100%                | 80-100%                    |   | 100% for two or more years                                      | 100%                                 |

ADF = Asian Development Fund; AfDF = African Development Fund, CDB = Caribbean Development Bank; FSO = Fund for Special Operations; IDA = International Development Association; IFF = Intermediate Financing Facility; IFAD = International Fund for Agricultural Development; SDF = Special Development Fund;

<sup>15</sup> Beginning in 2001, the CDB put in place a project evaluation system using six criteria of performance, which are scored individually and then combined into a ‘composite performance score’. The six are: strategic relevance, poverty relevance, efficacy, economic efficiency, institutional development impact, and sustainability. As well, three other criteria are scored independently but not combined in the composite performance score. These are: the performance of the Caribbean Development Bank itself, borrower performance, and timing performance.

<sup>16</sup> A project rated 3 or 4 on the scale 1. problem free 2. minor problems 3. major problems but improving 4. major problems and not improving

<sup>17</sup> IFAD’s proposed 11 flags are: compliance with loan covenants, project management performance, availability of counterpart funds, compliance with procurement procedures, quality and timeliness of audit, disbursement rate, performance of W&E system, beneficiary participation, responsiveness of service providers, gender focus in implementation, poverty focus in implementation.

<sup>18</sup> The IDA flags are: long effectiveness delays; poor compliance with legal covenants; project management problems; shortage of counterpart funds; procurement problems; poor financial performance; environmental/resettlement problems; significant disbursement delays; long history of past problems; in risky country; in a risky sub-sector; and poor macroeconomic setting.

<sup>19</sup> IFAD takes a more qualitative approach when it has fewer than three projects in a particular country. It takes into account whether the one or two projects are actual or potential problem projects, the status of attainment of the development objective, and implementation progress.

**TABLE 7: RATINGS CONDUCT, REVIEW AND ACCREDITATION PRACTICES**

| Practices                                   | Institution/Fund  |   |   |   |  |   |
|---|---|---|---|---|--|---|
|   | African Development Bank  | Asian Development Bank  | Caribbean Development Bank  | Inter American Development Bank   | International Fund for Agricultural Development      | World Bank, IDA   |
| <b>Frequency of Performance Assessments</b> | Annual  | Annual  | Biennial  | Biennial  | Annual   | Annual  |
| <b>Main Scorer(s)</b>                       | Country teams, and sector and thematic experts from the Operations Departments.               | Country teams.  | A Ratings Team of Senior Managers, advised by country economists and sector specialists | Country economists, sector and thematic experts from Regional Operations Departments  | Country Program Manager                              | Country economists, sector and thematic experts from Regional Operations Departments.   |
| <b>Review and challenge of scores</b>       | Central Departments and Central Offices of two Operations Complexes and their Vice Presidents | 2005. CPA Panel - Chief Economist, Director Generals of the Regional and Sustainable Development Department, and the Strategy and Policy Department, and Operations Group Director Generals | No  | CIPE Group: RES (Chief Economist) and Regional Economists   | Regional Economists. Division Directors              | Central Departments: Operations Policy and Country Services (OPCS) and Development Economics (DEC). Residual differences adjudicated by OPCS VP |
| <b>Ratings Approval</b>                     | Operations Vice Presidents and VP for Planning, Policy & Research                             | Vice Presidents Operations Groups and VP Knowledge Management and Sustainable Development   | Senior Management Group, with sign-off by VPs   | By Regional Operations Management before allocations are calculated and presented to the Board for the approval of allocations. | Asst. President, Programme Management Department.    | Regional Chief Economists and VP OPCS   |
| <b>Benchmarking</b>                         | Yes. Two countries in each region are benchmarks (eight in total).                            | No  | No  | No  | Some benchmarking, with a focus on the rural sector. | Twenty countries were benchmarks in 2006 for the March 2007 CPIA exercise (both IDA and IBRD countries)   |
| <b>Written substantiation</b>               | Yes (for internal use)  | Yes (for internal use)  | No  | Yes (for internal use)  | Write-ups shared informally.                         | Yes (for internal use)  |
| <b>Triggers<sup>20</sup></b>                | Yes   | Discontinued in 2005.   | No  | No  | No   | Yes   |

<sup>20</sup> “Triggers” are the country performance levels that “trigger” high, base or low allocations.

TABLE 8: ALLOCATION PARAMETERS

| Item  | African Development Fund   | Asian Development Fund  | Caribbean Development Bank (SDF)  | Inter-American Development Bank (FSO and IFF)   | International Fund for Agricultural Development  | World Bank, IDA  |
|---|--|---|---|---|--|--|
| <b>Minimum allocations</b>  | AfDF IX: SDR 5m<br>AfDF X: To be determined  | No minimum, but not zero  | No minimum, zero is possible.   | No minimum, but not zero  | \$US1 million p.a.   | In 2006 every country received an allocation of SDR 1.1 million in addition to its formula-based allocation. <sup>68</sup> |
| <b>Small country preference</b>   | Minimum allocations favour smaller countries   | Yes. Separate pool for Pacific countries; formulate weight moderates the influence of population on allocations | Yes. LogPOP used in the allocation formula which lessens the influence of larger populations  | The performance-allocated dollars (60% of the total Fund) are distributed without attention to population | No   | Minimum allocations favour smaller countries   |
| <b>Separately allocated pool of funds for special groups of countries</b> | Yes, 95% of allocation for 38 AfDF only countries; 5% for two blend countries                        | Yes. 4.5% of commitment authority for Pacific developing member countries with access to fund.                  | Yes. New members Haiti.   | Two funds, different eligible countries and levels of concessionality.                                    | Until 2006 allocations were made within, not across, regions. In 2007 the allocation “competition” is worldwide. | No   |
| <b>Allocation caps or ceilings</b>  | Yes, capped allocation for one AfDF-only country: Ethiopia   | Cap on countries that are on the “graduation watch list” (only Indonesia at this time)                          | Group 1 countries are technically eligible for SDF up to the amount of their own contribution   | No  | Single country allocation limited to 5% of total available lending resources                                     | Capped allocations to three blend countries: India, Pakistan, Indonesia  |
| <b>Set aside (emergency and disasters)</b>                                | None from concessional AfDF resources. Some from non-concessional AfDB window                        | None. IDA 13 guidelines adopted. Softer terms post-disaster.  | \$8 million (SDF 6) for natural disaster response, (in part available for major economic transitions, emergencies, HIV/AIDS) + \$4 million for MDG-related projects | General reserve can be used for natural disaster emergency lending.                                       | No   | IDA13: Natural disaster grants up to \$75 million per annum<br>IDA14: none   |
| <b>Set aside (priority action areas, like AIDS)</b>                       | AfDF IX: 18-21% grants for specified activities; AfDF X: None  | 2% for HIV/AIDS on a grant basis but within PBA allocations.  |   | No  | No   | IDA13: HIV AIDS grants<br>IDA14: none  |
| <b>Set aside (regional projects)</b>                                      | AfDF IX: 10% for multinational or regional projects. Increased in AfDF X to 15%                      | Up to 5% of ADF commitment authority (2005). Explicit eligibility criteria provided.                            | \$10 million (SDF VI)   | No  | No   | SDR300 million p/a (plus SDR 100 million out of participating country envelopes) (IDA 14)                                  |
| <b>Different allocation rules for post-conflict countries?</b>            | Yes, the country performance rating is adjusted by a post-conflict enhancement factor. <sup>21</sup> | ADB will adopt the IDA 13 post-conflict PBA Framework from 2005.  | No  | N/A   | Under review   | Yes. Three years of special consideration + four years transition.   |
| <b>Different allocation rules for very weakly performing countries?</b>   | No   | Case by case consideration but subject to an allocation ceiling set by the PBA formula.                         | No  | N/A   | No   | No   |

AfDF = African Development Fund; FSO = Fund for Special Operations (Inter-American Development Bank); IDA = International Development Association; IFF = Intermediate Financing Facility (Inter-american Development Bank); SDR = Special Drawing Rights of IMF.

