

PFM: From Assessment to Reform

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Module 2: Political Economy of PFM

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- What is Political Economy analysis?
- Why is Political Economy analysis important?
- Political Economy of the budget
- Exercise: Examples of informal practices
- Implications for budget reform
- Case study (1) – Ghana
- Use of PE analysis to improve country programmes

What is **Political Economy** analysis?

Political economy (PE) analysis is concerned with:

- Interaction of political and economic processes in a society
- Distribution of power and wealth between different groups and individuals
- Processes that create, sustain and transform these relationships over time

Why is PE analysis important?

It helps to understand:

- What drives **political behaviour**
- How this shapes particular policies and programmes
- Who are the main **winners** and **losers**
- What are the implications for development strategies and programmes

Why is PE analysis important? (2)

- PE analysis helps to understand how development outcomes are shaped by:
 - **Interests** and **incentives** facing different groups in society, in particular political elites
 - Formal and informal **institutions**
 - **Values** and **ideas**, incl. political ideologies, religion and cultural beliefs
- Development can be blocked by politically and economically **powerful groups** which benefit from the status quo

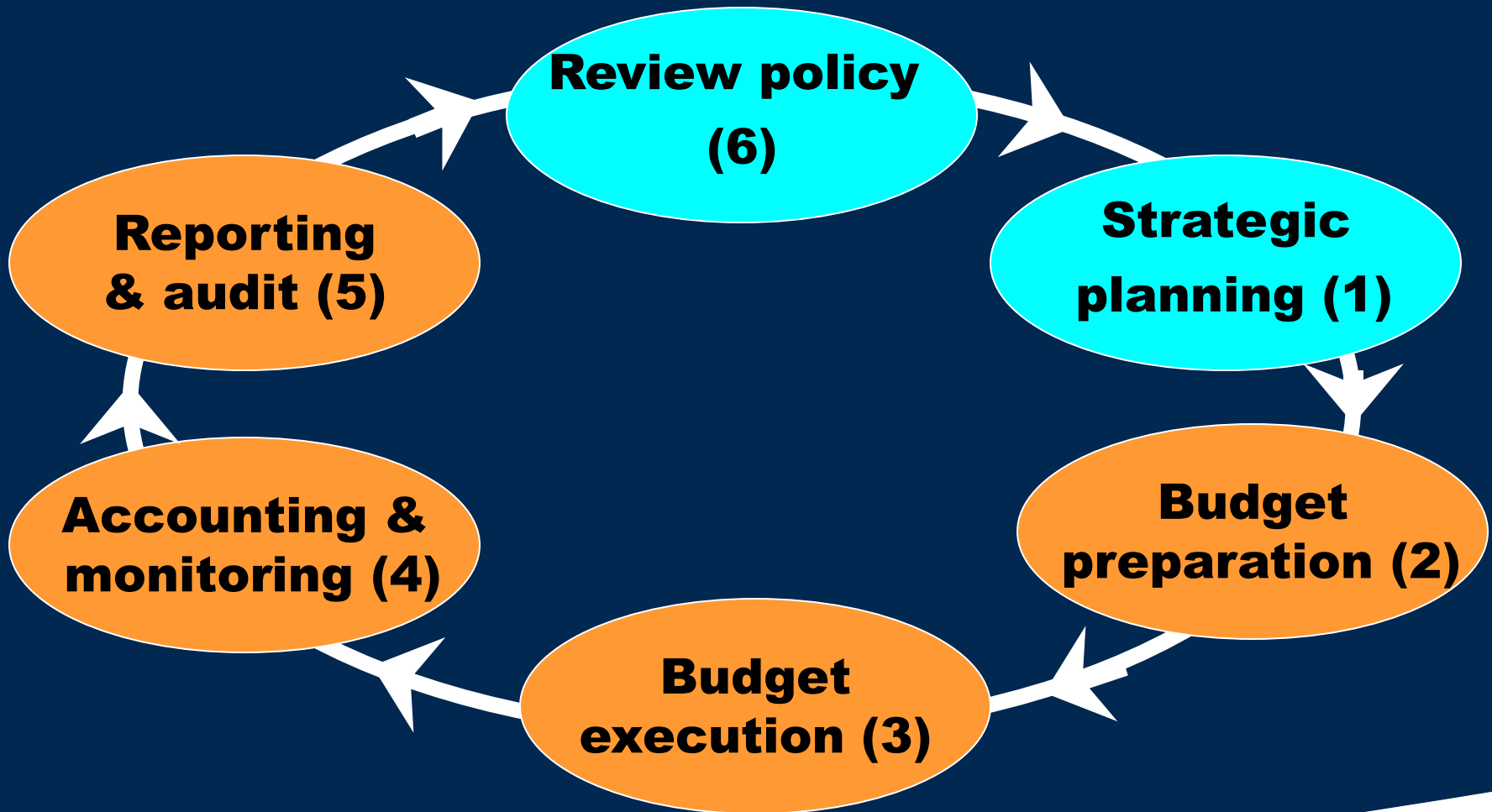
Why is PE analysis important? (3)

