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Using a Multidimensional Vulnerability Index in MDBs Rules

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Why?

- Vulnerability is a major obstacle to sustainable development
- Structural vulnerability = structural handicap → needs of concessional finance
- Current MDB responses useful, but fragmented, not transparent....
- ...and mainly ex post , implemented after shocks occur
- Need of a preventive approach to build resilience
- Prevention less costly than damages, aid more effective in vulnerable contexts

Which Rules?

- *Allocation* rules more important than rules of *eligibility* for concessional finance
- Eligibility rules can be improved thanks to the use of a VI combined with income pc (several options)
- Only through allocation the *different vulnerability levels of the countries* may be taken into account, and thus their *relative needs*, making the rules more equitable
- Since the common rule of allocation in MDBs is the PBA (various modalities), a VI is to be introduced in the PBA

From the PBA to a PVBA

- PBA = Performance-Based Allocation (used for decades), with
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  changing meaning of « performance » over time (aid effectiveness factor or incentive to adopt good policies)
- Measured by policy and institution indicators from CPIA
- Formula: Geometric (multiplicative, with an exponent for each variable): Ai = f[(performance, population, income pc (needs)]
- Adding vulnerability to better reflect needs leads to a PVBA, an allocation more equitable and resilient-focused

Which Vulnerability Index ?

- The relevant index for aid allocation should meet 3 conditions which UNGA MVI aimed to fill (as well as Commonwealth UVI)
- *Multidimensional*: economic, environmental, social/fragility
- *Universal*: relevant for various kinds of countries (LDCs, SIDS, …).
- *Exogenous*: structural, independent of present policy
- Principles on which MVI relies more important than its content
- MDBs may choose their own index, meeting same principles
- FERDI to release such an index, tailored to aid allocation

Implementation concerns (I)

- Feasible? Already done (EU, Caribbean DB, etc.)
- Possible negative impact on country ratings? No, would lead to more support/resilience for vulnerable countries
- Index avaibility and quality? MVI has proved that building relevant indices was possible according to agreed principles

Implementation concerns (II): Performance and Incentives

- Does adding a MVI reduce performance impact ?
- No, with present formula vulnerability and performance *reinforce each other* (vulnerability increases marginal impact of performance)
- Simulations (ADF) lead to reallocation within best performers, without a decrease of their share: incentives maintained
- No risk of wrong incentives (moral hazard):if structural index
- This can be enhanced by *adding resilience policy* into CPIA

Implementation concerns (III): detrimental to LICs and LDCs?

- Harmful to LICs/LDCs? No robust base to say that
- 1) Depends on the *weight given to income* pc in the formula
- 2) For a given weight, with the present formula *the lower the income pc , the higher the marginal impact of vulnerability*
- 3) It also depends on the VI: eg with FERDI's index higher *relative average of LDCs vulnerability* than with HLP MVI
- Finally no competition with highly vulnerable high-income countries because those are very small countries

Testing the Impact: A Key Step

- *Need of transparent simulations* to assess who gains or loses, relatively to the global envelope
- Maintaining absolute levels of relative losers possible with larger envelopes, less easy in the present context
- Requires an *independent assessment* led in cooperation with MDBs-and with specific simulations for each MDB, using *appropriate indices* of vulnerability