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**IDA's Performance-Based Allocation System:  
A Review of the Governance Factor**

**International Development Association  
Resource Mobilization (FRM)**

**October 2006**

## **List of Abbreviations and Acronyms**

ARPP	Annual Review of Portfolio Performance
CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessments
CPAR	Country Procurement Assessment Reports
CPIA	Country Policy and Institutional Assessment
ESW	Economic and Sector Work
GMR	Global Monitoring Report
IRAI	IDA Resource Allocation Index
KK	Kaufmann-Kraay
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
OECD	Organization for Economic Co-operation and Development
OPCS	Operations Policy and Country Services
PBA	Performance-Based Allocation
PCPI	Post Conflict Progress Indicators
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PRSP	Poverty Reduction Strategy Paper
WBG	World Bank Group

## Table of Contents

Executive Summary .....	i
I. Introduction .....	1
II. A Summary of the IDA Resources Allocation Framework .....	1
III. IDA's PBA System .....	2
IV. Review of the Experience with the Governance Factor .....	7
A. Has the governance factor achieved its intended aims? .....	8
B. What impact does the governance factor have on the country performance ratings? ....	10
C. What are the implications of the 2006 GMR and the WBG governance strategy for the governance factor? .....	14
V. Summing up and Next Steps .....	18
 <u>Charts</u>	
Chart 1: IDA Country Performance Rating.....	3
Chart 2: Relation between Governance Quintiles and IDA Commitments.....	10
Chart 3: Relationship between Commitments and Governance – IDA12 vs. IDA13.....	10
Chart 4: Impact of the Governance Factor on Country Performance Ratings .....	12
 <u>Tables</u>	
Table 1: Estimated Shares in Total IDA14 Resource Envelope .....	2
Table 2: Country Performance Ratings with and without the Governance Factor .....	13
Table 3: Separating Governance and Policy Effects in Country Performance Ratings .....	13
Table 4: Governance Dimensions and the CPIA .....	15
Table 5: 2005 CPIA Guidepost Indicators .....	17
 <u>Text Boxes</u>	
Box 1: Revised CPIA Criteria.....	3
Box 2: Disclosure of Country Performance Assessments.....	5
Box 3: Specific Components of the Governance Factor .....	5
Box 4: How CPIA ratings are based on improved diagnostics .....	17
 <u>Annexes</u>	
Annex 1: Overview of IDA's Performance-Based Allocation System.....	20
Annex 2: CPIA Cluster D Questionnaire.....	23



# IDA's Performance-Based Allocation System: A Review of the Governance Factor

## Executive Summary

1. **Purpose.** Each year, IDA resources are allocated to partner countries based on the rules agreed upon during the replenishment discussions. Accordingly, a major portion of IDA's resources are allocated using IDA's Performance-Based Allocation (PBA) system. In this system, governance plays a major role. The stress on governance has evolved over the past decade and was put in place by donors because of its importance for improving the development performance of partner countries and for mitigating fiduciary risks to aid funds. During IDA13, a "governance factor"<sup>1</sup> was introduced into IDA's PBA system to strengthen the link between governance and IDA allocations. During the IDA14 replenishment negotiations, Deputies requested a review of IDA's "experience with the governance factor." This paper responds to that request.
2. **The governance factor.** The governance factor comprises five criteria drawn from the Country Policy and Institutional Assessment (CPIA)<sup>2</sup> and one criterion derived from the Bank's Annual Review of Portfolio Performance. These criteria attempt to measure public sector management and institutions in partner countries and are applied as a multiplier in the formula. Overall, because of the introduction of the governance factor in IDA13, the effective weight of governance in the country performance ratings (on which the PBA system rests) is around 66 percent.
3. **What does this review focus on?** This review of the governance factor examines three questions. *First*, did the governance factor achieve its intended aims of signaling the importance of governance in the Bank's operational work, making it a key element in country dialogue and directing scarce IDA resources to better-governed countries? *Second*, what impact did the governance factor have on country performance ratings and therefore on IDA allocations? *Third*, what are the implications of two recent governance-related Bank documents – the 2006 Global Monitoring Report (GMR) and the World Bank Group governance and anti-corruption strategy –for the governance factor? More specifically, does the governance factor capture the relevant dimensions of governance (for development performance and fiduciary reasons) when evaluated against the governance framework laid out the GMR? Is the governance strategy consistent with the governance factor (and more broadly the PBA system)?
4. **Main conclusions.** The review shows that the governance factor has signaled the importance of governance across the World Bank Group (WBG) for its operational work, made it a key element in country dialogue, and has resulted in more resources being directed to IDA countries with better governance. This review also finds that the introduction of the governance factor has increased the responsiveness of country performance ratings (and therefore IDA allocations) to changes in governance. It has also increased the dispersion of country performance ratings, thus accentuating the differences between strong and weak governance countries. At the same time,

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<sup>1</sup> The governance factor evaluates public sector management and institutions of client countries, and is applied as a multiplier in the formula.

<sup>2</sup> These assessments focus on four main areas: economic management, structural policies, policies for social inclusion/equity, and public sector management and institutions.

however, the governance factor has made the formula more complex and has contributed to volatility in IDA allocations.<sup>3</sup> In light of the governance framework developed in the 2006 GMR,<sup>4</sup> the review confirms that the CPIA cluster D<sup>5</sup> is a sound indicator for measuring governance in IDA's PBA system for the purpose of allocating resources. Finally, the review finds that the recent WBG governance and anti-corruption strategy<sup>6</sup> supports IDA's PBA system as the appropriate mechanism for governing IDA allocations.

5. *Next steps.* Management proposes that the IDA's PBA formula be simplified. The 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. Management also proposes that volatility of country performance ratings (which arises because of the way the formula is constructed) be mitigated in the formula. Part of this volatility comes from the governance factor, which was dealt with to some extent at the time of the IDA14 replenishment discussions. Another part of the volatility is caused by the portfolio performance ratings that feed into the PBA system (an issue not discussed in this paper).<sup>7</sup> Management proposes that issues related to volatility also be dealt with at the time of the simplification of the formula. If this is of interest to the Deputies, management will present options for simplification of the formula and reduction of volatility during the IDA15 replenishment discussions.

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<sup>3</sup> A part of this volatility was dealt with during IDA14 replenishment discussions by using a moving average of the procurement rating in the governance factor. See paragraph 24.

<sup>4</sup> World Bank (2006). Global Monitoring Report.

<sup>5</sup> Cluster D is a part of the CPIA, which assesses public sector management and institutions. This feeds into the calculation of the governance factor. See paragraph 9 for details of the specific aspects of governance assessed in the governance factor.

<sup>6</sup> World Bank Group (September 2006). "*Strengthening Bank Group Engagement on Governance and Anticorruption.*"

<sup>7</sup> Initially, management wanted to expand the scope of this paper to include a discussion of portfolio performance ratings and propose options for changes. However, for reasons described in footnote 37, a decision was made to postpone this discussion until the IDA15 replenishment discussions.

# IDA's Performance-Based Allocation System: A Review of the Governance Factor

## I. Introduction

1. **Background.** Over the past decade, donors have increasingly emphasized good governance<sup>8</sup> as a major factor in allocating IDA resources. This emphasis on governance is motivated by the fact that there is “strong evidence of a link between the quality of a country’s governance system and its development performance.”<sup>9</sup> Apart from development-related considerations, the emphasis on governance is also driven by the need to mitigate fiduciary and reputational risks to IDA funds posed by weak governance in IDA countries. Since good governance is broadly correlated with good policies, in emphasizing governance, donors also stress good socio-economic policies in the allocation of IDA resources.
2. **Purpose of this paper.** During IDA13, a “governance factor”<sup>10</sup> was introduced into IDA’s Performance-Based Allocation (PBA) system to strengthen the link between governance and IDA allocations. During the IDA14 replenishment negotiations, Deputies requested a review of IDA’s “experience with the governance factor.” This paper responds to that request.
3. **Layout.** This paper is structured as follows. Section II provides a context by describing the IDA resource allocation framework. Section III provides a short overview of IDA’s PBA system and describes the governance factor in detail. Section IV reviews IDA’s experience with the governance factor. Section V concludes with some recommendations. Annex 1 provides a detailed look at IDA’s PBA system. Annex 2 shows guidelines issued to Bank staff for rating cluster D in the CPIA.

## II. A Summary of the IDA Resource Allocation Framework

4. **IDA14 resource allocations.** IDA resources (or commitment authority)<sup>11</sup> are allocated in accordance to the rules agreed upon during the replenishment negotiations. Table 1 shows the estimated shares of IDA14 resources by usage categories. An estimated 62 percent of the total IDA14 resources will be allocated to *IDA countries* using the PBA system and will therefore

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<sup>8</sup> According to the Global Monitoring Report (2006), “Public sector governance refers to the way the state acquires and exercises the authority to provide and manage public goods and services – including both public capacities and public accountabilities. . . . [T]he relevant aspects of governance are those for achieving the Millennium Development Goals.” Pg. 124.

<sup>9</sup> The Global Monitoring Report (2006), Pg. 121. In addition, see D. Kaufmann (October 2006) in an article entitled “Human Rights, Governance, and Development” in *Development Outreach* (pg. 19), who points out that “success in socio-economic development is dependent in great measure on an environment where there is control of corruption, transparency, rule of law, and corporate ethics. Therefore, it requires *particular focus* [emphasis added] on governance and integrity issues.” In a World Bank Policy Research Working paper (February 2005, No.3524) entitled “Sowing and Reaping: Institutional Quality and Project Outcomes in Developing Countries,” Dollar and Levin examine microeconomic evidence on factors conducive to the success of aid-funded projects in developing countries. Using the success rate of World Bank financed projects in the 1990s (as defined by OED), the authors found a strong relationship between institutional quality and project success.

<sup>10</sup> The governance factor evaluates public sector management and institutions of partner countries, and is applied as a multiplier in the formula. The governance factor, introduced during IDA13, replaced the governance discount.

<sup>11</sup> Commitment authority depends on donor contributions and internal resources.

influenced by the governance factor (since it is one of the main components of the PBA system, see Section III). The remaining 38 percent of IDA14 resources are allocated on the basis of other rules agreed upon during the IDA14 negotiations: (a) around 20 percent is estimated to go to *creditworthy blend countries* (India, Indonesia and Pakistan), whose allocations are capped at levels well below what they would have otherwise received based on their performance and population;<sup>12</sup> (b) another 8 percent of the IDA14 resources are estimated to go for *special purposes* mentioned in Table 1; and (c) around 10 percent of IDA14 resources are estimated to go to *post-conflict countries*, whose performance is evaluated using Post-Conflict Progress Indicators (PCPI). It provides eligible countries some extra financial assistance for a limited period of time to support their recovery. Compared to regular IDA country allocations, the exceptional allocations to post-conflict countries are not as heavily influenced by governance. Recognizing the exceptional needs of these countries, (i) governance criteria are adapted to the circumstances prevalent in these countries and (ii) all dimensions of country performance – including governance – are weighted equally as there is no additional stress on governance through the governance factor. Annex 1 provides details on the exceptions to the PBA system which were agreed upon during the IDA14 replenishment negotiations.

