

LEARNING PRODUCT

# The Role of Political Economy Analysis in Development Policy Operations



**IEG**  
INDEPENDENT  
EVALUATION GROUP

**WORLD BANK GROUP**  
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**WHAT  
WORKS**

# The Role of Political Economy Analysis in Development Policy Operations

IEG Learning Product

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# Abbreviations

CEM	Country Economic Memoranda
CoP	Political Economy Community of Practice
DPOs	Development Policy Operations
GAC	Governance and Anti-corruption Strategy
GPE	Governance and Political Economy
HD	Human Development
ICRR	Implementation Completion and Results Reports
IDA	International Development Agency
IEG	Independent Evaluation Group
JSAN	Joint Staff Assessment Note
LP	Learning Product
NDS	National Development Strategies
NDS	National Development Strategy
NRM	Natural Resource Management
PEA	Political Economy Analysis
PER	Public Expenditure Reviews
PGPE	Problem-driven Governance and Political Economy
PPAR	Project Performance Assessment Report
PRSCs	Poverty Reduction Strategy Credit
PSIA	Poverty Social Impact Assessment
SCDs	Systematic Country Diagnostic Reports
SORT	Systematic Operations Risk-rating Tool

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# Overview

This learning product reviews the extent to which political economy analysis (PEA) is used to improve the design of development policy operations (DPOs) and how effective it has been. The learning product draws on the following sources: i) Independent Evaluation Group (IEG) reviews of implementation completion and results reports (ICRRs) of DPOs; ii) project performance assessment reports (PPARs); iii) program documents of 40 randomly selected DPOs and analytical products; iv) case studies on the use of PEA in DPOs from IEG evaluations and other World Bank studies; and v) interviews with task team leaders (TTLs) and managers. The main findings are summarized as follows:

**PEA can improve the design of DPOs by identifying implementation risks and mitigating actions.** IEG's evaluative evidence indicates that DPOs benefit from the availability of quality PEA. The lack of PEA to support politically sensitive and difficult actions tend to reduce the effectiveness of operations.

**There are different ways to make use of PEA.** First, the assessment of the eligibility of the client countries for budget support can benefit from PEA. Second, PEA can provide important insights on the political feasibility of

specific reforms supported by DPOs. Third, PEA can inform specific design elements, including choices of programmatic instruments vs. stand-alone operations, or front-loading vs. back-loading of important reform actions in a programmatic series. And fourth, PEA can be used in self evaluations (such as implementation completion reports) to better analyze factors affecting program effectiveness and to contribute to knowledge and improved design of subsequent operations.

**Many analytical products as well as project or program documents in the World Bank already contain PEA relevant for DPOs.** Stand-alone PEA reports are rarely commissioned for DPOs. DPOs largely draw on PEA on country-level and cross-sectoral issues that are typically found in studies, such as institutional and governance reviews, country economic memoranda, poverty and social impact assessments, and public expenditure reviews. DPOs also make use of various sector studies and notes that may contain PEA. Risk assessments in operational documents often draw on PEA, and, thus, can reveal the extent to which political economy perspectives have been applied through formal or informal analysis. More recently, systematic country diagnostics have created new



## OVERVIEW

opportunities for assessment of the overall policy environment and political feasibility of specific reforms.

**The learning product finds that specific PEA customized for DPOs' reform priorities is likely to be under-provided.** Most PEA used in DPOs is geared toward countrywide governance and institutional issues. DPO teams are generally well informed about the overall policy environment and political economy issues. At the same time, the political feasibility of specific reforms supported by DPOs may not receive adequate attention.

**Several factors identified by the learning product may explain the under-provision of reform-specific PEA.** First, the reliance on national development strategies (NDS), which are used to signal ownership and political feasibility of reform programs, might have reduced the perceived need to conduct PEA for individual reform measures. Evidence points, however, to the fact that the need for PEA for politically sensitive reforms has not diminished, even when DPOs are closely aligned with the NDS documents. The presence of particular reform measures in an NDS does not always guarantee their implementation or ownership because operationalization of NDS and the links to policy making may be weak. The reliance on NDS as a guide to political feasibility may lead to the under-provision of PEA. Second,

evaluative evidence points to a variation in the institutional depth of reform actions supported by DPOs: those with fewer significant reform measures have less need for PEA, and hence less demand. Third, budgets for analytical inputs for program preparation have been under pressure in recent years, while resources from trust funds that finance most formal PEA have also been declining, affecting the ability of the team to conduct PEA. And fourth, the lack of a confidential platform for politically sensitive discussions may undermine staff incentives to conduct PEA.

**More broadly, the under-provision of PEA could be a symptom of broader issues concerning the results orientation of DPOs with respect to specific reforms.** The key metrics of results orientation in DPOs is the extent to which DPOs promote policy and institutional change in specific reform areas as reflected in the policy matrix of the instrument. At the same time, other aspects outside the policy matrix, such as predictable financing and, on the back of it, maintaining the World Bank's relevance in the policy dialogue on macro-fiscal frameworks, sector policies, and poverty reduction are also important determinants of the quality of the World Bank's engagement through DPOs. These "reforming" and "financing" elements of budget support can reinforce each other if the World Bank's and clients' priorities are strongly aligned. But

there may be trade-offs between the two when there is a lack of alignment. The trade-offs can manifest in a weaker focus on specific reforms, and, as a result, can lead to under-provision of PEA.

**Better prioritization of reforms supported by the World Bank and risk assessment of specific reform actions may strengthen the results orientation in development policy financing (DPF) with respect to policy and institutional change and increase demand for PEA. Stronger**

integration of DPF with systematic country diagnostics and country partnership frameworks that are underpinned by solid technical and PEA to identify the most critical reforms and to monitor achievement of results can be a way to strengthen the reform pillar of the instrument. In addition, individual risk assessment for all reform actions supported by DPOs may enhance the World Bank's knowledge about the theory of change in those reform areas and contribute to more informed risk-taking in DPOs.



# 1. Introduction

1.1 This learning product reviews the World Bank's experience in the use of political economy analysis (PEA) in development policy operations (DPOs). It is part of the program to strengthen learning and knowledge products in the World Bank (including the Independent Evaluation Group [IEG]). It is also intended to contribute to the World Bank's ongoing reflections on the design and use of DPOs. In FY 2015, IEG produced four learning products, including: (1) macro-fiscal frameworks in DPOs, (2) use of public expenditure reviews in DPOs, (3) social and environmental risks in DPOs and (4) results frameworks in DPOs. This learning product builds on these learning products and a number of proproject-level evaluations (project performance assessment reports [PPARs] for Tanzania, Vietnam, Uganda, and Ghana), IEG's review of implementation completion reports (ICRs) of DPOs, and relevant major evaluations.

1.2 Political economy analysis, whether through formal analysis or other channels, is an important knowledge product for the World Bank's engagement with its clients. Although the World Bank's mandate explicitly precludes it from engaging in politics, an understanding of the political economy is critical for the organization's effectiveness. A political economy perspective broadens the World Bank's operational considerations beyond technical analysis to the significance of power relations and the national political processes.<sup>1</sup>

1.3 The overarching objective of the World Bank's DPOs is to promote policy and institutional change for growth and sustainable reduction in poverty.<sup>2</sup> The World Bank pursues this objective through a civil approach that puts a premium on borrowers' ownership of policy reforms and allows flexibility (in case of programmatic series) to accommodate changes in the pace and contents of reforms.<sup>3</sup> This places an emphasis on accurate reading of the political economy for successful program design and implementation. Recent trends in country policy and institutional assessments (CPIAs), however, indicate that nearly half (22 out of 48) of the countries requesting DPO support have experienced a decline in their CPIA scores.<sup>4</sup> This highlights the

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<sup>1</sup> The Political Economy of Policy Reform: Issues and Implications for Policy Dialogue and Development Operations

<sup>2</sup> World Bank OP 8.60.

<sup>3</sup> Good Practice Note for Development Policy Lending, 2011

<sup>4</sup> Based on a subset of World Bank borrowers that had a CPIA score below 4 in 2006. The list of countries with a decline in CPIA score includes several countries that experienced external shocks and civil conflicts in recent years, such as Yemen, Tunisia, and Mali. However, many other countries in the list that experienced a decline in CPIA, such as Tanzania, Ghana, and Honduras were not subject to such major shocks and deterioration in institutional developments can be attributed to reform slippages and reversals.

importance of strengthening DPO programs and the role of political economy analysis in enhancing the quality of World Bank operations.

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### Box 1.1. The World Bank's Recent Political Economy Analysis Work

PEA, which has a long history in the World Bank, received new impetus following the adoption of the Governance and Anti-corruption Strategy (GAC) in 2007. The momentum was strengthened by the availability of funds through the Governance Facility for PEA, which, however, expired in 2012. The Good Practice Framework developed by the Governance Network was published in 2009 providing guidance on PEA sponsored through the facility and as an attempt to institutionalize PEA as a diagnostic tool. The Social Development Network of the World Bank contributed to the momentum by publication of a report on network's lessons from the use of PEA in its operations. The Political Economy Community of Practice (CoP), consisting of around 400 staff members, serves as a platform for knowledge sharing and is the repository of more than 400 specific PEA conducted in the World Bank from 2005-2015. As of May 2016, there were uncertainties in the organizational structure in which CoP will function due to ongoing restructuring in the Governance Global Practice of the World Bank.

*Source: An evaluation of Political Economic Analysis in Support of the World Bank's Governance and Anti-Corruption Strategy, IEG working Paper, 2011*

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1.4 DPOs have evolved, in part, driven by the World Bank's recognition of the importance of the political economy context for successful policy lending. By the end of the 1990s, a consensus had emerged that the World Bank's adjustment lending operations, which mostly relied on high risk-high return structural reforms often representing first-best solutions, had under-delivered in many cases because of the failure to take political economy realities into account.<sup>5</sup> As a result, a recognition emerged about ownership as a key ingredient for successful reform implementation. This was reflected in the reforms of the instrument in the early 2000s that channeled the energy in the World Bank toward promoting nationally owned reform programs developed through participatory processes and consensus building. The World Bank's Good Practice Framework does not discuss political economy analysis in the context of DPOs. Policy lending draws on insights generated by various analytical tools as well as policy dialogue during program preparation that should generate insights about the feasibility of reforms.