<sup>21</sup> The post-conflict enhancement factor has an upper bound of 1.5, but actual range applied to seven eligible countries was 1.13 to 1.30 during ADF-IX cycle (2002-2004).

**TABLE 9: ALLOCATION MANAGEMENT**

| <b>Item</b>  | <b>African Development Fund</b>   | <b>Asian Development Fund</b>  | <b>Caribbean Development Bank (SDF)</b>                 | <b>Inter-American Development Bank (FSO and IFF)</b>  | <b>International Fund for Agricultural Development</b> | <b>World Bank, IDA</b>                      |
|--|---|--|---|---|--|---|
| <b>Allocation Period</b>   | Annual (three-year rolling)   | Two years  | Four years  | Two years, firm   | Three years  | Annual (three-year rolling)                 |
| <b>Reallocation of unused resources</b>  | Mainly in final year of 3-year cycle  | Annual   | Biennial (mid-term). In fact 2003 (mid-point) and 2004. | Near end of second year (from countries with lower demand to countries with unmet demand). PBA coefficients applied once  | Annual reallocation                                    | Annual                                      |
| <b>Rollover unused country allocations from one allocation period to the next?</b>               | Year-by-year country allocations may vary depending on changes in annual country portfolio performance reviews. Reallocation from non-performers to good performers in the final year of the allocation cycle | At the end of period, unused allocations can be carried forward for 12 months.   | Yes, subject to biennial reallocation decisions.        | Yes. The amount less than 25% of the allocation can be rolled over, for pipeline projects approved in the first semester of the following year. Also some exceptions made (Haiti 2003, 2004). | Yes  | Limited rollover permitted.                 |
| <b>Conditional approvals when insufficient commitment authority within an allocation period?</b> | Yes   | Yes  | No  | Yes if country does not have sufficient resources to fully fund a project (FSO only).   | No   | No  |
| <b>Conditional approvals across replenishment periods?</b>                                       | No  | No   | No  | Yes   | No   | Yes (in selected cases)                     |
| <b>Limits on the % of the multi-year allocation that can be taken up in one year</b>             | Yes, on average 33% annually but flexibility allowed for some frontloading to high performers   | From 2005, annual approvals may vary as a percentage of the total biennial allocation, depending on country size and size of total allocation. | No  | Total approval limit of \$400 million p.a. Individual 'advances' on next year's allocation if unused funds available.   | No   | Extreme "frontloading" is normally resisted |
| <b>General reserve</b>   | No  | No   | Yes. \$10 million for technical assistance              | \$100 million   | No   | No  |

FSO = Fund for Special Operations (Inter-American Development Bank); IDA = International Development Association; IFF = Intermediate Financing Facility (Inter-American Development Bank); SDF = Special Development Fund (Caribbean Development Bank)

**TABLE 10: DISCLOSURE OF COUNTRY ALLOCATIONS, PERFORMANCE SCORES AND ASSOCIATED MATERIALS**

| <b>Institution</b>  | <b>Overall score disclosed?</b> | <b>Cluster scores disclosed?</b> | <b>Criterion scores disclosed?</b> | <b>Ratings narratives disclosed?</b> | <b>Monetary allocations disclosed?</b> | <b>Posted on website?</b> | <b>Annual report on PBA published?</b> |
|---|---------------------------------|----------------------------------|------------------------------------|--------------------------------------|--|---------------------------|--|
| <b>Caribbean Development Bank</b>   | Yes                             | Yes                              | Yes                                | No                                   | Yes                                    | No                        | No                                     |
| <b>African Development Bank</b>   | 2004 quintiles. Yes, from 2005. | Yes, from 2005.                  | Yes, from 2005.                    | No                                   | No                                     | Yes, from 2005.           | Yes, from 2005                         |
| <b>Asian Development Bank</b>   | 2004 quintiles. Yes, from 2005. | Yes, from 2005 .                 | Yes, from 2005 .                   | No                                   | Yes (to Board)                         | Yes, from 2005 .          | Yes, from 2005                         |
| <b>Inter-American Development Bank</b>  | Yes                             | Yes                              | No                                 | No                                   | Yes                                    | Yes                       | No                                     |
| <b>International Fund for Agricultural Development (Rural Sector Performance)</b> | Yes                             | Yes                              | Yes                                | No                                   | Yes                                    | Yes                       | Yes                                    |
| <b>World Bank, IDA</b>  | 2004 quintiles. Yes, from 2005  | 2004 quintiles. Yes, from 2005   | 2004 quintiles. Yes, from 2005     | No                                   | No                                     | Yes                       | Yes                                    |

**Stages of Disclosure**

| <b>Institution</b>                                     | <b>Disclosure to DMC governments</b>  | <b>Disclosure to Board</b>  | <b>Disclosure to public</b>   | <b>Accommodation of DMC Views</b>  |
|--|---|---|---|--|
| <b>Caribbean Development Bank</b>                      | Full disclosure of ratings  | Full disclosure of ratings  | Full disclosure but not active publication  | Discussion at Board and annual meetings  |
| <b>African Development Bank</b>                        | From 2005 during rating exercise  | 2004 Quintile results only; 2005 actual scores  | 2004 Quintile results only; 2005 actual scores  | After public disclosure, dissenting RMC views addressed (2005)   |
| <b>Asian Development Bank</b>                          | Preliminary discussion during rating exercise. Numerical disclosure during country programming together with average ratings for all other countries. | Full numerical disclosure prior to Board discussion of Country Strategy and Program Updates                   | Full public disclosure after Board discussion of Country Strategy and Program Updates.                          | Country notices appended as appropriate  |
| <b>Inter-American Development Bank</b>                 | CIPE country performance assessment discussed with countries at their request   | Each country's CIPE (CPIA) and cluster scores (not individual criteria scores) are disclosed                  | Each country's CIPE (CPIA) cluster scores (not individual criteria scores) are disclosed                        | Disclosure only in discussions after the scoring is complete.  |
| <b>International Fund for Agricultural Development</b> | Rural development-policy performance assessment and portfolio performance discussed with each MDC in advance during the rating exercise.              | Full numerical disclosure prior to Board in PBA papers. Country Strategic Papers reflect findings.            | Full disclosure following Board as per IFAD disclosure procedures unless specifically requested/agreed by Board | Comments received on Board papers prior to presentation may require tabling of points raised and agreements reached. |
| <b>World Bank (IDA)</b>                                | Preliminary discussion during rating exercise. Numerical disclosure of scores during country programming together with average ratings                | 2004 quintile group ranking disclosed; 2005 actual scores disclosed. Dollar allocation amounts not disclosed. | 2004 quintile group rankings disclosed; 2005 actual scores disclosed, Dollar allocations not disclosed (2007).  | Countries will have opportunity to express dissenting views when scores are disclosed publicly (after 2005)          |



