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Agenda Item 4 - Finance Committee Report

Resource Allocation in the CGIAR - Does the Balancing Donor Concept Need Adjusting?

Attached is a paper entitled "Resource Allocation in the CGIAR - Does the Balancing Donor Concept Need Adjusting?" dated September 21, 1993 prepared by the CGIAR Secretariat. The document is transmitted as background material to the Finance Committee's Report, Agenda Item 4.

Attachment

Distribution

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From: CGIAR Secretariat

September 21, 1993

Resource Allocation in the CGIAR - Does the Balancing Donor Concept Need Adjusting?

To reconcile its donors' autonomous funding decisions with the System's collectively approved strategies and priorities, the CGIAR deploys a balancing facility which allots funds to centers to the extent they do not receive full funding for their approved core programs. Since the inception of the CGIAR, the balancing facility has been provided by the World Bank which makes its contribution available for this purpose without restrictions.

The balancing facility has served the CGIAR well by stabilizing the resource flows to the centers. In the past, in conditions of sufficient overall funding, the facility was able to fill funding gaps at individual centers, and thus allow the CGIAR to work as an integrated system. However, with funding stagnating or in decline, a larger number of sponsored centers and growing demand on center research, it has become increasingly difficult, or even impossible, to fill gaps. More importantly, however, by still attempting to do so, the facility may have discouraged resource mobilization efforts by individual centers, and contributed to the worsening resource malaise. Disincentives to fund-raising, latent when funding was plentiful, are increasingly felt as the System comes under financial stress. One of the undesirable consequences could be that in the current year the CGIAR will be unable to draw the full amount of the World Bank's contribution because of insufficient matching contributions from other donors.

To reduce the disincentives for fund-raising by individual centers, the paper recommends broadening the scope of interventions by the facility. After exploring various options the conclusion is that there appears to be a need for maintaining some contingency to fill funding gaps of individual centers and stabilizing resource flows in the short run. After meeting this need, the bulk of the resources could be distributed in two possible ways. The facility could apply its funds to match centers' successful efforts in raising core-funding in order to set a positive incentive to mobilize resources. Alternatively, the facility could continue to support the strategies and priorities endorsed by the Group but act as a "donor of first resort" instead of "donor of last resort" and provide a percentage of CGIAR approved requirements to all centers.

Next Steps

The Finance Committee is requested to consider the proposal to overhaul the current operation of the balancing facility. Earlier drafts of this paper have been shared with the Center Directors' Public Awareness and Resources Committee. The Center Directors as a group are likely to consider the proposals at their forthcoming meeting in October 1993 and advise the Finance Committee of their views.

Attachment

Distribution:

Chairman and Members of CGIAR Finance Committee
Chairman and Members of the CGIAR Oversight Committee
TAC Chairman and Secretariat
Center Directors

Resource Allocation in the CGIAR -

Does the Balancing Donor Concept Need Adjusting?

I. Introduction

1. The CGIAR supports its international research centers because coordinated and sustained agricultural research, undertaken internationally, will produce new production technologies, better policies and increased research capabilities which, in turn, will result in more, and more equitably distributed food for the developing world. To this end, the Group sets itself a common research strategy and priorities, and makes funding available for research that falls within these priorities.
2. The CGIAR could accomplish its purpose by pooling resources and distributing them among its centers and research activities through a centralized allocation mechanism. It has chosen not to do this, and instead has opted for a decentralized mode, which leaves both donors and centers maximum discretion: it is the prerogative of each individual donor to select centers and activities they want to support, while centers develop their research proposals and offer them for funding.
3. If the System worked like a stock or commodities exchange, with donors bidding for center programs they want to support, it would clear the market, and each center would find funding for all its research proposals. While in several respects the System resembles a market place, it is an imperfect one, with donors only morally committed to contribute funds to the System, and no pricing mechanism that would allow donors to bid according to expectations of returns or benefits they hope to derive from supporting one center and not supporting another.
4. To reconcile its donors' autonomous funding decisions with the System's collectively approved strategies and priorities, the System deploys a balancing mechanism (or balancing facility as it will be referred to in this paper) which allots funds to centers to the extent they do not receive full funding from other donors for their approved programs. Since the inception of the CGIAR, the balancing facility has been provided by the World Bank which makes its contribution available for this purpose. Because it provides funding where others don't, the Bank is frequently referred to as the System's "donor of last resort".
5. The balancing facility has served the CGIAR well as long as financial support for the CGIAR was strong and its funding on the increase. In conditions of sufficient overall funding, the facility was able to fill funding gaps at individual centers, and thus allow the CGIAR to work as an integrated system. However, with funding stagnating or in decline, a larger number of centers sponsored, and demand on center research growing, it becomes increasingly difficult, or even impossible, to fill gaps. More importantly, however, by still attempting to do so, the

facility may have discouraged resource mobilization efforts by individual centers, and contributed to the worsening resource malaise. Disincentives to fund-raising, latent when funding was less constrained, are increasingly felt as the System comes under financial stress. One of the undesirable consequences could be that in the current year the CGIAR will be unable to draw the full amount of the World Bank's contribution because of insufficient matching contributions from other donors.

