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# The Political Economy of Policy Reform:

Issues and Implications for Policy Dialogue and  
Development Operations



Social Development Department  
Environmentally and Socially Sustainable Development Network  
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## EXECUTIVE SUMMARY

This study addresses the political economy of sector reforms. Sustainable reform processes which improve equity, efficiency and effectiveness in key economic and social sectors are often important elements of national poverty reduction strategies in low- and middle-income countries. For international development agencies wishing to engage in these processes, understanding the significance of power relations within the sector, vested interests, and the links to national political processes can be critical to being an effective actor in policy dialogue. This study explores these issues through the analysis of case studies of World Bank engagement in two areas: agricultural liberalization, and public-private partnerships in water supply and sanitation.

**The objectives of the study** are twofold: (a) to analyze the political economy of reform by looking at stakeholder interests, incentives, institutions, risks, opportunities, and processes from a social analysis perspective; and (b) to illustrate "what works, why and how" for a better understanding and management of political economy issues in the design and implementation of reforms and development operations. **The methodology used** is a combination of document-based case studies, a literature review, interviews with key informants among World Bank task team leaders and sector specialists, as well as open consultations with representatives of the public and private sector, research organizations, and multi- and bilateral development agencies.

Policy design and implementation is a complex, multi-directional, fragmented and unpredictable process. A political economy lens broadens operational considerations beyond technical solutions to include an emphasis on stakeholders, institutions and processes by which policy reform is negotiated and played out in the policy arena. Understanding the relationship between policy-induced changes in incentives and sanctions on the one hand, and changes in behavior and interests on the other hand, allows development practitioners to engage more effectively in "pro poor" policy reforms and operations by considering stakeholder perspectives in operational design and implementation.

The background to the study is a growing concern among development practitioners with political economy risks associated with reforms and development operations. This has grown out of the move away from the rather rigid policy conditionalities associated with the structural adjustment era and towards a new development approach that emphasizes the need for reform processes to be underpinned by a sufficient level of commitment within the country concerned to be sustainable over the longer term. For development practitioners this has a number of implications. Attitudes and behaviors need to be geared to facilitating and supporting change rather than enforcing or demanding it. And sensitivity to context is essential. A vital component of understanding context is the political dynamics of policy change – how reforms get tabled and why; how they are perceived; and who will support, oppose or attempt to change the proposals which have been made.

Development practitioners engaged in policy dialogue often have in-depth knowledge about the political economy of the contexts where they work, but their expertise tends to remain 'hidden' due to the sensitivity of such issues in an ostensibly technical relationship with the client government. The present study intends to capture and synthesize the experience of operational teams that work in complex political economies. While the study focuses on the experience of World Bank task teams, the intention is to distill from this experience a conceptual framework and analytic approach to political economy of reform processes which will assist a wide range of development practitioners in engaging more effectively in dialogue to promote policy reform.

To address these challenges the study uses a framework which builds on the Poverty and Social Impact Analysis (PSIA) methodology developed by the World Bank and a range of development partners. PSIA refers to the analysis of the distributional impact of policy reforms on the well-being or welfare of different stakeholder groups, with a particular focus on the poor and vulnerable. The study builds on the extensive literature developed in this area by offering supplementary tools for understanding the power dynamics of policy change. In order to do this we consider a range of political economy approaches (in terms of theory and methodology) which have been applied to development problems, and propose an analytical approach based on a ‘power-based model’ of social and institutional change.

The study draws on operational experiences to inductively develop a conceptual framework that offers an innovative way to look at the political economy of policy reforms. **The framework combines a diagnostic component with a typology of actions which can translate the analytical findings into more effective reform processes and operations.** The diagnostic element distinguishes conceptually between the reform context, the reform arena and the reform process. The *reform context* refers to a country’s socio-economic, political, cultural and historical characteristics, including its development trajectory and the current development aid architecture. Analyzing the reform context involves looking at political processes within the sector, and the potential links to national political institutions and stakeholders. Another key element of the reform context is the reform agenda itself – what it comprises, what assumptions underpin it, how and why it was tabled, and by whom. The *reform arena* comprises the institutions that govern relations and behavior within the sector in question, and the stakeholders with their economic and political interests that both drive and are affected by the proposed policy reforms. The *reform process* refers to change through information flows, public debate, coalition building, participation, transparency, communication and the interaction of actors in the policy arena over time. The *action framework* illustrates operational implications and offers measures that development practitioners can use to design and implement reforms and operations.

Through the systematic combination of diagnostic and operational elements, the framework aims to assist development practitioners to better understand and manage the political economy of reform, to design more equitable and sustainable reforms and operations, and thus to enhance development effectiveness.

In summary, the study points to the following three key messages for effective engagement by development agencies in processes of sector level policy reform and operations:

1. The importance of **good political economy analysis**, applied early in the process, to effective donor engagement in sector policy reforms and operations.
2. The significance of a sustainable process of **building coalitions for change** that involves dialogue with a broad range of stakeholders, including client governments, donors, other development partners, and the public.
3. The importance of **promoting transformative processes of institutional change**, including empowering forms of bottom-up accountability.

In terms of attitudes, behaviors and general professional practice within development agencies, the findings suggest that further emphasis should be given to

1. Getting a **contextual understanding of the issues by combining analysis and dialogue**, including insight into the likely distributional equity outcomes of any given reform, plus better access to reliable data which will improve operational design.
2. **Broadening the range of interaction of development partners with a wider range of stakeholders** (not limited to Finance or Sector Ministries), including sub-national or local governments; the parliament, including the political opposition; private sector; civil society, and formal and informal institutions.
3. Applying a **partnership approach**; based on listening and learning, more emphasis on participatory approaches for improved communication; and valuing and using local expertise wherever possible.

Taking a stronger process-oriented approach implies that practices and procedures of development agencies should become more flexible. In relation to the World Bank, the following areas emerged as important for enhanced agility and flexibility:

1. The choice and use of development support, including timing and sequencing of different lending and non-lending activities.
2. The design of lending operations, including timeframes and budgeting for loan preparation and implementation, and
3. Conducting and incorporating political (economy) analysis into the design, implementation and performance assessments of reforms and operations.

Finally it is important to acknowledge some limitations of the material presented here. The experiences in all the case studies are from one institution – the World Bank. We have attempted to draw out general lessons for the practice of international development agencies (aimed predominantly at multi- and bi-lateral public agencies); we believe that the material makes an important contribution to the evolving understanding of this agenda due to the general dearth of ‘policy ethnographies’ of the kind presented here. But further development of knowledge would clearly be helped by similar consideration of the role of political economy analysis in other agencies. Secondly, the perspectives presented here were retrospective, and drawn predominantly from members of World Bank task teams. An enhanced understanding would be provided by a longer-term process of action research which engages at the country level from the inception of reform processes onwards, and which has access to the full range of relevant stakeholders. Applying the framework for analysis developed here across more sectors would help to test and develop it as a tool for strengthening policy and operational practice. The study presents a solid basis for a future program of work which can address these issues.