**AN EXAMPLE OF A WORLD BANK CPIA WRITE-UP TEMPLATE**

**CPIA Q13: Quality of Budgetary and Financial Management**

**“Template” for Explanatory Write-up**

| No. | Question                                      | CPIA 2005 | CPIA 2006 | Explanation   |
|-----|---|-----------|-----------|---|
| 13  | Quality of Budgetary and Financial Management |           |           | <p>[Provide possibly 1-2 sentences on each of the bullets listed below. Also include quantitative information wherever relevant for the rating]</p> <p><b>Sub-question (a). A comprehensive and credible budget, linked to policy priorities</b><br/> <b>Rating =</b></p> <ul style="list-style-type: none"> <li>• <u>Budget-policy Link:</u></li> <li>• <u>Forward Look in Budget:</u></li> <li>• <u>Consultation with Spending Ministries in Budget Formulation:</u></li> <li>• <u>Budget Classification:</u></li> <li>• <u>Budget Comprehensiveness:</u></li> </ul> <p><b>Sub-question (b). Effective financial management systems to ensure that the budget is implemented as intended in a controlled and predictable way</b><br/> <b>Rating =</b></p> <ul style="list-style-type: none"> <li>• <u>Deviations of Actual from Budget:</u></li> <li>• <u>Budget Control, Monitoring and Reporting Systems:</u></li> <li>• <u>Arrears:</u></li> </ul> <p><b>Sub-question (c). Timely and accurate accounting and fiscal reporting, including timely and audited public accounts and effective arrangements for follow up.</b><br/> <b>Rating =</b></p> <ul style="list-style-type: none"> <li>• <u>Reconciliations:</u></li> <li>• <u>In-year Fiscal Reporting:</u></li> <li>• <u>Annual Public Accounts:</u></li> <li>• <u>Timeliness and Quality of Audits:</u></li> <li>• <u>Follow-up on Budget Reports and Audits:</u></li> </ul> <p><b>Information Sources:</b></p> |



**COMPARITIVE TABLE OF RED FLAGS FOR “PROBLEMATIC PROJECT”**

| <b>Asian Development Bank<br/>(fail 4/10 criteria)</b> | <b>World Bank/IDA<br/>(fail 3/10 criteria)</b>                                      | <b>IFAD<br/>(fail 5/11 criteria)</b>              | <b>Inter-American Development Bank<br/>(fail 2/3 criteria)</b>  | <b>African Development Bank<br/>(fail 2/6 criteria)</b> |
|--|---|---|---|---|
| Implementation delays                                  | Long effectiveness delays   |   | > 11 months from approval to contract validity; or > 12 months from contract validity to eligibility (16 months if legislative ratification required) | > 12 months from approval to effectiveness              |
| Poor compliance with legal covenants                   | Poor compliance with legal Covenants  | Compliance with loan covenants unsat              |   | Conditions precedent rated < 1.5 out of 4.0             |
| PMU/PIU operations                                     | Project management problems   | Project management Performance unsat              |   | Project management rated < 1.5 out of 4.0               |
| Counterpart funds/co-financing                         | Shortage of counterpart funds   | Availability of counterpart Funds unsat           |   | Counterpart funding rated < 1.5 out of 4.0              |
|  | Procurement problems  | Compliance with procurement procedures            |   | Procurement rated as < 1.5 out of 4.0                   |
| Cost over-runs   | Poor financial performance  |   |   |   |
|  | Environmental/resettlement Problems   | -   |   |   |
| Significant disbursement delays                        | Significant disbursement Delays   | Disbursement rate unsat                           | < 25% in 3 years, 75% in five years, or 10% of available balanced in past 12 months, or > 24 months extension of date of final disbursement           |   |
| Risky sector in country with history of past problems  | Long history of past problems: (a) in a risky country and (b) in a risky sub-sector | -   |   |   |
|  | Poor macroeconomic setting  |   |   |   |
| Poor compliance with audit or financial statements     |   | Quality and timeliness of Audit unsat             | Audited financial statement > six months late   |   |
|  | -   | Performance of M&E unsat                          |   |   |
|  |   | Beneficiary participation                         |   |   |
|  |   | Responsiveness and selection of service providers |   |   |
|  | -   | Gender focus unsat in implementation              |   |   |
|  | -   | Poverty focus unsat in implementation             |   |   |
| Environment/social problems                            | -   |   |   |   |
| ADB field visits                                       | -   |   |   |   |
|  |   |   |   | IP/DO rated unsat 2 years in row                        |



## **GLOBAL ENVIRONMENTAL FACILITY ALLOCATION SYSTEM**

The Global Environment Facility (GEF) Council adopted a performance-based allocation framework in September 2005.<sup>69</sup> The Resource Allocation Framework (RAF) is a system for allocating resources to countries in a transparent and consistent manner based on global environmental priorities and country capacity, policies and practices relevant to successful implementation of GEF projects.<sup>70</sup>

Allocations are based on two factors:

- (a) Potential to general environmental benefits, measured by the GEF Benefits Index (GBI): a measure of the potential of each country to generate global environmental benefits in a particular focal area; and
- (b) Potential for successful implementation of GEF projects, measured by the GEF Performance Index (GPI): a measure of each country's capacity, policies and practices relevant to a successful implementation of GEF programs and projects.

### **GEF Performance Index (GPI)**

The GEF Performance Index is composed of three indicators:

- (a) Portfolio Performance Indicator (PPI), with a weight of 10%, equally split between an indicator developed from GEF project ratings contained in the Project Implementation Review and an indicator developed from ratings by the World Bank Operations Evaluation Department of implementation completion reports of World Bank environment-related projects;
- (b) Country Environmental Policy and Institutional Assessment Indicator (CEPIA), with a weight of 70%, based on the "Policies and Institutions for Environmental Sustainability" indicator<sup>71</sup> from the World Bank's Country Policy and Institutional Assessment (CPIA); and
- (c) Broad Framework Indicator (BFI), with a weight of 20 percent in GPI, based on the average of the five indicators<sup>72</sup> under the "Public Sector Management and Institutions" cluster of the CPIA.