6. The paper discusses the key principles under which the CGIAR currently operates (Section II), and describes the ways in which activities are programmed, resources allocated, and how both are reconciled (Section III). It then reviews incentives and disincentives for centers to mobilize resources as they are inherent to the balancing facility as it now operates (Section IV).

7. In order to strengthen incentives for fund-raising by individual centers, the paper recommends in its Section V to broaden the scope of interventions by the facility. Various options are explored, and summarized in tabular form in Annex I. There appears to be a need for maintaining some contingency to fill funding gaps of individual centers and to stabilize resource flows in the short run. For the remainder, the facility could apply part of its funds to match centers' successful efforts in raising core-funding in order to set a positive incentive to mobilize resources. Alternatively, the facility could support programs in accordance with the strategies and priorities endorsed by the Group by providing a fixed percentage of CGIAR approved center requirements as a "donor of first resort", providing funds to all centers in advance of commitments by other donors. A combination of gap-filling and up-front distribution (first-donor option) may be the most appropriate use of the facility in the current overall funding situation of the CGIAR.

II. Donor Autonomy, Center Independence, And A Common Research Agenda

8. As an informal association, the CGIAR brings together donors concerned with raising agricultural productivity in developing countries under sustainable conditions, and international research centers whose mandate it is to develop new technologies, policies and research capabilities to enhance agricultural production and productivity in those countries. The CGIAR is open to any government, agency or organization, public or private, that is willing to support its goals financially on a sustained basis. There are no legal or formal arrangements governing membership or burden-sharing among donors. The CGIAR operates on the basis of three key principles: (i) as a group it decides on a common strategy and a set of research priorities; (ii) the international research centers, as legally independent entities, develop and present their research proposals in accordance with the Group's overall strategy and priorities; (iii) the donors then fund directly, and independently from each other, research activities of individual centers of their choice, according to their foreign aid policies and priorities.

9. By limiting itself to setting a common strategic agenda, while leaving its funding and implementation to donor members and centers, the CGIAR would seem to have made an ingenious choice. Separating individual funding responsibilities from group decisions such as the choice of centers to be sponsored by the CGIAR, and research priorities to be supported, has greatly enhanced the Group's capacity to reach consensus, that in more structured organizations would require intricate and long negotiations. It also has allowed donors, individually or collectively, to draw advice from sources of their choice, be it the scientific community, the CGIAR Technical Advisory Committee, or the CGIAR Centers. It also has enabled the Group to function with minimal organizational infrastructure, mainly needed for monitoring the judicious allocation of funds among centers and their responsible use.

Setting the Common Agenda

10. As a group, the CGIAR has a dynamic, multi-year strategy and set of priorities, which it endorses upon recommendations from TAC. The Group's collective endorsement of the strategy and priorities does not constitute a binding commitment for individual donor members. It is, however, a relevant framework against which members can make their own program choices and resource allocations. For the centers, the CGIAR strategy and priorities provide the guideposts for formulating their program proposals, knowing that the degree of adherence of their proposals to the strategy and priorities enhances their acceptability to the CGIAR.

Donor Autonomy

11. Donor funds are not centrally pooled: each donor contributes to centers of its choice, and in the amount it wishes. This gives donors a measure of control over the use of funds; they can choose research activities consistent with their own developmental objectives and select the centers which in their perception contribute most effectively to their own policies and strategies. A close donor-center relation has become increasingly important as pressures on donor agencies grow to account for the use of taxpayers' funds. The high degree of donor discretion in allocating funds to individual centers and center programs may explain why CGIAR programs still received strong donor support after aid fatigue began to slow aid flows in the mid-eighties.

Center Independence

12. The centers formulate their research proposals and estimate their funding requirements. These are reviewed by TAC, consolidated and then presented to the CGIAR for approval. The aggregation of all center programs as endorsed by TAC and approved by the Group becomes the System's core program. Details on the planning and budgeting cycles are in para. 21.

13. Centers are free to suggest, and donors free to fund, center activities that build on the approved core program, have a high priority, but may not be international or strategic in nature, either because they are targeted at individual countries or have limited developmental goals, and therefore go beyond a center's primary mission. Such "complementary" programs offer a way for centers to augment their resources.