**Table 1: Estimated shares in total IDA14 resource envelope**

	<b>Approximate shares in total IDA envelope</b>
Capped allocations to creditworthy-blend countries	20%
Special allocations (regional projects, arrears, tsunami, Iraq)	8%
Performance-based allocations	72%
<i>Of which:</i>	
<b>PBA-CPIA based</b>	<b>62%</b>
PBA-PCPI based	10%

### III. IDA’s PBA System

5. **The PBA system.** As mentioned in the previous section, IDA allocates a major part of its resources using the PBA system (see Annex 1 for an expanded overview of this system). This section sets the stage for this paper by providing a short description of the main components of the PBA system, with a special focus on the governance factor.

6. **The PBA system and the country performance ratings.** In the PBA system, the country performance ratings play a major role. Chart 1 shows the main components of the country performance ratings – the CPIA, the portfolio performance ratings and the governance factor. Each year, Bank country teams prepare CPIA ratings<sup>13</sup> for their respective countries, which assess the quality<sup>14</sup> of a country’s present policy and institutional framework (Box 1). Portfolio performance ratings, constructed from the Bank’s Annual Review of Portfolio Performance (ARPP), reflect the percentage of IDA-funded investment projects at risk in each country. The governance factor, calculated using parts of the CPIA and portfolio ratings, aims at assessing public sector

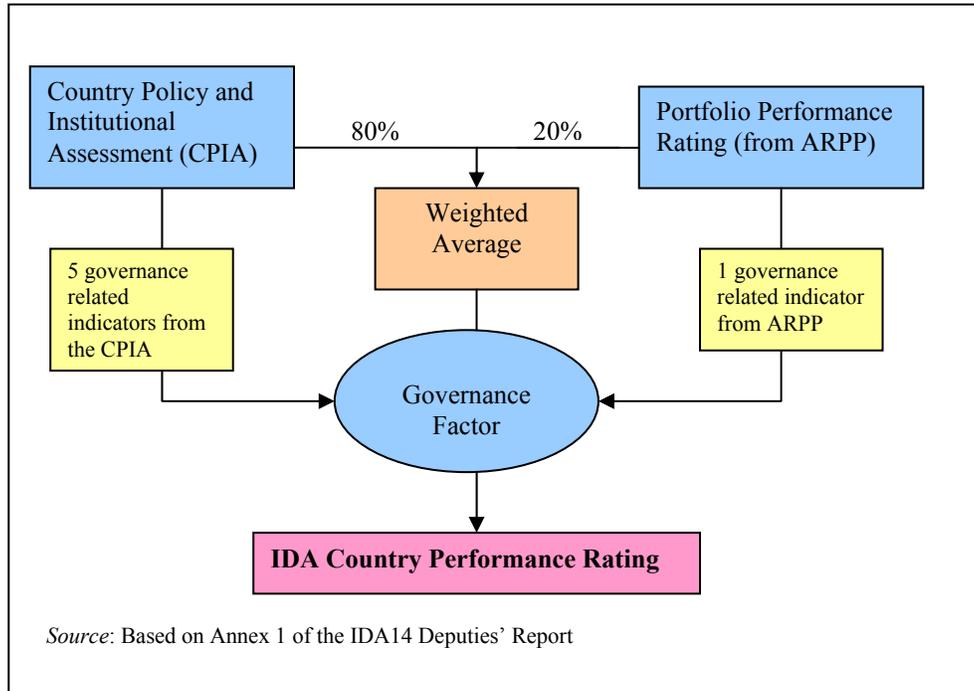
<sup>12</sup> If allocations to these countries with large populations were not capped, they would absorb more than two-thirds of IDA resources.

<sup>13</sup> Although the CPIA is initially prepared by Bank country teams, it undergoes an extensive Bank-wide review.

<sup>14</sup> “Quality” refers to how conducive that framework is to fostering poverty reduction, sustainable growth, and effective use of development assistance.

management and institutions in a country to make sure that IDA resources are being used well. The CPIA, portfolio and governance factor feed into the calculation of the country performance ratings and are now publicly disclosed by IDA (Box 2).

**Chart 1: IDA Country Performance Rating**



**Box 1: CPIA Criteria**

**A. Economic Management**

1. Macroeconomic Management
2. Fiscal Policy
3. Debt Policy

**B. Structural Policies**

4. Trade
5. Financial Sector
6. Business Regulatory Environment

**C. Policies for Social Inclusion**

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**

12. Property Rights and Rule-based Governance
13. Quality of Budgetary and Financial Management
14. Efficiency of Revenue Mobilization
15. Quality of Public Administration
16. Transparency, Accountability, and Corruption in the Public Sector

7. The equation for calculating the country performance ratings for each country is shown below. The weighted average of CPIA ratings (80 percent) and portfolio performance ratings (20 percent) is multiplied by the governance factor.

*Equation (1): Country performance rating formula*

$$\text{Country performance rating} = (0.8 \times \text{CPIA} + 0.2 \times \text{portfolio performance rating}) \times \text{governance factor}$$

8. **The governance factor.** As seen in equation (1), the governance factor is applied as a multiplier. It is made up of six criteria,<sup>15</sup> of which five are drawn from Cluster D of the CPIA ratings and the sixth from the ARPP. The governance factor for each country is calculated as follows:

*Equation (2): The Governance factor*

$$\text{Governance Factor} = (\text{average rating of 6 governance criteria} / 3.5)^{1.5}$$

The average rating is divided by 3.5, which is the mid-point of the CPIA scale, and then raised to an exponent of 1.5, forming the governance factor. So for governance scores below 3.5, the overall country performance rating is increased while for scores below 3.5, it is decreased.

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<sup>15</sup> The governance factor in IDA14 includes one less criterion than in IDA13. The omitted criterion is the result of the consolidation of the CPIA questionnaire in 2005, which reduced the number of criteria from 20 to 16.

### **Box 2: Disclosure of Country Performance Assessments**

**Why were the country performance scores disclosed?** Since CPIA and country performance ratings are crucial to the allocation of billions of dollars of scarce concessional resources from IDA, there was a growing sentiment among IDA's Board of Executive Directors in favor of disclosing them to the public. Ahead of the Board's decision to disclose the ratings, country authorities were consulted. Also in the run-up to the decision to disclose the ratings, an external panel<sup>16</sup> was assembled to review and recommend ways of strengthening the CPIA process and methodology. With these steps in place, the Board approved the disclosure policy on September 7, 2004.<sup>17</sup>

**What was disclosed and where?** For the first time, in June 2006, IDA disclosed the 2005 CPIA ratings<sup>18</sup> for all IDA-eligible countries (ratings of IBRD countries are not disclosed). The numerical scores for all 16 criteria that constitute the CPIA were disclosed as well.<sup>19</sup> In addition, IDA country performance ratings and its components (governance factor, portfolio ratings) were also disclosed. The tables were presented both in alphabetical order and ranked by performance. The information was placed on IDA's external website and was accompanied by a statement indicating that the ratings are a product of staff judgment and do not represent the views of the Board of Executive Directors or the countries they represent. To address possible questions that may arise, the ratings were accompanied by a list of frequently-asked-questions as well as a description of how IDA's resources are allocated.

**Donor Harmonization.** Disclosure of ratings in June 2006 was also preceded by extensive discussions with other Multilateral Development Banks (MDBs). Besides frequent one-on-one discussions between IDA staff and other MDBs, two technical workshops were held (January 2005 hosted by the Asian Development Bank and March 2006 hosted by the African Development Bank) to share experiences related to resource allocation systems as well as the disclosure of country performance ratings. At these workshops, MDBs shared their strategies on disclosure and discussed issues related to resource allocation. The next MDB workshop is scheduled to be hosted jointly by IDA and the Inter-American Development Bank in early 2007 and will discuss early experience with disclosure as part of its agenda. The disclosure of ratings will enable a better sharing of information among all development partners.

9. **What specific aspects of governance does the governance factor measure?** The six governance criteria that make up the governance factor are summarized in Box 3.

### **Box 3: Specific Components of the Governance Factor**

#### Country Policy and Institutional Assessment (CPIA) cluster D:

Q12. Property rights and rule-based governance

Q13. Quality of budgetary and financial management

Q14. Efficiency of revenue mobilization

Q15. Quality of public administration

Q16. Transparency, accountability, and corruption in the public sector

#### Annual Review of Portfolio Performance (ARPP):

Procurement flag

<sup>16</sup> World Bank (June 2004), "Country Policy and Institutional Assessments: An External Panel Review – Panel Recommendations and Management Follow-up," (SecM2004-0304).

<sup>17</sup> World Bank (September 2004), "Disclosing IDA Country Performance Ratings," IDA/R2004-0210.

<sup>18</sup> For the purpose of disclosure, CPIA ratings are renamed IDA Resource Allocation Index (IRAI) to underscore its role in the IDA resource allocation process.

<sup>19</sup> To ensure candor in assessments, the write-ups underpinning these ratings are not disclosed. They are, however, shared with the respective country authorities.

- *Cluster D of the CPIA assessment:* This cluster assesses the quality of a country’s public sector management and institutions. Annex 2 shows detailed guidelines provided to Bank staff to help them rate individual countries on each criteria on a scale of 1 to 6 and to ensure consistency of ratings across countries.
  - i. *Q12* rates the extent to which the legal system and rule-based governance structure facilitate private sector activity by enforcing property and contract rights and therefore captures elements of the investment climate directly relevant for measuring governance.
  - ii. *Q13* assesses the quality of budgetary and financial management across countries, which is crucial for the effective use of aid resources by partner countries, especially as more donors move towards increased policy-based lending.
  - iii. *Q14* evaluates the efficiency of revenue mobilization. As countries develop, internal revenues should increasingly be able to finance their public expenditures while decreasing their dependency on external aid.
  - iv. *Q15* rates the quality of public administration and shows the extent to which government staff (including teachers, health workers and police) are organized to design and implement government policy and deliver services effectively.
  - v. *Q16* measures two levels of accountability – first, the extent to which the executive is accountable for its use of funds and the results of its actions by the electorate, legislature and judiciary; and second, the extent to which public employees within the executive are required to account for the use of funds, their administrative decisions, and results obtained.
  
- *Procurement rating from the ARPP:* The procurement rating is based on the “procurement flag,” which is drawn from the ARPP. For an IDA project, the procurement flag measures the quality, reliability and transparency of procurement administration. The procurement flag is raised for a project when it is rated “marginally unsatisfactory” or worse. The percentage of IDA projects in a country’s portfolio with the procurement flag raised is converted into a procurement rating by using a conversion scale. However, it should be noted that when the procurement flag is raised for a project, it does not automatically signal misuse of resources – delays in implementation and reporting could also cause the procurement flag to be raised. Since IDA14, a three-year moving average of the procurement rating is used to calculate the governance factor.

