

## Helpdesk Research Report

# Political economy analysis for economic and private sector reforms

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## Question

*Identify examples of political economy analysis (PEA) being used to support economic and private sector (EPS) policy or institutional reforms. If possible, identify how widely used PEA is within development actor economic programming and which PEA tools seem most appropriate in the sector.*

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## 1. Overview

It is inherently difficult to identify how widely political economy analysis<sup>1</sup> (PEA) is used to support economic and private sector (EPS) programming for a number of reasons. PEA is one of a number of factors that can influence programming and implementation and it is difficult to state categorically that a PEA had a definitive impact on reforms. It is also likely that there are a large number of PEAs which are undertaken internally in donor, and other, organisations. These can impact on the choice and type of policy and institutional reforms, but this decision process would not be visible externally.

This helpdesk report looks firstly at the range of tools and approaches that relate to PEA and identify those most relevant to EPS reform. A quick mapping of key bilateral and multilateral donors shows which

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<sup>1</sup> Political economy analysis (PEA) looks to analyse 'the interaction of political and economic processes in a society: the distribution of power and wealth between different groups and individuals, and the processes that create, sustain and transform these relationships over time' (Collinson, 2003, p. 3).

tools are favoured or have been produced by different donors and how they are being used. The final section outlines a number of case studies where authors have concluded that PEA has impacted on EPS reform.

### ***Tools and approaches***

Development actors may analyse a country's context **informally or without using specific tools**. Of the tools that exist, some are more appropriate for macro-level analysis, sectoral analysis and others for problem-driven analysis. These tools have not been specifically designed with EPS reform in mind.

A notable guidance document is that by Davis (2011) which provides an overview of tools and approaches specifically for analysing the **political economy of business environment reform**. He also provides a number of key techniques, what he terms as 'field-craft' which could by themselves be considered an approach or tool for EPS reform.

Another notable approach is the **Making Markets Work for the Poor (M4P)** approach which uses PEA analysis to develop market systems to benefit the poorest. M4P programmes inherently contain elements of PEA and therefore they provide a clear example of PEA being used to support EPS reform.

### ***Donor PEA in EPS reform and Case Studies***

**DFID** have undertaken a large number of PEAs, particularly 'Drivers of Change' studies. These have had identifiable impacts on DFID and joint-donor programming in Bangladesh, Kenya, Nicaragua and Nigeria. In Bangladesh, donors started to engage with a wider range of actors as potential agents of change, and also decided to reform the regulatory environment. In Kenya, it became clear that donor influence would not rival the influence of the patronage networks involved in politics and business. In Nicaragua, donors began to identify and promote pro-growth coalitions and push for dialogue amongst key actors. In Nigeria, PEA has become routine in programming and has influenced the selection of activities and the monitoring and evaluation frameworks of EPS reforms. Even where DFID do not explicitly undertake PEA in the choice and design of their programmes, implementing organisations on the ground may engage in PEA to help them undertake interventions.

There are a number of PEA tools developed by **other bilateral donors**. This includes: the Strategic Governance and Corruption Assessment (SGACA) (the Netherlands); Power Analysis (SIDA) and an unbranded PEA tool by Norad (Norway). A SIDA Power Analysis study in Kenya has been observed to have impacted on EPS reforms, pushing SIDA to reassess the importance of growth for poverty reduction.

In terms of multilateral donors, the **UNDP** have an Institutional and Context Analysis (ICA) methodology and have undertaken a number of PEAs relating to EPS reform. The **World Bank** have developed a Problem-Driven Governance and Political Economy (PGPE) framework, with a problem-driven focus, and have developed an Institutional and Governance Review (IGR) tool, with a public institution focus. The **European Commission (EC)** are looking to integrate PEA into the Project and Programme Cycle Management. The **Asian Development Bank (ADB)** has been quite active in terms of producing PEA documents on reform and PEA guidance documents. The extent of the analyses being undertaken by these organisations suggests that PEAs are in demand and are very likely to be used, or at least noted, by practitioners engaged in EPS reform. In Bangladesh the IGR there was observed to have impacted on EPS reform and the understanding that growth depends on mobilising political will to overcome vested interests blocking reform.