14. It is the primary responsibility of the individual centers to appeal for donor funding. This creates a competitive environment for center resource mobilization. Invariably, some centers will be seen by some donors as contributing more effectively than others to their own strategic concerns, and will be more successful in meeting their funding goals. Others who do not will depend more heavily on the balancing facility.

The Need For A Balancing Facility

15. The three mentioned principles - donor autonomy, center independence, and a common research agenda - will work in consonance only if the supply of funds matches the centers' demand, and donor preferences mirror center needs. With the degree of funding discretion the System leaves to donors, this is unlikely to happen. Despite the overall consensus established on strategies and priorities, some funding needs will always remain unmet.

16. Center independence and donor autonomy will thus not permit a coherent set of strategies and priorities to be implemented unless a "balancing facility" underwrites approved programs as a whole and meets requirements of individual centers' programs which remain unfunded after all donors have made their allocations to individual centers.

17. Since the inception of the CGIAR, the World Bank has provided this balancing facility by allowing its entire contribution to the CGIAR to be allocated in accordance with the priorities collectively approved by the CGIAR. World Bank funds are provided without restrictions as to their application to activities or to types of expenditure. Also, the World Bank has traditionally guaranteed to provide a set percentage -first 10, now 15 percent- of the System's total core funding needs. While critical to the overall operation of the system, this policy has allowed the Bank to leverage total funding and, at the same time, to support long term or new initiatives which may not, or not yet, be attractive to other donors. The contribution is managed and allocated on behalf of the World Bank by the CGIAR Secretariat.

III. Programming And Resource Allocation

18. A system that leaves as much autonomy as the CGIAR allows its donors and centers, invariably operates under a high degree of uncertainty. This is reflected in its programming and resource allocation procedures which are described in the following paragraphs.

19. Traditionally, the CGIAR has used a two-tier programming and resource allocation process: procedures applying to programs and activities endorsed by the CGIAR and constituting the "core" of the system and center programs, differ from those that apply to activities that are not part of, but complement, these core activities. These latter activities, mostly project based activities, allow centers to pursue new research opportunities and to mobilize funding outside traditional CGIAR allocation channels.

The Core Program and Its Funding

20. The core program includes a center's basic activities, i.e. activities that are considered vital to accomplishing its mission. In addition to actual research and research-related activities (such as training, information and communication services), the core program includes operation and maintenance of the physical plant and infrastructure, and the managerial and administrative services necessary for the efficient operation of a research organization.

21. Programming the core funding requirements involves the centers, TAC, the CGIAR Secretariat and the donors in a complex iterative process. Periodically (i.e., every five to ten years), the Centers prepare strategic plans in which the needs of center clients (their diverse partners in developing countries) as well as CGIAR strategies and priorities are reflected. Center strategies are presented for information to TAC and the CGIAR. In a next step, Centers prepare five year programs and budgets which translate their strategies into operational proposals, and constitute, in the aggregate, the medium-term program of the CGIAR; centers' five year plans are reviewed by TAC to ensure their consistency with system strategies and priorities. Subsequently, TAC submits a set of recommendations to the CGIAR which endorses it after review and discussion. Finally, centers prepare annual work programs and budgets which are reviewed by TAC for consistency with the approved five-year program, and for progress made towards achieving the system's medium-term strategies and priorities. Once approved by the CGIAR, the annual programs and budgets become the basis for the yearly allocation of funds by donors.

22. The actual allocation of funds to centers is the prerogative and responsibility of donors who allocate them to centers in accordance with their own policies and preferences. Normally, they "pledge" their contributions at ICW for the coming year.

23. Before and at ICW, the CGIAR secretariat attempts to relate pledges to aggregate demand, and informs the group and the centers of the outcome. Subsequently, it monitors funding as it becomes available, both at the aggregate level, and to individual centers. As other donors confirm their core contribution and allocate it to centers, the World Bank's contribution is applied by the Secretariat to balance the funding for the core programs. This is done based on a formula (see para. 32 below) and in several installments, as information on donor allocations becomes available. Allocations may have to be reversed if a donor makes a previously unannounced allocation to a center.

24. While donor pledges made at ICW are translated to funding decisions only over the course of the year, centers must decide at the beginning of the year, if not before, which programs to carry out and to what extent, with necessarily incomplete knowledge of the source and level of funding they will eventually receive. As funding pledges materialize centers need to continually adjust their operating programs to match donor commitments. Such adjustments are made difficult by the fact that part of core funds are restricted and can only be used for specified programs and activities.

25. Because it provides a secure back-up source of unrestricted funding, the balancing facility substantially aids center financial management.

Complementary Programs and Their Funding

26. In contrast to core programs, complementary programs are agreed between a donor and a center, outside the conceptual and procedural framework of the CGIAR. They are subject to only limited oversight from TAC which sees to it that they do not conflict with the objectives of core programs. Complementary activities are always financed outside the core program and the balancing facility.