10. ***Balancing country performance and needs.*** Finally, in addition to the country performance ratings (Equation 1), calculated as described above, IDA also uses measures of population and GNI per capita in allocating resources. Equation 3 shows that a country’s performance is the dominant determinant of IDA allocations – a score twice as high would result in four times the allocation, other things remaining constant. Population also affects allocations significantly – the relationship is linear whereby a higher population results in a proportionately increased allocation. Finally, although all IDA countries are poor, there is a modest bias towards countries with lower GNI per capita given IDA’s focus on poverty alleviation. In addition, each country also receives a minimum allocation. Other Multilateral Development Banks use similar PBA systems to allocate resources.

*Equation (3): PBA formula*

$$\text{IDA country allocation} = f(\text{Country performance rating}^{2.0}, \text{Population}^{1.0}, \text{GNI/capita}^{-0.125})$$

11. ***IDA allocations and commitments.*** The PBA system is used to allocate resources in advance of each fiscal year. Revising allocations every year based on the latest country performance assessments ensures that they are responsive to changes on the ground. However, IDA allocations are not entitlements. According to the current practice, Bank country teams could choose to commit amounts that are above or below the annual performance-based IDA allocations for operational reasons (e.g., infrastructure projects could be lumpy or projects are not ready in a timely manner). This front or back loading of IDA resources from year to year is regulated such that the total IDA commitments for the replenishment period as a whole are broadly consistent with a country's performance-based IDA allocation.

#### **IV. Review of the Experience with the Governance Factor**

12. ***Evolving role of governance.*** The weight of governance in the PBA formula evolved over time, reflecting donors' interest in signaling the importance of governance for development performance in partner countries and for mitigating fiduciary risks to IDA funds.<sup>20</sup> As section III shows, with the introduction of the governance factor, governance is double counted in the country performance ratings. It enters as part of the CPIA (where it has the same weight as other CPIA clusters) and also as part of the governance factor in an exponential manner. The term "effective weight" was introduced to measure how much a change in governance-related criteria affects country performance ratings compared to non-governance related criteria. These calculations show that the effective weight of governance in the country performance ratings formula is 66 percent.<sup>21</sup>

13. ***Structure of the review.*** Given the significant role of governance in driving IDA allocations, this paper reviews IDA's experience with the governance factor by examining the following questions:

- A. Has the introduction of the governance factor fulfilled its intended aims?
- B. What impact does the governance factor have on the country performance ratings, which mainly drive IDA allocations to countries?
- C. What do the two recent governance-related Bank documents – the 2006 GMR and the WBG governance strategy – imply for the governance factor? Specifically, in light of the governance monitoring framework laid out in the 2006 GMR, does the governance factor

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<sup>20</sup> Cluster D of the CPIA is correlated with the average of clusters A, B, and C suggesting that countries with better institutions also tend have better economic, structural and social policies and vice versa. From a practical standpoint, for the purpose of allocating scarce IDA resources, the weight on cluster D in the PBA formula is justifiable for several reasons. First, given the importance of governance for growth, the emphasis on governance in the PBA formula serves as an important signaling mechanism. Second, emphasis on cluster D is important for mitigating fiduciary and reputational risks to IDA. And finally, the correlation between clusters A, B and C is not perfect and therefore, if cluster D is not given more weight, more IDA resources would flow to countries with weak governance such as Cambodia, Chad, Haiti, and Lao PDR.

<sup>21</sup> Consolidation of CPIA criteria from 20 to 16 as recommended by the Expert Panel led to a drop in effective weight of governance from 68 percent to 66 percent. Despite this small drop, it is still higher than the effective weight of governance in the PBA systems of other Multilateral Development Banks.

still capture aspects of governance<sup>22</sup> which are relevant for improving the development performance in partner countries and for mitigating fiduciary risks? What does the recent WBG governance strategy imply for the governance factor and, more generally, for IDA's PBA system?

#### **A. Has the governance factor fulfilled its intended aims?**

14. ***IDA12 and the governance discount.*** During IDA12, Deputies introduced a governance *discount* to stress the importance of governance – if a country scored poorly (2.0 or lower) on at least three of seven governance criteria, a one-third discount was applied to the overall IDA rating.<sup>23</sup> If a country was subject to the governance discount, the link between country performance and allocation was such that its allocation could fall by as much as 50 percent. The governance discount had some drawbacks. First, it was discontinuous because it focused only on countries with very weak governance and did not apply to all countries. Second, small deteriorations in one of the criteria could trigger the governance discount (thereby halving allocations). This resulted in distortions in the rating process, by causing an upward pressure on the ratings at the cutoff point.

15. ***IDA13 and the governance factor.*** IDA Deputies requested that an alternative mechanism be explored that would “(a) provide as strong a signal effect regarding the importance of governance as the governance discount; (b) apply this signal to countries at all levels of governance performance; and (c) avoid the “discontinuity” effect at a particular level of governance.”<sup>24</sup> Therefore, during IDA13, the Deputies introduced a governance factor to strengthen the relationship between country performance ratings and governance. This was done by deliberately double counting the governance criteria in the formula – first in the CPIA ratings and then in the governance factor. In addition, the governance factor was applied equally to all IDA countries at all governance levels (not just the weak governance countries as in IDA12).

16. ***Intended aims of the governance factor.*** The governance factor was intended to address concerns with the governance discount while retaining some of its key objectives of “(i) signaling concerns about weak governance; (ii) making governance a key focus of country dialogue and policy reform; and (iii) sharply reducing the allocation of funds in cases of weak governance, where there was a significant risk that IDA resources would not be effectively used.”<sup>25</sup> This section examines whether the governance factor has achieved these objectives.

17. ***Signaling the importance of governance.*** With regard to points (i) and (ii) above in paragraph 16, over the past two IDA replenishment periods (from FY2000-05), IDA has indeed been intensifying its focus on governance. The greater attention to governance in the PBA formula comes at a time when governance is playing a bigger role in IDA's operational work.

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<sup>22</sup> As pointed out in the 2006 GMR, it must be noted that the term governance is complex to define and often difficult to measure. “While the word is often used as a euphemism for corruption, a country's governance system comprises the full array of state institutions and arrangements that shape the relations between state and society.” Pg. 123.

<sup>23</sup> The seven criteria included 6 from the old CPIA questionnaire (criteria 4 and 16-20) and the procurement process from the ARPP.

<sup>24</sup> IDA (2001), “*Enhancing IDA's Performance Based Allocation System*”, IDA, September 2001, pg. 4.

<sup>25</sup> IDA (2001), “*Enhancing IDA's Performance Based Allocation System*”, IDA, September 2001, pg. 4.

- a. *Poverty Reduction Strategy Papers (PRSP) and Country Assistance Strategies (CAS)*: CASs, which are aligned with PRSPs, are increasingly covering governance. President Wolfensohn set the stage for increased attention to governance within the World Bank in his landmark speech in 1996 on the “cancer of corruption.” Following this, the Board endorsed the Bank’s first anticorruption strategy in September 1997. Until then, the first CAS Retrospective (1998) found that “the majority of CASs had not considered governance issues or corruption as development challenges or areas for Bank involvement.”<sup>26</sup> This Retrospective recommended that corruption and governance “be addressed in CASs for those countries where they are important for country (development effectiveness) or Bank (fiduciary) reasons.”<sup>27</sup> The focus on governance within the Bank was further sharpened in 1999, when the Bank issued an Anticorruption Action Plan. As a result of these efforts, there was progress in mainstreaming the analysis of governance and corruption in the Bank’s work. As the second CAS Retrospective report (2000)<sup>28</sup> found, there was progress made in coverage (78 percent of CASs reviewed discussed governance and corruption issues) and in quality of diagnostics through the increased use of Bank country corruption and governance assessments.<sup>29</sup> The last available CAS Retrospective (2003)<sup>30</sup> mentions that all CASs discuss governance based on in-depth analytical work. The 2006 CAS guidelines reiterate the need for CASs to conduct “a careful diagnosis of governance conditions, including corruption and financial accountability issues, their impact on country strategy, and the risks they pose to Bank Group activities.”<sup>31</sup>
- b. *Lending*: IDA lending targeted to the “public sector governance and rule of law” theme has continued to represent an important share of total investment lending: 37 percent during IDA12 and 38 percent under IDA13.<sup>32</sup> Moreover, as pointed out in the Development Policy Lending Retrospective,<sup>33</sup> policy-based operations in IDA countries emphasize public sector governance in their conditionality. During FY05-06, 47 percent of conditions for policy-based operations for IDA countries were categorized thematically under “Public Sector Governance.”
- c. *Economic and Sector Work (ESW)*: The number of ESW relating to governance and underpinning CASs has increased in recent years. IDA Deputies specifically requested that efforts be made in this direction during the IDA13 period, when 36 Country Financial Accountability Assessments (CFAA), 33 Country Procurement Assessment Reports (CPAR), and 29 Public Expenditure Reviews (PER) were produced, more than half of which were for client countries in Africa. During IDA12, the corresponding figures were 21 CFAAs, 19 CPARs and 20 PERs. Additionally, there is a growing trend towards using recommendations from these diagnostic studies to inform CASs.

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<sup>26</sup> “Country Assistance Strategies: Retrospective and Outlook”, OPS March 1998, pg. 16

<sup>27</sup> Ibid., pg. 37.

<sup>28</sup> “Country Assistance Strategies: Retrospective and Implications”, OPCS, May 2000

<sup>29</sup> About one third of the CASs use information from CPARs, CFAAs, PERs, or ESW in their diagnosis of governance conditions and risks of corruption.

<sup>30</sup> “Country Assistance Strategies: Retrospective and Future Directions”, OPCS, March 2003

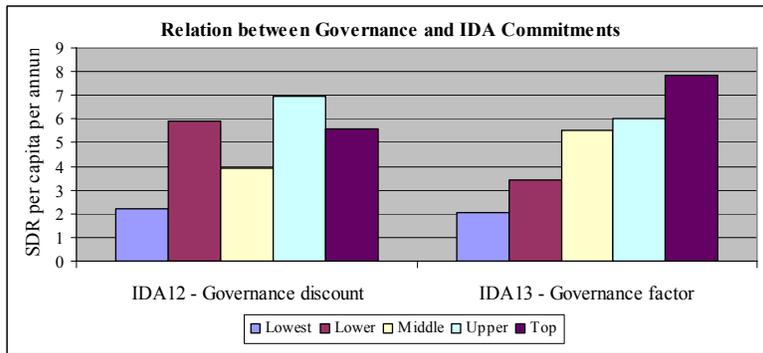
<sup>31</sup> World Bank (March 2006). “Guidelines to Staff for CAS products.”

<sup>32</sup> Source: Business Warehouse and Staff estimates.

