

## **Implementing Performance-Based Aid in Africa: *The Country Policy and Institutional Assessment***

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### **Abstract**

Unlike most other donors, IDA bases its country envelopes on a formal performance assessment, the Country Policy and Institutional Assessment (CPIA). This paper takes the CPIA instrument as given. It outlines the process of estimating country ratings with special reference to the (Sub-Saharan) Africa Region, and addresses a number of questions concerning (a) how the CPIA compares with other ratings, (b) the relationship between the CPIA and country performance, and (c) the likely errors of CPIA-type ratings and their implications for disclosure and performance-based allocation of development assistance.

CPIA estimates are broadly correlated with the rankings of a number of other indicators, including the KKZ governance indicators and the Heritage Foundation's Economic Freedom Indicator. The closest association is found with the similar, but independently estimated, performance index of the African Development Bank. Comparing African countries as a group with others, we found no evidence of an "Africa bias", either positive or negative, relative to other indicators.

CPIA ratings have been quite strongly associated with medium-run growth performance. In Africa, over 1996-2002, high-rated CPIA countries typically grew 3-4% per year more than lower-rated countries. Countries increasing their CPIA ratings over a sustained period tend to experience a growth boost and those seeing a large decline in ratings tend to see a growth slowdown. The results do not conclusively prove causality. However, country-level changes in CPIA ratings are not associated with recent growth, suggesting that the CPIA score is not simply a mirror of observed performance.

CPIA scores are to be disclosed for IDA countries from 2005, and the question arises of how accurately they are estimated. Using the "natural experiment" provided by independent CPIA-type ratings from the African Development Bank, the paper estimates the standard deviation of a CPIA rating at 0.24 on the 1-6 scale. Our results suggest that it is reasonable to disclose ratings within a confidence interval of 0.5 centered on the estimate and to allow some flexibility in allocations in response to measurement uncertainty. CPIA scores can help to indicate where performance needs to be strengthened and how fast this can be done - taking into account both historical performance and what has been possible in other countries. A more open CPIA process can help to structure policy dialog while linking resource allocation to results.

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**Africa Region**  
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# **Implementing Performance-Based Aid in Africa:**

*The Country Policy and  
Institutional Assessment*

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**November 2004**

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## **Implementing Performance-Based Aid in Africa:** *The Country Policy and Institutional Assessment*

### **Summary**

Unlike most other donors, IDA bases its country envelopes on a formal performance assessment, the Country Policy and Institutional Assessment (CPIA). This paper takes the CPIA instrument as given. It outlines the process of estimating country ratings with special reference to the (Sub-Saharan) Africa Region, and addresses a number of questions concerning (a) how the CPIA compares with other ratings, (b) the relationship between the CPIA and country performance, and (c) the likely errors of CPIA-type ratings and their implications for disclosure and performance-based allocation of development assistance.

CPIA estimates are broadly correlated with the rankings of a number of other indicators, including the KKZ governance indicators and the Heritage Foundation's Economic Freedom Indicator. The closest association is found with the similar, but independently estimated, performance index of the African Development Bank. Comparing African countries as a group with others, we found no evidence of an "Africa bias", either positive or negative, relative to other indicators.

CPIA ratings have been quite strongly associated with medium-run growth performance. In Africa, over 1996-2002, high-rated CPIA countries typically grew 3-4% per year more than lower-rated countries. Countries increasing their CPIA ratings over a sustained period tend to experience a growth boost and those seeing a large decline in ratings tend to see a growth slowdown. The results do not conclusively prove causality. However, country-level changes in CPIA ratings are not associated with recent growth, suggesting that the CPIA score is not simply a mirror of observed performance.

CPIA scores are to be disclosed from 2005, and the question arises of how accurately they are estimated. Using the "natural experiment" provided by independent CPIA-type ratings from the African Development Bank, the paper estimates the standard deviation of a CPIA rating at 0.24 on the 1-6 scale. Our results suggest that it is reasonable to disclose ratings within a confidence interval of 0.5 centered on the estimate and to allow some flexibility in allocations in response to measurement uncertainty. CPIA scores can help to indicate where performance needs to be strengthened and how fast this can be done - taking into account both historical performance and what has been possible in other countries. A more open CPIA process can help to structure policy dialog while linking resource allocation to results.

## Introduction

Since 1977, the World Bank has carried out an annual performance assessment of its client countries' capacity to effectively absorb development assistance. This assessment, the Country Policy and Institutional Assessment (CPIA), is one of the main criteria used to allocate International Development Assistance (IDA) resources between low-income developing countries. Unlike many other ratings, the CPIA is, at present, confidential. The questionnaire is in the public domain, and partial information on country rankings has been available since 2000 in the form of country rankings by quintiles, but detailed ratings for a given country are only shared with the authorities of the country concerned.

As part of the process of increasing the transparency of ODA and working towards a model based on greater coordination and partnership, the Bank intends to move towards disclosure of the CPIA scores of IDA countries in 2005. Disclosure may become more complete in later years, and will possibly extend to the country write-ups on which ratings are based. This trend will inevitably increase public scrutiny of the CPIA process and the ratings. It may also result in wider use of formal performance-based allocation processes by other donors.

CPIA disclosure offers a number of clear advantages. Public scrutiny will focus greater attention on performance estimates and help to ensure consistent treatment across countries. Disclosure increases opportunities to improve the methodology. In addition, it can provide better comparative information to enable the IDA countries to learn from each other and to help harmonize the aid allocations from various donors.

But disclosure also presents some risks. Without wider and deeper knowledge of the system and the process, especially in the countries being rated, ratings may be misinterpreted. Some countries object to disclosure on the grounds that it could affect their credit ratings, and it is significant that disclosure is only moving forward for IDA countries rather than for all developing countries. There are inherent conflicts of interest in the World Bank being, at the same time, the unique CPIA rating agency, a cooperating partner in the development efforts of its clients, and an advocate for the interests of developing countries in general. Disclosure is likely to increase these tensions, and could create an environment where it becomes progressively harder to award low marks to poor performers. On the other hand, such a conflict of interest is not easy to avoid, because closeness to the client is needed to provide an in-depth knowledge of the policies and institutions in a given country. Even if an independent agency were mandated to produce estimates, there is no simple way out of this conflict of interest problem, since the Bank could not be held accountable for good use of the resources it provides if these were to be distributed according to a formula based on criteria and judgments which it did not control.<sup>1</sup>

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<sup>1</sup> The performance-based system of the Millennium Challenge Account, recently set up by the US Government, uses a set of public indicators, including some produced by the World Bank, to screen

The purpose of this paper is to increase understanding of the ratings and of the process of producing them, and to consider their likely precision and its implications for disclosure and performance-based IDA allocation. In the course of estimating CPIA ratings, individual country estimates are routinely compared with benchmarks derived from a number of other ratings. But so far, studies have not estimated the standard errors of CPIA estimates. Another important issue is how levels and changes in CPIA ratings relate to growth outcomes. The paper focuses especially on Sub-Saharan Africa (Africa), which includes half of the total number of IDA countries.