Has the Two-Tiers System Outlived its Usefulness?

27. In the early years of the CGIAR, types of funding coincided broadly with the types of programs: core funding supported core programs, while complementary programs were financed from other than core funds. In recent years, however, the distinction has become blurred. As demand for center products and services grew, while core funding did not increase in step, new initiatives -even when they were clearly of a core program nature- were launched as special projects; for instance, most of the capital cost of the ICRISAT Sahelian Center was financed from non-core funds, as was IITA's biological control program. In some instances, funding agencies made it a condition that their contributions not be treated as core funding, out of concern that this would imply a commitment for continued support beyond the initially budgeted stage. In other cases, non-core funding has led to the creation of core programs, as activities originally conceived as complementary broadened into mainstream activities of a center.

28. What determines the nature of a contribution as "core" or "complementary" has thus become a matter of case law. It is now accepted that core activities can be funded from non-core funds. The CGIAR Secretariat currently reports as "core" all support of core programs, irrespective of whether they are provided as core-contributions or not.

29. Despite its apparent shortcomings, the CGIAR's two-tier system deserves to be maintained: it is the core program that allows collective decision making on goals and priorities, its monitoring and reviews, and thus forms the essence of the System. Allowing only one funding category to include all activities would not strengthen System cohesion. Because agreement by the Group would be required for every activity undertaken by a center, this would likely prevent the System from reaching agreement, or at best lead it to agree on the smallest common denominator. Put more pointedly, the fact that non-core activities are permitted and legitimate, allows the Group to act collectively. Preventing donors from funding activities outside approved core activities may prevent new research initiatives from being tried, very probably lead donors to seek investment opportunities outside the CGIAR, and thus close access to additional funding sources.

30. However, adjustments to the two-tiers system seem warranted, particularly in the way the balancing facility is operated, in order to minimize undesirable effects on resource allocation and mobilization. These will be examined in the following Section.

IV. The Balancing Facility

31. The balancing facility is operated in a mechanistic way; no value judgment or discretion enters into this process. Its resources are allocated among centers as a function of the difference between their approved core requirements and the funds made available by donors other than the World Bank. The objective is twofold: to bring core funding of all centers as close as possible to the CGIAR approved level of core funding requirements, i.e. gap-filling, and to assure stable resource flows in an environment of floating exchange rates. Since the actual amounts of donor contributions and their dollar equivalents are not known until late in the CGIAR's financial year, the exact amount payable by the balancing facility to individual centers normally cannot be determined until the last quarter of the year.

32. The Bank's contribution to any single center is limited to 25% of a center's approved core funding. After a center has reached it for three consecutive years, this maximum is reduced, in three equal steps to 15 percent over the subsequent three years. The purpose is to prevent a center from becoming too dependent on funding from the facility, soften the "distortion" of funding preferences expressed by donors, and provide an incentive to renew efforts at mobilizing funds from other sources.

33. Without a balancing facility which reconciles collectively approved funding requirements with actual funding made available by individual donors, the CGIAR could not operate as a cohesive, policy based research facilitator. In fact, if the balancing facility were to be discontinued, the CGIAR would turn into a loose association in which donors and centers would pursue their own interests with scant attention to common goals and strategies; it would no longer be a cohesive system. The question, therefore, is not whether the system could survive without a balancing facility, but rather whether the way the facility currently operates can be improved in order to correct some of the shortcomings identified below.

Advantages of the Current *Modus Operandi*

34. The current operating mode of the balancing facility has served the System well. Its provision has allowed centers to commit funds to research programs in the absence of firm donor commitments and thus permitted the orderly conduct of business. It has also provided some protection against unforeseeable events for which a center normally does not make provisions in its budget: e.g. it has compensated centers for exchange rate fluctuations that intervene between the time a donor pledges funds and disburses them. From time to time, it has also compensated centers (through a special stabilizing mechanism) for adverse movements in local purchasing power where they could be documented on the basis of reliable data. Thus, it has helped to stabilize the financial environment in which centers operate.

Drawbacks of the Current *Modus Operandi*

35. However, with core funding declining in both absolute and relative terms, the balancing facility as currently operated gives centers a false sense of security. It may also discourage centers that depend on the facility for an important share of their funding needs, from seeking alternative funding sources. These and other concerns will be explored in the following paragraphs.

