ANNEX 2

IDA'S PERFORMANCE-BASED ALLOCATION SYSTEM FOR IDA17

I. Introduction

1. IDA's performance-based allocation (PBA) system will continue to be the basis for the distribution of IDA resources during the IDA17 period. This annex provides an updated overview of the PBA system and highlights enhancements agreed during the IDA17 deliberations. As in IDA16, the PBA allocations will be subject to: (i) grant-related discounts and re-allocations; and (ii) MDRI netting out, capped to 30 percent of a country's gross PBA allocation, and reallocation of compensatory resources.

II. The PBA System for IDA17

2. The Country Performance Ratings of IDA countries are assessed annually using the Country Policy and Institutional Assessment (CPIA) ratings. The CPIA assesses each country's policy and institutional framework and consists of 16 criteria grouped into 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 1).[1] To ensure that the ratings are consistent with performance within and across regions: (i) detailed questions and definitions are provided to country teams for each of the rating levels for each of the 16 criteria; and (ii) a World Bank-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.

Box 1: CPIA criteria

A. Economic Management
1. Monetary and Exchange Rate Policies
2. Fiscal Policy
3. Debt Policy and Management

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

[1] For details on the CPIA Questionnaire, see: http://www.worldbank.org/ida/papers/CPIAcriteria2011final.pdf

3. The CPIA underpins IDA's Country Performance Rating (CPR) but is not its only determinant. In addition to the CPIA, the IDA Portfolio Performance Rating (PPR),[2] which captures the quality of management of IDA's projects and programs, enters the calculation of the CPR. As in IDA16, the CPR in IDA17 will be calculated as:

$$\textbf{Country Performance Rating} = (0.24 * CPIA_{A\text{-}C} + 0.68 * CPIA_{D} + 0.08 * PPR)$$

where $CPIA_{A\text{-}C}$ is the average of the ratings of CPIA clusters A to C, $CPIA_{D}$ is the rating of CPIA cluster D.

4. The formula underpinning the PBA system is presented below. Country performance (with an exponent of 4 in the allocation formula)[3] is the main determinant of IDA country allocations. Country needs are also taken into account through population size and GNI per capita. Population affects allocations positively (with an exponent of 1) while the level of GNI per capita is negatively related to allocations (with an exponent of -0.125). Specifically,

$$\textbf{IDA country allocation} = f(\textbf{Country Performance Rating}^{4}, \textbf{Population, GNI per capita}^{-0.125})$$

5. Starting in IDA17, the base allocation will be increased from SDR 3 million per year (SDR 9 per replenishment) to SDR 4 million per year (SDR 12 million per replenishment) in order to better meet the fixed costs of country engagement and maintain an effective country program. Since base allocations form an important share of allocations to small states, this will likely benefit mainly small states, several of which are fragile and conflict-affected states (FCSs).

6. Two additional steps are required to arrive at a country's "final" allocation. First, grant allocations are discounted by 20 percent. Of this discount, 13 percentage points are reallocated to all IDA-only countries, excluding gap and post-conflict countries, and 7 percentage points are made available on hard terms to creditworthy blend countries. Second, for countries eligible for debt cancellation under the MDRI initiative, the debt service due in the relevant fiscal year is netted out from that year's allocation. The amount deducted as foregone debt service from an eligible country's gross annual PBA allocation is capped at 30 percent of such gross PBA allocation. [4] This capped deduction will continue to apply during the IDA17 period. As before, the netted-out amounts are redistributed to all IDA-only countries, excluding gap countries.

7. Country allocations will be determined annually with changes reflecting, inter alia, the country's own performance and its performance relative to other countries, changes in eligibility for IDA resources and for IDA grants, and availability of IDA resources. The allocation norm is the basis for the financing scenario set out in CASs or ISNs.

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[2] The PPR reflects the health of the IDA projects portfolio, as measured by the percentage of problem projects in each country.

[3] The CPR exponent will be reduced from 5 in IDA16 to 4 in IDA17 to increase the poverty-orientation of the regular PBA system. This will allow an increased IDA engagement in the poorest countries, notably the broader group of FCSs, most of which have low per-capita Gross National Income (GNI) levels, while preserving the principle of performance orientation in the allocation system.

[4] Refer to IDA (2010), A Mechanism for Mitigating the Allocation Impact of MDRI Netting Out.