The paper does not address the deeper question of whether the CPIA as currently measured is the “right” indicator of performance, whether the questions are all relevant, and whether the weighting of criteria is optimal. Taking the questionnaire as given, the paper considers the following: How are CPIA ratings actually estimated? How do they compare with other relevant indicators? How do they evolve over time for individual countries? Is there any evidence of an “Africa effect”, with shared reputation imparting a downward bias – or advocacy imparting an upward bias – to the estimates? Is there any evidence that country performance relates systematically to the ratings – and if so in what direction? What is the likely standard error of CPIA-type ratings, and what are the implications for disclosure? How flexible can IDA allocations be while still remaining performance-based? Looking forward, how can a performance rating be used more effectively as a core instrument of country dialogue rather than simply as a resource allocation mechanism?

Section II outlines the process of producing CPIA ratings in the World Bank, with special reference to practice in the Africa Region. Section III compares CPIA ratings with a number of other indices. Section IV outlines CPIA trends between 1996 and 2002, and the relationship with growth. Section V considers the precision of estimates, relative to “true” but unknown values and the implication of such errors for disclosure. It also considers the degree to which IDA allocations can be flexible while still remaining within a performance-based framework. Section VI concludes.

## **The Ratings and the Process**

The CPIA is an assessment tool for the Bank, to gauge the likely return to development assistance in specific countries and to guide IDA allocations to countries below the income threshold. CPIA assessments do not directly reflect specific “outcome” criteria as set out in the Millennium Development Goals (MDGs), such as poverty reduction, school enrollment, maternal health, etc; neither do they directly rest on proxy outcome variables such as GDP, export or investment growth rates. They rely on the judgments of technical analysts to assess how well a country’s policy and institutional framework fosters poverty reduction, sustainable growth and the effective use of development assistance. Ratings are against specific criteria but are subjective. The emphasis is on policy actions and institutional effectiveness rather than outcomes,

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countries for eligibility. However, this screening is only advisory. Discretion in the allocation is still possible, with criteria undefined.



although where there is timely information on outcomes it should, of course, inform the judgments.

Reflecting an increasingly wholistic view of development, the CPIA has evolved considerably since its introduction in 1977. Social and governance criteria have been strengthened over the years, and questions have been added on environment and gender, reducing the former dominance of macroeconomic and structural criteria. These changes have been fairly gradual, however, and have rarely resulted in major reshufflings between African countries. The current questionnaire includes 20 questions encompassing four broad clusters: (A) economic management; (B) structural policies; (C) policies for social inclusion; and (D) accountability and public sector management. Performance is reviewed against specific criteria for each question, and is translated into scores ranging from 2 (unsatisfactory) to 5 (good). Three consecutive years at 2 on a specific question automatically drops a rating to 1, while a rating at 5 over three consecutive years is automatically promoted to a 6. The final rating is the simple average score across the 20 questions.

Table 1 groups African countries in terciles according to their 2002 CPIA scores. It is clear that countries' positions do not simply reflect narrowly economic factors. Almost all in the lowest tercile have been severely affected by conflict while most of the rest have faced severe problems of political governance. Oil exporters, too, typically fall into the lower half of the CPIA ratings. There is no clear relationship with income levels – Africa's IBRD countries span a wide spectrum of CPIA ratings.

**Table 1: African Countries: 2002 CPIA Terciles**

CPIA Terciles	Countries
<b>Highest Tercile</b>	Benin, Botswana, Burkina Faso, Cape Verde, Ghana, Mali, Mauritania, Mauritius, Namibia, Rwanda, Senegal, South Africa, Tanzania, Uganda, Zambia.
<b>Middle Tercile</b>	Cameroon, Chad, Côte D'Ivoire, Eritrea, Ethiopia, Gabon, The Gambia, Guinea, Kenya, Lesotho, Madagascar, Malawi, Mozambique, Niger, Sierra Leone, Swaziland.
<b>Lowest Tercile</b>	Angola, Burundi, Central Africa Republic, Comoros, Congo, Democratic Republic, Congo Republic, Equatorial Guinea, Guinea-Bissau, Nigeria, Sao Tome and Principe, Seychelles, Sudan, Togo, Zimbabwe.

The CPIA process at the Africa Region is coordinated by country economists, with substantial inputs from sector specialists, other members of country teams, and country directors. In the first stage of the process several so-called “benchmark” countries from each of the six Bank Regions are assessed and intensively reviewed in a Bank-wide process to help ensure consistency across Regions. In the second phase, each Region completes the assessment of the remaining countries taking as a reference the regional benchmark countries. Intensive discussions take place between the country economists and regional experts in specific areas (for example, private sector, financial

systems, gender and environmental management) to ensure regional consistency. The office of the Regional Chief Economist reviews submissions for all African countries, chairing several meetings where ratings are debated. To reduce the potential impact of overall views on country performance, this phase emphasizes comparative checks across indicators. The final phase involves rounds of review between the Regions and Bank's central units. Ratings can be challenged to ensure Bank-wide consistency (in 2003 the Africa Region fielded some 120 challenges suggesting increasing or lowering ratings on individual questions) and those responsible for the ratings must respond.

In short, the CPIA ratings are scrutinized carefully within and across the Bank by staff with extensive in-country and sector knowledge, but consultations outside the Bank, whether with the countries themselves or external experts, are not used as direct inputs into the CPIA scores. Checks against external ratings are an essential part of the process, but are used to flag possible anomalies rather than used to set ratings. The overall process – a blend of art and science -- takes from three to four months. The cost Bank-wide has been estimated at over \$1 million annually, mostly in the form of staff time.

When finalized, the ratings are used as an input into the IDA allocation process, of which more below. Ratings for individual countries are discussed with the country authorities by the respective country directors. They are not otherwise disclosed. Increasingly, strengths and weaknesses in key aspects of the CPIA play a role in country policy dialogue and they have begun to receive more explicit attention in the formulation of the Bank's Country Assistance Strategies.

