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PERFORMANCE-BASED ALLOCATION SYSTEM: A CRITICAL REVIEW OF THE CPIA

A DISCUSSION NOTE FOR AFRICAN GOVERNORS

OFFICES OF THE AFRICAN EXECUTIVE DIRECTORS
THE WORLD BANK GROUP
# Table of Contents

Executive Summary ........................................................................................................................................................................ iii

I. Background .......................................................................................................................................................................................... 1

II. Overview of the Performance-Based Allocation System ........................................................................................................ 1
   (i) *The Framework* ........................................................................................................................................................................ 1
   (ii) *Purpose of the CPIA* ......................................................................................................................................................... 1
   (iii) *Elements of the CPIA* ................................................................................................................................................... 2

III. Review of the PBA System during IDA16 and Beyond ..................................................................................................... 3

IV. Conclusion ..................................................................................................................................................................................... 5
Executive Summary

As innocent victims of food, fuel and financial crises, African countries warrant higher levels of grants and highly concessional funds to meet their essential spending needs, make progress toward the MDGs, and respond in a counter-cyclical way to the sputtering global economy without deepening their debt difficulties.

In light of the above, we welcome the review of the PBA formula as part of the IDA 16 replenishment negotiations. However, we acknowledge that what are being proposed for review are only short-term measures to improve the PBA. In the medium to long-term, IDA Deputies have to tackle the longstanding difficulties of the PBA formula, especially the CPIA.

As a principle, the outcome of the application of the PBA, of which the CPIA is one components, should result in increased resource flows to Africa, particularly to those countries with moderate CPIA scores that do not qualify for special allocations, for instance, for conflict-affected states. However, we recognize that the PBA is a zero sum game, which implies that its application could lead to gains for some African countries and to reduction for others. The only way to ensure that every African country is on the winning side is to increase the overall IDA envelop. In this connection, the IDA borrowers’ representatives could support the following key points during the discussions of IDA16 as short-term measures to improve the PBA system.

- measures proposed to strengthen support for fragile and conflict affected countries during IDA16;
- proposal to assist reengaging countries, for example, Sudan and Zimbabwe re-engage with the WBG;
- proposal for an extension of the phase-out period for assistance to conflict affected countries;
- modifying the requirements for IDA’s regional program to allow projects with only two countries (instead of three) when at least one of the countries is a conflict affected country;
- eliminating the per capita allocation ceiling and raising the base allocation to all countries from current SDR1.5 million to SDR 3.0 million to benefit small states and the proposal to relax or modify the three-country requirement for regional projects on the IDA regional financing window.

These steps are in the right direction, but more reforms are needed. In its current form, the PBA was designed in a way that places a large weight on performance relative to need in determining aid allocations. In measuring performance, it gives emphasis to those aspects of a country’s overall CPIA score which reflect the quality of its governance system. For these reasons, allocations of IDA resources to fragile states and conflict-affected countries are significantly lower than they would be if allocations were based only on need. At the same time, the two
measures of country need used in the PBA do not necessarily reflect the exceptional needs of fragile states in post-conflict reconstruction.

In the medium to long-term, we would like to see a PBA system that not only improves the relevance of the CPIA but also addresses the longstanding criticism regarding the objectivity of the CPIA formula. We are therefore advocating for reforms of the CPIA that contain the following key elements.

- Discontinue the use of CPIA overall index, but continue to produce the separate CPIA components to allow for country specificity;

- The weight of the Governance cluster should be reduced substantially as the current weighting punishes African countries and creates volatility in aid allocation;

- Given IDA’s mandate of fighting poverty, the CPIA formula should place a large weight on need rather than performance. The two measures of country need (population size and GNI) currently used in the PBA do not necessarily reflect the exceptional needs of fragile states and conflict-affected countries in post-conflict reconstruction;

- Increase the weight of Social Inclusion and Equity (cluster C) and add an assessment of other disadvantaged socio-economic groups. Only gender is currently being assessed with respect to equality, but according to IEG (2009), country evidence indicates that social exclusion of other marginalized groups have severe poverty and growth implications;

- CPIA formula should take into account vulnerabilities in order to capture structural bottlenecks to growth, in particular internal and external shocks and lack of human capital.
I. Background