PEAs seem to still be very much in demand amongst development organisations. For example, the World Bank's Private Sector Development programme have initiated a political economy study of Somaliland to input into EPS reform although it is unclear what tool or approach is being used for this.

## 2. Tools and approaches

Prior to the formalisation of the PEA as tools, many development actors carried out their own informal analysis into political and economic processes in a society. This contextual analysis and understanding would often influence country programme design and implementation. Many development actors continue to undertake such an informal process or at least maintain an understanding of how political economy processes impact on their work.

There now are a variety of defined methodologies to undertake PEA. Some of these methods have been structured into tools, whereas other methods are more amorphous and are best described as approaches. There are different levels of analysis with different purposes for PEA, and consequently a number of different tools appropriate for these levels:

**Table 1: PEA purpose and tools for different levels of analysis**

Level	Purpose	Tool
Macro-level country analysis	To enhance general sensitivity to country context and understanding of the broad political-economy environment.	<ul style="list-style-type: none"> <li>▪ Drivers of Change (DFID)</li> <li>▪ Strategic Governance and Corruption Analysis (SGACA, Netherlands)</li> <li>▪ Power Analysis (Sida)</li> </ul>
Sectoral Analysis	To identify specific barriers and opportunities within particular sectors (e.g. health, education, roads).	<ul style="list-style-type: none"> <li>▪ Analytical framework for Understanding the Political economy of Sectors and Policy Arenas (DFID/ODI)</li> <li>▪ Addressing Governance in Sector Operations (EC)</li> </ul>
Problem driven analysis	To understand and resolve a particular problem at the project level, or in relation to specific policy issue (e.g. growth or public financial management reform).	<ul style="list-style-type: none"> <li>▪ Political Economy of Policy Reform (World Bank SDD/OPM)</li> <li>▪ Policymaking Process Framework (IADB)</li> <li>▪ Problem-Driven Governance and Political Economy Analysis (World Bank)</li> </ul>

**Source:** DFID (2009); Davis (2011)

Davis (2011) emphasises that:

- These tools are general and not specifically adapted for EPS reform interventions.
- Analysis of the political economy environment is not a one-off exercise, but needs to be repeated regularly.
- There is inevitably a political economy impact of the reform processes that development agencies and host governments put in place.

From the literature on tools and approaches on PEA, the most relevant to EPS reform seem to be Davis' (2011) guidance document on business environment reform, and the Making Markets Work for the Poor (M4P) approach.

## 2.1 The Political Economy of Business Environment Reform

In the guidance document on the political economy of business environment reform, Davis (2011) looks to provide insights about how business environment reformers can address the challenges of political economy. The document itself is not a tool as such, but sets out guidance to identifying appropriate tools and carrying out the process of business environment reform.

Davis (2011) argues that private sector development professionals need to develop what he terms 'field-craft' - an ability to understand and manage these issues as an integral part of their job. To optimise the ability to deal with political economy issues he identifies a number of key skills:

- **Talk to specialists in other disciplines** as many private sector development challenges are faced by those working in other areas of development programming.
- **Use the business environment itself as a diagnostic.** A country's business environment reflects the local history and circumstances and an assessment of what reform is needed of a country's business environment can also be used as an assessment of the political economy.
- **Observe and listen.** Communicate and collaborate with a range of people to gain insights and views that help in developing an understanding of the host country and of the political economy challenges and how they might hinder or shape efforts at business environment reform.
- **Continually evaluate** during reform to ensure things are on-track and the evolving political economy.
- **Develop a wide network** of people who will be able to provide an on-going range of perspectives into what is going on in a country.
- **Remember the art of the possible.** Be sanguine about what can and cannot be achieved.
- **Address the effects of constant staff rotation.** If regular turnover of staff is inevitable, then agencies need to ensure that hand-over procedures are as comprehensive as possible to maintain a sophisticated understanding of the country within the organisation.