The strength of a CPIA-type process is its ability to draw on detailed country experience across many sectors. The challenges are twofold: to strike a balance between country knowledge and advocacy and cross-country consistency, and to match the detailed country knowledge to the assigned scores in a consistent manner. Although checks against outside indicators are increasingly used, many CPIA indicators lack clear outside comparators. Some questions can be scaled relatively independently of the level of development -- for example, the competitive environment for the private sector, or the quality of financial system regulation. Others cannot be considered independently of income and development levels. For example, the nature of the risks faced by a population and the appropriate form of any system of social protection depend in a fundamental way on the level of development – in poor countries this may involve mitigating the impact of harvest failures; in richer countries, it may emphasize unemployment insurance. It can be difficult to assign a clear CPIA score in some cases, and ambiguity can lead to a tendency to bunch around the middle ratings of 3 to 3.5 (moderately unsatisfactory to neutral).

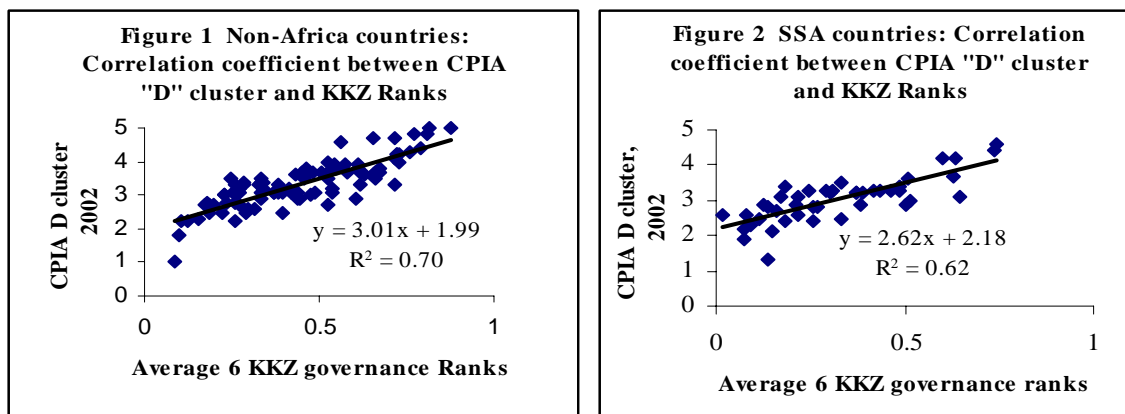
A further limitation to such a process is that knowledge will neither be complete nor uniform across countries and clusters. Analytic work tends to have wider coverage and is likely to be more up-to-date for larger countries with better-developed lending programs. This could affect the quality of judgments for smaller and less favored countries. A recent assessment of the degree of knowledge across clusters in the Africa region suggested somewhat less confidence in judgments on structural policies relative to

those on the quality of macroeconomic and public sector management.<sup>2</sup> This may reflect the greater focus of analytic work in recent years on public expenditures than on the business climate and the determinants of growth, as well as access to the work of the IMF which greatly helps the assessment of macroeconomic management. With advent of national poverty reduction strategies (PRSPs), information on policies for social inclusion and equity has become more available. In addition, this area has been a major focus of attention since the rise to prominence of the MDGs.

### The CPIA relative to some Comparators.

In addition to the performance index of the African Development Bank (of which more below) several publicly-available indices cover areas relevant to CPIA assessments. We consider three: the Kaufmann, Kraay and Zoido-Lobaton (KKZ) governance indicators assembled by the World Bank Institute, the Economic Freedom Indicator (EFI) produced by the Heritage Foundation and the UN's Human Development Indicator (HDI). These indicators focus on different areas but do tend to be correlated with each other across the global cross-country spectrum of income levels and development.

**The KKZ indicators** consider six dimensions of governance: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. We take a simple average of the six KKK dimensions, creating an indicator that most closely relates to CPIA D cluster. Figures 1 and 2 show the relationships between the two for IDA countries outside Africa and for African countries.



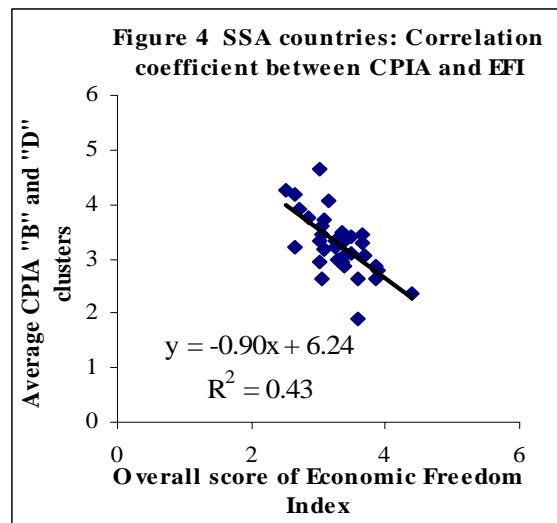
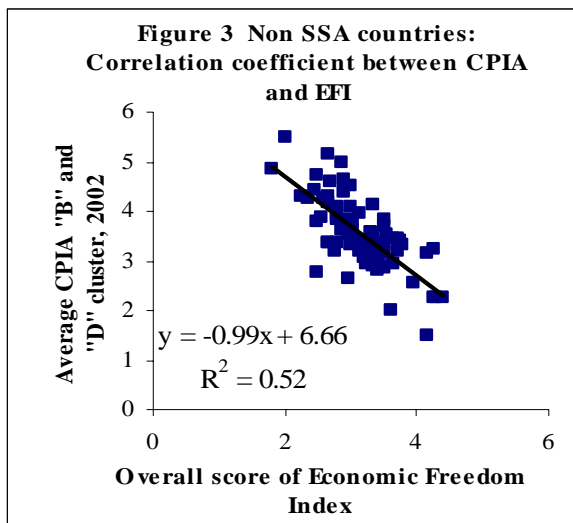
Sources: World Bank CPIA and KKZ governance indicators.

The two indicators are quite strongly correlated. A pooled regression suggests that there are no significant differences in either intercepts or slopes of the linear relationships across between the two sets of countries.<sup>3</sup>

<sup>2</sup> See "What and how well do we know about our client countries? Africa Region 2001 PREM Forum Survey Results", by Paula Donovan, Brian Ngo and Xiao Ye, March 2002.

<sup>3</sup> In the pooled regression the CPIA is taken as the dependent variable. An Africa dummy was used to test differences in the intercepts and a cross variable, constructed by multiplying KKZ indicators with the Africa dummy, was used to test differences in the slopes. Neither dummy is statistically significant.