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<sup>5</sup> Borrower Ownership of Adjustment Programs and the Political Economy of Reforms, World Bank Discussion Papers

1.5 To address the key question of the learning product on the extent and effectiveness of the use of PEA for design and implementation of DPOs, this review addresses the following questions:

- Can PEA improve DPO design and in what areas?
- What analytical products contain PEA relevant for DPOs?
- Is the provision of PEA sufficient for informed risk-taking in DPOs?
- What are the factors that can affect the provision of PEA in DPOs?

1.6 In terms of sources of evidence, this study mostly builds on evaluative findings from previous IEG work, including ICRRs, PPARs of long-term programmatic series (Tanzania, Vietnam, Uganda, and Ghana PRSCs). Supplementary evaluative evidence was gathered through a portfolio review of randomly selected DPOs, internal PEA reports, and Systematic Country Diagnostic reports (SCDs) relevant for DPOs. Table 1 shows the documentary sources for this study. This learning product also draws on interviews with World Bank task team leaders (TTLs) and managers.

**Table 1.1. Sources of Documentary Evidence**

Evaluative Reports	Operational Documents	
Independent Evaluation Group	Country and Task Team	Political Economy Community of Practice
400 IEG Reviews of Implementation and Completion Reports (ICRRs)	40 program documents of randomly selected DPOs (See Annex C)	600 Internal reports relevant for DPOs
20 IEG Project Performance Assessment Report (PPARs)	10 SCDs	
	Miscellaneous (Public Expenditure Review, Joint Staff Assessments, Poverty and Social Impact Assessments, etc.)	

Source: IEG

1.7 The focus of this learning product is on formal PEA conducted in the World Bank through various analytical products. The role of informal PEA that provide inputs for program preparation may be substantial too. Although assessing the full extent of informal PEA is rather difficult under an IEG learning product that largely draws on existing evaluation evidence, in deriving the lessons this learning product factored in available information on informal PEA collected through interviews of World Bank staff. The learning product also draws on the risk assessment review in DPOs that can point to the extent of the use of both formal and informal PEA.

## 2. Political Economy Analysis in DPOs<sup>6</sup>

2.1 This section provides an overview of the use of PEA in the context of DPOs. It illustrates i) the types of analytical products containing PEA; ii) frequency of their use; and iii) the issues covered. This overview is a synthesis of evaluative evidence from IEG's reviews of ICRs and PPARs, as well as a portfolio review of PEA products and randomly selected DPOs.

### The use of PEA in the World Bank Group

2.2 PEA, whether through formal analysis or tacit understanding, is an important element in the World Bank's engagement with clients. Although the World Bank's charter explicitly prohibits political involvement, an awareness of the political economy is critical for effective diagnostics and design of World Bank operations.<sup>7</sup> A political economy perspective broadens the World Bank's operational considerations beyond technical solutions and takes into account the significance of power, relations, vested interests, and social divisions. This point of view enhances the World Bank's engagement and effectiveness as a development partner.<sup>8</sup>

2.3 PEA has a long history in the World Bank. It received new impetus in 2007 from the adoption of GAC Strategy. The availability of funding for PEA through the Governance Facility, a donor-supported funding source for analytical activities, added to the momentum. The Governance Network issued the Good Practice Framework in 2009 to institutionalize PEA as a diagnostic tool. The Social Development Network contributed to the interest by publishing a report on the network's lessons of experience from the use of PEA. Today, the Political Economy Community of Practice (CoP), with membership of around 400 staff, serves as a platform for knowledge sharing. Its repository contains a database of more than 600 PEA products delivered by the World Bank during 2005-2015.

2.4 The number of PEA reports has gone down with the closing of the Governance Facility, but there is evidence that PEA has gained traction in the context of the World Bank's increasing focus on results. The mainstreaming of PEA in operations has gone

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<sup>6</sup> The term "development policy operation" is used in this paper to refer to budget support operation of the World Bank. When similar operations are conducted by other donors, the more general term "budget support" will be used. In effect, the two terms – DPO and budget support – are interchangeable

<sup>7</sup> Fritz, V., Kaiser, K. and Levy, B., 2009. Problem-driven governance and political economy analysis. The World Bank.

<sup>8</sup> Norton, A., Beddies, S., Holland, J., Garbarino, S., Gamper, C., Ruckstuhl, S. and Sjorslev, J., 2008. The political economy of policy reform: Issues and implications for policy dialogue and development operations. The World Bank and Oxford Policy Management.

beyond producing specific PEA products. In recent years, more analytical products and operational documents funded from World Bank administrative budgets have applied PEA “lenses” in their analysis.<sup>9</sup> In addition, the new SCDs were introduced which have a specific mandate to identify binding constraints for growth and poverty reduction and to derive the best response through assessing political feasibility.

2.5 The approach to PEA in the World Bank has evolved. The so-called “problem-driven” PEA that focuses on specific reform issues, preferably the most important binding constraints, rather than addressing only broad and cross-cutting governance issues has gained wider acceptance. Such ideas as “working with the grain” and “good-fit” give more weight to incremental institutional changes in a particular situation, rather than the pursuit of the most optimal policy.<sup>10</sup> Many stakeholders find that these concepts contributed to the operational relevance of PEA.

### **Analytical framework of budget support and the role of PEA**

2.6 PEA is seen as a useful approach for enhancing the development effectiveness of donor-led interventions. Its role in DPOs, which is known more generally as “budget support,” is especially important because, with a greater reliance on country systems and possible information asymmetries, it is particularly susceptible to the “principal-agent” problem.<sup>11</sup> Policy and operational frameworks for budget support of different donors vary, but one common feature is the emphasis on the alignment of donors’ and recipients’ priorities.<sup>12</sup> To ensure that the alignment is valid, it is incumbent on the donors to acquire adequate understanding the recipient’s political economy.

2.7 Budget support became an important part of World Bank support as it became evident that cross-cutting policy reforms were often critical for achieving broader development objectives. Investment lending – or projects – are sometimes hampered by broader issues beyond the scope of the project, including macro-economic or structural imbalances. Structural adjustment credits (SACs) were introduced by the World Bank in the 1980s to ensure adequate macro and policy environment through a combination of external financing and structural conditionality. However, the results of World Bank-supported structural adjustment programs in the 1980s and 1990s were mixed. The lack of adequate assessment of the political economy and reform ownership was deemed a

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<sup>9</sup> Unpublished Note prepared by the Political Economy Community of Practice (by Sakuntala Akmeemana).

<sup>10</sup> Working with the Grain by Brian Levy. New York: Oxford University Press, 2014.

<sup>11</sup> An agency problem, or principal-agent problem, arises when the agent, such as the government of an aid recipient, may or may not act in the best interest of the principal, say, the donor or the World Bank.

<sup>12</sup> Reconciling Alignment and performance in budget support Programs: What Next?; Budget Support as More effective Aid? World Bank 2006.



key factor.<sup>13</sup> The experience with SACs highlighted the inherent limitations of conditionality when ownership was not in place.

2.8 With the reorientation of donor aid to focus on aid effectiveness and donor harmonization under the Monterrey Consensus in 2002 and Paris Declaration in 2005, the emphasis shifted from heavy reliance on conditionality towards better selection of recipients that are able to demonstrate sufficient ownership of growth promoting and poverty reducing reforms. Increasingly, donors applied pre-conditions such as country-owned national development strategies (NDS), pro-poor public expenditure frameworks, and growth-oriented policies. Of particular importance are the technical merits of NDS and the extent of its ownership of the key stakeholders. Although the use of conditionality by the World Bank did not disappear entirely, the mechanism to pursue reform measures through DPOs of more recent vintage (since the early to mid-2000s) was more flexible. The resulting new model of budget support that was first introduced in PRSP countries also applied to the World Bank's broader client base.<sup>14</sup> The focus on NDS and a flexible approach to conditionality became the main feature of the World Bank's budget support generally.

### **Relevance of PEA in the current operational framework**

2.9 The current framework for budget support hinges first on countries' readiness based on their development strategies, macroeconomic environment, and the quality of public expenditures.<sup>15</sup> These are considered "pre-conditions" of the World Bank's budget support. As an instrument for promoting reforms, DPOs target specific policy and institutional improvements in various sectors through sector-specific prior actions. DPOs can support reforms in any one sector or many sectors simultaneously. According to the 2015 DPO Retrospective of the World Bank's Operational Policy and Country Services (OPCS), more than half of the prior actions in 2012-2014 were outside macro-fiscal and public financial management. This fact underscores that DPOs aimed to influence a wide scope of policy and institutional reforms.

2.10 Under the current operational framework, PEA is especially relevant for assessing the ownership by the government of the national development strategies, pro-poor public expenditures, and growth oriented policies. While the assessment of pre-conditions – macro-economic framework and pro-poor public expenditures – requires a sound technical analysis, a political economy perspective can add value. Paying special attention to the fiscal balance in an election year, for example, often reveals the degree

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<sup>13</sup> Borrower Ownership of Adjustment Programs and the Political Economy of Reform, World Bank, 1993.

<sup>14</sup> Poverty Reduction Support Credit, an Evaluation of World Bank Support, IEG 2010

<sup>15</sup> OP 8.60 and BP 8.60.

of commitment of the incumbent administration to economic stability. The World Bank's current procedures do not mandate PEA in the preparation of DPOs, but the OPCS good practice guidance note requires an assessment of country's ownership of reforms (see Box 2.1). The steps recommended for the DPO teams, such as government track record, public support of key policy makers, and engagement of interest groups in the policy dialogue, are clearly elements of PEA.

### Box 2.1. Indicators for Assessing Country Ownership

- The government has recently taken initial steps to implement elements of the reform program to be supported by the operation.
- The government has a good track record in implementing related reforms.
- The reform is specifically endorsed in the country's formally adopted national development strategy, PRSP, or similar document that has been widely discussed and formally approved.
- The government has taken the initiative in formulating the reform agenda and presenting it to the World Bank.
- Key policy makers articulate their intellectual conviction that the reform is needed.
- Top political leaders have publicly stated their support for the reform.
- The government has undertaken efforts to build support for the reform among key constituencies.
- Relevant interest groups have been engaged in dialogue with the government about the reforms and have indicated general support. Potential beneficiaries have been mobilized, and the concerns of groups that might suffer losses from the reforms have been taken into consideration.
- The reform has been openly advocated during the campaign of an elected government.

Source: OPCS

2.11 Assessing the ownership of broad reform programs and their individual components supported by DPOs is an integral part of the overall risk assessment that allows informed risk taking in DPOs. In this respect, risk assessments typically reflect the extent of PEA conducted for program preparation, including formal and informal PEA. This potential link is used in the learning product to derive inferences on the extent of the use of informal PEA based on the review of risk assessment for DPOs.