- Development is fundamentally a **political** process → the UK will increasingly put politics at the heart of its action
- Not only think about what to support, but also about how to provide support, taking political feasibility into account
- PE analysis can help to explain why development often fails to take place
- It encourages donors to be **realistic** in their development objectives and expectations

Political economy of the **budget**

- Power relations and political incentives shape budget processes
- Technical improvements can help resolve capacity constraints ...
- ... but **political incentives** often explain why technical resources are not deployed effectively or used responsibly!

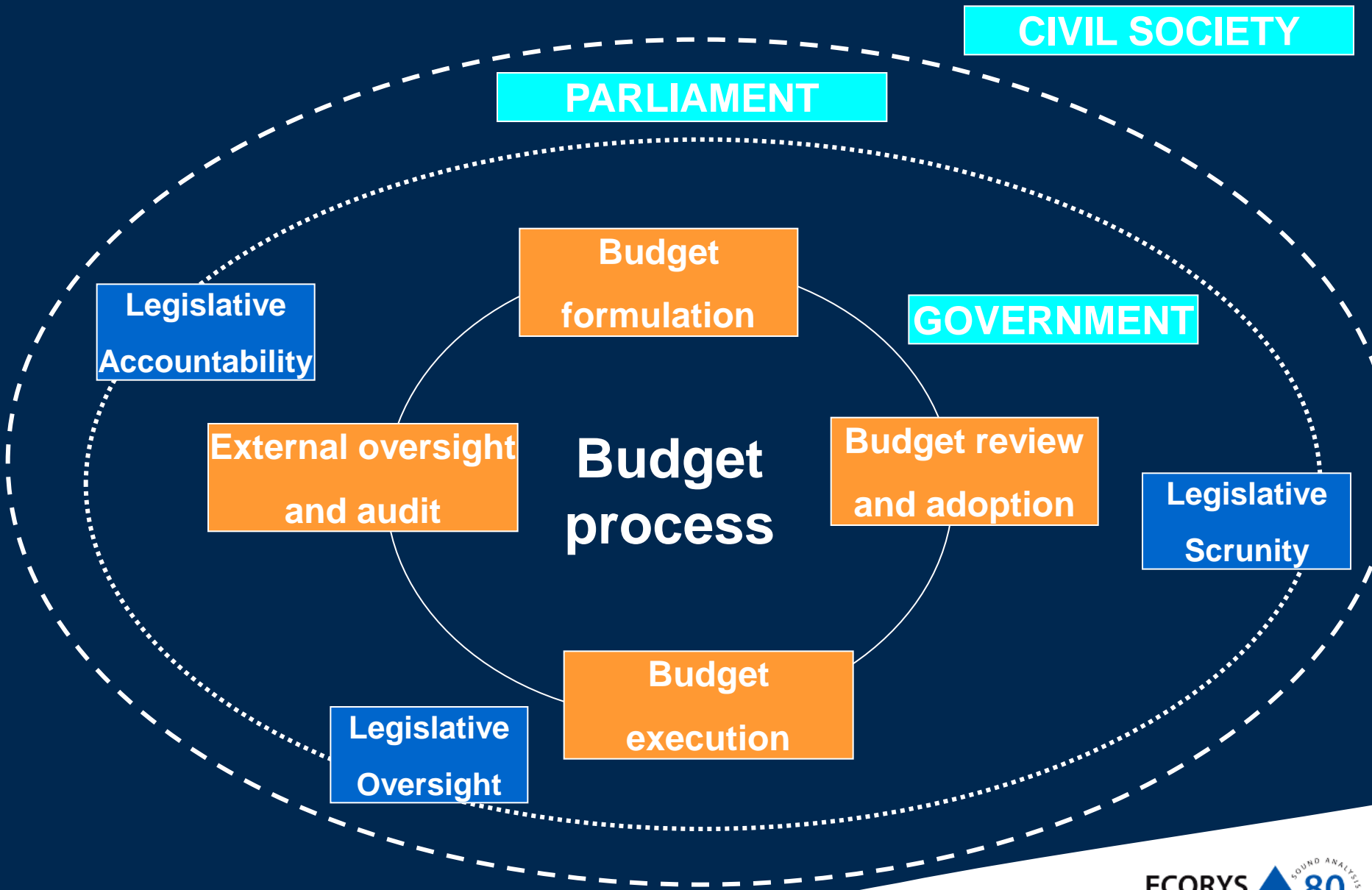
The budget as a **process** ...