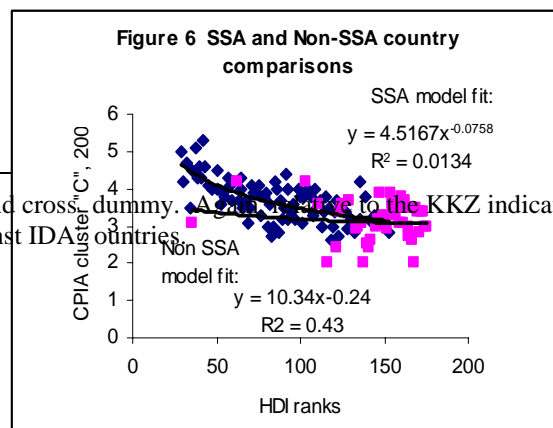
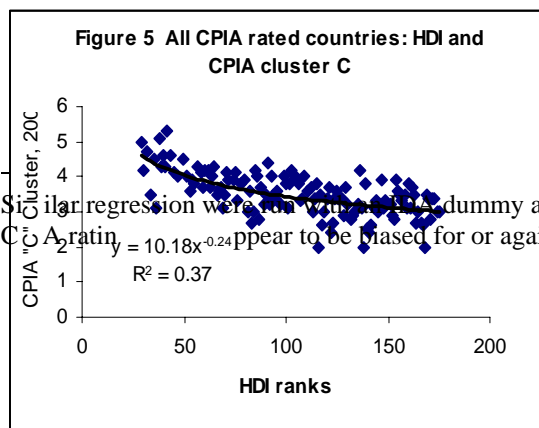
**The Economic Freedom Index (EFI)** focuses on the openness of trade policy, the fiscal burden of government, degree of government intervention in the economy, monetary policy, capital flows and foreign investment, banking and finance, wage and price flexibility, property rights, degree of regulation and the level of black market activity. These indicators are most closely related to the CPIA B and D clusters. Figures 3 and 4 compare the average score of CPIA B and D clusters with the EFI rating, considering African countries and non-African IDA countries. (note that a lower score indicates a better performance on the EFI index). There is again a moderately strong relationship, both for the African and non-African countries. Pooled regressions indicated that neither an Africa level dummy or an Africa slope dummy is statistically significant different.



Source: World Bank CPIA, EFI from Heritage Foundation.

**The Human Development Index (HDI)** combines social indicators (life expectancy, adult literacy, enrollment ratios) with GDP per head up to a threshold level. It therefore differs from the CPIA, KKZ and EFI indicators in being based on quantifiable outcomes rather than on scores for qualitative assessments of policies and institutions. The HDI is most appropriately compared with the CPIA C cluster, and causality is plausibly bi-directional. On the one hand, a higher HDI index signals greater capacity for effective service delivery, which should permit a higher CPIA C cluster rating. Conversely, countries are unlikely to be able to create and retain high HDI indicators in the absence of effective systems of delivering services to their populations.

Figures 5 shows the relationship between the CPIA C cluster scores and the HDI

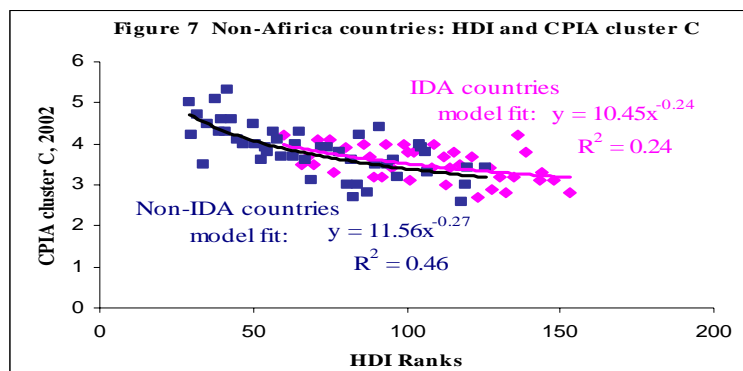


Similar regression were run with an SSA dummy and cross-dummy. A significant effect to the KKZ indicator, CPIA rating appear to be biased for or against IDA countries.

rank ordering across developing countries in 2001, and Figure 6 distinguishes African and non-African countries. Lower HDI rankings signify better outcomes. The patterns suggest an important difference between African countries and others: the former cluster at the lowest extreme of the HDI range, whereas the latter spread across the HDI range. Countries with better HDI ratings typically score higher on the CPIA, but the relationship is not pronounced except for the higher-ranked countries, most of which are outside Africa. Within Africa there is therefore no significant relationship. However, regressions also provide no evidence that African countries score higher or lower on the CPIA than other countries with comparable HDI ratings.<sup>4</sup>

Data sources: UNDP 2003 Human Development Report and World Bank CPIA.

Figure 7 depicts the HDI-CPIA relationship for all rated countries outside Africa. Again, the relationship is weaker for the poorer IDA countries, but since many of the non-African IDA countries score better on the HDI index than their African counterparts, the result is stronger than for African countries. Capacity and human capital do therefore appear to be factors in enabling countries to achieve higher CPIA scores, but their effect only begins to kick in after some threshold level is achieved.



Data sources: UNDP 2003 Human Development Report and World Bank CPIA.

**The African Development Bank’s Ratings (AfDBR).** For countries in Sub-Saharan and North Africa, the annual performance assessment of the African Development Bank (denoted AfDBR) is the closest comparator to the CPIA. The assessment instrument is structured along comparable clusters though not identical. Assessments are made using a similar process to that used in the World Bank. These two ratings are made independently – staff at the World Bank and the AfDB are not provided with the ratings of the other institution as comparators. However, each year representatives from the AfDB and the Africa Region review the statistical relationships between their ratings.

Table 2 shows correlations between the two ratings, overall and by cluster, for recent years. For three of the four years, the overall correlation coefficient is close to 0.9. The two sets of ratings correlate most closely in the areas of macroeconomic policy and least closely in the areas of structural policy -- as noted above, the area where staff

<sup>4</sup> Pooled regressions find Africa-specific level and slope variables to be not significant.

surveys in the Africa Region indicate the least confidence concerning the knowledge base, at least in the World Bank.

**Table 2: Correlation Coefficients: AfDB and World Bank Ratings for All African Countries**

	Correlation coefficient between AfDB and WB ratings			
	1999	2000	2001	2002
Overall rating	0.93	0.87	0.81	0.87
Cluster A, Macroeconomic policies	0.87	0.84	0.80	0.88
Cluster B: Structural policies	0.84	0.82	0.66	0.72
Cluster C: Growth with equity	0.77	0.73	0.68	0.78
Cluster D: Governance	0.90	0.83	0.82	0.77

Data sources: AfDB and WB CPIA ratings.

Rank comparisons between the two ratings also suggest a high degree of agreement on policy and institutional performance across African countries. In terms of country quintiles, rankings are consistent for the highest and the lowest groups of countries and also for North African countries. Differences occur mostly within the middle three quintiles, where countries' scores tend to be clustered very close to each other. Typically, between five and seven countries out of 52 are ranked ten or more places apart. Differences appear to take place on a fairly random basis across countries. There is also no evidence of systematically different scoring of the Middle East and North African (MENA) countries relative to those in Sub-Saharan Africa, despite the fact that in the World Bank these groups are assessed in separate Regions.