## 3. Evidence from IEG Reviews and Evaluations on the use of PEA

3.1 Evaluative evidence on the role of PEA in DPOs comes from about 400 reviews of ICRs (ICRRs) prepared in 2005-2015, as well as a number of PPARs. A review of this evidence suggests that while the World Bank draws on country-level diagnostics that often contain elements of PEA, there may be an under-provision of PEA in sector-specific reforms that the DPOs seek to accomplish.

### How is PEA used in DPOs?

3.2 One in six ICRRs (or 17 percent of the total) mentioned PEA either as a contributor to success or as a gap in cases of failure. This is a significant percentage since there are no requirements in ICR or ICRR methodologies to reflect on the political economy. The results below illustrate the range in which PEA has been put to use.

3.3 **Assessing the choice of the instrument and eligibility for budget support:** Some ICRRs highlight that PEA has helped to shed light on ownership of the overall reform program as a pre-condition for budget support. More specifically, in some ICRRs successful design and implementation of reforms is attributed to quality PEA, where PEA realistically assesses the feasibility of the government reform program (Afghanistan) and creates a platform for policy dialogue using PEA (Mozambique). ICRRs also discuss cases where the absence of PEA leads to weak implementation. Other instruments, such as technical assistance, could be more effective (Cote d'Ivoire). Evaluative evidence also suggests that the World Bank's choice of the instrument may be affected if the focus is only on technical analysis, such as fiduciary assessment, without paying attention to the political economy (Namibia and Iraq). Beyond available evidence from ICRRs, this learning product also highlights the important role of PEA in many of the World Bank's decisions to drop plans for DPOs in the pipeline because of high risks of non-implementation of reform programs<sup>16</sup>.

3.4 **The availability of quality PEA does not always translate into better design:** The insights from PEA are not always taken into account. For example, the knowledge gained from PEA about the role of political cycles in Vietnam (timing of Party Congress) in reforms was not adequately used in preparation of a major DPO. In

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<sup>16</sup> These decisions are mostly based on informal PEA, which are difficult to observe. However, a number of cases are known to the World Bank from country or program level evaluations.

Ghana, available quality PEA revealed the complexity of public wages and the difficulties in wage control in an election year. Those risks, however, were not adequately mitigated in the design, resulting in the implementation of a DPO in an unstable macroeconomic environment<sup>17</sup>.

**3.5 In the context of specific reforms:** PEA is used to promote sensitive reforms in many areas including power tariffs, agriculture subsidies, public wages, tax exemptions, land use, social protection, and healthcare, among others. As an example, the failure to conduct a proper “mapping of the stakeholders” was found as a major shortcoming in a DPO seeking power sector reforms in the Dominican Republic (further elaborated in a case study below).. A Malawi DPO was not able to achieve the intended results because political constraints in the reform of fertilizer subsidies were not anticipated. The lack of PEA compromised the design on tax reforms in Honduras. In addition to these cases, Box 3.1 summarizes a case study conducted for this learning product on DPOs implemented in a challenging political economy environment without formal assessment of political feasibility of reforms.

**3.6** Another lesson from the review of ICRRs is that some political risks can be mitigated by appropriate consultations and addressing grievances. The Lao People’s Democratic Republic’s (PDR) experience, for example, suggests the importance of i) identifying champions in government with a well-defined reform agenda; and ii) engaging with a broader range of actors. A case from Mexico illustrates the importance of engaging with the line ministries and with agencies that are subjected to reforms to ensure their ownership as well. Romania’s example illustrates that political support for reforms needs to be broad-based, including some degree of support from the opposition, when social consensus is unclear. In such an environment, finding the common ground between government and opposition through PEA is needed to prevent policy reversals.

**3.7 Informing specific design elements:** Some ICRRs offered lessons about the choice between programmatic versus stand-alone DPOs based on PEA. For example, in a DPO in Cote d’Ivoire, the ICRR pointed out that a stand-alone operation would have been more effective than a programmatic series because of high risks of reform non-implementation. By contrast, St. Lucia’s case suggested that a programmatic series was beneficial in a contentious political context, but it was necessary to design interventions in a multi-year perspective to sustain continuing policy dialogues around key issues.

**3.8 Evaluating results of DPOs:** Some ICRRs highlighted the importance of providing PEA in the ICRs to inform the preparation of follow-up operations. For

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<sup>17</sup> IEGs evaluation of Vietnam and Ghana PRSCs (2015 and 2016, respectively)

## CHAPTER 4

### FACTORS AFFECTING THE PROVISION OF PEA

example, an ICR on a Vietnam DPO did not provide an account of political economy factors that were key in the failure of public investment reforms even though another operation targeting the same reform areas was in the pipeline. PEA at completion could have helped with the design of the next operation. By contrast, PEA provided in the ICR of a DPO in Uganda on legislative politics and its impact on World Bank-supported legal initiatives was useful for the World Bank's follow-up operations.

#### Box 3.1. The Dominican Republic: Power Sector Reforms

The power sector in the Dominican Republic has been in distress since the early 2000s. The persistent gap between tariffs charged and the operating cost was exacerbated by the widespread theft and poor collection of bills. The losses placed a severe financial strain on the sector, limiting its ability to improve services. A DPO approved in 2005 was the first in a planned program of three (two development policy loans and one investment loan) to address challenges in the power sector. The development objective was to support the government's strategy for the recovery of the power sector through set of important reforms that were at the core of government strategy. There appeared to be a sense of urgency among the stakeholders to work out strong and lasting solutions.

The program, however, could not achieve substantial results. The government's payments of subsidies and its bills to the utility company remained irregular; the tariff regime remained grossly inadequate to cover costs; the regulatory agency remained weak. Allowing tariffs to fluctuate according to the agreed formula was difficult for the government to comply with, even when there were no spikes in oil prices. IEG's review highlighted that although some of the key risks were identified at the outset, such as the possibility of fading government ownership of the reform program, political economy barriers to achieving difficult reforms continued strong consumer resistance to bill paying and tariff increases (especially given poor service quality), no further analyses were done on mitigation of those risks. The design was predicated on the assumption that large and rapid disbursements of budget support would motivate the authorities to implement the reforms strenuously. This, however, was not consistent with the history of budget support in the Dominican Republic that showed that DPLs were difficult to implement with frequent dilutions of prior actions.

Many political economy issues were at work to undermine the outcomes of power sector reforms. The political economy setting is believed to be one where politicians are more likely to deliver specific favors to particular groups than to promote general welfare. In the Dominican Republic at the time of this operation, voters had learned to expect short-term benefits, like lower electricity tariffs, instead of more distant gains like financial sustainability of public utilities. Politicians – or more generally policy entrepreneurs – knew that refusing to adjust tariffs – and thus violating agreements with external partners – carried little cost. In addition, stemming power losses called for a change of deep seated behavior among employees of distribution companies, including weeding out illegal power connections and collecting payments fully and promptly, which may have been contrary to prevailing social norms. A careful review and analysis of the political economy prior to the implementation of DPOs could have made a difference. It could have informed the task team and the government of the challenges that lay ahead – and possibly of a different approach that

would allow more time and more grassroots consultations to build the necessary political coalitions.

*Source: IEG Learning Product on World Bank's support of Financial Viability of Power Sector; IEG review of DPO Program Documents; and IEG analysis.*

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## What are the sources of PEA used in DPOs?

3.9 The World Bank conducts PEA in different ways to inform the preparation of DPOs. These include formal analysis and informal use of tacit knowledge by country and program managers. This study draws mostly on documented sources and primarily focuses on formal PEA. Nonetheless, IEG recognizes the importance of informal PEA. In fact, many managers in the World Bank believe that most PEA remains informal due to possible sensitivities that may arise from formal PEA analysis. The value of formal analysis, however, is to create institutional memory and documentation of evidence for the future.

3.10 To determine the characteristics of PEA used in DPOs, the following genres of documents have been reviewed:

- First, about 600 internal and external reports in the repository of PEA (managed by the Political Economy CoP).
- Second, 40 randomly selected program documents of programmatic or stand-alone DPOs in the period 2006 - 2014 (around 20 percent of total) with a special focus on analytical underpinnings of operations and risks assessment.
- Finally, the World Bank's newly launched diagnostic instrument, SCDs.

3.11 As illustrated in Figure 2, one can distinguish three broad levels of PEA:

- The macro or country- level;
- The sector and thematic level; and
- The project- and policy-specific level.

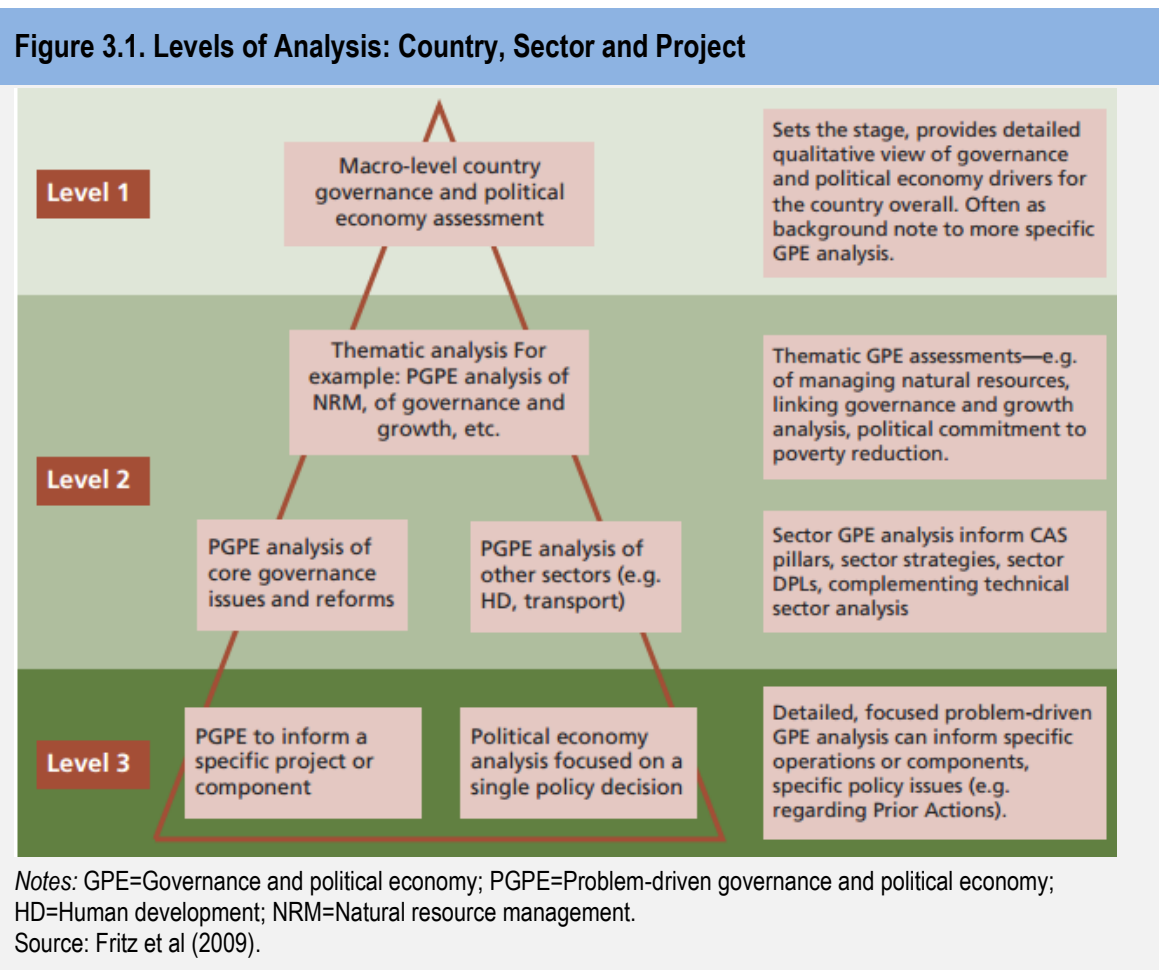
3.12 PEA can focus at one level only or cover several levels. Country-level analysis captures the overall governance and the main political drivers. Analysis at this level deals with important factors, such as geopolitics, social divisions – economic, ethnic, or religious – and the distribution of economic rents, as well as how they have evolved. Sector and thematic PEA focuses on specific areas and may cover an entire sector “value chain” or selected issues within a sector or broad theme. The third level is problem-driven governance and political economy (GPE) analysis focused on specific projects or

