March 31, 2008

INDEPENDENT EVALUATION GROUP (IEG)

Special Study on the Bank's "Country Policy and Institutional Assessment" - CPIA

Approach Paper

1. Over the past three decades the Bank has been leveraging its considerable analytical, advisory and operational presence in developing countries to systematically assess the key aspects of their policy and institutional performance. Annual country policy assessments were initiated in the late 1970s to help guide the allocation of IDA resources as a key input to the IDA country performance ratings.[1] Country Policy and Institutional Assessment (CPIA) is also a key ingredient in several important corporate activities; they inform CAS business plans and country policy dialogue, assist in the assessments of portfolio risks by the Quality Assurance Group (QAG), help identify countries requiring extra attention on fiduciary standards and governance, provide a background for IEG CAEs and other evaluation work, as well as inform research on determinants of economic growth and poverty reduction.[2]

2. The present CPIA Study is closely related to a series of recent and ongoing thematic evaluations on public sector reform; economic and sector work; decentralization; the *Doing Business* indicators; and development results in middle-income countries. The study would shed some light on the reliability, consistency and usefulness of CPIA ratings.

The CPIA Exercise

3. The long-stated objective of CPIA exercise is to provide, for all borrowing countries (both IDA and non-IDA), a consistent, timely (annual) and reliable assessment of cumulative government actions in implementing policies and reforming institutions. The purpose of CPIA country assessments is to help foster development outcomes through:

- Improved IDA performance-based allocations (PBA);
- Better determination of country creditworthiness and Bank financing envelopes for non-IDA countries; and
- Enhanced development research.

4. The CPIA exercise rates countries according to the quality of the present policy and institutional framework. In assessing country performance, Bank staff look primarily at how conducive the policies and institutions are to sustainable economic growth,

[1] As indicated in the 14th IDA replenishment report: "IDA's Performance-Based Allocation system (PBA) has formed the basis for distributing IDA's resources since 1977." *IDA14 Performance-Based Allocation System: IDA Rating Disclosure and Fine-Tuning the Governance Factor (2004)*.

[2] See for example, *Global Monitoring Report 2004: Policies and Actions for Achieving the MDGs and Related Outcomes.*

poverty reduction, and the effective use of development assistance. The areas of coverage (thematic clusters) and specific rating criteria have evolved substantially over time, reflecting lessons learned and mirroring the evolution of the development paradigm and the changing emphasis in the development process itself.[3] Along with the changes in content, the CPIA generation and computation process have undergone three major revisions during the past ten years. As presented in Box 1, changes in the CPIA exercise include the reduction in the overall number of criteria, reassignment of some criteria across clusters, changes in the weighting system, and the provision of more detailed guiding questionnaires, including a fully specified expanded rating scale.

Box 1: Main changes in the CPIA Exercise (1998-2006)

1998*	1999-2003	2004-2006
	Clusters A. Economic Management (4 criteria) B. Structural Policies (6 criteria) C. Pol. for Social Incl/Equity (5 criteria) D. Public Sector Mgt & Inst. (5 criteria)	**Clusters** A. Economic Management (3 criteria) B. Structural Policies (3 criteria) C. Pol. for Social Incl/Equity (5 criteria) D. Public Sector Mgt & Inst. (5 criteria
	Weights: 5% each criterion	**Weights**: 25% each cluster
	Rating scale: 1 – 6	**Rating scale:** 1 – 6
	Rating procedure: Detailed descriptions of ratings 2, 3, 4 and 5 provided in the questionnaire. Write-ups justifying the ratings required from 2001. Rating disclosure for IDA countries -- by quintiles -- from 2000.	**Rating procedure:** Detailed description of all ratings 1 - 6 provided in the questionnaire. Disclosure of numerical ratings for all IDA countries from 2005.
	Number of Indicators: **20**	**Number of Indicators**: **16**

* Data is not publicly available.