36. The facility reduces the incentive for centers to mobilize additional core resources. If the sum of donor funding commitments to a center core program falls short of requirements, the facility will automatically provide the balance, if not for the totality, at least in part. For the center concerned there is thus little or no reason to try to mobilize resources to fill the gap. In fact, the facility can have the opposite effect: if a center succeeds in mobilizing additional core resources to fill its funding gap, its "entitlement" against the facility is reduced correspondingly, resulting in a zero-sum game for the center. By contrast, if a donor offers funding for a program or activity which is mutually defined as complementary -though it may be of a core nature- funding of such activity is additional to the center's total funding. From its narrower perspective, a center gains by transferring activities out of its core program to the complementary program; and donors may be willing to support such practices if the underlying activities are consistent with their own priorities which are not necessarily identical to those of

the system. It should be noted, however, that the system as a whole loses from this practice since the World Bank currently matches its contribution only against core funding, and not against funding provided for complementary activities.

37. The facility allows the CGIAR to defer hard decisions on whether to discontinue unpopular and ineffective programs. Because the CGIAR allows donors to allocate their funds to centers and programs of their choice, and not necessarily in line with the collectively approved program, there will be discrepancies between approved center funding requirements and funds made available to them. For legitimate reasons, a donor can decline to allocate funds to a core program, e.g. because of procedural restrictions internal to the donor, or incompatibility of a core program with a donor's short term priorities. However, if donors generally withhold support for a center or program, this is likely to signal a more serious problem, i.e. a basic discrepancy between a center's aspirations and donor preferences.^{1/} This has permitted donors to collectively approve an unattractive or ineffective center program, while individually denying it their support and leaving it to the charge of the balancing facility, rather than deciding collectively to discontinue such program.

38. Allocations by the facility may be perceived by donors as frustrating their own funding intentions. Assume a donor wishes to influence the overall thrust of a center's research program, and to that effect re-allocates restricted core resources from existing towards a new set of center activities. Since the balancing facility will support the center's unfunded activities, such support is likely to be viewed by that donor as foiling its efforts at re-directing center activities, thus depriving the donor of a sense of ownership and leverage.

39. The balancing facility tends to strain donor solidarity. For the CGIAR to function effectively as a system requires that donors contribute to the core program they collectively approved. If a donor fails to comply with this implicit understanding and primarily funds complementary programs, this will be offset, at least in part, by the balancing facility. Yet, donors who live up to the understanding and provide their share of support to core activities, may feel shortchanged by such practice. In their view, a donor who supports primarily complementary activities enjoys preferential treatment, operates outside the CGIAR framework, reaps the benefits of the System without bearing the cost, and, in short, receives a free ride. The balancing facility is seen as contributing to this.

Changing The *Modus Operandi*

40. All this suggests a need for adjusting the way in which the balancing facility is presently operated. However, before reviewing alternative options it is useful to define the criteria by which a preferred option could be selected. Six such criteria, which a modified allocation

^{1/} The longer such a discrepancy persists, the more important a factor the balancing facility becomes among a center's financial planning parameters; and, eventually, seeking additional funding for complementary activities becomes the only avenue for short term growth.

formula should meet in order to buttress the System's financial health and efficiency, and several options are presented in tabular form in Annex I, and reviewed in more detail below.

Criteria for a Modified Allocation Formula

41. Criterion # 1: The balancing facility should support the integrity of the CGIAR as a System by allowing the implementation of its collectively taken decisions, embodied in its strategies, priorities and center action plans. It should apply its funds to collectively approved core activities.

42. Criterion # 2: The balancing facility should endeavor to stabilize the flow of core funding by shielding centers from exogenous short-term effects for which they cannot make budgetary provisions, particularly sudden and unpredicted fluctuations in exchange rates, and losses in purchasing power in the host country.

43. Criterion # 3: To a reasonable extent, the facility should also protect the centers from endogenous factors, such as abrupt changes in donor allocations or the level of their contributions. Such changes are often driven by short-term considerations not compatible with the long-term nature of center research, e.g. a donor's desire for quick product delivery; a dislike for basic research, and for centers or center programs in their formative stages when results and returns cannot be assessed.

44. Criterion # 4: The facility ought to reward, or at least not penalize, centers which succeed in mobilizing additional core funds. This criterion needs to be qualified in two respects: First, an allocation formula which applied all or most of the funds in the facility for this purpose is likely to challenge and distort the System's integrity (criterion # 1). Second, such formula may not be easy to administer as it may be difficult in specific cases to determine the additionality of funds. If, for instance, a donor re-allocates core resources from one center to another, this should not trigger a reward from the facility for the beneficiary center.

45. Criterion # 5: The facility should continue to allow donors to directly influence center programs through their funding allocations. A close donor-center relationship imparts a sense of ownership important for a donors internal mobilization efforts.

46. Criterion # 6: The facility should be operated in a clear and transparent fashion, and on the basis of reliable, and generally available data. Recipient centers should be able to anticipate the outcome with a reasonable degree of accuracy. For instance, while exchange rate fluctuations can easily documented on the basis of IMF statistics, variations in dollar purchasing power in a host country which are not reflected in the exchange rate, can often not be documented. On these grounds, the facility should continue compensating for exchange rate fluctuations but normally not for losses of purchasing power not reflected in a host country's exchange rate (see para. 34 above).