The country performance score is computed from the GEF Benefits Index (GBI) and the GEF Performance Index (GPI) as follows:

$$\text{Country Performance Score} = \text{GBI}^{0.8} \times \text{GPI}^{1.0}$$



## **ASIAN DEVELOPMENT BANK PORTFOLIO PERFORMANCE SCORING SYSTEM**

In March 2001, the Asian Development Bank (ADB) Board approved the Policy for the Performance-Based Allocation of ADF Resources. The allocation formula contains a portfolio performance variable. It assigns a weight of approximately 15% to 18%<sup>73</sup> to portfolio performance in the country performance rating, the lowest among the MDBs. ADB bases its portfolio performance rating on an estimate of the proportion of ‘projects at risk’. The “% projects at risk” is calculated in the following way: (the number of actual problem projects + the number of potential problem projects) ÷ (total number of active ADB projects in the country). Staff who are responsible for monitoring projects make estimates of ‘projects at risk’ at the time of a mission to the country. Background information, along with recommendations on how to rate project performance, are sent by the mission leader to the Country Portfolio Assessment Working Group.<sup>74</sup>

The ADB Policy on Performance-Based Allocation states three groups of indicative criteria to be taken into account in determining projects at risk: Implementation progress, likely achievement of development objectives) on a four-point scale<sup>22</sup>, and potential problems. (Four or more “red flags” in the Project Performance Report.) A red flag is raised, automatically, if the Project Performance Report rates one of the following as unsatisfactory or only ‘partly satisfactory’<sup>22</sup>: implementation delays; poor compliance with covenants; PMU/PIU operations; fielding consultants; counterpart funds/co-financing; cost overruns; poor compliance with audits or financial statements; environmental/social problems; significant disbursement delays; a risky sector in a county has a history of past problems; and ADB field mission visits.

The percentage of projects-at-risk is converted to a country portfolio rating<sup>23</sup> as shown in Appendix C, Table 6.

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<sup>22</sup> Highly satisfactory (expected to exceed most of its major development objectives); satisfactory (expected to achieve most of its major development objectives); partly satisfactory (expected to achieve some of its development objectives); and unsatisfactory (unlikely to achieve its major development objectives.)

<sup>23</sup> The portfolio performance rating approximates a linear rule  $r = 6 - 10p$ , where “r” is the portfolio performance rating and “p” is the decimal proportion of projects at risk in the country’s active portfolio.



## **WORLD BANK/IDA PORTFOLIO PERFORMANCE SCORING SYSTEM**

The World Bank's portfolio performance score<sup>75</sup> is based on all operations, not only those funded on concessionary terms. That is, it includes all active<sup>76</sup> projects in the current fiscal year, whether funded by IBRD, IDA, GEF, the Montreal Protocol or Special Financing. It is calculated in two steps. First the percentage of "projects at risk" is calculated. This is based on the ratio of the number of "actual problem projects"<sup>77</sup> + "potential problem projects"<sup>78</sup> to total active projects. Second, the percentage of projects at risk is converted to a portfolio performance score on a scale 1.0 to 6.0, using a conversion table. (See Appendix C, Table 6)

A World Bank project is 'at risk' if it is an actual problem project because implementation progress is unsatisfactory or development objectives are unlikely to be achieved, or it is a potential problem project because the project has three 'red flags' out of 11 risk factors that are historically associated with unsatisfactory outcomes. The 11 risk factors are the 12 factors used by the World Bank Quality Assurance Group to assess portfolio performance, except for the CPIA flag, which was omitted because it is counted in another part of the resource allocation formula. Therefore the criterion becomes "two out of eleven risk factors having a red flag".<sup>79</sup>

In 2006 the risk factors taken into account were: legal covenants;<sup>80</sup> safeguards;<sup>81</sup> counterpart funds;<sup>82</sup> monitoring and evaluation;<sup>83</sup> financial management;<sup>84</sup> procurement;<sup>85</sup> project management;<sup>86</sup> long-term risk;<sup>87</sup> effectiveness delays;<sup>88</sup> disbursement delays;<sup>89</sup> country environment (CPIA);<sup>90</sup> country record.<sup>91</sup> However the World Bank's regional operational managers can over-ride the at-risk rating at their discretion, by using a 'golden flag'. This flag can be used to change ratings in either direction, although when used it has generally been to move projects out of the at-risk category.



## **INTER-AMERICAN DEVELOPMENT BANK APPROACH TO PORTFOLIO PERFORMANCE SCORING**

The Inter-American Development Bank (IDB) provides two sources of concessionary funding, the Fund for Special Operations (FSO) and the Intermediate Financing Facility (IFF). The Fund for Special Operations is restricted<sup>92</sup> to the five poorest members of the Bank – Bolivia, Guyana, Haiti, Honduras and Nicaragua. Approximately 32 million people live in these countries. In addition, a small amount has been allocated to the Caribbean Development Bank for ‘on lending’ to the OECS countries. The Intermediate Financing Facility was established during IDB-6 (1982). Currently, the eligible borrowers are Suriname (among the C countries) and Ecuador, El Salvador, Guatemala and Paraguay (among the Group D1 countries). Approximately 39 million people live in these countries.

The IDB has a simple linear allocation formula that allocates 60% of its funds (FSO) entirely according to the country performance rating. The IDB gives 30% weight to portfolio performance within the “country performance rating” in the allocation formula, compared with policy and institutional performance (CIPE) that receives 70% weight.

The active portfolio is defined as all projects approved by the Board of Executive Directors that had outstanding undisbursed balances at the most recent year- end, excluding the Project Preparation and Execution Facility, export financing facilities, Mezzanine Investment Funds, MIF projects and non-reimbursable technical cooperation.

IDB calculates a country’s portfolio performance differently from the other MDBs in two ways. First, IDB does not convert raw percentages of problem/alert projects to a 1-6 scale using an arbitrary equivalence table. Instead the IDB measures a country’s portfolio performance as the undisbursed amount in problem or on-alert projects compared with the total amount undisbursed from all current projects in the country (expressed as a percentage).<sup>93</sup> Second, the raw scores are not used in the allocation formula but are normalised relative to the average performance score. Since all variables in the allocation formula are standardised in this way, it is relatively easy to understand intuitively the weights for each variable.

The other MDB’s conversion of percentage projects at risk to a 1-6 scale (or in the case of the CDB 1-5) is a kind of partial normalisation, since the policy/institutional performance variable is measured on the same 1-6 or 1-5 scale. The current IDA effort to constrain the “volatility” of the portfolio performance variable may be a further step towards normalization. However, the IDB method of normalisation is less arbitrary and has the advantage of being applied consistently to all of the variables in the allocation formula, not only to the country performance variables.

In its early deliberations<sup>94</sup> the IDB considered using “average age of a US\$1.0 disbursed” as a portfolio performance variable but decided against it.

## **APPENDIX I**

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### **Definition of Projects at Risk**

The Inter-American Development Bank operates a Portfolio Performance and Management Reporting System (PPMR). Country offices report on project performance in terms of the extent to which projects are expected to achieve their development objectives, whether implementation progress is satisfactory, and whether key assumptions and enabling conditions continue to be favourable for smooth implementation and achieving objectives. This enables the IDB to identify problem projects.