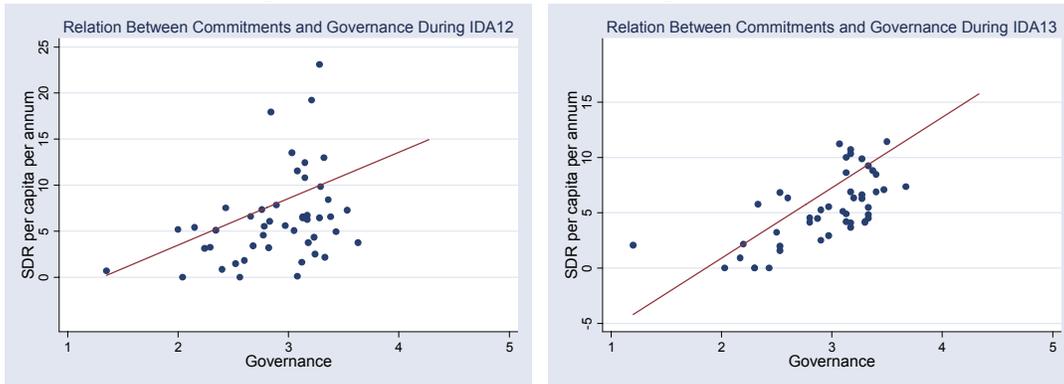
<sup>33</sup> “Development Policy Lending Retrospective”, OPCS, July 2006, pg. 18.

18. **Has the governance factor had the desired impact on IDA commitments?** With regard to (iii) in paragraph 16, in practice, the governance factor resulted in lower per capita IDA commitments in countries with weaker governance. Moreover, unlike IDA12, the governance factor in IDA13 strengthened the link between IDA commitments and governance, for countries at all levels of governance performance (see paragraph 15). Chart 2 relates resources per capita per annum (in SDR) to average governance performance as measured by the CPIA’s cluster D. It shows how commitments during IDA13 were effectively aligned with governance performance at all levels as compared to IDA12, when governance did not figure as prominently in the PBA formula (except for the lowest quintile). Chart 3 also shows that commitments have become more responsive to changes in governance: a given improvement in performance now translates into a more substantial increase in resources used.

**Chart 2: Relation between governance quintiles and IDA commitments**



**Chart 3: Relationship between commitments and governance<sup>34</sup> – IDA12 vs. IDA13**



**B. What impact does the governance factor have on the country performance ratings?**

19. **Impact on country performance ratings.** This section examines the impact of the governance factor on the IDA country performance ratings (and therefore on IDA allocations). Specifically, it looks at whether (i) the country performance ratings have become more responsive

<sup>34</sup> Linear approximations. Governance is measured by the CPIA’s cluster D. While governance has become the main determinant of IDA allocations, it should be noted that other elements of the PBA formula also contribute to final allocations. These are not shown in the charts.

to changes in governance and (ii) the dispersion<sup>35</sup> of country performance ratings has increased with the introduction of the governance factor.

20. ***Country performance ratings and governance.*** The governance factor has greatly increased the responsiveness of country performance ratings to changes in governance in two ways. First, there is a double counting of governance in the current country performance ratings formula through the CPIA governance cluster and the governance factor multiplier. Second, the governance factor is raised to the power of 1.5. The combination of these two features raises the effective weight of governance to 66 percent in the country performance rating, and establishes an exponential relationship between governance and country performance ratings. Consequently, any change to the governance factor rating is reflected more than proportionately in the country performance ratings.

21. ***More dispersed IDA country performance ratings.*** One of the reasons for introducing the governance factor was to increase dispersion of country performance ratings within the set of IDA countries to help differentiate more the allocated resources depending on the country's quality of governance. CPIA ratings – on which IDA country performance ratings are based – tend to cluster around the median rating. The introduction of the governance factor in the country performance ratings formula has accentuated the differences between worse performers and better ones. This is evidenced by the dispersion among country performance ratings, measured by the standard deviation across the subset of countries<sup>36</sup> for each year, which increased from 0.49 in FY02 to 0.93 in FY05. At the same time, the spread between the minimum and maximum country performance ratings in the subset of countries expanded from 1.98 and 4.50 in FY02 to 0.59 and 5.81 in FY05.

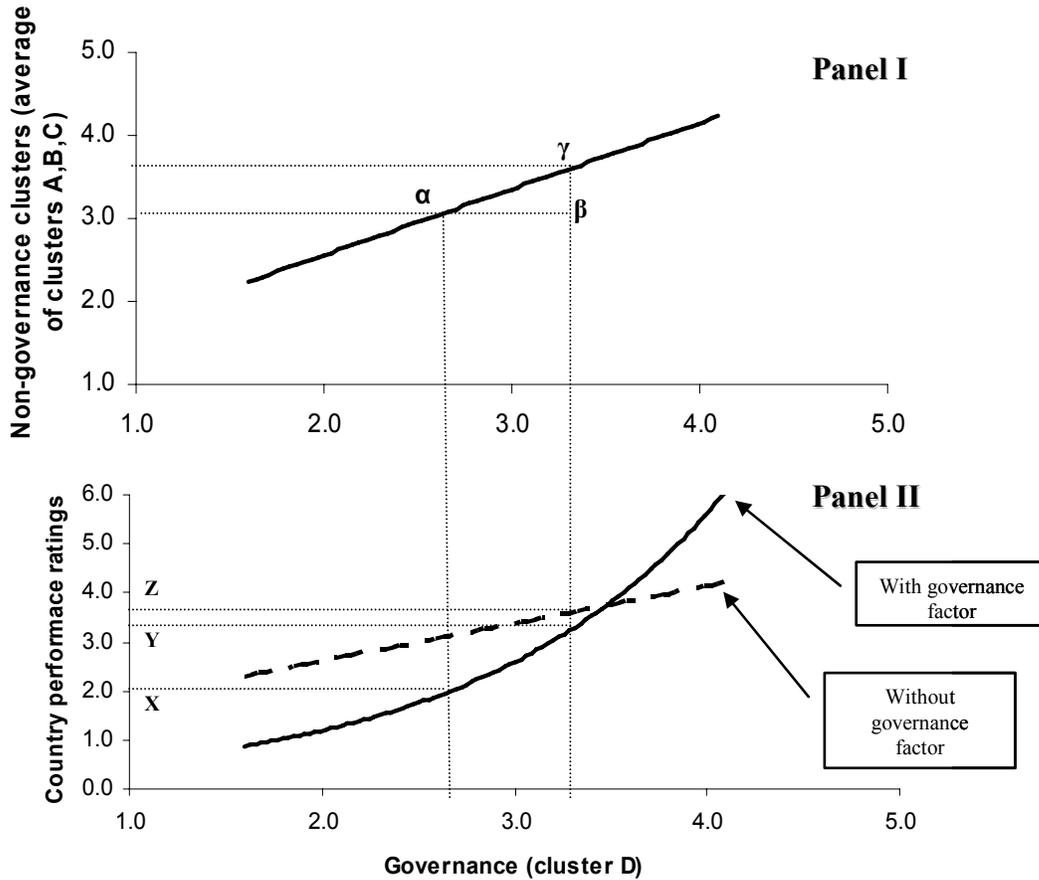
22. ***An example of how the governance factor affects country performance ratings.*** Chart 4 illustrates how changes in cluster D are amplified in country performance ratings because of the governance factor. In Panel I, a movement in CPIA rating from  $\alpha$  to  $\gamma$  can be broken down into a movement in cluster D from  $\alpha$  to  $\beta$  and in the non-governance clusters (average of A, B and C) from  $\beta$  to  $\gamma$ . Panel II shows that the same change in cluster D from  $\alpha$  to  $\beta$  has a larger impact on country performance ratings after the introduction of the governance factor. Without the governance factor, the country performance rating would move from Y to Z while with a governance factor it would move from X to Y.

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<sup>35</sup> Dispersion of country performance ratings ensures that the differences between countries with weaker and stronger governance performance are accentuated in order to direct more resources to the latter.

<sup>36</sup> This subset excludes capped countries, post conflict countries, inactive countries and countries for which there is no consistent data for the years considered.

**Chart 4: Impact of the Governance Factor on Country Performance Ratings**



23. Tables 2-3 underpin chart 4. Table 2 shows how country performance ratings change due to movements in CPIA clusters with and without the governance factor. In table 2, a change in CPIA rating from 3.0 to 3.6 can be broken down into movements in cluster D from 2.7 to 3.4 and in the average of clusters A, B and C from 3.1 to 3.7. The same change in cluster D has a bigger impact on country performance ratings in the presence of the governance factor (from 2.1 to 3.1) compared to when there is no governance factor (3.1 to 3.2). Adding in the movements due to non-governance clusters (A, B, and C) further increases the country performance ratings from 3.1 to 3.4 with the governance factor and from 3.2 to 3.6 without the governance factor. Table 3 separates the overall movement in country performance rating into changes due to governance and non-governance clusters; whereas a change in cluster D caused 28 percent of the improvement in country performance ratings calculated without the governance factor, the same change in cluster D is now responsible for 74 percent of the improvement in country performance ratings with the governance factor.

**Table 2: Country Performance Ratings With and Without the Governance Factor**

	Economic and social policies (average of clusters A, B, C)	Institutions (cluster D)	Overall CPIA	Country performance ratings with governance factor	Country performance ratings without governance factor
<b>Point <math>\alpha</math></b>	3.1	2.7	3.0	2.1	3.1
<b>Point <math>\beta</math></b>	3.1	3.4	3.2	3.1	3.2
<b>Point <math>\gamma</math></b>	3.7	3.4	3.6	3.4	3.6

**Table 3: Separating Governance and Policy Effects in Country Performance Ratings**

	Absolute change in country performance ratings with governance factor	Absolute change in country performance ratings without governance factor	Percentage change (Country performance ratings with governance factor)	Percentage change (Country performance ratings without governance factor)
Total Change in CPR ( $\alpha$ to $\gamma$ )	3.4-2.1= <b>1.3</b>	3.6-3.1= <b>0.5</b>	100%	100%
Governance ( $\alpha$ to $\beta$ )	3.1-2.1= <b>1.0</b>	3.2-3.1= <b>0.1</b>	74%	28%
Other Policy ( $\beta$ to $\gamma$ )	3.4-3.1= <b>0.3</b>	3.6-3.2= <b>0.4</b>	26%	72%

24. ***But volatility of country performance ratings has increased.***<sup>37</sup> The introduction of the governance factor has increased responsiveness of country performance ratings to governance and has also increased their dispersion. At the same time, as expected, it has contributed to increased year-to-year changes in the country performance ratings. While changes in governance now generate larger changes in country performance ratings, these are generally predictable because the formula is deterministic. However, among the components of the governance factor, the procurement ratings are more volatile than cluster D and are more difficult to predict.<sup>38</sup> Accordingly, in IDA14, a three-year moving average for the procurement ratings was introduced.<sup>39</sup> A simulation using data from FY03-07<sup>40</sup> shows that the median standard deviation of country

<sup>37</sup> Volatility in country performance ratings is also caused by the portfolio performance ratings (see Chart 1). Implementation experience has shown that the portfolio performance ratings are the most volatile component of country performance ratings. The conversion scale introduced at the beginning of IDA14 further exacerbated the volatility. Although the impact of the volatile portfolio performance ratings on the country performance ratings is mitigated because of their small effective weight in the formula relative to the other components (as opposed to the governance factor which magnifies small changes in underlying components), it remains a cause for concern. Initially, management wanted to expand the scope of this paper to include a discussion on proposed changes in the calculation of portfolio performance ratings. However, in the context of the 2006 ARPP, questions were raised on whether IDA allocations should be de-linked from the early risk warning system. Specifically, it meant that portfolio performance ratings should include only the percentage of actual problem projects in the portfolio (rather than percentage of actual problem projects plus potential problem projects). Pending the outcome of these discussions at the end of the year, management decided to postpone the discussion by Deputies on this topic until the first meeting of the IDA15 replenishment discussions.