5. The *spiritus movens* behind these changes has been the desire of IDA Deputies to improve the efficiency of IDA allocations through a better and more transparent CPIA exercise.[4] In 2004, at the initiative of the IDA Executive Directors, an External Panel reviewed the CPIA ratings process and methodology. As a result, a series of changes were promptly introduced starting with the 2004 CPIA exercise. Furthermore, numerical ratings for all IDA countries were disclosed starting in 2005.

6. As currently configured, the CPIA exercise assigns ratings to each country in four main areas or clusters: macroeconomic management, structural policies, policies for social inclusion and equity, and public sector management and institutions. A total of 16 criteria under these four areas are rated using a 1-6 rating scale—with 6 denoting the highest quality. Four of the criteria (nos. 1, 2, 3, and 11) are rated directly, two are

---

[3] For a detailed list of the CPIA rating criteria see Annex 1.
[4] See *Country Policy and Institutional Assessments: An External Panel Review – Panel Recommendations and Management Follow-up*, (SecM2004-0304), June 15, 2004.

computed as a weighted average of two sub-components (no. 4 on trade and no. 8 on equity of public resource use), and the remaining ten are computed as a simple average of between two and five sub-components. Finally, an overall CPIA rating for a given country is obtained as a simple average of the ratings for each of the four areas. In effect, therefore, the methodology awards different weights to individual criteria. As detailed in Box 2, criteria within the first two clusters effectively receive weights of 8.33 percent, while criteria in the latter two clusters get 5 percent weights.

7. From a procedural point of view, the CPIA exercise involves two distinct, consecutive phases: the benchmarking phase and the general country rating phase.

- In the benchmarking phase, a small, representative sample of countries drawn from all regions is rated. The sample is chosen to be representative of both IDA and non-IDA client countries, and of various levels of policy and institutional performance (from poor to top performers).

- In the rating phase, staff rate the remaining countries using benchmark countries' scores as guideposts. The CPIA guiding questionnaires make it clear that both factual knowledge and the professional judgment of Bank staff are present as key inputs in determining country scores.

8. The benchmarking phase and the country rating phase share a common four-step procedure. In the first step, country teams generate a set of proposed ratings for a given country. This process is usually led by country economists with active participation from sector specialists and country management. In the second step, ratings for the various countries within a given Region are reviewed and (as necessary) revised and balanced at the regional level to ensure cross-country comparability and equality of interpretation and treatment. Typically, a team led by the regional Chief Economist manages this process. In the third step, the network anchors and other relevant central VPUs review the ratings at the Bank-wide (global) level to ensure cross regional comparability of scores. Country ratings are taken as definitive upon completion of the fourth step, which involves a review meeting with representation from the regions, network anchors, and central VPUs based on a full range of internal and external information to inform and guide the discussion.[5]

9. From the data point of view, CPIA ratings are staff assessments (expert opinions) of the quality of the policy and institutional framework in each of the Bank's client countries. The assessments are informed by the Bank's own country and global knowledge base, as well as relevant external information and knowledge. As noted in paragraph 6, ratings follow a predefined format. They are expressed as numerical scores and vary in half point increments. They are also substantiated through qualitative write-ups. The four-step rating process is designed to secure consistency and comparability across countries and regions and, to the extent possible, over time. It should be stressed that the focus of CPIA ratings is supposed to be on government actions in implementation, not on policy intents, exogenous factors, nor on outcomes.

[5] *Country Policy and Institutional Assessments. 2006 Assessment Questionnaire*. OPCS.

CPIA and the IDA Performance Based Allocation System

10. The main purpose and single most important use of CPIA ratings is to help promote the effective use of IDA resources, defined as the allocation of IDA funding in line with achievements in implementing good policies and institutions. Other things being equal, higher CPIA ratings result in a greater allocation of IDA funds. Hence, the allocation system rewards the implementation of good policies and institutions as they create an environment more conducive to the achievement of good development and poverty reduction outcomes, and the more efficient use of aid resources.