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policy decisions. Such analysis aims to generate advice to a single operation or to aid in dialogue on a specific issue.

3.13 A number of observations can be made based on this multi-genre review:

- There is a distinction between problem-driven PEA and more generic PEA. The former, issue-focused (sector- or reform-specific) PEA, targets problems that DPOs address through prior actions. The latter, generic PEA, addresses cross-cutting governance or macro-economic issues, including ownership of national development strategies.
- Another distinction is between specific PEA products versus the World Bank’s mainstream analytical products, such as country economic memoranda (CEM), public expenditure reviews (PERs), poverty social impact assessments (PSIAs), joint staff assessment notes (JSANs), risk assessments, and SCDs that may use special PEA. In the category of specific PEA, the work is specifically commissioned for a DPO or for related investment lending.



3.14 The review for this learning product identified the following products that provide DPO-relevant PEA.

3.15 **PEA specifically conducted for DPOs:** The portfolio analysis indicates that this category is very rare. There are few reports in the repository that were specifically prepared for DPOs. This is confirmed by the portfolio review of program documents of selected DPOs. Out of 40 DPOs, only two included specific PEA reports prepared for operations. One example is the PEA on the mining sector in Burkina Faso, which provided important insights on natural resource management. A key fact is that the World Bank seldom commissions formal PEA for DPOs.

3.16 **Sector-specific PEA conducted for parallel project financing relevant for DPOs:** Although this subcategory is more common than specific PEA for DPOs, it is still not widespread. Fewer than one in six DPOs draw on sector-specific analytical products with PEA prepared as part of the World Bank's investments lending. In such cases, PEA is found in sector-specific technical notes, often not published on the World Bank's website.

3.17 **"Generic" PEA relevant for DPOs:** This type of PEA is more prevalent. Although not specifically prepared for DPOs, they provide important insights about cross-sectoral governance and institutional issues (institutional and governance reviews, for example). About half of the DPOs reviewed for this study had country-level PEA available at the time of preparation. Although this type of PEA can help in assessing the overall reform momentum in the country, it typically does not provide insights about sector-specific reforms except in cases where the PEA covers the same issues (as with DPOs on governance reforms).

3.18 **Joint staff assessment notes:** JSANs were introduced in the early 2000s jointly by the World Bank and the International Monetary Fund (IMF) to assess the national development strategies of International Development Association (IDA) countries as a criteria for concessional lending. The focus of the notes has been on the extent to which national development strategies are pro-poor, linked to the budget, and reflect broader views on country development. JSANs contain some elements of PEA because of the focus on the feasibility of broad reform programs and the assessment of stakeholder consultation and participation. The operational importance of JSAN has declined recently because the role of PRSPs as a platform for mobilizing donor assistance has diminished (further discussed in section 2) and many IDA countries have graduated. JSANs are no longer mandatory for IDA countries and are currently being phased out.



3.19 **Poverty and social impact assessments:** PSIA's are important analytical products that the World Bank has employed for more than a decade. By definition, PSIA's can be used to examine changes in power relations, which are political economy issues.<sup>18</sup> One World Bank study<sup>19</sup> has identified PSIA's from the period 2003 to 2007 that provided good analysis of the losers and winners of reforms and insights about the interests of elites and their influence on reform proposals. But not all PSIA's use PEA lenses. The study previously mentioned also listed seven DPOs that drew on PSIA with PEA (Burkina Faso, Senegal, Tanzania, Indonesia, Malawi, Chad, Mozambique, and Mexico). The PSIA of Tanzania looked at important political economy aspects of crop board reforms and is summarized in Box 3.2.

3.20 The review of randomly selected DPOs for the period between 2007 and 2014 uncovered only one DPO that draws on PSIA with PEA (the Kyrgyz Republic energy sector). Although the findings of the 2008 study and the results of the portfolio review are not directly comparable, there is an indication (also confirmed by interviews) that the use of PSIA's as PEA for DPOs might have become less prevalent in recent years. Box 3.2 provides a summary of a cases study on the use of PSIA's as PEA for DPOs.

### Box 3.2. Tanzania Crop Board Reform: PSIA and DPOs

Crop boards play a significant role in determining the production and investment environment of agricultural Tanzania's export crops. Issues attributed to their activities had raised concern about industry performance. In 2003, the government requested support for further analysis of the boards in the form of a PSIA, which was conducted jointly by the government, the World Bank, and the European Union. The PSIA provided very important insights on political economy of reforms and possible options to advance the reform agenda. It revealed many important challenges, such as the institutional vacuum after liberalization, uneven private sector participation, unfair trading, mixed public and private activities and conflicts of interest, lack of accountability, smallholders unawareness of the pricing mechanisms, and quality rewards. The study also showed that parts of government and smallholder producers were skeptical about the market economy and adhered to socialist principles and traditions. Hence, the crop boards and some government agencies at the political level opposed to the reforms that would reduce controls over private agents and require greater accountability to producers in service delivery. The study also revealed strong support for reform at the technical level in the government. The study developed three reform options in addition to a fourth option of "no change."

The World Bank supported the crop board reforms through two series of PRSCs. The original plan was ambitious, but the delays in implementation began at the early stages of reform. In spite of several actions, there has been insignificant progress in reforms under DPOs reflected in IEG's evaluation. Critical factors that the PRSCs seem to have overlooked were the political

<sup>18</sup> Tools for Institutional, Political and Social Analysis of Policy Reform.

<sup>19</sup> The Political Economy of Policy Reform, The World Bank, 2008.

economy factors behind sensitive reforms identified by PSIA. The PSIA had noted that export crops, such as coffee, could be a lucrative business for a wide range of stakeholders, including public sector employees. Political life was dominated by clientelist politics and clientelist political organizations. Powerful interests, within and outside of the crop boards, defended the status quo that benefits them. Despite general political will for reform, actual commitment to a prompt reform implementation was less well established. IEG's review found that the links between PSIA findings and the design of PRSCs were quite weak.

The importance of the political economy factors behind agriculture sector reforms in Tanzania were further highlighted by another study on the political economy of agricultural sector reforms that recommends to focus on broader demand-side governance interventions to have a greater potential for improving the incentives of politicians to effectively implement growth and poverty-reduction policies.

*Source: The Political Economy of Policy Reform (The World Bank, 2008); PPAR of Tanzania PRSCs (IEG 2013)*

**3.21 Public expenditure reviews (PERs):** The review finds that PERs had elements of PEA in only two (Pakistan subnational water sector reform program and Lao PDR multi-sector DPO) of 40 DPOs that informed the design of operations. This small number of PEA-relevant PERs suggests that this high-profile and widely-disseminated document may be more appropriate for technical analysis than for PEA.

**3.22 Risk assessment:** According to the review, risk assessment turns out to be an important instrument containing elements of PEA. The guidance note on DPOs instructs every operation to identify risks, present a strategy for mitigating the risks, and explain why the remaining risks are worth taking. Some of the questions in the checklist of the operational guidance for risk assessment are relevant for understanding the political economy and, in this respect, risk assessments offer an opportunity to apply political economy lenses in World Bank analysis. At the same time, risk assessments may reflect the extent of underlying PEA for program preparation, both formal and informal.

**3.23** Most program documents (PDs) for DPOs identify risks associated with the political economy. In most cases those were country-level risks rather than reform-specific risks. Less than half of PDs provided risk assessment about individual reform areas and a minority of multi-sector operations provided sector-specific risk assessments for the sectors covered. Only two DPOs out of 40 reviewed provided risk assessment, some of which drew on formal and informal PEA, per each policy area or reform action.

**3.24** In addition to assessing the risks, PDs provide risk mitigation measures, some of them informed by PEA. In 20 percent of PDs, the risk mitigation section provides discussions of the political economy. Examples of PEA in risk mitigation include the

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front-loading of reforms in Pakistan's programmatic DPOs and the use of special sector notes for discussion with opposition parties in Panama to address political risks.

3.25 In 2014, a risk assessment of DPOs was integrated with the World Bank-wide risk assessment framework, the Systematic Operations Risk-Rating Tool (SORT). Under the new approach, the focus was still on assessing the risks to the development objective stemming from the country's political economy and governance, but without assessing the overall riskiness of a country. The framework highlights that political and governance risks should be assessed specifically against the development results associated with the operation. This highlights the importance of the problem-specific approach to risk assessment. The SORT itself is not intended to be a risk management strategy or mitigation plan. Instead, it is intended to be the screening mechanism on which such a plan would be based.<sup>20</sup>

3.26 This evaluation highlights that the risk analysis underpinning program preparation may also point to the extent of informal PEA undertaken by World Bank teams working on DPOs, a largely unobservable activity that would otherwise be very difficult to capture. Many stakeholders indicated that informal PEA play an important role as formal analysis with sensitive materials is not always possible. However, even informal PEA should be reflected to a certain extent in the risk assessment sections of program documents.

