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FROM: Vice President and Secretary

**Linking IDA Support to Country Performance
Third Annual Report on IDA's Country Assessment and Allocation Process**

Attached is an information paper entitled "Linking IDA Support to Country Performance – Third Annual Report on IDA's Country Assessment and Allocation Process". As Executive Directors may recall, this is one of the annual reports required under the IDA12 Replenishment Agreement.

Questions on this document may be referred to Mr. Rajasingham (x32068) or Mr. Van Bolhuis (x33298).

Distribution:

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LINKING IDA SUPPORT TO COUNTRY PERFORMANCE

Third Annual Report on IDA's Country Assessment and Allocation Process

**International Development Association
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Acronyms and Abbreviations

ARPP	Annual Review on Portfolio Performance
CAS	Country Assistance Strategy
CPIA	Country Policy and Institutional Assessment
DRC	Democratic Republic of the Congo
ESW	Economic and Sector Work
GNI	Gross National Income
IDA	International Development Association
PBA	Performance-Based Allocation system
PCPA	Per Capita Per Annum
PR	IDA Country Performance Rating
PRSP	Poverty Reduction Strategy Paper
SDR	Special Drawing Right
TSS	Transitional Support Strategy

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1. The Role of Resource Allocation in Increasing Aid Effectiveness

1. IDA has seen a marked improvement in the quality of its portfolio since the mid-90's¹. Despite the growing complexity and more demanding nature of the development agenda, IDA's portfolio showed a sharp reduction in the projects at risk of not achieving their objectives. In the five years from FY96 to FY01, these fell from 28% to 13%². This improvement can be attributed to a number of factors, including:

- *enhanced modalities of IDA's lending operations* by sharpening country focus, centered on CASs developed with broad participation; tightening social and environmental project standards; improving fiduciary performance through country assessments of financial management and project procurement and fiduciary safeguards; and increasing efforts to link country efforts to key global challenges; and, especially
- *a better targeting of resources on countries with good policies*. IDA's funding has become increasingly well-targeted by using its Performance-based Allocation (PBA) system. Recent research on aid effectiveness shows that a typical dollar of IDA flows leads to an increase in gross investment of nearly two dollars, including in good policy environments about 60 cents of foreign direct investment. As a result, the overall return—in terms of the income growth spurred by IDA—may be as high as 40 percent³.

2. IDA's PBA system allocates its funds guided by its assessment of the quality of client countries' policies and institutions. This system has in fact become a standard setter for many multilateral and bilateral development agencies, even as the PBA system continues to incorporate new findings concerning its methodology and application. The partner agencies consult regularly with IDA on the latest methodological enhancements in its assessment system, as well as on the way this assessment is used in determining the country allocation.

3. IDA now reports annually on its PBA system's evolution and results. This is the third such report⁴. Section II presents the enhancements made in 2001 in the PBA system and the experience with implementing that system. Section III discusses the important role that IDA's PBA system will have to play as the development community focuses on aid effectiveness and measured outputs and outcomes in recipient countries.

2. Enhancing and Implementing IDA's Performance-Based Lending Framework

4. At the time of each triennial replenishment negotiation, IDA Deputies take stock of how well the system has performed and what enhancements ought be put in place. Thus the evolution of IDA's PBA system tends to advance in particular during the replenishment years. This was

¹ As measured by the Bank's independent Operations Evaluation Department

² *Annual Report on Portfolio Performance* FY01, World Bank Quality Assurance Group, Dec.2001

³ *The Role and Effectiveness of Development Assistance—Lessons from World Bank Experience*, World Bank, March 2002, p.xix

⁴ *IDA Country Performance Rating Process – Annual Report 1999—IDA/Sec 2000-58*, February 10, 2000 was the first report; and *Linking IDA Support to Country Performance—Recent Experience and Emerging Issues—IDA/SecM2001-0067*, January 30, 2001 was the second report.

the case in 1998, at the time of the IDA12 negotiations, when a set of enhancements were implemented including, in particular, steps to stress good governance. The changes in the system emanating from the IDA13 replenishment negotiations are reviewed in this section. Section 2.1 provides the highlights of how the PBA system evolved during 2001. Sections 2.2-2.7 present more detail on the 2001 enhancements and implementation results of the system⁵.

2.1 Highlights of the PBA System in 2001

5. Highlights of the PBA system's changes and results in 2001 are the following:

(i) the assessment process

- strengthened the Country Policy and Institutional Assessment (CPIA) process by providing specific definitions for all the rating levels of its 20 criteria (with indicators where possible)⁶, and requiring a written explanation for the criteria ratings;
- corrected for an upward bias in the portfolio rating; and
- provided incentives for good governance across the full spectrum of performance by replacing the governance discount by the governance factor. This eliminated a discontinuity in the assessment process and resulted in greater dispersion in the performance ratings⁷.