11. For any given country, the CPIA ratings represent only one factor, albeit a key one, driving the IDA Performance Based Allocation process. The PBA also looks at country's portfolio performance, population size and the level of development in determining the allocation of IDA funds on the basis of a complex formula.[6]

12. Despite the importance that CPIA ratings have in the present allocation of IDA funds, the evaluation of key assumptions underlying the PBA and the assessment of the IDA allocation formula falls outside the scope of the present study.

Objectives and Methodology of the Study

13. The main objective of the study is to analyze and review the CPIA system, and, to the extent possible, explore the main uses of country ratings in determining performance based allocation of funding to IDA eligible clients, as well as in a range of further corporate functions and in development research.

14. The study will analyze:

a. How CPIA ratings are formulated in practice looking in particular at:
    - The content and design of the index;
    - The weighting system; and
    - The generation process.

b. How CPIA ratings have affected actual IDA funds allocation and, to the extent possible, how it has affected the assessment of country credit-worthiness for non-IDA countries. However, the study will not attempt a review of the IDA allocation formula, which falls outside the mandate of the present study and would require a separate evaluation. Likewise, the study will not attempt to review the process of determining country credit worthiness.

c. The issue of rating disclosure, mainly evaluating the options of disclosing written justifications for IDA countries; and that of rating disclosure for non-IDA countries.

[6] See Annex 2 for detail on the Performance-Based Allocation system.

Box 2: Present CPIA Criteria and Weights, 2006

CLUSTER / **Criterion** / Component	**Weights**
A. ECONOMIC MANAGEMENT	**25.00%**
1. Macroeconomic Management	**8.33%**
2. Fiscal Policy	**8.33%**
3. Debt Policy	**8.33%**
B. STRUCTURAL POLICIES	**25.00%**
4. Trade	**8.33%**
4.a. Trade restrictiveness (75%)	6.25%
4.b Customs / Trade facilitation (25%)	2.08%
5. Financial Sector	**8.33%**
5.a Financial stability (33%)	2.78%
5.b Efficiency, depth, strength (33%)	2.78%
5.c Access to financial services (33%)	2.78%
6. Business Regulatory Environment	**8.33%**
6.a Entry, exit, competition (33%)	2.78%
6.b Ongoing business operations (33%)	2.78%
6.c Factor markets (labor and land) (33%)	2.78%
C. POLICIES FOR SOCIAL INCLUSION AND EQUITY	**25.00%**
7. Gender Equality	**5.00%**
7.a Equal access to HC development (33%)	1.67%
7.b Equal access to productive and economic resources (33%)	1.67%
7.c Equal status and protection under law (33%)	1.67%
8. Equity of Public Resource Use	**5.00%**
8.a Alignment of public expenditures with poverty reduction (67%)	3.33%
8.b Regressive nature of public revenues (33%)	1.67%
9. Building Human Resources	**5.00%**
9.a Health and nutrition services (33%)	1.67%
9.b Education (33%)	1.67%
9.c HIV/AIDS, TB, malaria (33%)	1.67%
10. Social Protection and Labor	**5.00%**
10.a Social safety nets (20%)	1.00%
10.b Protection of basic labor standards (20%)	1.00%
10.c Labor market regulations (20%)	1.00%
10.d Community driven initiatives (20%)	1.00%
10.e Pension and old age savings programs (20%)	1.00%
11. Policies and Institutions for Environmental Sustainability	**5.00%**
D. PUBLIC SECTOR MANAGEMENT AND INSTITUTIONS	**25.00%**
12. Property Rights and Rule-based Governance	**5.00%**
12.a Legal basis for secure property and contract rights (33%)	1.67%
12.b Quality and enforcement of laws on economic activity (33%)	1.67%
12.c Crime and violence (33%)	1.67%
13. Quality of Budgetary and Financial Management	**5.00%**
13.a Comprehensive and credible budget (33%)	1.67%
13.b Effective financial management systems (33%)	1.67%
13.c Timely and accurate accounting and fiscal reporting (33%)	1.67%
14. Efficiency of Revenue Mobilization	**5.00%**
14.a Tax policy (50%)	2.50%
14.b Tax administration (50%)	2.50%
15. Quality of Public Administration	**5.00%**
15.a Policy coordination and responsiveness (25%)	1.25%
15.b Service delivery and operational efficiency (25%)	1.25%
15.c Merit system and ethics (25%)	1.25%
15.d Pay adequacy and wage bill management (25%)	1.25%
16. Transparency, Accountability, and Corruption in the Public Sector	**5.00%**
16.a Accountability of the executive (33%)	1.67%
16.b Access to information on public affairs (33%)	1.67%
16.c State capture by narrow vested interests (33%)	1.67%