3.27 **Systematic country diagnostics:** SCDs were introduced in 2014 to enhance the link between diagnostics and the World Bank's country engagement. The corporate guidelines on their preparation mentions that "recognizing that there is no blueprint for poverty reduction and income growth, SCD[s] would take into account country context, including political economy factors, in identifying constraints, solutions, and opportunities". This implies the use of PEA in the preparation of SCDs. As part of this exercise, IEG conducted a review of 10 SCDs relevant for preparation of DPOs (out of total 31 SCDs).<sup>21</sup>

3.28 All relevant SCDs were found to include a focus on the political economy in the areas covered by DPOs, but with varying depth. This suggests that SCDs are potentially an important instrument that can inform the design of DPOs and implementation. Half of the reviewed SCDs (Albania, Chad, Cote d'Ivoire, Jordan, and Panama) provided sector- or problem-specific PEA in the areas relevant for DPOs. The coverage varied from drawing on a specific sector study with indepth PEA to assessments of political feasibility. The example of Chad is instructive. PEA in SCDs gives rich political insights

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<sup>20</sup> Interim Guidance Note Systematic Operations Risk-Rating Tool (SORT), June 25, 2014, the Word Bank.

<sup>21</sup> Defined as cases when SCD preparation was followed by preparation of a new DPO series

and assesses the feasibility of proposed actions including possible measures to mitigate risks (for example, compensatory mechanisms for those who will lose rents as a result of reforms in price setting for export crops). The remaining SCDs (Columbia, the Arab Republic of Egypt, Honduras, Indonesia, and Madagascar) offer only generic PEA on overall reform momentum without a specific focus on sectors or problems. This can be useful for DPOs, albeit they may not substitute for analysis of specific issues.<sup>22</sup>

### **Is PEA underprovided in DPOs?**

3.29 As the review of evaluative evidence indicates, the importance of PEA is recognized in assessing country-level risks and the feasibility of individual reform actions to be implemented in a challenging context. The World Bank has conducted PEA through various instruments such as sector-specific studies for DPOs or for investment lending operations implemented in parallel to DPOs, PSIAAs, PERs, SDCs, and in operational risk assessments. In addition, informal PEA used at various decision points of World Bank engagement may also be playing a role.

3.30 A key finding emerging from this review is that the World Bank mostly draws on country-level PEA involving cross-cutting governance and institutional development issues. By and large, this knowledge is gained through the assistance with preparation of NDSs in IDA countries and through work on SCDs and country assistance/partnership strategies. It helps in assessing operational risks. At the same time, the use of sector-specific or reform-specific PEA remains uncommon. In fact, the World Bank seldom commissions sector-specific PEA for DPOs. While there has been more attention given to the feasibility of individual reforms with the introduction of SCDs, this instrument is yet to mature.

3.31 The lack of formal sector or problem-specific PEA does not necessarily imply that PEAs are underutilized. Notably, PEA is not always warranted, but it is of utmost importance in situations where uncertainties or sensitivities abound with respect to reforms. Also, many sector-specific issues can be addressed through informal PEA.

3.32 Nevertheless, relative to the ambitions of the instrument in promoting reforms, the dearth of sector-specific PEA may well be a sign of under-provision. As the World Bank's DPOs pursue very specific sector objectives, there is a high premium on understanding both the technical merits and political feasibility. In some cases, the World Bank may also need to work on expanding the reform space and finding common grounds. The literature on the use of PEA for World Bank DPOs highlights

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<sup>22</sup> An upcoming IEG evaluation of SCD/CPF will provide a comprehensive coverage of various aspects of SCD/CPF

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specific areas where such analysis can be used, including a) defining politically feasible prior actions; b) directing resources efficiently to the most promising reform prospects; c) identifying specific opportunities for reform and developing risk mitigation strategies; and d) building consensus for reforms.<sup>23</sup> This suggests a substantial reform- or problem-specific focus in PEA which may be lacking.

3.33 This review also highlights that although the World Bank uses informal PEA (mostly unobservable) for program design, the fact that risk assessment in DPOs, which should to some extent reflect the results of informal PEA, is mostly about country-level and cross-cutting governance issues rather than specific reforms may point to an overall weaker focus on the political feasibility of specific reforms both in formal and informal PEA.

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<sup>23</sup> Nunberg, B., Barma, N., Abdollahian, M., Green, A. and Perlman, D., 2010. *At the Frontier of Practical Political Economy*.

## 4. Factors Affecting the Provision of PEA

4.1 This section looks at factors emerging from evaluative evidence that may affect the extent of provision of PEA in DPOs and specifically in the sector-specific problems that DPOs aim to address. These factors include 1) reliance on NDS and sector strategies; and 2) the depth of reforms supported by DPOs.

### Reliance on NDS as a building block for DPOs and implications for PEA

4.2 A new paradigm of donor harmonization and predictable aid flow emerged in the early 2000s. It sought to bring about higher investments and pro-poor expenditures in poor countries with demonstrated capacity for managing aid resources without stringent conditionality.<sup>24</sup> In this new concept, country-owned NDSs for growth and poverty reduction became the main platform of harmonized budget support. Defined as outcome-oriented documents that draw on a long-term vision, incorporate sectoral strategies, and shape countries' public expenditures,<sup>25</sup> NDSs became a screening mechanism for assessing a borrower's ownership of public expenditure and reform programs<sup>26</sup>.

4.3 The approach of relying on NDSs was in line with the notion of "best-practice" budget support where the reform program owned by the governments was supported and performance was to be measured by the extent to which the NDS was implemented.<sup>27</sup> Although this was initially an aid delivery approach for IDA countries, the reliance on NDSs soon became an important feature of the World Bank's budget support applied in both IDA and International Bank for Reconstruction and Development countries.<sup>28</sup>

4.4 Under this new approach, the donors, including the World Bank, directed their efforts to helping the clients to prepare NDSs as a building block for budget support with an emphasis on stakeholder consultations and consensus building to ensure ownership of pro-poor and growth-oriented programs. A new product, the joint staff advisory note, was introduced by the World Bank and IMF for a formal assessment of

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<sup>24</sup> This approach is perhaps best exemplified in the Millennium project.

<sup>25</sup> Results-Based National Development Strategies: Assessment and Challenges Ahead, World Bank, 2007

<sup>26</sup> Reconciling Alignment and Performance In Budget Support programs: What Next? David Booth, Karin Christiansen, and Pablo De Renzio, ODI (published in "Budget Support as More Effective Aid?" World Bank 2006)

<sup>27</sup> Aid Effectiveness: Opening the Black Box, François Bourguignon and Mark Sundberg, The American Economic Review, Vol. 97, No. 2 (May, 2007).

<sup>28</sup> PRSC Evaluation, IEG 2010.

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NDSs in IDA countries to determine their readiness for concessional borrowing. These efforts in many cases involved political economy issues, although the focus was on country-level, rather than problem-specific PEA.

4.5 In spite of the reliance on the NDS, DPOs remained a pragmatic instrument to advance specific reform objectives. Under the new framework, the concept of "prior actions" – a softer form of conditionality – emerged both as a monitoring device for the implementation of the NDS and for targeting specific reforms. In an early generation of PRSPs, there was a premium placed on prior actions that directly came from NDS. This practice naturally changed the way the World Bank assessed the feasibility of individual actions taken from NDS. The expectation was that, since these actions came from NDS, they would be implemented sooner or later. Thus, the reliance on NDS, which signaled ownership and political feasibility of clients' reform programs, might have reduced the perceived need to conduct PEA for individual measures supported by DPOs.

4.6 An example is found in an IEG's evaluation of programmatic series of Tanzania, Vietnam, Uganda and Ghana Poverty Reduction Support Credits (PRSCs). According to these evaluations, many important triggers proposed at the outset were directly taken from the NDS. Nonetheless, many triggers were dropped or weakened in subsequent series because of inadequate political support. In retrospect, sector-specific PEA could have shed light on the feasibility of these reforms.

4.7 In general, there is mixed evidence on the performance of NDSs – both in terms of operational relevance for DPOs and in terms of the links to national budgeting processes. The 2007 World Bank review<sup>29</sup> concluded that in spite of initial successes, the links between NDSs and the budget remained weak in most countries and progress in developing results-oriented frameworks was limited.<sup>30</sup> IEG's evaluation of PRSCs mentions that NDSs did not always provide good quality poverty and growth diagnostics. No systematic assessments of NDSs have been conducted recently. However, the role of PRSPs as a donor platform for harmonized budget support in many countries<sup>31</sup> has declined. Thus, the reliance on NDSs as a guide to the political feasibility of specific reforms may be misguided.<sup>32</sup> The need for PEA to assess

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<sup>29</sup> Results-Based National Development Strategies: Assessment and Challenges Ahead, World Bank, 2007.

<sup>30</sup> The report uses three criteria to assess whether a country has an operational development strategy: a unified strategic framework, prioritization within that framework, and a strategic link to the budget.

<sup>31</sup> For example, Vietnam, Ghana and Rwanda.

<sup>32</sup> Shortcomings of the model of budget support that relies on PRSPs due to the lack of adequate monitoring framework were discussed at the outset of the new approach, in particular in Reconciling Alignment and performance in budget support Programs: What Next?; Budget Support as More effective Aid? World Bank 2006.

borrowers' ownership and develop options for expanding the reform space has not diminished.

### **Anatomy of DPO-supported reforms and implications for PEA**

4.8 According to the World Bank's Operational Policy,<sup>33</sup> a DPO promotes policy and institutional change for sustained poverty reduction and economic growth. The types of reforms that DPOs support have evolved. (See Box 4.1).<sup>34</sup> One way of looking at the relevance of reform measures supported by DPOs is to assess the extent to which they tackle the borrowers' key constraints for growth and development. As the 2015 DPO Retrospective highlighted,<sup>35</sup> the link between the reforms addressed by budget support and prioritization exercises, such as growth diagnostics or other tools, is sometimes not clear. IEG's evaluative evidence suggests that the presence of specific reform actions in a DPO is not necessarily a reflection of its importance for the recipients' development agenda. The measures supported often are those "available" at the time of program preparation.<sup>36</sup>

4.9 With respect to the strength of reforms, evaluative evidence indicates that along with important actions, DPOs may support measures that lack the depth to trigger institutional change.<sup>37</sup> Weak prior actions do not necessarily indicate that particular reform areas are not important, but they may point either to the lack of sufficient reform momentum or to the lack of relevance of this reform area to their development agenda. This may naturally reduce the incentives and demand for PEA.