(ii) the allocation process:

- eliminated the discontinuity in the allocation formula by applying the same exponent to the performance score across the whole performance range;
- provided more explicit guidance on the increase of the high case over the base case envelope, reflecting improved performance as high-case triggers are met;
- developed a systematic methodology to guide IDA's funding response in post-conflict countries. The eligibility of Afghanistan, DRC, and Burundi for post-conflict allocations represented practical applications during 2001.
- increased the dispersion of country allocations. In 2001 the average allocation to countries in the top quintile was 4.7 times that of countries in the bottom quintile (this compares to a factor of 4.0 in 2000).

⁵ For an overview of IDA's current PBA system, including the enhancements agreed in the context of the IDA13 negotiations, see <http://www.worldbank.org/ida/IDAPerfaJan02.pdf>

⁶ See Annex I

⁷ In 2001 the average IDA Performance Rating of countries in the top quintile was 2.7 times that of countries in the bottom quintile (this compares to a factor of 2.1 in 2000).

2.2 Country Policy and Institutional Assessment

6. *CPIA Questionnaire*⁸. During the spring of 2001, the CPIA criteria (see [Annex 1](#)) and their definitions were subjected to a thorough review. This resulted in a number of enhancements⁹ including:

- the criteria were sharpened, especially with respect to public expenditures, financial management and procurement practices (criteria # 8,12 and 17);
- the question of crowding out development expenditures with nonproductive expenditures was incorporated in public expenditure reviews (criterion # 12);
- the alignment between the CPIA and the PRSP process was strengthened (criteria # 4,12, and 17); and
- definitions were provided for each rating level (increasing the objectivity of the exercise), while also making sure that those for high ratings were realistic.

7. *CPIA 2001 Ratings*. [Box 1](#) presents by quintiles the *overall 2001 CPIA ratings* for the rated IDA countries. The population-weighted average CPIA score was 3.40, practically unchanged from the average score in 2000 of 3.42, while the ratio of the average ratings of the top and bottom quintiles increased from 1.51 in 2000 to 1.71 in 2001. See [Annex 2](#) for the quintile-based information for each of the four CPIA clusters: Economic Management; Structural Policies; Policies for Social Inclusion/Equity; and Public Sector Management and Institutions.

Box 1 - 2001 Country Policy and Institutional Assessment (CPIA)	
First Quintile	Albania, Armenia, Bhutan, Cape Verde, Grenada, India, Maldives, Mauritania, Samoa, Senegal, Sri Lanka, St. Lucia, St. Vincent and the Grenadines, Tanzania, Uganda
Second Quintile	Benin, Bosnia and Herzegovina, Burkina Faso, Dominica, Ghana, Honduras, Lesotho, Madagascar, Malawi, Mozambique, Nepal, Rwanda, Pakistan, Vietnam, Zambia
Third Quintile	Azerbaijan, Bangladesh, Bolivia, Eritrea, Ethiopia, Georgia, Guyana, Indonesia, Kenya, Kirgыз Republic, Moldova, Mongolia, Nicaragua, The Gambia, Former Republic of Yugoslavia
Fourth Quintile	Cambodia, Cameroon, Chad, Comoros, Republic of Congo, Cote d'Ivoire, Djibouti, Guinea, Kiribati, Mali, Niger, Nigeria, Tonga, Vanuatu, Republic of Yemen
Fifth Quintile	Angola, Burundi, Central African Republic, Democratic Republic of Congo, Guinea-Bissau, Haiti, Lao PDR, Sao Tome and Principe, Sierra Leone, Solomon Islands, Sudan, Tajikistan, Togo, Uzbekistan, Zimbabwe
Countries not rated in CPIA 2001 exercise: Afghanistan, Liberia, Myanmar, Somalia	

⁸ For the complete 2001 CPIA questionnaire, see <http://www.worldbank.org/ida/cpiaq2001.pdf>

⁹ For a detailed summary see the IDA13 background paper *Status Report of the World Bank Working Group on CPIA 2001*, World Bank, May 17, 2001.

mid-point on governance will receive a discount. The design of the governance factor ensures a special focus on governance for IDA countries at *all* levels of governance performance. Experience with this new governance mechanism will be examined at the mid-term review of IDA13.

¹⁰ If a country scored poorly on at least 3 out of these 7 criteria, a discount of 1/3 was applied to the overall IDA rating.

¹¹ See [Annex 1](#)