15. In the context of the present study, CPIA ratings will be evaluated in three main dimensions: reliability (data quality and design), consistency, and usefulness. In this sense, IEG seeks to test the CPIA exercise by assessing the relevance and appropriateness of the thematic clusters and individual criteria; the extent to which ratings are well informed, the effects that different features of the institutional arrangements underlying the process have on staff; the coherence of ratings across countries and regions; the sensitivity of CPIA ratings to procedural changes; the use of ratings in IDA allocations; and their usefulness of ratings to Bank staff (in research and ESW), policy makers and external analysts.

Reliability

16. **The CPIA generation process and the quality of CPIA data.** The study will direct the brunt of its attention on better understanding the CPIA generation process and the quality of data CPIA process generates. It will address questions such as: Has the CPIA generation process been perceived as reasonable by Bank staff and management? Do key stakeholders find the CPIA process and the country ratings useful, credible and reliable? How do CPIA ratings compare to other similar indexes? That assessment will be done on the basis of existing data sources and additional information collected through targeted questionnaires and interviews.

17. The study will utilize past reports and evaluations, and survey the existing research literature on the impact of policies and institutions on growth and poverty reduction. It will sparingly conduct new empirical research only when necessary and avoid repetition of results already established in the development literature.

18. Specially designed short questionnaires will be used to solicit views (perceptions) from key participants in the CPIA generation exercise on the quality of the rating exercise and the reliability of the results in cross-country and cross regional comparisons. The questionnaires will target two main subgroups in the CPIA generation process: (a) the producers of CPIA scores (i.e. country economists and other members of country teams), and (b) the managers of the CPIA generation process (including regional chief economists and network anchors). In addition, a different type of questionnaire will seek feedback from the main users of the CPIA ratings in the IDA allocation process and in the research and ESW. Finally, a special questionnaire will be used to solicit views from select client countries. The questionnaires will be administered through an online survey tool (via e-mails) to a representative random sample in each of the four target groups.

19. For a subset of focus countries (including outliers either in terms of resource allocations or performance), the study will also conduct a number of consistency checks of CPIA ratings against external indicators on the same or similar aspects of policy and institutional performance to identify potential gaps and trace back the source of discrepancy to either the quality of the rating process at the level of individual CPIA criteria, possible disconnects in utilizing the Bank's knowledge base, or to other process and substantive factors affecting the evaluation (such as incentives, conflict of interest,

nature of the consistency review at the regional level and by the networks, changes in the methodology and available information etc.). This expanded analysis will also utilize short, focused case studies to better understand the underlying causes of non-marginal changes in the CPIA performance.

20. **CPIA design issues (weights, theoretical underpinnings).** As appropriate, the study will also render views on the existing system of weights and the implicit theoretical underpinnings of the CPIA system, focusing in particular on the views of key stakeholders and users of the CPIA ratings, as well as on the "possible errors of omission" implicit in the present 4-cluster-16-criterion CPIA design.[7]

21. The study will explore the issue of weights through a sensitivity analysis of the effects of changes in various components of CPIA (clusters and criteria) on the final CPIA rating, assuming that a sophisticated statistical analysis (principal components, cluster or factor analysis) does not have to be repeated at this time.

Consistency

22. As part of that analysis, the study will look at comparability of ratings across countries and over time as rating differences potentially have a significant impact on the allocation of IDA funds and other corporate activities. To assess country comparability, ratings and scale descriptions will be carefully reviewed to check to what extent policy actions and their rating levels are comparable across criteria and whether they reflect a neutral stance vis-à-vis alternative development models.

