

1. INTRODUCTION

It is widely recognized within the international development agencies that understanding the political context of reform processes is important for engaging effectively in policy dialogue that promotes policy change¹. It is also recognized that a failure to anticipate political and institutional challenges is often a chief cause of unsuccessful policy reform processes. This study addresses the following questions: Why do policy reform processes sometimes stall, stop, reverse, or go off track despite their content, design and implementation appearing technically sound? What can be done to mitigate this? Why does the reform get tabled? Why do reforms that were designed to benefit poor and vulnerable groups, fail to achieve this goal? Are some stakeholders deliberately blocking the process because they stand to lose from the reforms, or see opportunities for further benefits if the content is changed? If this is the case, are they right in their assessment? Or is there friction in the legislative process because some stakeholders weren't invited to the decisive policy formulation roundtable? Could it be that the reform is based on a blueprint from a different country and has not been tailored to the context? Or perhaps the reform sequence is 'out of sync' with other processes in that society.

The study addresses these issues by examining the experience of operational teams from the World Bank, working on policy reforms and programs in the agriculture and water sectors, and by drawing on expertise of other development practitioners in bilateral development organizations, public and private sector, and academia. Development practitioners often possess a deep understanding of how a sector in a country works, and of the political economy context. This knowledge is rarely captured and shared, either because of lack of time, or because of the sensitivity of the information. The present study aims at capturing and synthesizing the experience of operational teams working in complex political economies. From this, it aims at providing a systematic approach to the analysis of the political economy of policy reforms. While the study focuses on the experience of World Bank task teams in engaging in reform processes, the intention is to distil from this experience a conceptual framework and analytic approach which will assist a wide range of development practitioners in engaging effectively in dialogue to promote policy reform.

The purpose of the study is to provide guidance to development practitioners in assisting partner countries to initiate debate and steer through reform processes that lead to more equitable development outcomes. The specific objectives of the study are to: a) unpack the "black box" of political economy by applying a social analysis framework to the study of stakeholder interests, incentives, institutions and risks; and b) illustrate "what works, why and how" for a better understanding and management of political economy issues in reform design and implementation.

From the perspective of equity and poverty reduction, stakeholder influence and interests, and associated power relations, determine the distribution of costs and benefits of agriculture and water sector operations among different social groups which are competing over resources, goods and services. From a policy perspective, stakeholders influence decisions of *whether* and *how* the challenges in reforms of agriculture and water sector are addressed in national development strategies, and in subsequent policy development and implementation.

¹ "Understanding socio-economic and political factors to impact policy change" (World Bank 2006 f) provides an overview of approaches to understanding the political dynamics of development co-operation, including the 'Drivers of Change' approach piloted within DFID, Sida's 'Power Analysis', the Country Social Analysis Framework developed within the World Bank, or the German development approach that focuses on develop partner countries' negotiating capacities through long-term assignments of its advisors into partners' institutions.

The new “international aid architecture” of country-driven development strategies under the Paris Declaration², has opened up institutional space for a more reflective lending approach that considers the political economy risks to sustainable and effective policy reform and which adopts a more nuanced perspective on the notion of “country ownership” of reform. A World Bank review of lending practices³ states:

“Careful review of the country’s political economy and of stakeholders’ concerns is required to identify the scope for a sustainable reform program. Given the complexity of country situations, such an assessment goes beyond a simplistic notion of ownership that presupposes a uniform government position or a full consensus. It would not be sensible to suppose that all recipient countries are functioning democracies, respond to the interests of the majority of the population, avoid elite or foreign-interest capture, and maintain a stable course on reforms. A realistic assessment of ownership relies on the government’s track record of reform and acknowledges the political economy dimensions that reforms may be owned by some constituencies and opposed by others who stand to lose from them.”

The recognition of the importance of the political economy context for reform is accompanied by a growing emphasis on effecting policy change through dialogue and consensus building rather than through the use of somewhat blunt and often ineffective conditionality instruments.

For the purposes of the analysis presented here, **‘political economy’ is understood as the study of the interactions between political processes and economic variables.** A political economy lens can help us to better understand the dynamics of policy reform processes. Stakeholders’ interests and the power relations between social actors obviously influence their support or opposition to the reform. The sequencing and timing of actions associated with policy reforms can also determine the level of tension and conflict, the duration, and ultimately the success or failure of reforms.