47. Options to remedy some of the drawbacks of the current *modus operandi* basically fall into two broad categories: those which adjust the current allocation formula; and those which overhaul its operating procedures to better meet the criteria described above.

(1) Modifying the Current Allocation Formula

48. Under the current formula (para. 32 above) the facility funds up to 25 percent of the approved core program of a center; and under the tapering provision, if shortfalls remain at a high level, i.e. above 20 percent of the approved core program for more than three years, the balancing contribution is phased down to 15 percent over following three years.

49. This phasing-down will not correct the undesirable incentive to inflate complementary programs at the expense of core programs (para. 36 above). Because of the uncertainty over the amount eventually available from the facility, it also places a heavy burden on the centers' budget management and monitoring needs. And it delays the decision to deal with poor performers (para. 37 above).

50. Some of these drawbacks could be addressed with a "Fast Cutback Formula" which would, for instance, eliminate the three-year grace period, lower the maximum for which balancing is provided to, say, 10 percent of the approved program, and progressively penalize shortfalls above 10 percent (see example given in Annex II). Or a "Graduated Cutback Formula" could be considered which would result in less draconian reductions of funding from the facility. Unlike the "Fast Cutback Formula", it would apply the higher penalties only to the incremental shortfall. For a comparison of the effects of both formulas see Annex II.

51. Such formulas could be further tightened through sunset provisions which would require the CGIAR to rule on the fate of a center with insufficient donor support. For instance, if a center has mobilized less than 70% percent of its approved program for three consecutive years, donors would decide on whether the center should be dissolved or merged.

52. While such modifications will strengthen the incentive for centers to secure a higher share than the current 75 percent of core funding, centers with sufficient core funding will still want to maximize complementary funding because of its additionality. But more importantly, such modifications would severely limit the capacity of the facility to tide over a center during temporary funding shortages, and would increase the uncertainty with regard to a center's annual funding situation.

(2) Widening the Scope of Interventions of the Balancing Facility

53. Currently the balancing facility can only intervene by filling gaps in the approved core program of a center that remains unfunded. It does so by mechanically applying the described

formula. No discretionary judgment enters into the process. It may be more effective to allow the facility to use its funds, or at least some of its funds, on a matching basis, or as up-front support to be provided in accordance with the System's agreed priorities.

Matching

54. Using the balancing facility to match core-funding pledges a center has received would set a strong incentive for centers to mobilize core funds. If the entire 15 percent World Bank contribution were to be used for this purpose, a center would receive, for instance, 17.65 cents for every dollar of core resources mobilized.

55. A matching formula would be desirable for the following reasons: Because there would no longer be a funding guaranty for unfunded core expenses, it would discourage centers from seeking special projects financing in order not to lose their access to the facility; it would also encourage centers who previously neglected their fund raising needs on the expectation of their secure access to the balancing facility. Of course, if the World Bank contribution were to be used in its entirety for matching, this would deprive the System of the balancing feature, and with it of the capacity to function as an integrated funding entity. One would also have to be concerned that centers more favored with donor support, and more successful in their fund-raising efforts, may run up substantial surpluses in excess of their approved core funding requirements. Conceivably, such surpluses could be retained in the System for short-term bridging assistance to less fortunate centers, while a surplus center would receive a credit which it could use in years of need. The practical implications of administering such credit system would, however, seem to outweigh its possible benefits.

Up-front Support ("First-Donor Support")

56. Another possibility would be to apply the World Bank contribution in support of System priorities, thus giving the Bank the status of "first donor" rather than of "donor-of-last-resort". The World Bank contribution would then be allocated strictly in line with agreed priorities by applying a certain percentage to each approved core program. Assuming the entire World Bank contribution would be applied in this way, this would provide up to 15 cents for each dollar of approved core requirements.

57. This formula would present advantages: (a) by funding each component of the collectively agreed System priorities, it provides the effective support to the System; and (b) centers could count on these funds with certainty regarding the amount available from the facility. However, such a formula does not take into account the actual funding situation of each center and therefore can lead to over-funding as well as critical underfunding, leading ultimately to distortions of the collective decisions.

Combination Formulas

58. While all three types of intervention (the present gap-filling, matching, and up-front payments), if applied alone, would seem to have their drawbacks, there are options worth exploring which would combine elements of these.