## 2.2 Making Markets Work for the Poor (M4P)

Making Markets Work for the Poor (M4P) is supported by DFID, Swedish International Development Agency (SIDA) and the Swiss Agency for Development and Cooperation (SDC), and provides a political economy perspective to the fields of private sector and market development (DCED, 2013). The approach is a framework for understanding 'political markets' and the role that vested interests, weak institutions and coordination failures can play in distorting market access, particularly for poor people (DFID, 2009). Rather than focus on general private sector development, M4P focuses on the underlying constraints that prevent the effective development of market systems around poor people (SDC & DFID, 2008a). M4P aims to be a flexible, comprehensive approach with application in both economic (e.g. agriculture, finance, investment climate and livelihoods) and social (e.g. water, health and education) fields (SDC & DFID, 2008a).

The M4P approach aims to go beyond the 'Drivers of Change' approach which can provide an understanding of the political economy but is less instructive in guiding what to do to influence it. Unlike 'Drivers of Change' the M4P approach places the political economy as one factor within a wider systemic framework of analysis and action.

A 2008 synthesis document on the M4P approach notes that there has been an upsurge of interest in market development approaches amongst aid agencies (SDC & DFID, 2008a). Alongside M4P there is UNDP's Growing Inclusive Markets, the IADB's Opportunities for the Majority and the IFC's Next Four

Billion. Though these approaches see a market-based economic engagement with the poor as essential for sustainable development, as M4P does, there is no significant emphasis on PEA for reform.

SDC and DFID (2008b) argue that the M4P approach can bring added value in relation to economics. The key benefit of the M4P is that it recognises the importance of understanding the alignment of key market functions and players and the incentives and motivations of those players, as the key to understanding why markets are currently suboptimal. It then uses this understanding as the basis for trying to identify what measures to take to stimulate sustainable changes in market systems that are more pro-poor.

### **3. Donor PEA in EPS reform**

#### **3.1 Bilateral donors**

##### ***DFID***

DFID has undertaken a large number of political economy analyses through its 'Drivers of Change' studies (DOC), which provide insight on how political economy analysis can be used to strengthen understanding and programming (DFID, 2009). The DFID (2009) How-to-Note does not specifically mention EPS development but growth is included as an example of issues that political economy analysis can help inform. The How-to-Note states that conventional donor analysis uses growth diagnostic tools to identify specific factors or 'binding constraints' that hold back growth in different contexts and at different points in time. PEA, the Note argues, provides greater insights into the deeper causes of failure to address the binding constraints to growth. As a result of PEA analysis, growth policies can take into account feasibility of enacting the policies and PEA can highlight actions to strengthen pro-growth coalitions.

Davis (expert comments) notes that even where donors do not explicitly use PEA in the design of projects and programmes, local organisations who implement these projects may use a political economy approach. The Growth and Employment in the States programme, focussed on supporting an improved business environment in Nigeria (GEMS3), is a prominent DFID programme which does not seem to highlight the need for political economy analysis (e.g. DFID, 2012). Nonetheless, Davis (expert comments) states that implementing organisations contracted within the GEMS3 programme have undertaken PEA training so as to better implement their programmes.

Section 4 highlights a number of case studies where the DOC approach is seen to have had an impact on EPS reforms.

##### ***Other bilateral donors***

In a review of PEA tools and literature, Mcloughlin (2012) identifies the other key PEA tools that bilateral donors have developed. The Dutch Foreign Ministry has developed the Strategic Governance and Corruption Assessment (SGACA) which aims to capture the informal, societal and sometimes intangible underlying reasons for the governance situation, which can often differ from the formal configuration of the state. SIDA's Power Analysis looks to identify where real power in a society lies, how it is distributed and possible conflicts of interests with an approach that emphasises that political economy analyses should primarily rely on local expertise. Norad's approach to political economy analysis includes an analysis of the legitimacy of the state and looks to analyse governance and statebuilding, particularly in situations of fragility.