<sup>38</sup> Whereas the five components of the governance factor are taken directly from cluster D, the procurement rating is derived from the ARPP using a more elaborate transformation process.

<sup>39</sup> IDA (September 2004). "IDA's Performance-Based Allocation System: IDA Rating Disclosure and Fine-tuning the Governance Factor."

<sup>40</sup> The subset of countries used to calculate volatility excludes post conflict, capped, and inactive countries.

performance ratings nearly doubled from 0.20 to 0.39 with the inclusion of the governance factor. Introducing a three year moving average for the procurement rating has reduced it to 0.28.

25. ***And 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.<sup>41</sup> 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.

### **C. What are the implications of the 2006 GMR and the WBG governance strategy for the governance factor?**

26. This sub-section reviews the governance factor in light of the 2006 GMR and the WBG governance strategy. What do these two developments imply for the governance factor and, more generally, for IDA's PBA system?

#### **The 2006 Global Monitoring Report**

27. ***A monitoring framework for governance.*** The 2006 GMR developed a “monitoring framework in the field of governance that is relevant for the scaling up of aid.”<sup>42</sup> In doing so, it identified relevant aspects of governance and reviewed available governance indicators (produced both within the Bank and outside) as well as measurement issues related to them. In light of the latest analytical insights provided by the 2006 GMR, does the governance factor (i) capture aspects of governance relevant for development effectiveness and for mitigating fiduciary risks, (ii) compare well with other indicators for the purpose of allocating aid, and (iii) incorporate good measurement practices?

28. ***Does the CPIA capture relevant governance dimensions?*** The GMR reviews governance monitoring indicators that have comprehensive country coverage and classifies these indicators based on three governance dimensions. According to the GMR, the CPIA – from which the governance factor is mainly derived – covers all three dimensions (Table 4).

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<sup>41</sup> Once PBA allocations are derived using the formula, additional layers of complexity are imposed by additional steps: (i) grants discounts and reallocations; (ii) the Multilateral Debt Relief Initiative (MDRI) netting-out mechanism and reallocations; and (if applicable), (iii) the free-rider policy.

<sup>42</sup> World Bank (2006). Global Monitoring Report Pg. 121.

**Table 4: Governance Dimensions and the CPIA**

<b>Governance Dimensions</b>	<b>Relevant CPIA Indicator</b> (Refer to Box 1 for description of the clusters)
<b>Overall governance performance</b>	
• Aggregate public institutions	Cluster D
• Policy outcome	Average of clusters A,B,C
<b>Bureaucratic capability</b>	
• Budget/financial management	Q13. Quality of Budget and Financial Management
• Public administration	Q15. Quality of Public Administration
<b>Checks and balances institutions</b>	
• Justice and the rule of law	Q12. Property rights and rule-based governance

29. *Is Cluster D a sound governance indicator for allocating aid?* To allow a ranking of countries for the purpose of distributing scarce IDA resources, a governance indicator should (a) be a broad measure of governance, which is useful in monitoring overall trends, (b) be able, at the same time, to identify specific strengths and weaknesses in detail, (c) cover the entire set of IDA countries and be assessed annually so as to be responsive to new developments (IDA resources are allocated yearly), (d) be unbiased with respect to the pool of countries it assesses, and (e) be transparent. Drawing on the GMR’s analysis of available indicators (and bearing in mind that all measures of governance are imperfect), cluster D has many of these characteristics and can therefore be seen as a sound indicator for allocating resources for the following reasons:

- a. *Balancing broad and specific measures:* As the simple average of the five governance-related questions, cluster D can be interpreted as a broad measure of governance. Such a measure can be used to distinguish between better and worse performers, and help identify trends across time. At the same time, it is a useful diagnostic tool for identifying specific areas of weaknesses that need to be addressed.<sup>43</sup>
- b. *Operational considerations:* It covers the full set of IDA countries and is revised annually to respond fairly quickly to changes on the ground. It is therefore, for most pragmatic reasons, a useful indicator for IDA because IDA allocations are made annually.
- c. *Comparable across countries:* It is generally comparable across countries. First of all, a number of countries within each region are chosen as benchmarks and carefully rated to provide relative guidance for their regional peers. Subsequently, CPIA ratings are subject to a careful Bank-wide review, during which networks weigh in on the ratings and suggest changes when necessary, based on their expertise.
- d. *Comparable over time:* It is generally comparable over time. When changes to the questionnaire have been introduced in the past, particular attention was always given to avoid disrupting the continuity across time by performing econometric and statistical simulations.<sup>44</sup>

<sup>43</sup> How these areas of weaknesses are actually addressed varies with country-specific conditions.

<sup>44</sup> See the Expert Panel Review cited in footnote 16.

- e. *Transparency*: It is becoming increasingly transparent. The CPIA questionnaire and resulting ratings divided by quintiles have been disclosed for a number of years already, and starting in FY06 all CPIA ratings and sub-ratings are publicly disclosed.
- f. *Dialogue with partner countries*: CPIA ratings are discussed with respective governments during preparation and after finalization. Therefore, the CPIA draws on an established country dialogue with the partner countries. Views are also exchanged with other Multilateral Development Banks.
- g. *Mitigates country bias*: Finally, it is assessed relative to a country's level of development.<sup>45</sup> This mitigates somewhat the country bias to which many governance indicators are subject to: expecting unduly high standards of governance, or rewarding one form of good governance over another.<sup>46</sup> If the CPIA did not mitigate this bias, less developed countries would consistently score lower, irrespective of the efforts made, and would thus consistently be allocated fewer aid resources.

30. ***Measurement has improved.*** Indicators measuring the quality of a country's institutions and institutional processes are subject to a margin of error and the CPIA is no exception. However, several steps have been taken to improve the measurement of the CPIA in general, and cluster D in particular. 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 of governance instead. Moreover, country teams have to provide written explanations that justify their ratings. Finally, the Bank-wide reviews of the regions' proposals have become more thorough. The networks perform more in-depth quantitative and qualitative analysis, often complemented by external indicators.<sup>47</sup> Table 5 provides a list of external indicators and diagnostics (Box 4) that are included in the IDA staff consideration while assessing Cluster D. In doing so, Cluster D also benefits from the advances made by other agencies in improving measurement of governance. Despite these measures, as with other governance indicators, CPIA is still subject to certain measurement errors.

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<sup>45</sup> "The criteria were developed to ensure that, to the extent possible, their contents are development neutral, that the higher scores do not set unduly demanding standards, and can be attained by a country that, given its stage of development, has a policy and institutional framework that strongly fosters growth and poverty reduction." World Bank (December 2005). "*Country Policy and Institutional Assessments: 2005 Assessment Questionnaire.*"

<sup>46</sup> OECD (2006). "Uses and Abuses of Governance Indicators." Pg. 71.

<sup>47</sup> The Bank uses all information at its disposal – internal and external – to rate the indicators. Based on these, Bank teams make informed judgment on the ratings that have to be justified with a narrative. Benchmarking and validation within central units remains a key part of the process.

**Table 5: 2005 CPIA Guidepost Indicators**

CPIA guidepost data	Cluster D
Investment Climate Surveys	Q12, Q14, Q15, Q16
Doing Business Indicators	Q12, Q13
Kaufmann - Kraay indicators (KK)	Q12, Q16
PFM assessments in HIPC countries	Q13
International Budget Project	Q13
Oxford Analytica Reports on Fiscal Transparency	Q13
Transparency International's Corruption Perception Index	Q16
Transparency International's Global Corruption Barometer	Q16
Reporters without Borders press freedoms index	Q16
Freedom House press freedoms index	Q16
Freedom House political liberties and civil liberties index	Q16

**Box 4: How CPIA ratings are based on improved diagnostics**

Bank country teams are increasingly relying on improved diagnostics within and outside the Bank to assign CPIA ratings. The example below, drawn from a country team's response to question 13 of CPIA for Country A, shows how they assess ratings based on specific information derived from the most recent Public Expenditure and Financial Accountability (PEFA) assessment. (See Annex 2 for specific issues that the question is expected to address.)

"Effective financial management systems = X. In 2 out of 3 years, budget out-turns were less than +/- 5 percent of the original budget, and the variance in the composition of expenditure out-turns additional to overall aggregate variance was 6.7 percent in 2002, 4.6 percent in 2003 and 3.9 percent in 2004 according to latest PEFA assessment of Dec. 2005 (suggesting rating of Y). Budget monitoring and control systems exist, but there are some deficiencies particularly regarding the control of expenditure commitments. Payment arrears are not a major issue; they are estimated at less than 2 percent of total expenditure, including late counterpart payments for projects (suggesting a rating of Z)."

**The WBG Governance and Anti-Corruption Strategy**

31. **Highlights of the WBG strategy.** The WBG governance and anti-corruption strategy<sup>48</sup> was discussed by the Bank's Board of Executive Directors in August 2006. The strategy aims at "developing capable and accountable states and institutions that can devise and implement sound policies, provide public services, and set the rules governing markets and control corruption, thereby helping to reduce poverty." In support of this goal, the WBG strategy delineates measures to be taken at the country, project and global levels. The WBG governance strategy comes at a time when other donors are also focusing on governance, given its centrality to growth and to minimizing fiduciary risks.<sup>49</sup>

<sup>48</sup> World Bank (September 2006). "Strengthening Bank Group Engagement on Governance and Anti-Corruption." SecM2006-0372/2.

<sup>49</sup> For instance, the European Commission has set aside €3 billion in the 10th European Development Fund to support countries that "have adopted or are ready to commit to a credible plan of concrete actions and reforms" in the field of governance ([http://www.europe-cares.org/africa/index\\_en.html](http://www.europe-cares.org/africa/index_en.html)). The U.K. has issued a White Paper that focuses primarily on governance and is planning to set up a £100 million Governance and Transparency Fund to strengthen civil society and the media, and therefore help citizens hold their governments to account. In addition, other agencies like USAID have published governance strategies.

32. ***An evolving WBG strategy.*** The WBG strategy will evolve based on experience and will build on government-led initiatives. Going forward, to identify ideas for implementation and to ensure a systematic approach to assessing governance, the WBG will consult partner countries, civil society, the private sector, and bilateral and multilateral donors. Meanwhile, further development and implementation of the WBG strategy will focus on bringing to the fore some good practice approaches and demonstration models that accord with the strategy (for example, strong country governance assessments, CASs with a governance theme, projects in different sectors with model anti-corruption plans, stepped-up governance engagement in high-opportunity countries) that will help make concrete the implications of the strategy to all stakeholders.