### **CPIA Ratings and Economic Performance, 1995-2002**

After a long hiatus, economic performance in Africa strengthened markedly in the second half of the 1990s. In contrast to the experience of the previous two decades, overall GDP per head began to increase, albeit only slightly. However, average progress masks widening divergence between countries. Some 13 countries have consistently experienced real GDP growth rates of 4% or more while a number of others have seen consistent decline. Available evidence suggests that, in Africa as elsewhere, poverty rates do tend to fall in response to high economic growth, even though there is considerable variation in this relationship.<sup>5</sup>

How does recent growth performance relate to CPIA levels and trends? CPIA ratings tend to have a degree of inertia but some countries do drift up or down over a period of several years. Table 3 shows changes by terciles, distinguishing three categories: the largest rating gains over 1996-2002, those with little overall trend change, and the group with the largest trend losses over the period. Not all of these trends reflect actual changes in country-level performance. Some may partly derive from changes made over time in the CPIA itself which can affect the ratings differently for different

<sup>5</sup> Poverty headcounts have tended to fall by 0.8 percentage points for every 1.0 percentage increase in private consumption per head. See *Strategic Framework for Assistance to Africa: IDA and the Emerging Partnership Model*, World Bank, 2003.

countries. This effect is usually not a major one, in part because the cluster scores themselves tend to be correlated: countries doing well in one area usually score highly in others, so that changes in weighting etc. usually have modest effects.<sup>6</sup> Since 1996, there has been a slight upward trend in African CPIA ratings of about 0.04 points annually, a little more than in other IDA countries. Rapidly-improving countries have managed to increase their ratings by much more -- an annual average of 0.15 points -- while lagging countries have seen their ratings fall, on average by 0.04 points. African ratings are more volatile than others -- the range of variation in trends is far wider in Africa, with some countries (notably Zimbabwe) declining precipitously and others gaining strongly. The latter are often countries such as the DRC which carry out basic macroeconomic reforms as they emerge from conflict.<sup>7</sup>

**Table 3: CPIA Trends: 1996-2002**

Tercile by Rates of Change (all rated countries)	Range of Annual Change	Average Annual change
Highest Tercile	Change >0.08	0.15
Middle Tercile	0.0 < Change <= 0.08	0.04
Lowest Tercile	Change <= 0	-0.04
Non-African IDA Countries	-0.11 ~ 0.15	0.028
African IDA Countries	-0.17 ~ 0.27	0.042

Data sources: World Bank CPIA, 1996-2002.

Some inertia is to be expected in the ratings because they assess institutions and capacity to implement policies rather than just “stroke-of-the-pen” policy changes. This can cause CPIA scores to lag reform efforts as better policies can require time to become properly reflected in the ratings. Conversely, a country with fairly strong capacity and institutions but with sharply deteriorating political and economic governance can for some years receive a reasonable CPIA rating, with the score falling over time as human and institutional capital runs down. Yet changes can have a large cumulative impact. Experience shows that a consistently well-performing country might expect to see its CPIA score increase by about 0.1 point per year. If sustained for a ten-year period, this would lift the rating from that of a middle-weak (3.3) to that of a strong (4.3) performer. Conversely, a country with deteriorating policies might see certain CPIA cluster ratings, in particular macroeconomic management, decline quite sharply, but sustain institutional capacity in other areas for a considerable period.

Leads, lags and shocks complicate measurement of the relationship between CPIA ratings and growth. Poor countries are vulnerable to a wide range of severe shocks which cause their year-to-year growth rates to be volatile. In addition to climatic and terms of trade shocks, many countries have experienced political shocks – Madagascar’s

<sup>6</sup> There are however some exceptions. Certain countries score relatively better on macro management than on structural policy or public sector management; others score more poorly in social sector-related areas. Differences within Africa are, however, less than across the whole spectrum of developing countries which includes a wider range of economic and social systems.

<sup>7</sup> Emerging trends in 2003 suggested continued polarization between improving and deteriorating groups.

economy, for example, contracted by 12% with political crisis in 2002 before rebounding by 9% in 2003. In addition, policy performance is clearly not the main driving force behind the economic growth of Africa's oil exporting countries, which relies heavily on foreign investments driven by conditions on world oil markets and the momentum of exploration and development activity. The six African oil exporting countries are excluded from the analysis.<sup>8</sup>

We use simple cross-country regressions to assess the recent relationship between policies and growth rates for African and other IDA countries. Growth rates and CPIA ratings are averaged over the period 1996-2001, and average growth of GDP per capita is regressed on (i) the average CPIA rating, (ii) the average annual change in the CPIA rating over the period, (iii) initial income, to allow for conditional convergence, and (iv) the age-dependency ratio, to include demographic influences. Descriptive statistics are shown in Table 4, and the regression results are shown in Table 5.

Table 4 indicates some distinctive features of the set of African countries relative to the others. Whereas the African countries show greater policy volatility and span a wider range of trends in the CPIA, they vary less in terms of initial income levels (which are lower in Africa) and age-dependency ratios (which are far higher in Africa).

Table 5 indicates some strong parallel relationships between the two sets of countries but also some differences. For the African countries all signs of coefficients are as expected. The explanatory power of the equations and the positive coefficients on CPIA scores are almost identical between the two groups. In pooled regressions, the Africa dummy is negligible and not significant. Policy, initial income and demography account for observed differences in growth: there is no "Africa effect". This also suggests that, relative to growth performance over six years, CPIA ratings do not have an upward or downward Africa bias.

There are differences however, in the details of the regressions. The coefficient on trends in CPIA scores is positive and fairly significant for African countries, but is negative and insignificant for the non-African IDA countries. This may be because greater political volatility in Africa causes its effects to be more pronounced. The precipitous decline in growth in conflict-affected countries due to civil wars or upheavals is often accompanied by a sharp decline in the CPIA; conversely, evidence shows that post-conflict countries can recover and grow rapidly for several years. Nevertheless, the negative sign of the coefficient for non-African countries is puzzling.

Conversely, initial incomes and age-dependency ratios population growth are significant determinants of growth for the non-African IDA countries, but are not significant in Africa. This is probably because there is relatively less variation in these

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<sup>8</sup> . With average growth of 30 percent since 1996 due to oil-related investments, Equatorial Guinea stands out as by far the most rapidly-growing country in Africa. Angola too has seen unusually rapid growth fuelled by high levels of FDI in the oil sector. Angola, Cameroon, Congo Republic, Equatorial Guinea, Gabon and Nigeria are excluded from the regression.



variables across the African sample. Results from the pooled sample regression shows coefficients consistent with an average of the African and non-African countries.