4.10 Flexibility is a major feature and attraction of programmatic DPOs. It allows DPOs to be adjusted to accommodate changes in the country's circumstances and thus can be quite useful in addressing the rigidity of conditionality. The World Bank's experience of the past decade shows, however, that balancing flexibility and performance cannot be taken for granted.<sup>38</sup> There has been both good practice and bad practice in the use of the instrument's flexibility. There are examples of deteriorating quality of prior actions of follow-on operations<sup>39</sup>. IEG's evaluative evidence indicates that the termination of a programmatic series, especially that of multi-sectoral DPOs,

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<sup>33</sup> OP 8.60, updated in 2014.

<sup>34</sup> Learning from Reforms, World Bank, 2005.

<sup>35</sup> 2015 Development Policy Financing Retrospective: Results And Sustainability, 2015, World Bank Group, Page 21.

<sup>36</sup> The term "Christmas Tree" has been in use in the World Bank to describe some of the budget support operations that include many policy areas and reform actions of varying quality.

<sup>37</sup> DPO's Results Framework, IEG Learning Product, 2015.

<sup>38</sup> DPO's Results Framework, IEG Learning Product, 2015.

<sup>39</sup> IEG evaluation of Tanzania and Vietnam PRSCs



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more often takes place because of problems with pre-conditions such as macroeconomic tensions and fiduciary risks rather than due to slippages in individual reform actions.<sup>40</sup>

4.11 The role of PEA in the context of flexible DPOs is not straightforward. PEA, which is about what is feasible and how the reform space can be expanded, can be used to derive scenarios of reform progression and to develop a strategy to maximize development impact. Good quality PEA, for example, informs the World Bank about the pros and cons of keeping aid flowing in a challenging environment to maintain the policy dialogue.<sup>41</sup> On the other hand, as some of the World Bank's TTLs highlighted, many PRSC clients tend to frontload their efforts in preparing PRSPs while becoming less engaged later on in expectations of flexibility from the World Bank<sup>42</sup>. In this context, PEA may not be very helpful, which may lead to its under-provision.

#### Box 4.1. Evolution of reforms supported by the World Bank's budget support

Reforms supported by the World Bank's budget support have evolved in recent decades shaped by several factors. First, with the transition from volatile and turbulent 1980s and 1990s to the era of so-called "great moderation" of the 2000s, the nature of issues that developing countries were facing have changed. Second, the development paradigm has also shifted, first from the pro-active industrial policies of the 1960s and 1970s to the "Washington consensus" of the 1980s and 1990s, and then to Millennium Development Goals. Third, there was an evolution in the aid paradigm that led to a major rethinking in the concept of budget support as an instrument, which resulted in reforms in the early 2000s.

The World Bank launched budget support on a large-scale in the early 1980s to support structural adjustments in client countries and to address major imbalances and structural issues in the 1980s and 1990s. Heavy conditionality became the feature of the instrument to support critical adjustments in large macro imbalances. Instruments' conditionality became controversial, however, as it increasingly embraced what was later framed as the "Washington consensus," which was not necessarily focused on country-specific development opportunities for growth and poverty reduction but rather on eliminating inefficiencies and market distortions inspired by the free market ideology.

With the reforms in the instrument in the early 2000s, alignment with national development strategies was seen as a powerful tool for bringing donors' and recipients' preferences together. At some point there were views that given the focus on alignment of NDSs, DPOs should no longer have a focus on specific reforms through conditionality. Changing the instrument to rely on high-level performance and eligibility assessments instead of specific reform conditionality was seen as an optimal way to address the intrinsic problem of a principle and agent that characterizes budget support. The World Bank, however, never

<sup>40</sup> Review of IEG validation of ICRs of programmatic cases that were terminated

<sup>41</sup> Aid and Reform in Africa, Lessons from Ten Case Studies, World Bank, 2001.

<sup>42</sup> This may be the symptom of moral hazard arising from the prior knowledge of the World Bank's flexibility.

abandoned its focus on specific reforms. The solution to the problem was to adopt a model of “softer” conditionality and support reforms identified in NDSs and government programs.

Contemporary budget support instruments target a wide spectrum of reforms derived from country-specific contexts. Although the primary focus of DPOs have been historically on reforms that enhance the quality of budget allocations and spending, such as macro-fiscal and PFM reforms, many DPOs support reforms that may not have direct and short-term consequences for public expenditures. DPOs may cover broad areas of reforms such as governance, social protection, and so on. Multi-sector DPOs may cover several policy areas.

*Source: IEG review of relevant literature cited in the bibliography*

4.12 The relative lack of reform-specific PEA in the context of variation in the quality of reform actions may be a symptom of a weakness in the results orientation of DPOs in specific policy and institutional reforms. Incorporation of less critical actions appears to undermine the instrument’s credibility and may be a lost opportunity for the World Bank in terms of leveraging the World Bank’s financing for promoting reforms. One lesson may be that stronger integration of DPF with SCD/CPF for identifying most critical reforms and monitoring achievement of results can be a way forward to further strengthen the instrument.

4.13 The results orientation of DPOs in specific reforms can be also discussed in the context of possible trade-offs between the “reforming” and “financing” objectives of the instrument. The key metrics of results orientation in DPOs is the extent to which DPOs promote policy and institutional change in specific reform areas as reflected in the policy matrix of the instrument. At the same time, other aspects outside the policy matrix, such as timely and predictable financing and maintaining the World Bank’s relevance in the policy dialogue on macro-fiscal frameworks, sector policies, and poverty reduction are also important determinants of the quality of the World Bank’s engagement through DPOs<sup>43</sup>. These “reforming” and “financing” elements of budget support can reinforce each other if the World Bank’s and clients’ priorities are strongly aligned. When they are not, there may be trade-offs between the two that could manifest in a weaker focus on specific reforms.<sup>44</sup> World Bank TTLs and managers mention that they in fact often face trade-offs between these “reforming” and “financing” roles of DPOs. This trade-off may cause under-provision of PEA compared to a model where the focus is primarily on results in specific reforms.

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<sup>43</sup> PRSC Evaluation

<sup>44</sup> This is related to the debate about possible inconsistency between “multiple objectives” and the number of instruments in DPOs when two distinct objectives are pursued with a single instrument. For further discussion see, for example, <http://blog-pfm.imf.org/files/op-ed.pdf>

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4.14 Stronger links between SCD/CPF and DPF may help to improve result orientation with respect to policy and institutional changes by helping the instrument to focus on the most critical reform actions identified by country diagnostics and to take more informed risks. Mandating risk assessment for individual reform actions for better understanding the underlying theory of change and possible risks will increase the demand for sector-specific PEA and may improve program design.

### **The Role of Incentives**

The incentive structure in the World Bank may also play a role in provision of PEA. First, the relatively scarce resources available to task teams may undermine the provision of PEA. World Bank budget for program preparation has been under pressure in recent years, which not always allows the teams to generate all of the necessary analytical inputs for preparing DPOs, including PEA. External sources, such as trust funds that used to fund many PEA reports, have been on the decline in recent years. Second, the lack of a confidential platform for politically sensitive discussions may also undermine staff incentives to conduct PEA.

# Appendix A: Dominican Republic Power Sector reforms and Bank's DPOs<sup>45</sup>

## The Context:

1. Utilities in the Dominican Republic were chronically unprofitable in the early 2000s. This was due to poor governance, lack of investment and mismanagement. In the case of electricity, the service was also unreliable, unavailable 20% of the time. The average Dominican company experienced 25 electricity blackouts a month – more than one per working day. More than 60% of Dominican firms considered electricity a major constraint on their business. Meanwhile, the persistent gap between tariffs charged and the operating cost was exacerbated by the widespread theft and poor collection of bills. The losses placed a severe financial strain on the sector, limiting its ability to improve services. Significant resources were needed to close the financial gap. In 2002, with the oil price spike in 2002, the distribution companies were unable to pay generation companies for the power purchases. The Government re-nationalized two of the three distribution companies in 2003.

2. These problems in the power sector were harmful to the economy. First, they deterred both domestic and international investment, especially in sectors that used electricity intensively. Second, they forced households and firms to incur additional costs in setting up and using alternative sources of electricity. About half of all businesses relied on costly back-up generators while some larger firms built their own power plants. And third, they substantially enlarged fiscal deficits. In 2002, the subsidies to electricity consumers reached 1.2 percent of GDP.

## The WB Operations

3. A DPO approved in 2005 was the first in a planned program of three (two development policy loans and one investment loan). According to the Program Document (PD), the development objective (PDO) of the program was to support the Government's strategy for the recovery of the power sector, and in particular to:

- (a) Improve the quality of service, especially by reducing the frequency and length of blackouts prevalent in recent years;

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<sup>45</sup> The case study extensively draws on IEG Learning Product in Bank's Support of Financial Viability of Power Sector, program documents, ICRs, and ICRRs of relevant DPOs

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- (b) Establish conditions that would permit the financial sustainability and efficient operation of all companies in the sector; and
- (c) Increase the percentage of the population with access to electricity.

4. The program had four policy pillars for the achievement of this PDO:

**Pillar I:** Restoring financial viability, with the following measures:

- (i) Elimination of government arrears;
- (ii) Prompt payment of bills and subsidies due by Government;
- (iii) Better targeting of subsidies; and
- (iv) Assuring financial sustainability of the electricity distribution companies (EDEs) through rationalization of tariffs, improved collection, enhanced efficiency and reduced operating costs.

**Pillar II:** Improving the supply of power to the poor.

**Pillar III:** Ensuring environmental sustainability through environmental regulations which are adapted to local conditions and properly enforced.

**Pillar IV:** Improving sector governance through:

- (i) Sustained improvements in the operating efficiency of the EDEs; and
- (ii) Dissolution, following successful reform, of the Power Sector Recovery Committee (PSRC); and
- (iii) Re-establishment of the responsibility of the National Energy Commission (CNE) for overseeing and administering the sector.