23. A desk review will be launched to assess the coherence of CPIA ratings across countries and over time, as well as identify sources of problems and scope for improvements in the guiding questionnaire and other CPIA instructions. Data permitting, an effort will be made to reconstruct a time comparable series for select CPIA criteria, utilizing the results of previous efforts inside the Bank and perform cross-country and regional comparative analysis.

Broader usefulness

24. The evaluation will also explore the use of CPIA ratings in different corporate functions and in internal and external research, as well as review the Bank's disclosure policy on CPIA.

25. The report will also seek to clearly position the CPIA set of policy implementation indicators focused on government actions vis-à-vis a growing set of output/result focused indicators dealing with similar aspects of institutional development

---

[7] Analytic work undertaken by DEC and OPCS concluded on the adequacy of an equal weighting system for CPIA. The analysis is presented in "Determining the Weights for the CPIA Index", Annex B of the document "Disclosing IDA Country Performance Ratings" (IDA/R2004-0210) of August 9, 2004.

in the broad areas of economic management, structural reforms, social inclusion and equity and public sector management.[8]

Team and Timeline

26. The evaluation will be conducted by the IEGCR under the leadership of Dusan Vujovic, Lead Economist. The team will include Carla Pazce, Janice Joshi, and a team of external consultants including data and survey specialists and an econometrician.

27. Peer reviewers will be Steven Webb (IEGCR), Victoria Elliott (IEGCM Consultant), Aart Kraay (DECRG) and a reviewer from outside the Bank (tbd). The study will seek active feedback from structured user/focus groups in designing the questionnaires, interview and case study formats. In addition, the study will share preliminary results with an Advisory Panel, mainly composed of external stakeholders including donors, academia and client countries.

[8] UNDP reference data-base maintains some 35 indicators just in the area of public governance. *See UNDP, Governance Indicators: A Users' Guide, UNDP, New York, 2004. 2nd Edition 2007. Internet: http://www.undp.org/governance/docs/policy-guide-IndicatorsUserGuide.pdf.*

Annex 1: Structure of CPIA Ratings, 1998-2006

1998*		1999-2003				2004-2006		
		No	**Cluster / Criteria**	**Weight on Overall Rating**		**No**	**Cluster / Criteria**	**Weight on Overal l Rating**
			Economic Management	***20%***			***A. Economic Management***	***25%***
	=	1	Mgt. inflat. & macro. imbal.	5%	=	1	Macro. Mgt.	8%
	=	2	Fiscal policy	5%	=	2	Fiscal Policy	8%
	=	3	Mgt. of public debt	5%	=	3	Debt Policy	8%
	}	4	Mgt. & sustain. Dev. program	5%	x			
			Structural Policies	***30%***			***B. Structural Policies***	***25%***
	}	5	Trade pol. & forex regime	5%	=	4	Trade	8%
	=	6	Financ. Stability	5%				
	=	7	Financial sector depth, effic. & res. Mob.	5%	}	5	Financial Sector	8%
	↘							
	=	8	Comp. environ. for priv. sector	5%				
	=	9	Factor & product markets	5%	}	6	Business Regulatory Environ.	8%
	=	10	Pol. & instit. for envir. sustain.	5%	↘			
			Pol. for Social Incl/Equity	***25%***			***C. Policies for Social Inclusion/Equity***	***25%***
		11	Gender	5%	=	7	Gender Equality	5%
		12	Equity of public resource use	5%	=	8	Equity of Public Resource Use	5%
		13	Building human resour.	5%	=	9	Building Human Resour.	5%
		14	Social protection & labor	5%	=	10	Social Protection & Labor	5%
		15	Monit & an pov. outc & imp	5%	x			
					↘	11	Pol. & Instit. for Environ. Sustain.	5%
			Public Sector Mgt & Inst..	***25%***			***D. Public Sector Management & Institutions***	***25%***
	↘	16	Property rights & govern.	5%	=	12	Property Rights & Rule-based Govern.	5%
		17	Quality of budg. & finan. Mgt	5%	=	13	Quality of budg. & finan. Mgt	5%
	=	18	Effic. of reven. mobil.	5%	=	14	Effic.of Revenue Mobil.	5%
		19	Quality of public admin.	5%	=	15	Quality of Public Admin.	5%
		20	Transpar. account. & corrup. in pub. Sector	5%	=	16	Transpar., Account. & Corrup.in Pub. Sec.	5%