African Ministers of Finance and Planning and Central Bank Governors met in Freetown, Sierra Leone, in August 2010 under the auspices of the African Caucus. The meeting was preceded by a seminar. One of the topics covered at the seminar was “Review of the Country Policy and Institutional Assessment (CPIA)”. After deliberating on this issue, the Ministers acknowledged the ongoing review of the CPIA by the World Bank and called for a process of structured discussions between IDA deputies, World Bank officials and Governors to review the CPIA methodology and implementation. The process was initiated during the second meeting of IDA 16 Deputies in Mali. To contribute to the review process, the Governors established a taskforce with the responsibility of coming up with a document to guide their engagement with the World Bank during the review process. This paper, intended for that purpose, highlights the general thrust of the PBA system with focus on the purpose and elements of the CPIA in the second section. Section III analyses the short-term review of the PBA system during IDA16 and pinpoints further reforms needed beyond IDA16 to improve the PBA system. The paper ends with a non-exhaustive list of issues that would guide Governors discussions.

II. Overview of the Performance-Based Allocation System

The World Bank allocates the bulk of its resources to IDA eligible countries using the PBA system. As background to the paper, this section describes the main steps in determining a country’s maximum resource allocation within the PBA framework, with the main focus on the CPIA.

(i) The Framework

The first step in determining a country’s maximum allocation within the PBA framework is to calculate the Country Performance Rating (CPR) index. The CPR combines the ratings for the four CPIA clusters with a measure assessing the performance of the World Bank projects in the respective country. In the second step, the CPR is combined with two country characteristic measures – “country population size” and “per capita income”. In addition, each IDA country receives a fixed minimum allocation, referred to as the base allocation, which is set at SDR1.5 million during IDA 15. Countries are rated on a scale of 1 to 6 based on the 16 criteria (see Box 1) and the results of the rating exercise are used to determine the maximum share of resources available to any given IDA country.

(ii) Purpose of the CPIA

The CPIA has been evolving since its introduction due either to change in the Bank’s thinking with respect to the development paradigm or to IDA negotiations, or both (IEG, 2009). The main factor determining a country’s IDA allocation is its performance in implementing policies that

1 Alexander 2010 states that the quality of Government Performance on IDA Projects refers primarily to the rate at which IDA financing is disbursed.
promote economic growth and poverty reduction, as measured by the Country Policy and Institutional Assessment (CPIA). The Bank uses the CPIA to assess the quality of a country’s present policy and institutional framework in fostering poverty reduction, sustainable growth and the effective use of development assistance\(^2\). In addition to determining IDA resource allocation, the CPIA also serves other Bank purposes. For example, the CPIA results serve as an input for Country Assistance Strategy (CAS); they also serve as input in the assessment of country portfolio risk and debt sustainability.

**(iii) Elements of the CPIA**

The most major restructuring of the CPIA occurred in 2004 based on the recommendation of an external panel review. As a result of this recommendation, the number of criteria was reduced from 20 to 16 criteria grouped into four plus one unambiguous (E) clusters as shown in Box 1. The criteria are weighted equally to derive the overall CPIA rating. The ratings are compiled annually in all countries by Bank country teams and then subjected to process of internal review.

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**Box 1: CPIA Clusters, Criteria and Assigned Weights**

A. Economic Management (Weighted 8%)
- 1. Macroeconomic Management
- 2. Fiscal Policy
- 3. Management of Public Debt

B. Structural Policy (Weighted 8%)
- 4. Trade Policy
- 5. Financial Sector
- 6. Business Regulatory Environment

C. Policies for Social Inclusion and Equity (Weighted 8%)
- 7. Gender Equality
- 8. Equity of Public Resource Use
- 9. Building Human Resources
- 10. Social Protection and Labor
- 11. Policies and Institutions for Environmental Sustainability

D. Public Sector Management and Institutions (Weighted 68%)
- 12. Property Rights and Rule-based Governance
- 13. Quality of Budgetary and Financial Management
- 14. Efficiency of Revenue Administration
- 15. Quality of Public Administration
- 16. Transparency, Accountability, and Corruption in the Public Sector

E. Country Portfolio Performance (Weighted 8%)

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In 2000, the Bank began disclosing the ratings, but only in aggregated format – countries were ranked and placed into one of five groups from best to worst, referred to as quintiles. In 2004, after calls from the Board and external review panel, the Bank management agreed to disclose the detailed score for the 2005 ranking. The ranking is particularly important as it plays a central role in the Bank’s allocation of grants and low interest loans to eligible IDA countries. Since the beginning of fiscal year 2009, the Bank has made transparent the weights of the clusters used in IDA allocation formula.