33. ***WBG Governance strategy and IDA's PBA system.*** The WBG strategy stresses that the PBA system continues to govern the allocation of IDA resources.<sup>50</sup> The weight of 66 percent given to governance in the PBA formula ensures that, all else constant, better-governed countries are allocated a higher per capita share of IDA resources. Moreover, since IDA allocations are revised each year based on the latest country performance assessments carried out by Bank country teams, upturns or downturns in governance are well reflected as changes in IDA allocations in a timely manner. As such, funding levels consistent with governance scenarios proposed in the strategy are built into IDA's PBA system. All countries are treated equitably because the same PBA formula is applied consistently to all countries and governance within this formula is assessed using the same criteria.<sup>51</sup>

34. ***Very exceptional deterioration in governance between assessments.*** In very exceptional cases, there may be a sharp deterioration of governance during the period between two annual country performance assessments. Under these circumstances, when IDA resources cannot be fully used in a productive manner by any Bank instrument, IDA commitments to the country could be lower than its performance-based allocation. In exceptional cases in the past, country teams chose not to commit their full performance-based allocations because conditions in the country (sometimes related to governance) would not ensure effective use of IDA resources. The WBG strategy will help systematize these choices by country teams by requiring CASs to spell out performance benchmarks to define circumstances under which IDA would move to a more restricted scenario. If country circumstances change in between PBA assessment periods in a way that was not foreseen even in the CAS and this warrants a shift in WBG approach, the Bank's governance strategy proposes that an appropriate document be presented to the Board for discussion.

## V. Summing up and Next Steps

35. ***Summing up.*** The introduction of the governance factor in country performance rating during IDA13 has coincided with increased attention being paid to governance by the Bank in all its operational work. Implementation of the PBA formula has ensured that more resources have been allocated and committed in better-governed countries. The review also finds that the inclusion of the governance factor has increased the responsiveness of country performance ratings (and therefore IDA allocations) to changes in governance. It has also increased the dispersion of country performance ratings, thus accentuating the differences between strong and weak governance countries. The 2006 GMR points out that the CPIA, on which the governance factor is based,

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<sup>50</sup> World Bank (September 2006), Pgs. 11 and 39.

<sup>51</sup> Recall that policies and institutions are assessed relative to a country's development.

broadly covers governance dimensions relevant for development effectiveness and fiduciary risk mitigation. It is found to be an appropriate indicator for the purpose of allocating IDA resources and its measurement is improving. In addition, the WBG governance strategy continues to regard IDA's PBA system as the appropriate mechanism for governing IDA allocations.

36. ***Next steps.*** Management expects that the prominence given to governance in the allocation of IDA resources will be maintained. Going forward, 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. Moreover, a simplified formula would better reflect the gains made in improving measurements of governance. Reducing the fluctuations in the formula's outcomes would make planning easier at the country level.

37. ***Possible areas for simplification and reducing volatility.*** In view of the discussion in this paper, one possible way to simplify the formula and to reduce volatility would be to *eliminate the double counting of governance* in the calculation of the country performance rating, while maintaining the current prominence given to it. Another possible area for modification to reduce volatility, discussed in footnote 37, 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.



## Annex 1: Overview of IDA's Performance-Based Allocation System

1. **Purpose of the annex.** This annex provides an overview of the PBA system and highlights the enhancements that were agreed upon during the IDA14 deliberations.<sup>52</sup>

<b>Box A1.1: CPIA Criteria</b>	
<b>A. Economic Management</b>	
1. Macroeconomic Management	
2. Fiscal Policy	
3. Debt Policy	
<b>B. Structural Policies</b>	
4. Trade	
5. Financial Sector	
6. Business Regulatory Environment	
<b>C. Policies for Social Inclusion</b>	
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	
<b>D. Public Sector Management and Institutions</b>	
12. Property Rights and Rule-based Governance	
13. Quality of Budgetary and Financial Management	
14. Efficiency of Revenue Mobilization	
15. Quality of Public Administration	
16. Transparency, Accountability, and Corruption in the Public Sector	

2. **Country Policy and Institutional Assessment (CPIA).** The performance of IDA countries is assessed annually using the CPIA. The CPIA assesses each IDA country's present policy and institutional framework for fostering poverty reduction, sustainable growth and ability to effectively use development assistance. The system has evolved over time and now comprises 16 criteria grouped in four equally weighted clusters: (i) economic management; (ii) structural policies; (iii) policies for social inclusion and equity; and (iv) public sector management and institutions (Box A1.1).<sup>53</sup> To ensure that ratings are consistent with performance within and across regions, (i) detailed questions and definitions are provided to country teams for each of the six rating levels for each of the 16 criteria; and (ii) an institution-wide process of rating and vetting a dozen 'benchmark' countries is carried out to anchor the ratings in all IDA regions. This is followed by a process of institutional review of all country ratings before they are finalized.

3. **Annual Review of Portfolio Performance (ARPP).** The CPIA underpins IDA's country performance ratings but is not its only determinant. To capture the important dimension of quality of development project and program management, the Bank's Annual Report on Portfolio Performance (ARPP) is used to determine a rating for each country's implementation performance. The portfolio ratings are based on the percentage of IDA funded projects in the country that are

<sup>52</sup> IDA (2005), "Additions to IDA Resources: Fourteenth Replenishment. Working together to Achieve the Millennium Development Goals."

<sup>53</sup> For the CPIA 2004 Questionnaire, see [www.worldbank.org/ida/pdf](http://www.worldbank.org/ida/pdf). There used to be 20 criteria; the reduction to 16 was based on a recommendation by the External Panel of Experts.

considered at risk. These percentages are translated into 1-6 scores with the help of a conversion table.<sup>54</sup>

4. **Governance factor.** The governance factor is derived from the five criteria in the CPIA's governance – or public sector management and institutions – cluster D, plus the three-year moving average of the procurement flag that is an element of the ARPP.<sup>55</sup> The average score of these six governance criteria is divided by 3.5, the mid-point of the 1-6 range, and an exponential of 1.5 is applied to this ratio:<sup>56</sup>

$$\text{Governance Factor} = (\text{average governance rating} / 3.5)^{1.5}$$

The country's overall rating is then multiplied by this factor, resulting in an increase or decrease of the overall IDA country performance ratings.

5. **Country performance ratings.** A weighted average rating is calculated of the CPIA (80 percent) and the portfolio rating (20 percent). In the second step, this composite rating is multiplied by the "governance factor" to produce the country's IDA country performance ratings (Chart 1).

6. **Balancing country performance and needs.** IDA's resources are allocated on the basis of the IDA country performance ratings (ensuring that good performers get a higher share of IDA's available resources), population, and GNI per capita:<sup>57</sup>

$$\text{IDA Country Allocation} = f(\text{Country Performance Ratings}^{2.0}, \text{Pop}^{1.0}, \text{GNI/Cap.}^{-0.125})$$

The formula shows that the country's policy and institutional performance is the dominant determinant (twice as high a score results in four times the allocation), while population also affects it significantly (the relationship is linear: a higher population results in a proportionally increased allocation). Finally, there is a modest bias in favor of the IDA eligible countries with a lower GNI per capita.<sup>58</sup>

7. **IDA allocations and Country Assistance Strategies (CAS).** The allocation norm establishes the financial resources available for each IDA country for a given year, and gives an indication of resource availability in the following year. The terms in effect for the allocation will be determined in accordance with the grant allocation system for IDA14. Country allocations vary over time with changes in a country's performance, as well as with changes in other countries' performance, changes in eligibility for IDA resources and for IDA grants, and overall IDA resource availability. The allocation norm is the basis for the financing scenarios set out in CASs or Transitional Support Strategies (TSSs).

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<sup>54</sup> The Conversion Table was amended during IDA14 to assure: (i) consistency with the new CPIA which now has definitions for each of the rating levels from 1-6; and (ii) alignment of the average ARPP ratings with that of the CPIA ratings by reducing the ARPP conversion scores.

<sup>55</sup> The moving average was introduced in 2004 to reduce unwarranted volatility of this governance indicator.

<sup>56</sup> Participants decided to maintain the 1.5 exponential of the governance factor. At the time of the mid-term review they will reflect on how this has affected the allocations at the country level, especially in the case of the strongest and weakest performing countries.

<sup>57</sup> For a more detailed specification of the IDA allocation formula.

<sup>58</sup> Poverty is heavily weighted in the allocation, since normally IDA eligibility requires that the country's per capita GNI is below the annually reviewed IDA operational cut off-level, which as of July 1, 2004, stands at \$895.

8. **Minimum allocation.** In addition to their performance-based allocations, all countries are allotted a basic allocation of SDR1.1 million per annum. In terms of per capita allocations, this benefits small states.

9. **Exceptions to the PBA system.** There are some considerations that merit exceptions to the allocation norms.

- First, capped blend countries with access, or potential access, to IBRD receive less than their allocation norms due to their broader financing options.
- Second, countries emerging from severe conflict can, under certain conditions, be provided with additional resources in support of their recovery and in recognition of a period of exceptional need. The special post-conflict allocations may be provided for up to four years, plus three years of phase down to the performance-based norm.<sup>59</sup> If such countries have large and protracted arrears to multilateral creditors, they may also be eligible for grant support in the pre-arrears clearance period.<sup>60</sup>
- Third, in cases where the existing allocation would not allow for a sufficient response, additional allocations may be provided to IDA countries in the aftermath of major natural disasters.
- Fourth, additional allocations may be provided on a one time basis to countries that are in the process of re-engaging with IDA after a prolonged period of inactivity on the basis of a strong transition plan with concerted donor support.<sup>61</sup> This exception will only be used after all other options have been exhausted, and its use is expected to be very limited in the IDA14 period. The level of resources made available will be less than what is typically provided under the post-conflict allocation system, and the duration of exceptional allocations will not exceed two years, with one further year's support possible subject to strong performance. The rationale for using this exception will be clearly presented in the TSS.
- Fifth, there is a special provision for selected regional integration projects. As a continuation of this pilot program which was started in IDA13, IDA14 envisages up to SDR300 million per annum of such projects, whereby SDR100 million is to be contributed from the participating countries' IDA allocations, and the balance from the special provision.

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<sup>59</sup> The duration of exceptional eligibility was lengthened following the review of the post-conflict allocation system at the IDA13 Mid-Term Review. At the same time, the post-conflict allocation norms were somewhat lowered so as to leave the overall extra post-conflict allocations unchanged. See *IDA's Performance-Based Allocation System: Current and Emerging Issues*, IDA/R2003-0203, October 24, 2003.

<sup>60</sup> This provision was first included in IDA12, and was kept unchanged in IDA13. The use of these grants is expected to be very limited, and must comply with the policy framework approved by IDA's Executive Directors in July 2001 for the provision of these grants.