III. Exceptional Regime for Countries Facing "Turn-around" Situations

8. A new exceptional regime for countries facing "turn-around" situations will be adopted in IDA17. Starting from IDA17, all new cases warranting the delivery of exceptional IDA support will be addressed within this new regime, including future post-conflict and re-engaging countries as well as countries that have not experienced significant levels of conflict or accumulated arrears but face a "turn-around" situation. The new regime aims at enhancing the targeting of IDA's exceptional support in a way that promotes improved policies and institutional reform and portfolio implementation.

9. To ensure a smooth transition for countries out of the existing exceptional post-conflict and re-engaging regimes, two interim measures have been implemented: (i) a case-by-case extension of their phasing out period for the duration of IDA17,[5] and (ii) the alignment of the level of support to these countries with the support to be provided under the exceptional "turn-around" regime, while reflecting the phasing-out period agreed for these countries.

IV. Other Exceptions

10. The following specific exceptions to the PBA formula will be in place during the IDA17 period.

- First, the allocation to Pakistan, a country with potential access to IBRD, will be "capped", and it will receive less than the allocation norms, due to its broader financing options.

- Second, IDA may provide exceptional allocations in the aftermath of severe natural disasters or economic crises from the Crisis Response Window, as per the implementation arrangements described in Annex 3 of the IDA16 Deputies' Report.

- Third, India will receive transitional support during IDA17 in the amount of SDR2.3 billion.

- Fourth, there is a special provision for selected regional integration projects. The IDA17 period envisages up to SDR686 million per year for such projects in topping up resources. These resources would be used to finance two-thirds of a country's share of the costs of a regional project, with the remaining one-third contribution from the country's IDA allocation.[6] There is a three-country requirement for accessing financing for regional projects, which is relaxed to <u>two</u> countries when at

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[5] This case by case extension of the phasing out period will be based on the criteria agreed in IDA16, namely: (i) limited economic status and financing options, measured by GNI per-capita lower than the IDA operational cutoff or lack of access to IBRD financing; (ii) presence of clear factors slowing down the transition, most notably a resurgence or continuation of conflict in parts of the country, measured by the presence of UN Security Council mandates for peace-keeping forces (with the exclusion of border monitoring missions); and (iii) PPR, averaged over the last three years, of at least 3.0. The decision rule is that the phase out period is extended if the country meets (i) and at least one among (ii) or (iii). Application of these criteria entails the extension of the phasing out for Afghanistan, Burundi, CAR, DRC, Haiti and Togo for the duration of IDA17. The original phasing out periods for Côte d'Ivoire and Liberia end in FY17.

[6] For small countries, a 20 percent ceiling will continue to be placed on their annual contributions to regional projects.

least one is an FCS.[7] In addition, IDA17 introduces the ability to: (i) finance, on a case-by-case basis and subject to a two-step process of early consultation with and approval by IDA's Executive Directors, with resources from the IDA regional program, projects that require financial participation of only one IDA country, where it can be clearly demonstrated that the project would have a transformational impact on the region, and that three or more countries (two, if one is an FCS) would receive substantial benefits from the project; and (ii) cap, on a case-by-case basis and subject to approval by IDA's Executive Directors, the amount that comes from a country's regular IDA allocation to 20 percent of that country's IDA17 allocation for regional projects where project costs are very large relative to the country's available IDA resources. Financing to support such exceptions would be limited to 20 percent of the overall IDA17 envelope for regional projects. Access to grants under the IDA Regional Program will be continued, including to selected institutions not linked to an IDA funded regional project but which support strategic regional priorities.

- Fifth, eligible countries can qualify for exceptional allocations to help finance the cost associated with the clearance of arrears to IBRD and/or IDA.[8]

V. Disclosure

11. IDA countries are informed of the performance assessment process, which is increasingly integrated into the country dialogue. Starting in IDA14, the numerical ratings for each of the CPIA and Country Performance Ratings criteria have been fully disclosed on IDA's external website. Starting in IDA15, the country allocations and commitments have been disclosed annually to the Executive Directors of IDA on an *ex post* basis (i.e., at the end of each fiscal year) to increase transparency. Starting in IDA16, the country allocations and commitments were disclosed on IDA's external website.

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7 Refer to IDA (2010), IDA's Performance-Based Allocation System: Review of the Current System and Key Issues for IDA16, http://siteresources.worldbank.org/IDA/Resources/Seminar%20PDFs/73449-1271341193277/PBAIDA16.pdf

8 IDA (2007), Further Elaboration of a Systematic Approach to Arrears Clearance, http://siteresources.worldbank.org/IDA/Resources/Seminar%20PDFs/73449-1172525976405/3492866-1172526109259/ArrearsClearanceMZ.pdf