* Data is not available publicly.

Annex 2: Description of PBA System

1. IDA Country Allocation
(Step 2)

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

IDA country allocation per annum = base allocation + f (Country performance rating 2.0, Population1.0, GNI/capita-0.125)

Base allocation = SDR 1.1 million (favors small countries, in terms of per capita allocations. It applies to everyone)

2. Country Performance Ratings (CPR)
(Step 1)

Current Formula
Country performance rating = (0.8 * CPIA + 0.2 * portfolio performance rating) * governance factor

3. Country Policy and Institutional Assessment (CPIA)
CPIA refers to the Country Policy and Institutional Assessment ratings, which has four clusters A-D. Clusters A-C assess a country's socio-economic and structural policies while Cluster D assesses public sector management and institutions. To fully underscore the importance of the CPIA in the IDA Performance Based Allocations, the overall country score is referred to as the IRAI (IDA Resource Allocation Index).

4. Annual review of Portfolio Performance (ARPP)
- Assess implementation performance (quality of development project and project management).
- Ratings based on percentage of IDA projects at risk.
- Translated to 1-6 scores (conversion table).

Projects at Risk (snapshot at the end of the year)
- Actual projects at risk (PAR):
    - with "unsatisfactory" Implementation Progress (IP): likelihood of attaining objectives of SAR/PAD; or
    - where Development Objectives (DO) "not likely to be achieved": IP and factors like design, unforeseeable events, etc.
- Potential Problem Projects (PPP):
    - Satisfactory but likely to be negatively affected : "risk flags".
    - For Investment Operations, those who have 3 or more flags in the last ISR
    - For Development Policy Operations, 3 out of 6 flags.
- Regional Operations Manager can overrule the ratings and decide project is at risk: "golden flag". (GF)

Age Correction
- If average age of Country's portfolio is less than 3.1 years, then age correction is applied.
- Even if Country has no projects at risk, the age correction will result in 6% projects a risk and a 4 rating.

Percent of projects =	[(PAR+PPP+GF)/ TP] + (3.1- AAP)5%	if AAP < 3.1
at risk	[(PAR+PPP+GF)/ TP]	else

TP: Total projects in Country Portfolio
AAP: Average Age of Portfolio

5. **Portfolio Performance Rating (PPR)**
   - Constructed from ARPP
   - Reflect IDA-funded projects at risk

Table A2.1: Conversion Scale

Percent of Projects at Risk	Rating
0%	6.0
1%	5.5
2%	5.0
3-4%	4.5
5-6%	4.0
7-10%	3.5
11-15%	3.0
16-32%	2.5
33-60%	2.0
61-99%	1.5
100%	1.0

6. **Governance Factor**

   Calculated using:

- CPIA's cluster D (questions 12 - 16) : 5 criteria
- Final Procurement Rating: 1 criteria
    - Number of projects with a procurement "flag" ("moderately unsatisfactory" or less)
    - Procurement flag measures quality, reliability and transparency of procurement administration for a project.
    - 3 year moving average of Procurement rating: "final procurement rating".
    - Procurement rating = f (# projects with procurement flag / Total projects in portfolio)

f ( ): Conversion table

Table A2.2: Conversion Scale to Obtain Procurement Ratings

Percent of Projects	Rating
0%	5.0
1-5%	4.5
6-10%	4.0
11-15%	3.5
16-20%	3.0
21-25%	2.5
>=25%	2.0

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