IDB also operates the Project Alert Identification System (PAIS). See <http://itc-apps-01/pais/> A project ‘on-alert’ is one currently rated as making unsatisfactory or very unsatisfactory progress on implementation<sup>95</sup>, rated low in terms of development assumptions<sup>96</sup>, or are flagged as having two or more indicators<sup>97</sup> that are characteristic of projects that may become problematic in the future.<sup>98</sup>

IDB measures country portfolio performance, for purposes of resource allocation, by the proportion of ‘problem projects’ and ‘projects on alert’. These data are set out in the *Annual Report on Portfolio Management, Performance and Results* (ARPRE) presented each year to the consideration of the Board of Executive Directors.

### **Issues**

The use of the undisbursed amount in problem/on alert projects (rather than the simple number of problem/on-alert projects) has certain advantages. If, for example, a very small project goes on alert, or a project goes on alert late in its life, then the country’s portfolio performance score will not be much affected. This avoids some of the “measurement volatility” problem experienced by other MDBs. However, on the other hand, if one large project goes on alert early in its life the effect on the country performance score would be correspondingly large.

## **AFRICAN DEVELOPMENT BANK PORTFOLIO SCORING SYSTEM**

In January 1999, the ADB's Deputies approved a performance-based resource allocation system (including a portfolio performance measurement system) that was substantially harmonised with the World Bank, but is different in some respects. It rates country portfolio performance on a 1.0 to 6.0 scale, depending on the percentage of projects at risk (actual and potential problem projects). The conversion protocol is shown in Appendix C, Table 6.

A project is identified as a "problem project" if it receives an average score of 1.5 or less on either the indicators of Implementation Progress (IP, 14 indicators) or the indicators of Development Objectives (DO, 4 indicators). Each of the indicators is scored on a 1.0 to 4.0 scale.

A "potential problem project" is one that meets at least two of seven criteria:

1. Elapsed time between approval and effectiveness is greater than 12 months. This applies to all operations – project and structural adjustment loans, as well as TAF activities.
2. Conditions precedent is rated less than 1.5
3. Procurement of goods and services is rated as less than 1.5
4. Project management is rated as less than 1.5
5. Counterpart funds is rated as less than 1.5
6. Country has a record of high rate of project failure (PPAR/PCR failure rate of 50% in a macro-economically weak country)
7. IP or DO rating is rated as unsatisfactory two years in a row.

## Endnotes

<sup>1</sup> In SDF 6 set-asides have been made for projects on regional integration and regional public goods, for project management training, the Caribbean Technological Consultancy Services (CTCS), MDGs and immediate disaster response. In addition there were allocations for the Basic Needs Trust Fund (BNTF), operations in Haiti, and for capacity building technical assistance to borrowing member countries (BMCs).

<sup>2</sup> CDB, Allocation of Special Development Fund Resources (Fifth Cycle), Working Paper, May 2001, SDF 5/3 NM-5, WP01/5.

<sup>3</sup> CDB, by Dr. Kenneth Watson, RideauGroup Consultants.

<sup>4</sup> CDB, “Replenishment of the Resources of the Special Development Fund (SDF 6) – Resolution and Report of the Contributors on SDF 6”, October 2005.

<sup>5</sup> CDB, “Resolution of the Contributors to SDF 6. Schedule 3 – Report and Conclusions of Negotiations for SDF 6”, October 2005. Para. 29 “Contributors also reaffirmed the importance of the SDF resource allocation strategy that had been introduced in SDF 5, and agreed that the same strategy should be used for determining indicative country allocations in SDF 6, with an emphasis on improving the application and use of the strategy in strengthening development effectiveness and results.” ... 5. SDF 6 ACTION PLAN AND MID-TERM REVIEW. ... 5.04 Contributors agreed that there would be a Mid-Term Review of SDF 6, similar to that undertaken for SDF 5, to be completed early in the third year of the Replenishment cycle. The Review should discuss progress made in implementing decisions and recommendations in this Report, SDF 6 operations to date, the operational programme for new members, and the status of funding for the Replenishment. ... 5.06 The exact content and coverage of the MTR will be finalized depending on emerging issues and concerns, but Contributors requested the Bank to have a report prepared for their consideration, at least one month before the MTR meeting, covering, among other issues: (a) overall progress on the operational programme, including implementation of the operational priorities set out in this Report; (b) status of funding, and availability and use of commitment authority; (c) progress with respect to the time-bound milestones in the SDF 6 Action Plan, as well as other aspects of the Results Agenda, in particular, application of the SDF resource allocation strategy, preparation of results-based country strategies, the Bank’s thematic and sector evaluation work, and the selected Indicators of Progress on the alignment, harmonization and results agenda; (d) progress with respect to development of a monitoring and evaluation framework for SDF based on Caribbean-specific MDGs, Targets and Indicators; (e) progress on other aspects of the SDF 6 programme; using the additional indicators requested by Contributors; and (f) planning for SDF 7, including the proposed programme evaluation of SDF.

<sup>6</sup> The tasks of the assignment were: (1) collect and analyse information about CDB’s experience and BMC perceptions of the allocation system; (2) describe the rationale, history and scope of the allocation system and formula; describe and analyse CDB’s method of scoring country performance; (3) review dollar allocations over time; (4) review the use of set-asides for special purposes; (5) describe the general outcomes of the allocation system and identify its strengths and weaknesses; (6) discuss the possibilities of harmonization with other multilateral development banks; and (7) formulate options for CDB’s allocation system in future, setting out the pros and cons of each option.

<sup>7</sup> A “public good” is one that benefits everyone in a society, such as clean air, while a “private good” benefits only certain persons or organizations.

<sup>8</sup> The “absolute” value ignores whether the number is positive or negative and simply expresses the size of the number.

<sup>9</sup> However the WB/IDA caps the allocations of its three largest “blend” borrowers at levels well below what the formula would produce, thus moderating the effect of population on the allocation in these three cases (India, Indonesia and Pakistan).

<sup>10</sup> Mid-Term Review of IDA 14. November 7, 2006. “IDA’s Performance-Based Allocation System: A Review of the Governance Factor”. IDA/Sec M2006-0561. Paragraph 36. Page 19.

<sup>11</sup> IDB uses the same formula for both its Fund for Special Operations (FSO), and its Intermediate Financing Facility (IFF).

<sup>12</sup> The WB used the term “Country Policy and Institutional Performance” (CPIA) for many years and recently has used the term “IDA Resource Allocation Index” (IRAI) to refer to the actual performance score resulting from the CPIA. The Inter-American Development Bank uses the term “Country Institutional and Policy Evaluation” (CPIE).

<sup>13</sup> Appendix A Table 3 shows a comparison of the PRES criteria with the CPIA criteria of the WB/IDA and the ADB. Table 4 shows a similar comparison between the CDB and IDB criteria.