5. This loan focused primarily on Pillar I since, according to the PD, the financial hemorrhaging had to be curbed before other reforms could bear fruits. No Pillar II measures were included in the conditionality and only one measure each for Pillars Three and Four. Outcomes of the Pillar One reforms were expected to be: Financially stronger EDEs, able to meet their payments to generators (with government subsidy if necessary), thereby permitting an improved power supply and a reduction in blackouts. Government, by remaining current in both its bill and subsidy payments, would no longer be a financial burden on the power sector. The tariff regime would provide appropriate economic signals to consumers. Subsidies would be better targeted for the poor. As a result of these improvements, service quality would be enhanced, especially through a reduction in the length and frequency of blackouts resulting from non-payment to generators. The loan was accompanied by a Technical Assistance Project, approved in 2004, supporting institutional strengthening in the CNE, the Office of the Superintendent of Electricity (SIE) and the Coordinating Entity for the Interconnected System (OC).

6. These reforms were at the core of Government strategy for counteracting the economic crisis that afflicted the Dominican Republic between 2002 and 2004 and for laying the

foundations for sustainable growth. There was a sense of urgency among the stakeholders to work out strong and lasting solutions.

### **Choice of the instrument**

7. Nonetheless, it was not clear whether a stand-alone DPL was the most appropriate instrument for the power sector in Dominican Republic. Two of the sector's core problems were: a) an over-dependence on imported oil (84% of power generation relies on fossil fuels) and b) the poor conditions of transmission and distribution infrastructure. They could not be adequately addressed by such an operation. Although an investment loan supporting infrastructure enhancements was planned to follow, it would have worked better if it had preceded or was implemented concurrently the DPL.

### **Other design issues**

8. The key risks were correctly identified at appraisal, among them: fading government ownership of the reform program, political economy barriers to achieving difficult reforms, continued strong consumer resistance to bill paying and tariff increases (especially given poor service quality), the persistence of governance issues and institutional weaknesses. But the design of a multi-tranche operation made it difficult for these risks to be adequately mitigated. The design was predicated on the assumption that large and rapid disbursements of budget support would motivate the Authorities to implement the reforms strenuously. This, however, was not consistent with the history of multi-tranche DPLs in the Dominican Republic. As the Program Document acknowledged, previous multi-tranche DPLs were difficult to implement with frequent dilutions of prior actions. A series of single tranche loans would have allowed both the Borrower and the World Bank to adjust to changing political and sector conditions, as well as to external shocks such as a spike oil prices.

### **Prior Conditions (first tranche) US\$50 million**

9. Among the prior actions of the first tranche were:
- A viable and binding agreement between the Government and power sector institutions to record arrears, schedule interest payments, and provide for a one year moratorium on debt repayment.
  - Government payment of electricity bills remains current. The Government has transferred appropriate subsidies to the CDEEE (Corporacion Dominicana de Empresas Electricas Estatales, the public holding company of state electricity companies) under budgetary allocation for the power sector as set forth in the Borrower's National Budget, and CDEEE has transferred the funds to the distribution companies as set forth in the Power Sector Action Plan.

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- Plans for the financial recovery of the power sector are approved and their implementation started, including: (a) the EDEs' loss reduction, cost control, and increased collection plans; and (b) an increase in the Cash Recovery Index (CRI<sup>46</sup>) from 45% in August 2004, to 50%.
- Revision and implementation of a formula for the automatic adjustment of retail tariffs in response to variations in the exchange rate, fuel prices and inflation.
- Formulation of a contingency plan in case the performance of the state -owned distribution companies fails to improve.
- Creation of a Power Sector Recovery Committee to oversee implementation of the recovery plan, and appointment of its Coordinator.
- Launching of a communications campaign to build awareness of the rationale behind the recovery plan.

#### **Second Tranche Conditions US\$ 50 million**

- Repeat of Condition on the Government being current on its payments (bullet 2)
- A further increase in the CRI to 55%.
- Continued application of the formula for automatic retail tariff adjustments.
- Signature of a Memorandum of Understanding between the Comision Nacional de Energia (National Energy Commission -- CNE) and the Secretaria del Estado de Medio Ambiente y Recursos Naturales (SEMA -- Ministry of the Environment and Natural Resources ) to improve environmental management in the sector, implement streamlined procedures for granting environmental licenses and monitor their implementation.
- Creation of hydro-generation and transmission companies which have a separate legal identity from CDEEE, with injection of their capital and preparation of their bylaws.

#### **Third Tranche Conditions US\$ 50 million**

- Repeat of Condition on Government payments being current.
- A further increase in the CRI to 60%.
- Repeat of condition on the use formula for automatic tariff adjustments.

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<sup>46</sup> The formula for computing the CRI is defined as:  $CRI = [\text{the energy billed by distributors} / \text{the energy purchased by distributors}] \text{ multiplied by } [\text{bills paid by consumers to distributors} / \text{total billing of the distributors to consumers}]$

- Selection of an option for private sector participation in distribution.

10. While the operation was active, financial conditions of the EDEs did improve during 2006 and 2007. Better revenue collection was reflected in the CRI, which improved from 45% in 2004 (one of the lowest in the world) to an estimated 68% in 2009. This progress, however, was overwhelmed by the substantial increase in the non-fuel operating costs of sector institutions and by a rapid rise in oil prices in 2008.

11. The Government cleared its arrears to sector institutions before Board approval in May 2005, but soon thereafter the payments faltered again. This caused a delay in making the loan effective, and hence the release of the first tranche, which did not take place until December, 2006. Bill and subsidy payments remained current throughout 2007, permitting the release of the second tranche in November. However, arrears to generators resurfaced in 2008, again due in large measure to higher oil prices, while the budget deficit attributable to the power sector rose to over US\$ 1.2 billion. Budget transfers were nonetheless insufficient to meet the contractual obligations to the generating companies. The Government also fell back into arrears on its bill payments. Although the sector's finances improved somewhat late 2008 and early 2009, as oil prices retreated from their previous peaks, the combined arrears on bill and subsidy payments were still in excess of US\$ 500 million at loan closure.

12. Meanwhile, the tariff regime implemented did not send appropriate economic signals to consumers and with higher oil prices in 2008 was grossly inadequate to cover costs. Contrary to the objective, the regulatory agency remained weak and it enjoyed little, if any, independence from the Government. It was established late – years after the legislation was approved in 2001 and 2002 and long after the so-called "first generation" reforms (which introduced private participation in generation and distribution) were initiated in the late 1990s.

13. Allowing tariffs to fluctuate according to the agreed formula was difficult for the Government to comply with, even when there were no spikes in oil prices. Tariffs were frozen in February 2006 and remained so throughout the life of the project. Waivers were granted by the World Bank on the tariff-related conditionality for both the first and second tranches. For the third tranche, the issue was moot given the failure to comply with other stipulated reform measures.

14. The World Bank justified the waivers on the grounds that:

- (i) Electricity prices were already relatively high (about 22 US cents/kWh);
- (ii) Service quality was poor; and
- (iii) Economic growth was strong (averaging 9.5% per year in real terms between 2005 and 2007), making it possible for the Government to make compensatory transfers that would still enable the project to achieve its other objectives.



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15. There were also political imperatives in light of the Dominican Republic's two -year electoral cycle. The President is elected for a four year term while the legislative elections are scheduled two years into the presidential term. Thus major elections are held every two years, thus reminding politicians of the risk of raising power tariffs.

16. No progress was made in targeting subsidies to the poor. Reduced payment arrears to generating companies cut the length and frequency of blackouts in 2006 and 2007. But they returned to the pre -project levels when the arrears expanded in 2008. Power rationing was estimated at 18%, but this figure was widely regarded as an understatement. Project results thus fell far short of the objective of establishing a financially stronger power sector. The loan's contribution to broader program objectives -- improved service quality, financial sustainability and increased access to electricity -- was also equally modest.

17. Many political economy issues were at work to undermine the outcomes of this operation. First, the political economy setting is one of entrenched clientelism where politicians are more likely to deliver specific favors to particular groups than to promote general welfare. In Dominican Republic at the time of this operation, voters had learned to expect short-term benefits, like lower electricity tariffs, instead of more distant gains like financial sustainability of public utilities. Politicians – or more generally policy entrepreneurs –knew that refusing to adjust tariffs – and thus violating agreements with external partners – carried little cost. On the other hand, a politician committed to pursuing general welfare, like raising power tariffs (according to an abstract formula) would appear quixotic to the voter and gain little support.

18. Second, most of the reforms envisaged in the power sector required high “implementation intensity”. The institutional overhaul, including the split-up of one vertically integrated firm into two generation companies and three distribution companies in 1999 as well as the backsliding three years later, was far reaching and difficult to internalize by management and staff. In addition, to stem power losses called for a change of deep seated behavior among employees of distribution companies, including weeding out illegal power connections and collecting payments fully and promptly, which may have been contrary to prevailing social norms.

19. A careful review and analysis of the political economy prior to the implementation of this DPO could have made a difference. It could have informed the task team and the Government of the challenges that lay ahead – and possibly of a different approach that would allow more time and more grassroots consultations to build the necessary political coalitions.

# Appendix B: Tanzania Crop Board Reforms and Bank DPOs

## Background

1. Until recently, crop boards played a key role in determining the production and investment of Tanzania's export crops--cashews, coffee, cotton, pyrethrum, sisal, sugar, tea and tobacco.<sup>47</sup> Their stipulated functions were to ensure quality and fair prices. Their activities, however, had raised many concerns about the country's agriculture and exports, including disruption of export trade; high administrative costs; low accountability to their constituents; and interference in the business of private marketing companies.

2. Crop boards were accountable to the Ministry of Agriculture and Food Security (MoAFS) and financed by withholdings from the trade, rather than general revenues. Cess and license fees provided more than 75 percent of their revenues, with the exception of cotton. The expenditures of these boards totaled about US\$ 5 million a year, much of it due to administrative expenses.<sup>48</sup>

3. **Reforms of Crop Boards.** The government prioritized a crop board analysis in Tanzania's 2001/02 Second Poverty Reduction Strategy (PRS) Progress Report. The rural development strategy, as well as the agriculture sector development strategy both emphasized the need to restructure these Boards. The review of the roles and funding of the Boards was a policy benchmark in the donor-supported Poverty Action Framework (PAF). By 2003, the Government had not yet devised a reform program, but addressed the concerns instead with various actions to increase stakeholder participation, reduced taxes and fees on small holders, and curbing the abuses of private traders (see documents (i) and (ii) under footnote 2 below). In 2003, the Government requested support for further analysis of the Boards in the form of a Poverty and Social Impact Assessment (PSIA).