59. In one combination, the facility would intervene by all three means described, i.e. provide balancing support to individual centers ("gap filling"), match core-donor contributions so as to offset the disincentive to obtaining core-funding observed in regard of the current balancing facility, and support CGIAR approved research activities through up-front payments. Since the incentive from matching and the disincentive provided by access for gap-filling could cancel each other out if available for the same year, the matching component could be paid in relation to core contributions obtained in the previous rather than in the current year. The incentive effect would not be diminished.

60. Such combined facility could allocate equal amounts for the three types of interventions, but other ratios could be considered. Thus one third of the World Bank contribution could be used for balancing center budgets, one third for up-front payments, and one third for matching. The application of penalty and sunset provisions discussed in para. 50 could be considered. The risk of some centers running up surpluses (observed in para. 55 above in case the whole World Bank contribution were used for matching), would be less of a concern; if they occurred they would be smaller.

61. Under another option the facility would meet gap-filling needs and at the same time distribute funds up-front. Several variants are possible. It could fill gaps opening in the current year, or, under a hybrid variety (because it would include a matching element along with gap-filling), would use as benchmark the average core funding a center has received over a period of, say, three years, and compensate for the difference between that average and the current year's requirements. This would even out shortfalls over a medium-term period and cushion sudden and steep reductions in core funding, but at the same time would provide an incentive (though not a very strong one) for a center to step up mobilization efforts in the year of funding contraction. Conversely, if funding has increased in the most recent year of the benchmark calculation, there would be little incentive to maintain a fund-raising drive, as any increment would result in the reduction of the payment from the facility. As a further variant, one could reserve a share of funds for up-front distribution, or to that end apply only the residual after all gap-filling needs have been met. However, unless the major share of funds is reserved for up-front distribution, any of these combinations is likely to discourage, or not sufficiently encourage core fund-raising efforts. In addition, their administration would be complex, and not meet the transparency requirement.

62. It may be more practical to combine up-front distribution with gap-filling. Since gap-filling can discourage fund-raising efforts, the larger share of funds in the facility should be applied to up-front distribution. The small portion available for gap-filling could tide over

centers which, due to donor actions or exchange rate fluctuations, have come under unexpected funding pressures. The facility could limit such bridging assistance to a maximum of 20 or 25 percent of a center's requirements, and not make it available to a center more than once in, say, three years. A formula combining these elements would appear to respond best to the needs of the CGIAR in its current funding situation.

63. The CGIAR Secretariat would continue to administer the facility on behalf of the World Bank. It would submit the proposed use of the funds available for balancing to the newly formed Finance Committee. This would allow donors to become aware of funding problems of individual centers and to suggest actions, for the current or a later budget year.

V. Conclusions And Recommendations

64. This paper has reviewed the working of the balancing facility currently provided in form of the World Bank contribution to the CGIAR. It has identified a number of disincentives that militate against fund raising efforts for core programs.

65. In order to compensate for these disincentives, it is recommended to broaden the scope of interventions of the facility. In addition to meeting funding shortages of individual centers (gap-filling) and with it providing some stability against surges in exchange rates and inflation which to date has been its only form of intervention, one should consider other alternative forms of intervention such as the use of its funds to reward successful fund raising efforts of individual centers (matching), and/or to directly support agreed priority activities ("first donor" or up-front distribution). A combination of gap-filling and up-front distribution may be the most appropriate use of the facility in the current overall funding situation of the CGIAR.

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Criteria for Choosing an Allocation Formula

	Criterion # 1 Does formula support "key principles" (collective agenda, autonomous center programming, individual donor allocations)?	Criterion # 2 Does formula shield centers from exogenous factors such as exchange rate fluctuations and purchasing power losses in host country	Criterion # 3 Does formula shield centers from System endogenous factors, such as sudden changes in donor contributions?	Criterion # 4 Does formula offer incentives for mobilizing funds additional to the System (not only to the individual center)	Criterion # 5 Does formula give donors a sense of ownership and constructive partnership?	Criterion # 6 Is formula simple and transparent?
Gap-filling						
Current Formula: compensates for shortfalls in core funding by providing up to 25% of donor approved amounts for three years, followed by three annual decreases to 21%, 18% and 15%	yes, it respects, and <i>indirectly</i> supports, collectively set priorities by making up for short-funding by other donors	disbursement in tranches permits adjustments	yes	no; provides disincentive to seek core funding above 75% of approved program. Declining support in years 4, 5 and six corrects disincentive in small degree	no; donors may see it as frustrating their own choices	requires pay-out in tranches as due amount not known until all donor contributions firmed up; available IMF data allow to compensate exchange rate fluctuations but <i>not</i> purchasing power losses in host country
Variation I - Fast Cutback: no grace period; penalty reduces support by 10% if shortfall exceeds 10% of approved core funding, and rises to maximum of 50% if shortfall exceeds 30%	same as above	same as above, though on reduced scale for centers more heavily dependent on facility	yes; though on reduced scale for centers more heavily dependent on facility	no; provides disincentive to seek core funding above 90% of approved program. Progressive penalty corrects disincentive effect as shortfall exceeds 10% threshold	yes; because of impact of penalty, and without grace period, risk of frustrating donor designs is much reduced	no; administration as complex, or even more so, than current formula.
Variation II - Graduated Cutback: same as Variation I, but higher penalties apply to incremental shortfall only	same as above	same as above	yes	no; same as above; because penalty less progressive,	no; same as above, though less severe penalty	no; same as above
Multi-year gap-filling would use as benchmark the average of previous three years' funding level	yes, as formula funds up to actual shortfall, though percentage of shortfall funded may differ substantially from one center to another (an acceptable consequence)	no; such factors would only be compensated for in the following year, and then only to the extent of one-third of their impact.	yes; would effectively protect against sudden funding shortfalls.	none for centers with stable of increasing core contributions; and a negative incentive for centers with declining contributions, as long as a year of high funding still enters into the calculation of the average.	no;	no; while average for past three years available, final allocation can only be determined once current year's shortfall is known