**Table 4: Descriptive Statistics for Growth Regressions: IDA countries.**

	Mean		Standard Deviation		Minimum		Maximum	
	SSA	Non-SSA	SSA	Non-SSA	SSA	Non-SSA	SSA	Non-SSA
Average 1996-2001/02								
Average CPIA	3.07	3.23	0.49	0.44	1.8	2.3	3.9	3.90
Annual CPIA change	0.042	0.028	0.092	0.066	-0.17	-0.11	0.27	0.15
Average GDP per capita growth	0.90	1.75	2.45	2.56	-6.6	-5.7	6.6	6.1
GNI per capita, 1996, \$US	348	988	233	872	110	230	1270	3680
Average age-dependency ratio	0.92	0.69	0.08	0.13	0.75	0.48	1.16	0.89

Data sources: World Bank WDI and GDF database and CPIA sheets.

**Table 5: Growth and Policy Performance: IDA Countries: 1996 – 2001/2**

	SSA IDA countries		Other IDA countries		All IDA countries	
	Parameter estimates	T-statistics	Parameter estimates	T-statistics	Parameter estimates	T-statistics
Intercept	1.16	0.14	9.62	1.8	7.36	1.8
Average CPIA	3.47*	4.2	3.04*	3.2	3.20*	5.5
Average annual CPIA change	8.33*	1.96	-3.63	-0.70	1.93	0.6
Average age dependency ratio	-8.50	-1.6	-7.18*	-2.3	-7.61*	-3.0
Logarithm of GNI 95	-0.61	-0.68	-1.92*	-3.6	-1.64*	-3.7
Africa country					-0.09	-0.1
R-Square	0.43		0.51		0.44	
# observations	32		32		64	

Dependant variable is annual average GDP growth per capita.

“\*” indicates statistically significant at 95 percent level.

From the regressions, performance as measured by the CPIA is strongly related to growth. The growth rate of an African country with a fairly high CPIA score of 4.0, for example, would have been 3.5% above that of a country with middle-low CPIA rating of 3.0. Over the period, this would have amounted to a cumulative gain of almost 20%. In addition, African countries increasing their CPIA ratings by an average of 0.1 points annually would have seen an extra growth boost of 0.83%, for an additional cumulative gain of 5%. Even initially weak performers can benefit from reforms if they are able to sustain them to boost ratings over time. Conversely, the sign of the change coefficient shows that for a country heading into a downward spiral growth performance will deteriorate more rapidly than the CPIA rating.

Though suggestive, these estimates do not conclusively prove causality. Despite the use of clear benchmarks to derive CPIA ratings, it is possible that assessments are colored by perceptions of “how well the country is doing” which are influenced by recent

growth trends. To test whether the CPIA scores themselves simply respond to observed growth rates, year-to-year changes in scores were regressed on the growth rates of the previous year, the most recently available information at the time of determining the ratings. There is no significant relationship between recent growth and changes in scores.<sup>9</sup> In addition, the estimates in Table 5 also do not distinguish between the effect of performance as measured by the CPIA and other influences on growth that may themselves reflect the CPIA rating. For example, growth in high-performing countries may be partly driven by increased ODA flows in response to higher CPIA scores. The inclusion of ODA flows as an independent variable does not, however, change the regression much. These tests provide a fair degree of comfort for the proposition that policy and institutions do influence performance in the medium-longer run, with Table 5 indicating a reduced form for the relationship. Other studies show that social indicators are also systematically better in high CPIA countries than in those with low ratings.<sup>10</sup>

### **Precision, Disclosure and the Allocation of IDA**

**The Precision of CPIA Ratings.** Any rating system, whether based on “objective” measurements or informed judgment, is bound to be subject to some error. At the most basic level, any rating system can be criticized on the basis of the variables selected, the scoring system used and the weighting of different questions. CPIA ratings might be expected to diverge from other ratings for many reasons. Assume, however, that the CPIA system and process can be accepted as a reasonable basis for a country assessment. Taking the instrument as given, how accurate are the assessments likely to be?

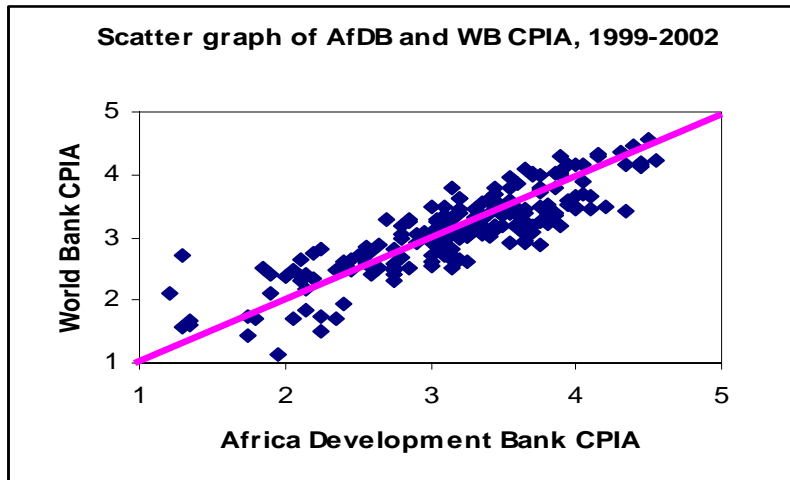
One way of assessing accuracy would be to compare a number of independent assessments using the same rating system. However, the Bank does not undertake multiple independent CPIA assessments – indeed, that would be impossible because the same staff would be called on to make each of them. However, a comparison between the World Bank’s ratings and the ratings of the African Development Bank, which uses a similar system, offers such a quasi-experimental opportunity. . As shown in Table 2 they are strongly correlated. Figure 8 illustrates how the two ratings correspond.

**Figure 8 CPIA distributions, 1999-2002**

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<sup>9</sup> The coefficient is negligible and the R<sup>2</sup>, corrected for degrees of freedom, is zero.

<sup>10</sup> See “Achieving the Millennium Development Goals in Africa: Progress, Prospects and Policy Implications” African Development Bank together with World Bank, July 2002. Table 2 shows averages for nine social indicators across three country performance groups derived from a combination of World Bank and AfDB ratings, including and excluding oil countries. With only one partial exception, the patterns of indicators conform to the performance groupings.



Data sources: Africa Development Bank and World Bank

We make the following assumptions:

- a. World Bank and AfDB estimates are independent.
- b. The two sets of estimates are normally distributed around the “true” CPIA with equal standard deviations: neither Bank is more accurate in rating countries.
- c. Standard deviations of the estimates are independent of the country.