<sup>14</sup> David Dollar and Lant Pritchett, “Assessing Aid – What Works, What Doesn’t and Why”, WB Report Number 18295. WB Website Summary: “This report assesses foreign aid, pointing out that aid is as much a matter of knowledge as it is about money. It discusses the continuing role of financial transfers from rich to poor countries, despite the integrated capital markets; and the role of effective aid in supporting institutional development policy reforms, crucial to a successful development. The report summarizes the findings of recent WB research on aid effectiveness. Two key themes emerge from this report: the importance of timing, and the mix of money and ideas in making aid effective. When countries reform their economic policies, well-timed assistance can increase the benefits of reform and maintain popular support for them. On the mix of activities, it is found that money has a large impact, but only in low-income countries with sound management. Without a reform policy, finance has little impact. To be effective in equitable and sustainable development, a three-way partnership among recipient countries, aid agencies, and donor countries is needed. The recipient countries must move toward sound policies. Development agencies must shift away from total disbursements and the narrow evaluation of implementation, instead create high impact assistance. Donor countries should continue to support aid as well. The report concludes that properly managed foreign aid can make a big contribution toward improvement in people’s lives.”

<sup>15</sup> David Dollar and Lant Pritchett, “Assessing Aid – What Works, What Doesn’t and Why”, WB Research Report Number 18295, November 1999. ISBN 0-19-521123-5

<sup>16</sup> There is a question whether the level of policy/institutional performance should be the sole determinant of a country’s score, or whether ‘momentum’ [improvement] should be assessed as well. It has been suggested that assessing policy/institutional level alone, as CDB does at present, may penalize countries that start at a low level of policy/institutional effectiveness, but are improving. Momentum of policy change, however, can be taken into account later in adjusting the indicative allocation in the second stage of developing a country-lending program in the country strategy.

<sup>17</sup> In the various PRES scoring exercises countries that improved by more than one rank include: Guyana, Anguilla, Turks and Caicos Islands, and St. Lucia. The countries whose policy/institutional performance deteriorated by more than one rank, included Grenada, British Virgin Islands, Montserrat, Trinidad and Tobago, and Cayman Islands, and Barbados

<sup>18</sup> CDB, J. Braithwaite, “Discussion Note: Review of the Poverty Reduction Effectiveness Situation Index”, August 2006.

<sup>19</sup> Braithwaite op. cit. p. 2 “The process of collaboration and collective assessment envisaged in the calculation of the PRES has not been fully adopted.”

<sup>20</sup> Mid-Term Review of IDA 14. November 7, 2006. “IDA’s Performance-Based Allocation System: A Review of the Governance Factor”. IDA/Sec M2006-0561. Paragraph 30. Page 16.

<sup>21</sup> The criteria are scored on a scale from 1 to 5 with 1 representing an unsatisfactory performance and 5 representing an excellent performance

<sup>22</sup> The policy-and-institutional performance variable was introduced into what had previously been an allocation system based entirely on need in order to give each country an incentive to reform its policies and institutions where such reform is needed. One would expect that the PRES would have a significant influence on SDF allocations, although it shares that influence with another performance variable (performance of the country’s CDB portfolio) and with three variables that measure need (population, per capita income, and vulnerability).

<sup>23</sup> The range of WB scores is from 1 to 6, and CDB scores from 1 to 5.

<sup>24</sup> In 2005 the Asian Development Bank adopted the CPIA clusters and criteria used by the WB/IDA, abandoning its earlier CPIA that had been different in some respects. The Inter-American Development Bank (IDB) uses essentially the same clusters as the other MDBs, but gives them different weights and has a much smaller number of individual criteria within the clusters (10 main criteria, no sub-criteria). IDB gives much greater weight to “social inclusion and equity” (35% rather than 25%), and considerably less weight to “(macro) economic management” (15% rather than 25%). It is perhaps noteworthy that IDB adds “inclusion of indigenous peoples and other minorities” to its “gender equality” criterion.

<sup>25</sup> WB/IDA, Resource Mobilization (FRM), “IDA’s Performance-Based Allocation System: A Review of the Governance Factor”, October 2006.

<sup>26</sup> See the Millennium Challenge Corporation for an approach to governance in a resource allocation context that is broader and more political.

<sup>27</sup> Mid-Term Review of IDA 14. November 7, 2006. "IDA's Performance-Based Allocation System: A Review of the Governance Factor". IDA/Sec M2006-0561. Paragraph 25. Page 14.

<sup>28</sup> Central African Republic, the Gambia, Madagascar, Tanzania, Cambodia, Indonesia, Vanuatu, Iran, Tunisia, Yemen Republic, Argentina, Grenada, Guyana, Mexico, Nicaragua, Paraguay, Albania, Slovak Republic, Tajikistan, and Pakistan.

<sup>29</sup> That is the comments of all country economists participating in the scoring exercise should be compiled into a single text.

<sup>30</sup> Average performance score 2001-2005, Appendix C, Table 1.

<sup>31</sup> Belize, Grenada, Guyana, St. Kitts and Nevis, St. Vincent and the Grenadines, and the Turks and Caicos Islands.

<sup>32</sup> Simple two-variable regression analysis shows a multiple R of 0.756578, an R squared of 0.572411, and a standard error of 0.101452, on the basis of six observations (six countries).

<sup>33</sup> The main reasons were that Dominica experienced severe fiscal distress during the SDF 5 period. Dominica has a relatively small population, a relatively high portfolio performance score, and its vulnerability score was relatively high.

<sup>34</sup> In 2006 the CDB included only investment loans in its Project Performance Index. Most multilateral development banks also include technical assistance projects as part of the performance index.

<sup>35</sup> The PRES is based on five criteria of poverty-relevant country performance: socially inclusive development, macroeconomic management, governance and public sector management, structural or microeconomic management, and environmental policies and management. Each criterion is given a consensus weight by CDB economists.

<sup>36</sup> Ibid, p.6

<sup>37</sup> CDB projects are scored at each stage of their lifecycle. A Performance Rating Summary is completed in the Project Portfolio Management System (PPMS) at project appraisal, at each supervision milestone, and at completion. The project supervisor enters scores and their justification. The standard criteria are scored each time, although at appraisal the expected performance is assessed, not actual performance.

<sup>38</sup> The PPES criteria are closely related to the harmonised project performance criteria promulgated by the Evaluation Coordination Committee of the OECD/DAC. Beginning in 2001, the CDB put in place a project evaluation system using these six criteria of performance, which are scored individually and then combined into a 'composite performance score'.

<sup>39</sup> As well, three other criteria are scored independently but not combined in the composite performance score. These are: the performance of the Caribbean Development Bank itself, borrower performance, and timing performance.

<sup>40</sup> The average should be of project scores at a set time each year, not an average of annual averages. The reason for this is to give full weight to other operations (TA) in the first year that they enter the calculation.

<sup>41</sup> CDB, IDMAG and RideauGroup, "Evaluation of CDB Technical Assistance Operations", 2007.