	Criterion # 1 Does formula support "key principles" (collective agenda, autonomous center programming, individual donor allocations)?	Criterion # 2 Does formula shield centers from exogenous factors such as exchange rate fluctuations and purchasing power losses in host country	Criterion # 3 Does formula shield centers from System endogenous factors, such as sudden changes in donor contributions?	Criterion # 4 Does formula offer incentives for mobilizing funds additional to the System (not only to the individual center)	Criterion # 5 Does formula give donors a sense of ownership and constructive partnership?	Criterion # 6 Is formula simple and transparent?
Matching						
against core contributions received in same year	no; on the contrary, it further distorts the funding discrepancies resulting from donor discretion in allocating their funds	no	no	yes	no	no; final allocation will have to await firming up of last donor commitments
against core contributions received in previous year	no; same as above	no	no	yes; one-year time lag unlikely to affect force of incentive	no	yes
Up-front distribution (first-donor option)	yes; in contrast to a gap-filling formula, it <i>directly</i> supports the collectively agreed priorities	no	no	no; but is incentive-neutral	no; but it does not interfere with their choices and preferences	yes
Combination formulas						
Matching + gap-filling matching would be effected against previous year's core contributions; a fixed share would be reserved for gap-filling	no; system supporting effect of gap-filling offset by matching	yes; but reduced as only part of facility available for gap-filling	yes, but reduced as only part of facility available for gap-filling	yes; as matching applies against prior year's contributions, its fund-raising incentive will not be offset by gap-filling disincentive	no	no; current year's donor commitments to be firmed up before gap-filling allocation can be made
Up-front distribution and gap-filling would set aside fixed shares for both purposes.	yes; would provide <i>direct</i> and <i>indirect</i> support	yes; but reduced as only part of facility available for gap-filling	yes, but reduced as only part of facility available for gap-filling	no; gap-filling component will provide disincentive	no	no; current year's donor commitments to be firmed up before gap-filling allocation can be made
Three-way combination (would combine elements of gap-filling, matching against prior year and up-front distribution in shares of one third each; other shares are possible)	yes; through up-front distribution and gap-filling	yes; through gap-filling	yes; through up-front distribution and gap-filling	yes; through matching component	up-front distribution and matching will not interfere with donor preferences	yes for up-front distribution and matching; no for gap-filling as current year's donor commitments to be awaited before gap-filling allocation can be made

Example of a Fast-Cutback Formula

If the shortfall in
approved core funding
amounts to

there will be a penalty of

< 10%	no penalty (balancing facility provides 100% of shortfall)
10-15%	10% penalty (balancing facility provides 90% of shortfall)
15-20%	20% penalty (balancing facility provides 80% of shortfall)
20-25%	30% penalty (balancing facility provides 70% of shortfall)
25-30%	40% penalty (balancing facility provides 60% of shortfall)
> 30%	50% penalty (balancing facility provides 50% of shortfall)

Comparison of Fast-Cutback and Graduated Cutback Formulas

Assume a shortfall of \$6.5 million on a \$20 million approved core program. The balancing facility would contribute under the

Fast-Cutback Formula

Graduated Cutback Formula

(higher penalty applies to increment only)

as shortfall exceeds 30%, maximum penalty of 50% applies	< 10%	100% of \$2.0 million	\$2.0 million
	10-15%	90% of \$1.0 million	\$0.9 million
	15-20%	80% of \$1.0 million	\$0.8 million
	20-25%	70% of \$1.0 million	\$0.7 million
	25-30%	60% of \$1.0 million	\$0.6 million
	> 30%	50% of \$0.5 million	\$0.25 million
\$3.25 million			\$5.25 million