... versus the budget as political arena

- Budget process takes place in a political arena of confrontation between competing interests
- Political incentives create a disjuncture between formal and informal practices
- Informal rules of the game undermine the formal budget process
- Interactions between actors and (informal) institutions define the budget arena ...
- ... which can result in process and outcome failures!

The budget arena



Exercise: Examples of informal practices?

Please discuss with your neighbour:

- Different examples of informal rules of the game that undermine the formal budget process
- How these informal practices undermine the budget process and development outcomes of budget policy
- Have you had personal experiences with these informal budget practices?

Formal versus informal institutions

Complementary

Substituting

Accommodating

**Competing or
subverting**

Neo-patrimonialism

- Formal institutions are largely reduced to 'façades'
- Political parties or ethnic/regional groups can be the basis for patronage networks
- Access to public goods and services depends on being part of such networks
- Patronage networks can also be important for distributing rents

BUDGET OUTCOMES

**Pro-poor /
Consistent with plan**

**Not pro-poor /
Consistent with plan**

**Pro-poor /
Not consistent with
plan**

**Not pro-poor /
Not consistent with
plan**

Example: Mozambique

- Primary motivation of politicians was to maintain the state apparatus and to attract donor support
- MoF was weak in relation to sector ministries
- Separation of party and state was weak
- Opposition had little capacity and incentives to influence budget planning
- Low tax effort and weak tax base resulted in little pressure for improving service delivery
- Donors undermined domestic accountability

Example: Malawi

- The budget process is a theatre that masks the real distribution of resources
- All stakeholders 'act' as if the budget formulation will actually have a bearing on the actual implementation and distribution of resources
- Decisions are influenced by informal practices which reduces transparency and limits civil society input to the budget process
- Informal processes undermine the formal institutions
- Outcome is a budget that secures the interests of the politically powerful actors

Implications for **budget reform**

- Reforming the budget process
 - Requires engaging with a broader set of formal actors and informal arenas beyond government
 - Is not only about promoting change, but also overcoming resistance to change
- Potential losers will defend the status quo
- Impediments to change
 - Rent-seeking
 - Patronage
- Political ownership of reform is essential

Implications for **budget reform** (2)

- Political will is essential to determining the credibility of, and commitment to, PFM reform
- PFM reforms must be politically feasible, and sequenced to build political momentum for reform
- Building demand for accountability can be a driver for PFM reform where there is a responsive government
- Incremental reform is more likely to succeed than big bang approaches
- PFM reforms are more likely to succeed where
 - There is the appropriate political space for reform
 - Reform fits within the political and electoral cycle

Case study (1) - Ghana

Assignment

- Read the Summary of the PEFA report
- Answer the following questions:
 1. What do you consider as the main technical weaknesses of the PFM system in Ghana?
 2. What political economy factors could provide an explanation for the existence of these weaknesses?

Example: Ghana

- Democratic deficit of the budget was tolerated due to patronage-driven politics and clientelism
- Resources of the state were used to build support and reward supporters
- Ritual of the formal budget process was maintained as a façade
- Electoral pressures within a competitive political system offered the best prospect of gradual change

Example: **Nigeria**

- Large oil revenues have created political, economic and social distortions
- Lack of sustained citizen pressure on government
- Competition for political power depends mainly on managing patronage relationships
- Policy process is personalised
- Risk of violent conflict reduces the space for reform
- Elites have an easy exit option
- Value systems promote opportunism and short-term behaviour

How can PE analysis of the budget improve **country programmes**?

- Gives a more holistic understanding of the budget process beyond looking at the performance of technical PFM systems
- Helps identify both risks and opportunities to pro-poor policy and PFM reform
- Helps identify budget and accountability reforms that contribute to fostering a political settlement and delivering on wider state-building objectives