<sup>61</sup> While these cases are rare, there are circumstances such as the recent Haiti transition where countries require exceptional assistance due to severe insecurity and the partial or total collapse of the state, but that are not eligible for IDA post-conflict assistance.



## Annex 2: CPIA Cluster D Questionnaire

### 12. Property Rights and Rule-based Governance

This criterion assesses the extent to which private economic activity is facilitated by an effective legal system and rule-based governance structure in which property and contract rights are reliably respected and enforced. Each of three dimensions should be rated separately: (a) legal basis for secure property and contract rights; (b) predictability, transparency, and impartiality of laws and regulations affecting economic activity, and their enforcement by the legal and judicial system; and (c) crime and violence as an impediment to economic activity. For the overall rating, these three dimensions should receive equal weighting.

**Note: As a criterion with multi-dimensions, a rating for each dimension should be provided in the write-up along with its justification.**

#### Guideposts:

PRMPS Governance Indicators (after opening the below link, click on CPIA Guidepost Data and see Guideposts for CPIA criterion 12):

<http://www-wbweb.worldbank.org/prem/prmps/publicsector/indicators.htm>

- 1**

  - a. Formal property rights are hardly recognized, and informal rights are seldom enforced. Formal contractual arrangements are little used. Manipulation of property and contract rights is endemic.
  - b. Laws and regulations are changed frequently, unpredictably and non-transparently to benefit a select few. The judiciary is an arm of the executive, and favoritism pervades the judicial system. Corruption in the judicial system is endemic. Judicial decisions are not publicly available.
  - c. The state is unable or unwilling to protect the lives and property of its citizens in most or all of its territory. The police are often a source of crime and violence against citizens.
- 2**

  - a. Enforcement of contracts and recognition of property rights depend largely on informal mechanisms. Property and contract rights are subject to manipulation by government officials or other elites.
  - b. Laws and regulations change unpredictably, for example through frequent and unpublicized executive decrees. Merit plays little or no role in judicial appointments. Laws and regulations are selectively enforced (e.g. against the political opposition), and their application and enforcement is regularly influenced by bribes. Judicial decisions are not publicly available.
  - c. The state is ineffectual in protecting citizens' lives and property against crime and violence in a significant part of its territory. Most victims do not bother to report crimes to the police.
- 3**

  - a. The law protects property rights in theory, but in fact registries and other institutions required to make this protection effective function poorly, making the protection of private property uncertain.
  - b. Laws and regulations are not changed arbitrarily, but may not be publicly available. Courts are costly and time-consuming to use. Delays are common, but generally are not pretext for bribes. Judicial decisions are sometimes publicly available.
  - c. The state is able to provide a modicum of protection against crime and violence. Most citizens view the police on balance as an impediment to crime and violence rather than a source.
- 4**

  - a. Property rights are protected in practice as well as theory. Contracts are enforced, but the process may be lengthy and expensive.
  - b. Laws and regulations are not changed arbitrarily, and are publicly available. Mechanisms exist to resolve conflicts of rules. Bribe-seeking by judges or clerks is rare. Courts may be costly and time-consuming to use, but judicial decisions are publicly available.
  - c. The state is able to protect the lives and property of most citizens from crime and violence most of the time. The police are generally trusted by citizens and viewed as reasonably honest and effective.
- 5**

  - a. All property rights are transparent and well protected. Property registries are current and non-corrupt. Contracts are routinely enforced.
  - b. Laws and regulations affecting businesses and individuals are determined through transparent political or administrative processes, and are publicly announced. Low-cost means are available for pursuing small claims. Application of laws and regulations is impartial and predictable. Citizens can pursue claims against the state without fear of retaliation.
  - c. A well-functioning and accountable police force protects citizens and their property from crime and violence. When serious crimes occur, they are generally reported to the police and investigated.
- 6**

Criteria for "5" on all four sub-ratings are fully met. There are no warning signs of possible deterioration, and there is widespread expectation of continued strong or improving performance.

### 13. Quality of Budgetary and Financial Management

This criterion assesses the extent to which there is: (a) a comprehensive and credible budget, linked to policy priorities; (b) effective financial management systems to ensure that the budget is implemented as intended in a controlled and predictable way; and (c) timely and accurate accounting and fiscal reporting, including timely and audited public accounts and effective arrangements for follow up. Each of these three dimensions should be rated separately. For the overall rating for this criterion, these three dimensions should receive equal weighting.

**Note: As a criterion with multi-dimensions, a rating for each dimension should be provided in the write-up along with its justification.**

#### Guideposts:

- [PEFA Performance Measurement Framework](#).
- Checklist of Budget/Financial Management Practices from Public Expenditure Management Handbook (see [Annex D](#)).
- IMF Code of Good Practices on Fiscal Transparency—Declaration on Principles at <http://www.imf.org/external/np/fad/trans/code.htm>
- PRMPS Governance Indicators (after opening the below link, click on CPIA Guidepost Data and see Guidepost for CPIA criterion 13):

<http://www-wbweb.worldbank.org/prem/prmps/publicsector/indicators.htm>

- 1
  - a. If there is a budget, it is not a meaningful instrument, nor an indicator of policies or tool for allocation of public resources. There is no forward look in the budget, nor any meaningful consultation with spending ministries. No consistent budget classification system is used. More than 50 percent of public resources from all sources do not flow through the budget.
  - b. Expenditures across broad budget categories have little or no relationship to the amounts budgeted. There is practically no monitoring and reporting of public expenditures. Payment arrears exceed 10% of total expenditures, or cannot be determined.
  - c. There is no reconciliation of cash accounts with fiscal records. No regular, in-year fiscal reports are produced. Public accounts are seldom prepared, or are more than five years out of date. The use of public resources is not on the public agenda.
- 2
  - a. There is no discernible link with government policies or priorities, and no forward look in the budget. The budget is formulated without meaningful consultation with spending ministries. No consistent budget classification system is in use. Significant fiscal operations (e.g., extra-budgetary expenditures and donor funded projects of 25-50 percent of total spending by value) are excluded from the budget.
  - b. Actual expenditures often deviate significantly from the amounts budgeted (e.g., by more than 30 percent overall or on many broad budget categories). There is no adequate system of budget reporting and monitoring. Payments arrears exceed 10% of total expenditures.
  - c. Reconciliation of banking and fiscal records is undertaken less frequently than monthly, and discrepancies are often left unexplained. In-year fiscal reports are largely useless, due to lengthy delays or inaccurate data. There are significant delays (more than three years) in the preparation of the public accounts. The accounts are not (professionally) audited or submitted to the legislature in a timely way, and no actions are taken on budget reports and audit findings.
- 3
  - a. Policies or priorities are explicit, but are not linked to the budget. There is no forward look in the budget. The budget is formulated in consultation with spending ministries. The budget classification system does not provide an adequate picture of general government activities. A significant amount of funds controlled by the executive is outside the budget (e.g., 10-25%), and a number of donor activities bypass the budget.
  - b. Expenditures deviate from the amounts budgeted by more than 20 percent overall, or on many broad budget categories. Budget monitoring and control systems are inadequate. Payment arrears are 5-10% of total expenditures.
  - c. Reconciliation of banking and fiscal records is undertaken less frequently than monthly, or discrepancies are not always accounted for. In-year budget reports are prepared quarterly less than 8 weeks after the end of the period, but their usefulness is undermined somewhat by inaccurate data or reporting only at high levels of aggregation. There are significant delays (e.g., more than 10 months) in the preparation of public accounts. Accounts are not audited in a timely and adequate way, and few if any actions are taken on budget reports and audit findings.
- 4
  - a. Policies and priorities are broadly reflected in the budget. Some elements of forward budget planning are in place. The budget is formulated in consultation with spending ministries, from a sufficiently early stage in the budget preparation process. The budget classification system is comprehensive, but different from international standards. Less than 10% of funds controlled by the executive are outside the budget.
  - b. Actual expenditures deviate from the amounts budgeted by more than 10 percent on many broad budget categories. Budget monitoring and control systems exist, but there are some deficiencies. Payment arrears may exist but are less than 5% of total expenditures.
  - c. Reconciliation of banking and fiscal records is undertaken satisfactorily, on a monthly basis. In-year budget reports are prepared quarterly less than 6 weeks after the end of the period, with reasonably accurate data, broken down to at least program or functional level. There are delays (e.g., more than 6 months) in preparation of the public accounts. The accounts are audited in a timely and professional manner, but few meaningful actions are taken on budget reports or audit findings.
- 5
  - a. Policies and priorities are linked to the budget. Multi-year expenditure projections are integrated into the budget formulation process, and reflect explicit costing of the implications of new policy initiatives. The budget is formulated through systematic consultations with spending ministries and the legislature, adhering to a fixed budget calendar. The budget classification system is comprehensive and consistent with international standards. Off-budget expenditures are minimal, and transparent.
  - b. The budget is implemented as planned, and actual expenditures deviate only slightly from planned levels.

(by less than 10 percent on most broad categories). Budget monitoring occurs throughout the year based on well functioning management information systems. Payment arrears are negligible or non-existent.

- c. Reconciliation of banking and fiscal records is practiced comprehensively, properly, and in a timely way (daily or weekly). In-year fiscal reports are prepared at least quarterly, issued within 4 weeks of end of period, and provide accurate data on all budget items, with coverage of expenditures at both the commitment and payment stages. The public accounts are prepared within 6 months of the end of the fiscal year, and include full information on revenue, expenditure, and financial assets and liabilities. Accounts are audited in a timely, professional and comprehensive manner, and appropriate action is taken on budget reports and audit findings.
6. Criteria for “5” on all three sub-ratings are fully met. In addition:
- a. Budget supporting documents are submitted to the legislature, with the annual budget, with information on macroeconomic assumptions, estimates of budgetary impact of major revenue and expenditure policy changes, and comparisons to previous budget outturns or estimated outturns.
  - b. Funds available to spending agencies or ministries are highly predictable within the budget year. In-year adjustments are infrequent, follow pre-specified guidelines, and are consistent with stated priorities.
  - c. The public has timely and inexpensive access to annual budget documentation, in-year and year-end reports, and external audit reports.

#### **14. Efficiency of Revenue Mobilization**

This criterion assesses the overall pattern of revenue mobilization--not only the tax structure as it exists on paper, but revenue from all sources as they are actually collected. Separate sub-ratings should be provided for (a) tax policy and; (b) tax administration. For the overall rating, these two dimensions should receive equal weighting.