As shown in Box 1, the governance cluster has eight and a half times the weight of each of the other clusters in the formula. This has also made transparent the weak link between the overall CPIA index and IDA resource allocation, with a country’s governance performance relative to its performance in the other clusters being more important in the allocation of resources. A rethinking of assigning relative weights could prove useful and duly recognize progress in ongoing reforms in IDA countries.

While the IDA resources are allocated through the Performance-Based Allocation system, certain considerations have merited exceptions. First, the so-called blend countries receive smaller allocations than what the PBA formula would allocate to them due to their broader financing options, including access to IBRD resources. Second, countries re-emerging from conflict, and countries re-engaging with IDA after a period of absence are rated by a special instrument - the Post Conflict Performance Indicators (PCPI) - and they receive significantly higher allocation. Third, there is a provision for funding selected regional projects to promote regional integration, and fourth, resources can be provided in the aftermath of natural disasters when existing allocation does not allow for sufficient response. The scope of such assistance is however narrowly defined and limited to natural disaster-related incidents.

III. Review of the PBA System during IDA16 and Beyond

The PBA is under review as part of the current IDA16 replenishment negotiations. As a principle, the outcome of the application of the PBA, of which the CPIA is one of the components, should result in more resources to Africa. Africa should continue to receive at least 50 percent of IDA resources as in the past. However, we recognize that the PBA is a zero sum game, which implies that its application could lead to gains for some African countries and to reduction for others. The only way to ensure that every African country is on the winning side is to increase the overall IDA envelop. In this connection, the IDA borrowers’ representatives could specifically support the following points during the discussions of IDA16 as short-term measures to improve the PBA system:

- Proposal to assist reengaging countries, for example, Sudan and Zimbabwe re-engage with the WBG;
- Proposal for an extension of the phase-out period for assistance to conflict affected countries;
- Modifying the requirements for IDA’s regional program to allow projects with only two countries (instead of three) when at least one of the countries is a conflict affected country;
• Eliminating the per capita allocation ceiling and raising the base allocation to all countries from current SDR 1.5 million to SDR 3.0 million to benefit small states and the proposal to relax or modify the three-country requirement for regional projects on the IDA regional financing window;

• Low CPIA scores on the “Building Human Resources” and “Environmental Sustainability” Indicators should increase allocations, rather than decrease them as is the case currently;

• The “ease of hiring and firing” indicator should be eliminated as it is no longer consistent with Bank policy.

• Revamp macroeconomic management and fiscal policy criteria to support the goals of growth with equity, attainment of MDGs, heighten agricultural and manufacturing productivity, domestic resource mobilization, and environmental sustainability.

In the medium to long-term, we would like to see a PBA system that will not only improve the relevance of the CPIA but will also address the longstanding misunderstandings regarding the objectivity of the CPIA formula. The thrust of the ongoing debate is the need for a balanced allocation system that responds to country needs while at the same time promoting performance.

We are advocating for reforms of the CPIA that contain the following elements3.

• Discontinue the use of the overall CPIA index. The Bank should consider not producing an overall CPIA index. Instead, it should continue to produce and publish the separate CPIA components as this would allow for country specificity. Country specificity implies that the appropriate weights of the different clusters could differ depending on the country’s initial conditions and stage of development (IEG 2009);

• Given IDA’s mandate of fighting poverty, the CPIA formula should place a large weight on need rather than performance in order to tackle the roots of poverty and environmental degradation more comprehensively. The two measures of country need (population size and GNI) currently used in the PBA do not necessarily reflect the exceptional needs of fragile states and conflict-affected countries in post-conflict reconstruction;

• Revamp monetary policy criterion to support greater access by domestic firms and consumers to affordable credit for expanding production and employment; increasing the domestic tax base, and maintaining low real interest rates, rather than attempting to maintain low inflation with high interest rates which dampen aggregate demand and growth prospects.