All of these assumptions can be questioned, but at least as a first approximation they appear to be reasonable.<sup>11</sup> Subject to the above assumptions, the difference between the two sets of ratings will be normally distributed, and with variance equal to the sum of the variances of the individual estimates of the World Bank and the AfDB. The standard deviation of the ratings of either the World Bank or the AfDB relative to the “true” CPIA is then the standard deviation of the differences between the two ratings divided by the square root of two.

To estimate the standard deviation of the CPIA ratings we use two approaches. The first simply uses the mean-adjusted difference between the two ratings while the second de-trends the difference using a linear regression, to allow for possible systematic difference in scaling between high and low ends. The results are almost identical, and we use the first set of estimates. Averaging over 1999-2002, these put the standard deviation of the Bank’s CPIA estimates, relative to the unknown “true” CPIA scores, at 0.24 (Table 6). This suggests that analysts are fairly well able to distinguish well-performing countries (average rating 4) from middle-performers (rating 3.5) and very well able to distinguish them from low performers (rating 3.0). But within these categories, there can be considerable uncertainty over the shading of performance.

<sup>11</sup> If both Banks rely on a similar set of information for some areas (for example, macroeconomic assessments of the IMF), assessments are more likely to be in a similar direction. This would tend to bias the estimate of standard deviation downwards. On the other hand, slight differences in the questionnaires and in weightings between the World Bank and AfDB will tend to bias the estimate upwards. As noted above, knowledge might also be less current for smaller and less active countries, resulting in larger errors than for larger, more active countries.

**Table 6: Standard Deviation of CPIA Estimates - 1999-2002**

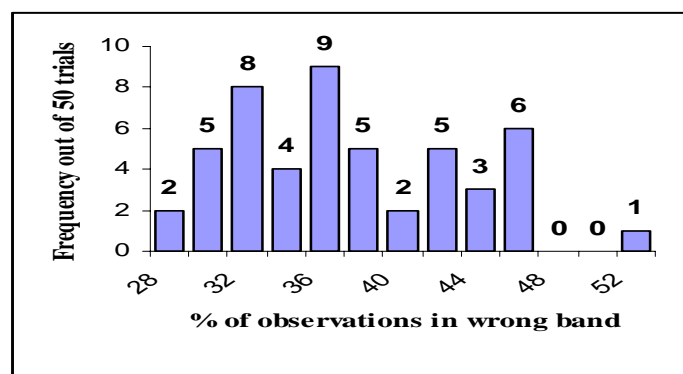
	<b>Standard Errors</b>	
	Standard Deviation of Differences: World Bank and AfDB SE(CPIA <sub>cj</sub> -CPIA <sub>ck</sub> )	Standard Deviation World Bank CPIA relative to “True” CPIA 0.7071* SE(CPIA <sub>cj</sub> -CPIA <sub>ck</sub> )
1999	0.29	0.20
2000	0.34	0.24
2001	0.42	0.29
2002	0.34	0.24
Average		0.24

Data sources: Africa Development Bank and World Bank CPIAs, 1999-2002.

**Disclosing Ratings Subject to Errors.** As noted above, disclosing CPIA ratings offers potential benefits and risks. One risk is that of diverting a great deal of energy into debating the reasons for minor differences in CPIA ratings, and in the process losing a focus on the big picture of what needs to be done to improve the policy and institutional framework. The results above suggest that if individual scores are made public they could be presented as the midpoint of a range of 0.5, spanning 0.25 points, about one standard deviation, on either side of the estimate. This would defuse debates on small differences and focus attention on what needed to be done to advance a country significantly up the CPIA scale. At the same time it would bolster the credibility of the CPIA by making explicit the likely degree of confidence in the estimate.

The initial proposal was to release CPIA scores by fixed letter grades. Indeed, the range of one letter grade (0.5 on the CPIA rating scale) was almost exactly equal to a one-standard-deviation range around the estimate of the “true” CPIA. However, the use of fixed letter intervals raises the problem that countries may be misclassified into the wrong letter grade because of measurement error. In order to estimate the expected frequency of misclassification, we carried out a Monte Carlo simulation. Normal random errors with standard deviation of 0.24 were superimposed on actual CPIA scores (taken as estimates of the “true” CPIAs) to produce fifty hypothetical sets of CPIA ratings. These were then compared with the original scores to derive the number of countries misclassified in each of the fifty trials. Figure 9 shows the frequency of countries falling into “wrong” letter bands in the 50 simulated trials. Between a quarter and a half of the 50 countries are likely to be misclassified using the letter-grade technique: on average, 37 percent of countries are misclassified. This suggests that letter-grade disclosure is far less informative than disclosing point estimates with confidence intervals.

**Figure 9 : False “Banding” Using Letter-grade Disclosure:  
Outcome of Monte Carlo Simulation.**



**Uncertainty of Ratings and IDA Allocations.** Together with income level and population, the IDA Performance Rating brings together three components: (i) the CPIA rating, (ii) portfolio performance and (iii) a governance factor, derived from averaging several ratings within the CPIA and a rating for procurement, and then taking the ratio of the result to 3.5 (which is considered to be a neutral rating) and raising this ratio to the power of 1.5. Because of the multiplicative super-weighting of the governance variables (which themselves are highly correlated with the overall CPIA), the IDA performance rating is highly elastic relative to the CPIA score. IDA allocations, in turn, have an elasticity of about 2 relative to the IDA performance rating. IDA allocations are therefore highly selective in terms of CPIA scores. All else being equal, high rated countries may receive up to \$14 per head whereas low-rated countries may receive only up to \$3-4 per head.

To estimate the overall relationship between the CPIA and the IDA allocation, a multivariate regression was estimated, pooling four years of data (1999-2002). A double log function was used to obtain the elasticity of the IDA allocation in regard to several explanatory variables, including the CPIA, population, level of GNI per capita, and a dummy variable for post- conflict countries which receive special allocations for a temporary period.

**Table 7: OLS Regression for IDA Allocation Per Head all IDA countries**

	<b>Coefficient</b>	<b>T-Statistic</b>
Constant	2.21*	6.2
CPIA	3.51*	18.8
Population	-0.37*	-19.2
GNI per capita	-0.4.6*	-8.1
Post conflict country	0.29*	2.0
FY 2000	0.004	0.04
FY2001	-0.13	-1.4
FY2002	-0.12	-1.3
R Square	<b>0.73</b>	
Number of observations	<b>279</b>	

\* indicates that the parameter is statistically different from zero at 95 percent level. All variables are in natural logarithm form except the dummy variables for fiscal years.