<sup>42</sup> The possible red flags are as follows: A performance score below 2.0 (out of 10) on any criterion; a composite performance score below 4.0; a performance score on any criterion that has declined by more than 15% since the last supervision report; an 'unsatisfactory' rating on the performance of the Caribbean Development Bank itself (which would have to be removed before the variable was used for allocation purposes) or an 'unsatisfactory' rating on borrower performance.

<sup>43</sup> One 'red flag' is raised if any of the following questions is answered positively: Is any performance criterion scored below 2.0? Is the composite performance score below 4.0? Has any performance score declined by more than 15% since the last supervision report? Is project timing more than 15% behind target? Is CDB performance unsatisfactory? Is the borrower/executing agency performance unsatisfactory?

<sup>44</sup> The smaller the number of projects that form the basis of the performance metric, the more unstable the metric is liable to be.

<sup>45</sup> In 2005, only 2 projects in the SDF capital portfolio (2.4%) were classified "at risk" compared with four projects in 2004 (5.1%) and 9 projects in 2003 (10.3%)

<sup>46</sup> Portfolio performance scores may be highly volatile where real volatility of performance is much less. Measurement volatility in a red flag system may be much greater than actual volatility of performance if the country portfolio is small. Consider a country that has five active projects, all of which are satisfactory on Implementation Performance and Development Objectives and has fewer than three red flags up. It would receive a rating of 6.0 on portfolio performance. If, now, one of the five projects gets another red flag and is counted "at risk", the country now has 20% of its projects at risk and a portfolio performance rating of 2.5. This is a very large change in score for a small change in actual performance. Three changes have been proposed by WB staff to lessen measurement volatility. These changes are: (1) Narrow the scale on which portfolio performance is scored from '1 to 6' to '1 to

4.5'. Consequently the conversion formula will also have to change (that is, the formula used to convert “% projects at risk” to a performance score on the 1 to 4.5 scale). The rationale for this change is that narrowing the range of the performance scale will constrain measurement volatility. It is unclear that this will be so, if scoring on the new scale is proportional to scoring on the old scale (as it probably would be). (2) Take readings of the portfolio performance at several times during the year (in fact at the end of each quarter) rather than only at one fixed date each year. The rationale is that this will make it less likely that the country manager will clean up the country portfolio to improve the portfolio score (by early termination of projects that are performing poorly). (3) Countries with portfolios of three projects or less (14 of 81 countries) will not have the portfolio performance component used in the calculation of their budget allocation. In effect these countries will have an allocation determined only by country policy and institutional performance (CPIA). Simulations by the WB staff indicate that these three changes would reduce measurement volatility by about two-thirds. It has been suggested that the proposed changes will make the measurement volatility confirm more closely to the real volatility of performance, will better align the ratings with portfolio norms<sup>46</sup> and will better align the range of portfolio performance ratings with the range of CPIA ratings.

<sup>47</sup> IDB considered another approach to the same issue, namely using “average age of a dollar disbursed” as a performance measure.

<sup>48</sup> The percentage of projects at risk has improved markedly in the past five years, although the bulk of the improvement has been in potential rather than actual problems so perhaps over-optimism is showing here.

<sup>49</sup> “Net Disconnect” is defined as “The difference between the percentage of projects rated as satisfactory by Operations Evaluation Department and the percentage rated by the Regions in the final Project Supervision Report as unsatisfactory for achieving the development objectives.” World Bank, “Definitions, Classifications, and Data Sources”, p. 4.

<sup>50</sup> The actual outcomes are measured for completed projects by Operations Evaluation Department of the WB a group that reports directly to the Board. The ‘disconnect’ is measured globally and for individual countries and sectors.

<sup>51</sup> Gross domestic product per capita.

<sup>52</sup> CDB, J. Melville et al, “Revised Economic Vulnerability Index – 2002”, March 2006.

<sup>53</sup> CDB, Natural Disaster Strategy and Operational Guidelines, April 1998.

<sup>54</sup> See “Adapting IDA’s Performance-Based Allocations to Post-Conflict Countries”, May 2001

<sup>55</sup> A minor qualification here is that “country performance” is the multiplicative factor in the World Bank/IDA and CDB allocation formulas, but the country performance score itself is the result of an addition of two weighted scores, one for policy-and-institutional performance and one for portfolio performance.

<sup>56</sup> Mid-Term Review of IDA 14. November 7, 2006. “IDA’s Performance-Based Allocation System: A Review of the Governance Factor”. IDA/Sec M2006-0561. Paragraph 37. Page 20.

<sup>57</sup> 0.5 is the minimum possible change since the scoring scale is calibrated in 0.5 increments.

<sup>58</sup> CDB, “Use of Grants in the Special Development Fund”, April 2005. SDF 6/1-EEN-4.Rev. 1.

<sup>59</sup> CDB, IDMAG and RideauGroup Consultants, “Evaluation of TA Operations”, February 2007.

<sup>60</sup> Op. Cit., paragraph 6.06

<sup>61</sup> CDB, “Resolution of the Contributors to SDF 6. Schedule 3 – Report and Conclusions of Negotiations for SDF 6”, October 2005. Paragraph 6.06.

<sup>62</sup> That is the comments of all country economists participating in the scoring exercise should be compiled into a single text.

<sup>63</sup> The average should be of project scores at a set time each year, not an average of annual averages. The reason for this is to give full weight to other operations (TA) in the first year that they enter the calculation.

<sup>64</sup> Portfolio performance scores may be highly volatile where real volatility of performance is much less. Measurement volatility in a red flag system may be much greater than actual volatility of performance if the country portfolio is small. Consider a country that has five active projects, all of which are satisfactory on IP and DO and has fewer than three red flags up. It would receive a rating of 6.0 on portfolio performance. If, now, one of the five projects gets another red flag and is counted “at risk”, the country now has 20% of its projects at risk and a portfolio performance rating of 2.5. This is a very large change in score for a small change in actual performance. Three changes have been proposed by WB staff to lessen measurement volatility. These changes are: (1) Narrow the scale on which portfolio performance is scored from ‘1 to 6’ to ‘1 to 4.5’. Consequently the conversion formula will also have to change (that is, the formula used to convert “% projects at risk” to a performance score on the 1 to 4.5 scale). The rationale for this change is that narrowing the range of the performance scale will constrain measurement volatility. It is unclear that this will be so, if scoring on the new scale is proportional to scoring on the

old scale (as it probably would be). (2) Take readings of the portfolio performance at several times during the year (in fact at the end of each quarter) rather than only at one fixed date each year. The rationale is that this will make it less likely that the country manager will clean up the country portfolio to improve the portfolio score (by early termination of projects that are performing poorly). (3) Countries with portfolios of three projects or less (14 of 81 countries) will not have the portfolio performance component used in the calculation of their budget allocation. In effect these countries will have an allocation determined only by country policy and institutional performance (CPIA). Simulations by the WB staff indicate that these three changes would reduce measurement volatility by about two-thirds. It has been suggested that the proposed changes will make the measurement volatility confirm more closely to the real volatility of performance, will better align the ratings with portfolio norms<sup>64</sup> and will better align the range of portfolio performance ratings with the range of CPIA ratings.