• Eliminate any reference to specific tariff rates in the indicator. Instead, it should focus on exports, export diversification, and regional integration. In addition, given the weak demand in some Western countries, the CPIA should reward countries that increase the focus of their export strategies on intra-African trade and South-South trade. Finally, the

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3 This section draws from IEG (2009) and Alexander (2010)
assessment of trade policies should take into account inter-sectoral labor mobility and the distributive impact of policies.

- Reduce the weight of the governance cluster (cluster D) from 68 percent to 50 percent (the weight in the AfDB CPIA) or less of the CPIA score. The current weight might be excessive and lacks a clear analytical justification. It also punishes African countries and creates volatility in aid allocations. Reducing the weight would allow IDA to consider other factors for lagging governance performance, such as the need to achieve stronger human development.

- Increase the weight of social inclusion and equity (cluster C) and add an assessment of other disadvantaged socio-economic groups. Only gender is currently being assessed with respect to equality, but according to IEG (2009), country evidence indicates that social exclusion of other marginalized groups have severe poverty and growth implications.

- Ensure that CPIA formulae take into account vulnerabilities to external shocks and structural bottlenecks to growth, in particular lack of human capital which can result in low CPIA scores on governance and policy criteria.

IV Conclusion

The CPIA was designed to guide IDA resource allocation and to help improve policies and institutional performance. However, this process has been criticized in the way it is designed and applied. Moving forward, and giving the findings of many studies, several recommendations to improve the CPIA and the PBA have been advanced including the call for undertaking a thorough review of the CPIA and revising the criteria. Calls have been made for the trade criterion to be included as a sub-component taking into account country-specificity. The redistribution of weights, if they are to be used at all; and placing emphases where emphases are due lie at the root of the repeated calls. Introducing a number of reforms, as discussed above, would support the CPIA and the Performance-Base Allocation system reaching this original objective.

To situate governors’ discussion the following questions/issues could be considered:

- How objective is the approach used to arrive at the allocation formula, particularly the assigned weight?

- How flexible or adaptable is the CPIA to external shocks?

- Do countries with higher CPIA score achieve better development results than those with lower score? (In other words, is there a direct correlation between the CPIA score and development results?)
Attachment

The use of the CPIA as a mechanism for allocating resources to IDA countries was recently reviewed by the World Bank’s Independent Evaluation Group (IEG) (see IEG, June 2009). The IEG review assessed the appropriateness of the CPIA as an indicator of a country’s policies and institutions to fostering poverty reduction, sustainable growth and the effective use of development assistance. In the broadest terms, the IEG evaluation (see Attachment) made a number of observations including the following:

• There is little consensus on the impact of aid on growth and the conditions under which aid can have a positive impact on growth.

• There is insufficient evidence to conclude that the governance cluster associates better with loan performance than the other clusters. Based on this finding, as well as the lack of consensus on the conditions under which aid has an impact on growth, it can be surmised that the way the CPIA enters the formula for the allocation of IDA funds is driven much more by fiduciary and possibly other concerns of donors than by the objectives of achieving sustained growth and poverty reduction (IEG 2009).

• The trade criterion does not adequately allow for country specificity, nor does it reflect the importance of complementary institutions for successful liberalization. In this context, specification of particular tariff rates for different ratings reflects a one-size fit all approach to trade liberalization that is not supported by country experience. This raises concerns about whether the CPIA sufficiently takes into account the needs of very poor countries, and whether it includes sufficient flexibility for countries to pursue different development strategies.

• The CPIA is missing an assessment on disadvantage socioeconomic groups other than gender. Social exclusion of other marginalized groups could have severe poverty and growth implications.

• The CPIA has also been criticized for its complexity and lack of transparency. Alexander (2010) states that IDA resource allocation system is a complex process involving many factors. This complexity, and the fact that the CPIA is built on confidential data, makes it impossible for outsiders to verify the results.

• Another shortcoming of the CPIA pointed out by Alexander (2010) is that it does not adequately address issues that are vital to Africa’s future, including economic vulnerability to internal and external shocks, MDGs, agriculture, manufacturing and environmental challenges.
References