From Table 7, a one percent increase (decrease) in CPIA results in a 3.5 percent increase (decrease) in IDA allocation. For a “true” typical CPIA rating of 3.3, a one standard-deviation range of plus or minus 0.24 therefore translates into a range of IDA allocations from 25 percent higher to 25 percent lower than the “true” allocation. There is therefore considerable room for flexibility in IDA allocations even while remaining within the framework of a strongly performance-based system.

The inertia in the CPIA also argues in favor of the practice of front-loading allocations for countries whose ratings are expected to improve rapidly in the near future. Conversely, CPIA inertia also argues for caution in committing the full allocation to countries that appear to be entering a downward spiral which is not yet reflected in the ratings. Such trends need to be quite decisive however, given the uncertainty attached to any CPIA rating and the possibility of subsequent revisions in later years.

## **Conclusion**

Unlike many other donors, IDA bases its country envelopes on a formal performance assessment, the CPIA. Taking the CPIA questionnaire and scoring as given, this paper has outlined the process of estimating CPIA ratings with special reference to the (Sub-Saharan) Africa Region, and addressed a number of questions concerning (a) how the CPIA compares with other ratings, (b) the relationship between the CPIA and country performance, and (c) the likely errors of CPIA-type ratings and their implications for disclosure and performance-based allocation of development assistance.

CPIA estimates are broadly correlated with the rankings of a number of other indicators, including the KKZ governance indicators and the Heritage Foundation’s Economic Freedom Indicator. They also relate to the Human Development Index, but the association only begins to kick in as the HDI ranking moves beyond the lowest range. The closest association is found with the similar, but independently estimated, performance index of the African Development Bank.

Comparing African countries as a group with others, we found no evidence of an “Africa bias”, either positive or negative, relative to other indicators. Comparing Sub-Saharan African countries with those of North Africa, we also found no bias in CPIA scores relative to AfDB ratings, even though these two groups of countries are rated by different operational regions in the World Bank. On average, African countries rate somewhat lower in the CPIA than IDA-eligible countries in other regions. But Africa also lags far behind in human development indicators, and the resulting weak institutions and implementation capacity partly explains their lower CPIA scores. Conflict erodes capacity: the lowest CPIA tercile in Africa largely comprises countries severely affected by conflict, with a heavy concentration in Central Africa.

CPIA ratings and trends are quite strongly associated with medium-run growth performance. In Africa, over 1996-2002, high-rated CPIA countries typically grew by 3-4% per year more than lower-rated countries. Because of the importance placed on institutional effectiveness and implementation rather than simply policies, the ratings have considerable inertia. Yet a consistently well-performing country can boost its CPIA

score from moderately weak to very strong over a period of about a decade. Countries increasing their CPIA ratings over a sustained period tend to experience a growth boost and those seeing a large decline in ratings tend to see a growth slowdown.

These results do not conclusively prove causality; neither do they disentangle the impact of the CPIA ratings themselves from all other factors and influences on growth that might be associated with the CPIA. However, some comfort to a causal interpretation is provided by the observation that country-level changes in CPIA ratings are not associated with recent growth experiences, and the results of other studies that show the long-run relationships between institutions and growth<sup>12</sup>.

African countries have relatively volatile policy ratings, and changes in CPIA's appear to be a more significant determination of growth than in other regions. But age-dependency ratios and initial levels of GDP per head are more important growth determinants outside Africa, where countries show more dispersion in these dimensions. Comparing African and non-African IDA countries, the coefficient on the CPIA in growth equations are similar. In a pooled regression, the "Africa dummy" is insignificant: policies and institutions, demographics and initial income levels account for African growth much as for poor countries in other regions.

As with any ratings CPIA assessments are subject to a range of uncertainty. Using the "natural experiment" provided by independent CPIA-type ratings from the African Development Bank, it is possible to derive an estimate of the standard deviation of a CPIA rating when the "true" rating is unknown. The standard deviation came out at 0.24 on the 1-6 scale. Analysts will be able to distinguish well-performing countries (average rating 4) from middle-performers (3.5) fairly well, and from low performers (3.0) very clearly. But within these categories, there can be considerable differences of view on the shading of performance. Arguments on small differences in ratings should not be permitted to obscure the bigger picture of what needs to be done.

The uncertainty inherent in any ratings system has implications for how best to disclose country scores. Our results suggest that it is reasonable to disclose ratings within a band or confidence interval of 0.5 centered on the estimate. Such a band is approximately equal to the estimated plus and minus one standard-deviation range. The initial proposal to use fixed ranges would have resulted in many countries being misclassified into the wrong grade – from simulations, as many as 37% would have been misclassified.

IDA is highly selective in its allocations. CPIA scores feed into the IDA performance rating, and the overall elasticity between allocations and CPIA ratings is 3.5. High performers may receive \$14 of IDA per head per year, low performers less than \$3. Modest differences in ratings therefore translate into large differences in allocations, and this is especially the case for the CPIA scores that form the super-weighted "governance"

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<sup>12</sup> For example, Acemoglu Daron, Simon Johnson, James Robinson, and Yunyong Thaicharoen, "Institutional causes, macroeconomic symptoms: volatility, crises and growth", *Journal of Monetary Economics* 50 (2003) 49-123.

cluster. While selectivity is desirable, there is clearly a danger in making allocations too dependent on imperfectly measured indicators, and this raises the question of whether the degree of selectivity is excessive. The estimated standard deviations of the CPIA suggest that a range of plus or minus 25% of the base allocation would still be consistent with the selective performance-based system. This flexibility could help to create space in allocations, for example, to vary them to partially cushion trade or climatic shocks. The inertia in CPIA ratings also supports the practice of anticipating major future trends in performance by frontloading allocations (in the case of rapidly improving countries) and of applying special caution in committing allocations in the case of severe backsliders.

Finally, the relationship between CPIA ratings and growth, as well as with a range of social indicators found by other studies, points to the value of expanding the use of the system beyond the allocation of resources and towards more systematic structuring of country dialogue. CPIA scores can help to indicate where performance needs to be strengthened and how fast this can be done - taking into account both historical performance and what has been possible in other countries. It is not necessary to subscribe to the letter of every specific CPIA question or to the exact weighting for the aggregate CPIA (for example, does the financial sector deserve a 10% weighting while environment or gender equality each only have 5%? ) to recognize that it includes a wide range of what is generally accepted as important for development. Opening up the CPIA may require some procedural changes. These could include instituting a round of consultations with countries on their preliminary ratings, and establishing an external advisory group to complement the process of internal scrutiny of individual ratings. But a more open CPIA process has potential to link policy and institutional assessments, knowledge creation, resource allocation, and the monitoring of results, into a seamless whole.



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