<sup>65</sup> IDB considered another approach to the same issue, namely using “average age of a dollar disbursed” as a performance measure.

<sup>66</sup> CDB, J. Melville et al, “Revised Economic Vulnerability Index – 2002”, March 2006.

<sup>67</sup> This conversion scale is quoted in ADB “2005 Annual Report on ADB’s Country Performance Assessment Exercise”, March 2006.

<sup>68</sup> The minimum allocation has been higher than the current figure. It was in 2004 SDR 3 million, for example.

<sup>69</sup> As specified in the annex of the Joint Summary of the Chairs, Special Meeting of the GEF Council, August 30 – September 1, 2005.

<sup>70</sup> The RAF will initially be applied to the focal areas of biodiversity and climate change. In GEF 3, these two focal areas together account for about two-thirds of the resources employed for programming in the GEF.

<sup>71</sup> CPIA Indicator # 11.

<sup>72</sup> CPIA Indicators # 12,13,14,15,16.

<sup>73</sup> The weight of the portfolio performance factor in the allocation formula is expressed by its exponent which is 0.6. However the effective weight varies, depending on the baseline situation of the country, as is always the case in a system that uses an exponential formula.

<sup>74</sup> The Country Portfolio Assessment Working Group comprises regional department representatives, knowledge departments and central services department (COSO, which is responsible for ADB-wide portfolio management).

<sup>75</sup> The use of a “portfolio performance” variable dates back not to the start of the World Bank/IDA allocation system but only to the mid-1990s. During the IDA 10 negotiations, donors asked that borrowers’ portfolio performance (in their existing portfolios of IDA credits) be taken into account in further resource allocations. Beginning in 1993, therefore, portfolio performance was given a weight of 20% among the variables in the resource allocation formula, although, at this time, it was not a separate factor, but rather was one of the criteria, among several, that comprised the measures of country performance. In 1995, the weighting of portfolio performance within the country performance score was reduced to 10%, and then to 7% in 1997. When the country performance factor in the allocation formula was redesigned in 1998, however, it was decided to have a separate portfolio performance factor outside the CPIA. Thereafter there were two performance factors in country performance in the IDA allocation formula – portfolio performance, with a weight of 20%, and policy/institutional performance, with a weight of 80%. At the same time, the methods of measuring ‘portfolio performance’ were changed to address methodological problems. Previously the score for portfolio performance had been based on estimates of the proportion of ‘problem projects’ in the country portfolio. This was controversial. It was thought that project managers might be reluctant to label a project a ‘problem’, despite growing difficulties and risks, especially if the result might be a loss of resources for their country program. Therefore the World Bank began measuring ‘projects at risk’ in 1996, in addition to actual problem projects, and, in 1998, began using the data to help allocate IDA resources. The assessment of ‘projects at risk’ in a country is based upon the findings of supervision missions and is updated after each mission, which generally occur about every six months.

<sup>76</sup> Excluding all projects that had been cancelled or closed.

<sup>77</sup> An “actual problem project” is one rated unsatisfactory on implementation progress or rated an unlikely to achieve its development objectives.

<sup>78</sup> A “potential problem project”, although it is currently rated as satisfactory on IP and DO, has risk factors historically associated with unsatisfactory outcomes.

<sup>79</sup> The definition of ‘red flags’ has changed over the years. For example, in response to recommendations in the FY99 *Annual Review of Portfolio Performance* some ‘red flags’ were changed.<sup>79</sup>

<sup>80</sup> Any of the critical legal covenants rated “not complied with” in the last ISR.

<sup>81</sup> Ratings of MU, U or HU on any applicable safeguard policy in the last ISR.

<sup>82</sup> Counterpart funding rated MU, U or HU in the last ISR.

<sup>83</sup> Monitoring and evaluation rated MU, U or HU in the last ISR.

<sup>84</sup> Financial management rated MU, U or HU in the last ISR.

<sup>85</sup> Procurement rated MU, U or HU in the last ISR.

<sup>86</sup> Project management rated MU, U or HU in the last ISR.

<sup>87</sup> Project with IP or DO rated MU, U or HU for any 24 months cumulative during the life of the project. This flag is removed when the project has been rated MS, S or DS for PIP and DO for the previous 24 months.

<sup>88</sup> Elapsed time between Board approval and effectiveness of more than nine months for investment, more than six months for policy-based lending and more than three months for emergency operations. This flag is turned off three years after Board approval.

<sup>89</sup> Disbursement delays of 24 months or more for investment operations. Delay is calculated based on the initial or formally revised disbursement schedule for the project.

<sup>90</sup> Located in a country with weak economic management (CPIA rating of less than 3.0 on a scale of 1 to 6). Once flagged the CPIA must exceed 3.5 for the flag to be removed. This flag also includes countries which are in a conflict or post-conflict environment.

<sup>91</sup> Located in a country with a net disconnect of 20% or more, or where net commitments associated with unsatisfactory projects, as rated by IEG, represent more than 40% of commitments for completed projects over the previous five years. In cases where the sample of IEG evaluations is too small, ICR data, data on mature projects, and experience of other donors is used to arrive at a robust conclusion. This flag also captures countries with less than satisfactory CAE ratings by IEG in the prior five fiscal years.

<sup>92</sup> Since 1994 ( IDB-8).

## REVIEW OF THE UNIFIED SPECIAL DEVELOPMENT FUND RESOURCE ALLOCATION SYSTEM

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<sup>93</sup> Ibid, p.6

<sup>94</sup> IDB, "Alternatives for a Performance-Based Allocation of FSO Resources and May 2001 Reallocation of Available FSO Resources", Strategic Planning and Budget Department, Washington DC, June 27, 2001, p.3

<sup>95</sup> Implementation is 'unsatisfactory' if most significant components are not in compliance with the original or revised project implementation and sequencing plan or there is a problem with the quality of the components. A serious delay in implementation of the project may be occurring. Corrective actions are being taken that may produce results. A project is very unsatisfactory if no feasible corrective action has been identified or there is no agreement with the executing agency on appropriate corrective actions.

<sup>96</sup> The likelihood that the key assumptions will hold true in practice is classified as low based on the latest information.

<sup>97</sup> Indicators include: Project has been under disbursement for more than 3 years and is less than 25% disbursed. Project has been under disbursement for more than five years and is less than 75% disbursed. Project took more than 12 months to achieve eligibility from date of contract validity. Less than 10% of available balances disbursed in previous 12 months. Eleven or more months elapsed between Board approval and contract validity in countries not requiring legislative ratification. Seventeen or more months elapsed between Board approval and contract validity in countries requiring legislative ratification. More than 24 months in extensions of date of final disbursement. More than 6 months delay in presentation of audited financial statements.

<sup>98</sup> IDB, 'Proposal for a Performance-Based Allocation of FSO Resources', Strategic Planning and Budget Department, June 6, 2002