The World Bank, working with other development partners, has developed a repertoire of tools for institutional, political and social analysis of policy reform⁴. **Poverty and Social Impact Analysis (PSIA)**⁵ is an essential policy analysis instrument for assessing the impact of the potential reforms on poverty and social outcomes. PSIA methods are also very useful for analysis of the political economy. Through PSIA, one can examine both the risks *to* a reform process, and the political economy risks *of* policy reform to equity outcomes. For example, a review of 23 PSIA exercises carried out in the agriculture sector concluded that in many instances social analysis had played a major role in uncovering political economy risks, and in providing practical strategies to handle or mitigate these risks⁶. Most of the risks identified were related to elite capture and control of rents, but in some cases, the risks of conflict between different government agencies, and lack of ‘buy-in’ from key stakeholders were also significant to determining outcomes. The PSIA approach, that combines analysis with policy dialogue, provides the conceptual and operational grounding for the present study.

This paper is built on primary and secondary data from World Bank operational experiences in two sectors across several regions. The two sectors also illustrate the two different primary channels for World Bank lending, development policy lending (which supports processes of policy change) and investment lending (which supports specific projects). In respect of agricultural liberalization, the study looks at development policy loans in four detailed case studies and four briefer case presentations. In respect of public-private partnership in water supply and sanitation, the study examines investment projects through four detailed case

² The Paris Declaration, endorsed on 2 March 2005, is an international agreement to which over one hundred Ministers, Heads of Agencies and other Senior Officials adhered and committed their countries and organisations to continue to increase efforts in harmonisation, alignment and managing aid for results with a set of monitorable actions and indicators.

³ Koeberle et al., 2005.

⁴ See, for example: the SDV’s Tools for Institutional Political and Social Analysis of PSIA Sourcebook (Holland, 2007)

⁵ The PSIA approach was jointly developed within the Bank by the Social Development Department and the PREM Poverty Reduction Department, with collaboration from a range of bilateral development partners, such as UK DFID and German Development Cooperation (see www.worldbank.org/psia/ for more details).

⁶ World Bank, 2006e

studies and four briefer examples. Existing material was used, but the interviews with operational task team members provided the essential insights into the political economy issues in each of the case studies.

The case studies were selected as a purposive sample according to the following criteria: a) sectors where political economy issues have markedly influenced national reforms and development partners' support; b) cases where the reform process has raised complex and important operational political economy issues that the literature has highlighted, and operational sector specialists have identified c) positive and negative operational experiences with handling political economy issues in reform processes; d) a good range of examples of different reform contexts by region and sub-region; and e) a balance between different World Bank lending instruments (half the case studies deal with development policy loans, and half with investment operations).

Table 1: Overview of case studies and examples per sector and lending instrument

	Agricultural liberalization <i>Development Policy Loans</i>	Public-Private Partnership in Water Supply and Sanitation – <i>Investment Projects</i>
Country Case studies (elaborated)	<ul style="list-style-type: none"> • Burkina Faso, cotton sector • Senegal, groundnut sector • Tanzania, crop board reform • Indonesia, rice tariff reform 	<ul style="list-style-type: none"> • Jordan, Amman water supply • Albania, water sector reform • Argentina, water supply and sanitation services reform in Salta Province • Bolivia, La Paz and Cochabamba water supply.
Country Case examples (brief)	<ul style="list-style-type: none"> • Malawi, ADMARC reform • Chad, cotton reform • Mozambique, cashew nut sector reform • Mexico, agricultural reform 	<ul style="list-style-type: none"> • Ghana, urban sanitation • Ghana, water sector reform • Vietnam, rural water supply • New Delhi, water sector reform

The structure of the report is as follows: Section 2 summarizes the approach taken in this work to political economy. Section 3 illustrates the study's analytical starting point. Section 4 summarizes aspects of agricultural and water supply reform, and discusses the political economy issues that are particular to those sectors, focusing on the following four questions:

- What are the most significant political and political economy risks to policy reform?
- Why do these variables operate in a given country and sector context?
- How do these variables impact policy reform processes and outcomes?
- How could these variables be addressed through effective management of political economy risks and opportunities?

Section 5 concludes by pulling out a number of operational implications for development practitioners in relation to managing political economy risks and opportunities in policy reform.