**Note: As a criterion with multi-dimensions, a rating for each dimension should be provided in the write-up along with its justification.**

#### **Guideposts:**

- WDI Table 5.6 on Tax Policies:

[Click here for WDI Tables and then select Section 5 – States and Markets](#)

- PRMPS Governance Indicators (after opening the below link, click on CPIA Guidepost Data and see Guidepost for CPIA criterion 14):

<http://www-wbweb.worldbank.org/prem/prmps/publicsector/indicators.htm>

- 1** a. Tax base is extremely narrow with many open-ended exemptions. Most tax revenues are collected from foreign trade and other distortionary taxes. There are high, multiple, and widely ranged import tariffs, which change frequently or are applied in a highly discretionary manner. Little is collected from income taxes.

b. Tax administration is extremely weak, with very low collection rates. It is organized by type of tax and business processes have not been reviewed and reformed. Computerization is limited to very basic functions. Many taxpayers must make several or more personal visits to tax offices. Corruption is endemic among tax and customs officials.
- 2** a. Tax system is poorly designed, with a narrow base and many open-ended exemptions. Taxes on foreign trade, turnover taxes and other distortionary taxes are the dominant source of revenue. There are high and multiple import tariffs. Both company and personal income taxes have high rates on a very narrow base and generate little revenue.

b. Tax administration is weak due to complex laws, poor information systems, corruption, weak capacity and political interference. Collection rates are low. Tax obligations are negotiable rather than rule-based. Appeals and other dispute resolution mechanisms have not been developed.
- 3** a. Taxes on trade are the dominant source of revenue; turnover and other distortionary taxes and levies remain. Consumption based taxes (e.g., a VAT) are planned or in limited use. Import tariffs are moderate, but there are too many rates. Income tax base is narrow and the rate structure is only partly rationalized.

b. Tax administration is weak, but tax laws are not inordinately complex, and information systems are functioning (e.g., unique taxpayer identification numbers used). Corruption exists, but there are efforts to improve integrity as well as capacity.
- 4** a. A significant amount of revenue is being generated by low-distortion taxes such as retail sales/VAT, property, etc. VAT has not been fully operational to include activities at the retail stage. Non-trivial amounts of revenue are generated from company and personal income taxes. Tax base is broad and exemptions are moderate and made time-bound, especially for promotion schemes. Trade taxes have few and low rates.

b. Tax administration is solid, cost of revenue generation has been reduced and there are relatively few cases of corruption and political interference. Eligibility for preferential rates and exemptions is largely transparent.
- 5** a. The bulk of revenues are generated by low-distortion taxes such as sales/VAT, property, etc. Import tariffs are low and relatively uniform, and export rebate or duty drawback are functional. There is a single statutory corporate tax rate comparable to the maximum personal income tax rate. Tax base for major taxes is broad and free of arbitrary exemptions.

b. Tax administration is effective, and entirely rule-based. Administrative and compliance costs are low. A taxpayer service and information program, and an efficient and effective appeals mechanism, have been established.
- 6** Criteria for “5” on both sub-ratings are fully met. There are no warning signs of possible deterioration, and there is widespread expectation of continued strong or improving performance.

## 15. Quality of Public Administration

This criterion assesses the extent to which civilian central government staffs (including teachers, health workers, and police) are structured to design and implement government policy and deliver services effectively. Civilian central government staffs include the central executive together with all other ministries and administrative departments, including autonomous agencies. It excludes the armed forces, state-owned enterprises, and sub-national government.

The key dimensions for assessment are:

- a. Policy coordination and responsiveness;
- b. Service delivery and operational efficiency;
- c. Merit and ethics;
- d. Pay adequacy and management of the wage bill.

For the overall rating for this criterion, these four dimensions should receive equal weighting.

**Note: As a criterion with multi-dimensions, a rating for each dimension should be provided in the write-up along with its justification.**

### Guideposts:

- Civil service wages and employment database at <http://www1.worldbank.org/publicsector/civilservice/development.htm>
- Civil Service website at <http://www1.worldbank.org/publicsector/civilservice>
- PRMPS Governance Indicators (after opening the below link, click on CPIA Guidepost Data and see Guidepost for CPIA criterion 15):

<http://www-wbweb.worldbank.org/prem/prmps/publicsector/indicators.htm>

- 1**
  - a. Mechanisms for coordination are non-existent or ineffectual, creating bureaucratic conflict and uncertain or conflicting policies.
  - b. Administrative structures are highly fragmented, with vague and overlapping responsibilities. Business processes are extremely complex and convoluted, with multiple decision layers, and many signatures required to move decisions forward.
  - c. There are no workable rules on hiring and promotion, which are based on bribes, personal ties, or ethnic affiliation rather than merit. Most public employees, even at lower levels, lose their positions on changes in government. Bribe seeking is endemic.
  - d. Level of public employment has little relation to provision of public services: either employment is too low or too few employees show up for work to provide essential services, or the wage bill consumes all of current spending, leaving no funds available for essential supplies such as drugs or textbooks. Pay and benefit levels, particularly at upper levels, are a small fraction of comparable private sector levels, and bribe payments represent a large share of income for many public officials.
- 2**
  - a. Mechanisms for coordination are weak.
  - b. Administrative structures are fragmented, with frequently overlapping responsibilities. Business processes are complex involving multiple decision layers, regularly causing unnecessary delays.
  - c. Hiring and promotion based on personal ties or time in service rather than merit. Most public employees serve at the pleasure of the current government, and bribe-seeking is accepted behavior.
  - d. Public employment as a share of total employment is clearly excessive. The wage bill represents an inordinate share of recurrent spending, with adverse impacts on the quality of public service delivery. Pay and benefit levels, particularly at upper levels, are far below comparable private sector levels, but benefits (housing, car, utilities, servants) for senior civil servants may be high and there are other complex and opaque forms of compensation. "Ghost" employees are on the payroll.
- 3**
  - a. Administrative structures are fragmented, and coordination mechanisms are generally inadequate to overcome parochial bureaucratic interests.
  - b. Business processes can be overly complex, often causing unnecessary delays.
  - c. Hiring and promotion formally merit-based, but there is extensive patronage in practice in several parts of government. Bribe seeking is accepted behavior in some agencies but not throughout government.
  - d. Public employment as a share of total employment is higher than needed and unsustainable if adequate wages were paid. The wage bill represents an excessively large proportion of total government expenditure. Some sectors are overstaffed (particularly health and education). Pay and benefit levels are generally inadequate and there are major difficulties in attracting and retaining staff in key technical areas.
- 4**
  - a. Mechanisms for policy coordination generally function effectively.
  - b. Administrative structures are generally well designed, although gaps or areas of overlap may exist. Initial efforts have been made to redesign business processes in selected areas.
  - c. Hiring and promotion merit-based but emphasize seniority unduly. Corruption may occur but is not general practice in any public agency.
  - d. Public employment as a share of total employment is somewhat higher than needed and the wage bill represents a large proportion of government spending. Pay and benefit levels are low but not unattractive when benefits and job security are factored in. Some sectors are overstaffed (particularly health and education) and there are some difficulties in attracting and retaining staff in key technical areas.
- 5**
  - a. Effective coordination mechanisms ensure a high degree of policy consistency across departmental boundaries.
  - b. Organizational structures are along functional lines with very little duplication. Business processes are regularly reviewed to ensure efficiency of decision making and implementation.
  - c. Hiring and promotion are based on merit and performance, and ethical standards prevail.
  - d. The wage bill is sustainable and does not crowd out spending required for public services. Pay and benefit levels do not deter talented people from entering the public sector. There is flexibility (that is not abused) in paying more attractive wages in hard to fill positions (e.g. rural teachers, technical specialists).
- 6**

Criteria for "5" on all four sub-ratings are fully met. There are no warning signs of possible deterioration, and there is widespread expectation of continued strong or improving performance.

## **16. Transparency, Accountability, and Corruption in the Public Sector**

This criterion assesses the extent to which the executive can be held accountable for its use of funds and the results of its actions by the electorate and by the legislature and judiciary, and the extent to which public employees within the executive are required to account for the use of resources, administrative decisions, and results obtained. Both levels of accountability are enhanced by transparency in decision-making, public audit institutions, access to relevant and timely information, and public and media scrutiny. A high degree of accountability and transparency discourages corruption, or the abuse of public office for private gain. National and sub-national governments should be appropriately weighted. Each of three dimensions should be rated separately: (a) the accountability of the executive to oversight institutions and of public employees for their performance; (b) access of civil society to information on public affairs; and (c) state capture by narrow vested interests. For the overall rating, these three dimensions should receive equal weighting. A rating for each dimension should be provided in the write-up along with its justification.

**Note: As a criterion with multi-dimensions, a rating for each dimension should be provided in the write-up along with its justification.**

### **Guideposts:**

PRMPS Governance Indicators (after opening the below link, click on CPIA Guidepost Data and see Guideposts for CPIA criterion 16):

<http://www-wbweb.worldbank.org/prem/prmps/publicsector/indicators.htm>

- 1**

  - a. There are no checks and balances on executive power. Public officials use their positions for personal gain and take bribes openly. Seats in the legislature and positions in the civil service are often bought and sold.
  - b. Government decision-making is secretive. The public is prevented from participating in or learning about decisions and their implications.
  - c. The state has been captured by narrow interests (economic, political, ethnic, and/or military). Administrative corruption is rampant.
- 2**

  - a. There are only ineffective audits and other checks and balances on executive power. Public officials are not sanctioned for failures in service delivery or for receiving bribes.
  - b. Decision making is not transparent, and government withholds information needed by the public and civil society organizations to judge its performance. The media are not independent of government or powerful business interests.
  - c. Boundaries between the public and private sector are ill-defined, and conflicts of interest abound. Laws and policies are biased towards narrow private interests. Implementation of laws and policies is distorted by corruption, and resources budgeted for public services are diverted to private gain.
- 3**

  - a. External accountability mechanisms such as inspector-general, ombudsman, or independent audit may exist, but have inadequate resources or authority.
  - b. Decision making is generally not transparent, and public dissemination of information on government policies and outcomes is a low priority. Restrictions on the media limit its potential for information-gathering and scrutiny.
  - c. Elected and other public officials often have private interests that conflict with their professional duties.
- 4**

  - a. External accountability mechanisms limit somewhat the degree to which special interests can divert resources or influence policy making through illicit and non-transparent means. Risks and opportunities for corruption within the executive are reduced through adequate monitoring and reporting lines.
  - b. Decision making is generally transparent. Government actively attempts to distribute relevant information to the public, although capacity may be a constraint. Significant parts of the media operate outside the influence of government or powerful business interests, and media publicity provides some deterrent against unethical behavior.
  - c. Conflict of interest and ethics rules exist and the prospect of sanctions has some effect on the extent to which public officials shape policies to further their own private interests.
- 5**

  - a. Accountability for decisions is ensured through a strong public service ethic reinforced by audits, inspections, and adverse publicity for performance failures. The judiciary is impartial and independent of other branches of government. Authorities monitor the prevalence of corruption and implement sanctions transparently.
  - b. The reasons for decisions, and their results and costs, are clear and communicated to the general public. Citizens can obtain government documents at nominal cost. Both state-owned (if any) and private media are independent of government influence and fulfill critical oversight roles.
  - c. Conflict of interest and ethics rules for public servants are observed and enforced. Top government officials are required to disclose income and assets, and are not immune from prosecution under the law for malfeasance.
- 6**

Criteria for “5” on all three sub-ratings are fully met. There are no warning signs of possible deterioration, and there is widespread expectation of continued strong or improving performance.