4. **Findings of the PSIA.** The World Bank, the Government Task Force (Ministry of Agriculture and Food Security (MoAFS), the Ministry of Cooperatives and Marketing (MoCM) and the European Union jointly conducted the PSIA. The study's focus was to review the Boards--specifically its regulatory, service & revenue collection functions, the institutional

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<sup>47</sup> Crop boards were formed after the liberalization of the early 1990s to replace the marketing boards, which had been created as monopoly public agencies to fulfill a range of marketing activities (see 'The Political Economy of Policy Reform: Issues and Implications for Policy Dialogue and Development Operations, 2008).

<sup>48</sup> This case study draws extensively from the following: (i) Poverty and Social Impact Analysis (PSIA) of Reforms, Lessons and Examples, Aline Coudouel, Anis A. Dani, Stefano Peternostro, 2006; (ii) The Political Economy of Policy Reform: Issues and Implications for Policy Dialogue and Development Operations, Social Development Department, The World Bank, 2008; and (iii) Project Performance Assessment Report, Tanzania, IEG, 2013.

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arrangements/ environments, and their impact on the incentives in production and marketing of the affected crops and to propose options to reform the crop boards. A comprehensive stakeholder dialogue characterized the PSIA process.<sup>49</sup>

The PSIA findings revealed:

- (i) There was an institutional vacuum after liberalization in the 1990s with uneven private sector participation, unfair trading, and some re-regulation to increase the role of crop boards;
- (ii) Crop boards mixed public and private activities and acted as both regulators and participants in markets with large scope for conflicts of interest;
- (iii) Boards were only accountable upward to MoAFS, but are financed entirely by their constituents in the industries and through property income; and
- (iv) Small holders did not fully understand the pricing mechanisms and quality rewards.

5. The PSIA, however, did not identify specific impacts on different stakeholders as the reform options were to be subject to national debates.

6. The study showed that parts of government and smallholders were skeptical of the market economy and adhered to socialist principles. Hence, the Crop Boards and the Ministry of Cooperatives opposed the reforms that would reduce their controls over private agents and require greater accountability to producers. At the political level, MoAFS was in favor of the reforms. At the technical level, the Government Task Force (MoAFS and Ministry of Cooperatives) also supported the reform. The PSIA developed four reform options including:

- (1) Boards that are publicly financed and focus on public services;
- (2) Boards that are privately financed;
- (3) Boards that are jointly financed, with associated private services financed by a levy and contracts for public services; and
- (4) Boards that remain as they are.

7. The study team recommends option 1 for the coffee industry, and option 3 for the cotton industry.

### **The Development Policy Operations (PRSCs)**

8. There were two series of PRSCs; a total of 8 operations with one approved each year. The first series, PRSCs 1-3 spanned the years 2003-2006 (US\$432 million), and the second series, PRSCs 4-8, covered 2006-2010 (US\$ 1,025 million).

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<sup>49</sup> See PSIA, 2006, and 'The Political Economy of Policy Reform: Issues and Implications for Policy Dialogue and Development Policy Operations', Social Development Department, 2008, p. 54-75 for details on the PSIA process.

9. **PRSCs 1-3.** The agriculture and rural development agenda was extremely ambitious. It included reforms of crop boards, particularly with respect to input supply, product quality, and competitiveness. A review of the crop boards was set as a prior action to PRSC-3. However, the Government delayed the preparation of an action plan for the reform, prompting the World Bank to reduce the PRSC-3 envelope from US\$175 million to US\$150 million.

10. **PRSCs 4 – 8.** The implementation of crop board reform was taken up under PRSC 4. Despite the delay, the government took an important step – changing crop board financing from the original crop cess to budgetary allocations. But amending the laws that governed the crop boards was delayed. The World Bank accommodated this change in strategy, and made the consultations and signing of MoUs with the crop boards a prior action for PRSC-5, and the submission of the legislative amendments of all crop boards a trigger for PRSC-6.

11. The prior actions for the series were somewhat weak and only partially achieved (PPAR, 2013). For example, the annulment of the cess had taken place long before, but was included as a prior action under PRSC 4. The government did not consolidate any gains from removing the cess, as Cabinet did not endorse specific reforms on the role and function of crop boards, including their regulatory functions, governance structures, and accountability to stakeholders. The joint evaluation of General Budget Support (ODI and DAL 2005) noted that it was not so clear that there was a strong political commitment from the Government in favor of implementing the reforms (PPAR, p. 99). Overall, the trigger and prior actions related to crop boards under PRSC 4-6 were generally met with significant dilutions under strong political resistance.

12. The PRSCs seemed to have overlooked the political economy and government ownership of sensitive reforms. The PSIA had noted that export crops, such as coffee, could be a lucrative business for a wide range of stakeholders, including public sector employees. As in many African countries that are agrarian and pluralistic, political life was dominated by clientelism and related political organizations. Powerful interests, within and outside of the crop boards, defended the status quo that benefited them.

### **Political Economy Analysis**

13. The World Bank carried out a **Political Economy Analysis** to support the Tanzania Poverty Assessment (PA), with immediate attention to opening up space for policy dialogue under the PA.<sup>50</sup> This was done in response to concerns within the country team that difficult political incentives were:

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<sup>50</sup> Using Political Economy Analysis for Country Poverty Assessment and Broader Strategy, Stuti Khemani, Development Research Group, World Bank, 2010.

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- a) Inhibiting adoption of even very obvious growth promoting policies;
- b) Allowing large capture of private rents from public resources, thereby reducing the resources that reach the poor; and
- c) Impeding the delivery of the World Bank's programs.

Two key arguments presented are:

- (i) The key issue for policy dialogue in Tanzania lies in the implementation of policies, to overcome governance problems of elite capture and political rent-seeking, rather than substantial disagreement between the Government and the World Bank on the general direction of good policies. Many rent-seeking opportunities were available to local officials and village leaders. Even if national anti-poverty programs and policies were well designed, their implementation appeared to be subject to large local political risks.
- (ii) The approach of advocating politically palatable "2nd Best" policies, as part of donor conditionalities, is likely to be misguided for two reasons.
  - a. First, because the World Bank's team did not have sufficient evidence that the policies they recommend, nor its "2nd Best" incarnation, will actually lead to the intended development outcomes; and
  - b. Second, because policies pushed through donor insistence is less likely to be effectively implemented and sustained, compared to policies that emerge through political bargaining within Tanzania, which the World Bank can influence through other types of governance interventions.

14. *In areas of policy disagreement, therefore, a "politically savvy" approach is to invest in more rigorous technical analysis of the costs of current government policies, and the benefits of specific reforms, which can be used to facilitate demand for better policies within Tanzania.*

15. Crop Boards, however, may not be different, and, furthermore, may be subject to even more inefficient rent seeking by a larger number of dispersed local officials. Focus group meetings suggested poor farmers lacked information about prices and market conditions, which likely enabled the leaders of these societies to collude with other actors in the warehouse receipt system to extract rents at the expense of better prices for farmers. The public good of greater access to agricultural market and pricing information through local radio ("farmer radio") and cell-phone networks were conspicuously absent from policy discussion in Tanzania. While greater government and cooperative society control over agricultural marketing was vigorously defended by district officials on the basis of enabling collective action among farmers to demand better prices from oligopolistic traders, these same respondents were unable to answer why the government hadn't invested in providing greater price information to farmers through mass media.

16. The note found that the World Bank's current approach to the Government's interventions in agricultural marketing appeared to be to criticize these as inimical to producer incentives to take advantage of global markets, and to convince the government that greater market liberalization and specific institutional reforms would give better incentives to producers and yield better outcomes (the study references Binswanger and Gautam, 2010; and Baregu and Verhoogeven, 2010). A political economy perspective suggests that the World Bank's persuasive powers would be circumscribed by two constraints: (i) a charge against the World Bank of taking policy positions that are ideological rather than fully substantiated by evidence; and (ii) the local political constraints of the interest groups being serviced by current government policies. The latter constraint seems to be increasingly acknowledged by the World Bank, and, addressed it appears largely through donor conditionality for institutional reforms. Simply pushing for reforms through donor conditionality risks yielding *de jure* reforms, but with *de facto* implementation on the basis of clientelist politics; or even reversals in *de jure* reforms.

17. For example, the World Bank's current approach to Crop Board reforms is subject to political risks of being ineffective in practice. With respect to passing government decrees to stop the levy of certain crop cess and requiring the Boards to prepare financial plans in line with the budgetary MTEF-- it is not difficult to conceive of ways in which such formal legislation or decrees could be bypassed at local levels either by calling a crop cess by a new name, or finding other ways to tax those producers whom the local politicians want to tax. The real determinants of local incentives to tax and manage revenues are likely to lie in the nature of local politics. Recommendations on governance reforms that engage stakeholders (demand-side governance reforms) would likely require more analytical work, with micro-empirical data to examine what institutional designs work at overcoming clientelist political constraints.

18. This is to identify a range of more innovative governance interventions to influence the demand of national political elite engaged in political bargaining with each other, the demand of private business interests engaged in influencing national policies, in addition to the demand of citizens for broad public goods. That is, governance interventions on the demand-side rather than the technical supply-side, but going systematically beyond the very local, social mobilization interventions typically associated with demand-side practices. Political economy analysis can help design such broader demand-side governance interventions to have greater potential in improving the incentives of politicians to effectively implement growth and poverty-reduction policies.



## Annex C: List of Reviewed DPOs

List of Randomly Selected and Reviewed DPOs

<b>Project number</b>	<b>Country</b>	<b>Project number</b>	<b>Country</b>
P034365	Guatemala	P117723	Vietnam
P055909	Tanzania	P118027	Afghanistan
P074181	Turkey	P122793	Vietnam
P074889	Tajikistan	P123267	Colombia
P083459	Mozambique	P123352	Nigeria: subnational
P094967	Bulgaria	P123679	The Gambia
PO83927	Uruguay	P125298	Lao PDR
P095730	Ghana	P126207	Burkina Faso
P096928	Benin	P126453	Tonga
P096962	Pakistan: sub-national	P127080	Burundi
P099420	Madagascar	P127956	Morocco
P101232	Uganda	P128023	Sao Tome and Principe
P102018	Romania	P128251	Tunisia
P105710	Panama	P128258	Pakistan
P107163	Indonesia	P128573	Lesotho
P107242	Lao PDR	P130972	Colombia
P115626	Armenia	P131028	Peru
P115732	Latvia	P147152	Grenada
P116972	Dominican Republic	P147226	Albania
P117273	Senegal	P150313	Ukraine





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