Research for this report did not identify any PEA studies by these bilateral donors which had a clear impact on EPS reform except for the case of Kenya (see section 4). It is likely that EPS reformers have used some PEA analysis in the design of the programme but the lack of literature suggests that PEA analysis is not explicitly undertaken for EPS reform or not acknowledged to have been undertaken.

## **3.2 Multilateral Donors**

### ***UNDP***

The Institutional and Context Analysis (ICA) Guidance Note is UNDP's methodology for undertaking PEA to support development programmes and was produced to help staff understand the political and institutional context in which they operate in a way that is suited to the needs and mandate of UNDP (UNDP, 2012).

The term 'institutional and context analysis' refers to analyses that focus on political and institutional factors, as well as processes concerning the use of national and external resources in a given setting and how these impact on programmes' implementation and policy advice. ICA assumptions and questions are similar to those that underpin political economy analyses. ICA aims to look at political and economic factors that play a role in development interventions, but also beyond those dimensions to facilitate a more holistic contextual understanding, with a view to achieving better results for the ultimate benefit of the national partners in question (UNDP, 2012).

There are a number of UNDP resources available which discuss the importance of PEA for growth. A UNDP (2011) document on The Political Economy of Renewable Energy in Southeast Asia summarises the findings from country-level PEA of recent renewable energy (RE) projects in Malaysia and the Philippines. Rather than being used explicitly in programming the paper was commissioned to 'stimulate wider discussion of PEA within the context of UNDP's work' (UNDP, 2011, p.2). Research for this helpdesk query did not identify examples of ICA clearly impacting EPS reform though the commissioning of these reports suggest they will input into UNDP's reform activities. It is also likely that though UNDP offices undertake some form of PEA such as ICA, few offices codify the findings and make these public (Melim-Mcloud, expert comments). Use of PEA may not be explicitly acknowledged in reports.

### ***World Bank***

The World Bank's Problem-Driven Governance and Political Economy (PGPE) framework synthesises the lessons and experiences of diagnostic work on corruption, governance and political economy analyses (Haider and Rao, 2010). The PGPE approach is similar to SIDA's Power Analysis and DFID's Drivers of Change approach in that both direct researchers to look at actors (or stakeholders), institutions and structures that influence poverty and development policies at the macro level (Mcloughlin, 2012). However the PGPE analysis can also be applied to the sector and thematic level; the project and policy specific level; or a combination of levels. During research for this report it was not possible to find examples of the PGPE approach being used explicitly for EPS reform.

An older World Bank tool was the Institutional and Governance Review (IGRs). These were analytical reports that focus on the functioning of key public institutions (World Bank, 2000). They take performance failures in policy management, service delivery, or accountability as the starting point for their analysis. They analyse the feasibility of reform recommendations with an assessment of political

realities and constraints to reform. An IGR was seen to have had an impact on EPS reform in the case of Bangladesh (see section 4).

### ***European Commission (EC)***

The European Commission (EC) has begun to examine ways to better integrate PEA into its Project and Programme Cycle Management (PPCM) Guidance using an approach largely based on the Strategic Governance and Corruption Assessment (SGACA) tool (Mcloughlin, 2012). If a PEA approach was integrated into the PPCM this would mean that all programmes including those that address economic and private sector reforms would involve some form of PEA. During research for this report it was not possible to verify that this now been incorporated into the PPCM. Neither was it possible to identify examples of an explicit PEA approach in EPS development for EC programmes.

### ***Asian Development Bank (ADB)***

The Asian Development Bank (ADB) has published a number of PEA-related documents. Recently they have produced a guidance note to provide ADB staff with guidance on how political economy analysis can be used to inform the design and implementation of ADB operations for more feasible and sustainable development outcomes (ADB, 2013a). They have also produced a book on managing reforms for development which is targeted at development practitioners involved in the policy reform process, and which aims to help them the understand political economy factors that shape actual outcomes (ADB, 2013b). The Political Economy of Economic Reform in the Pacific document presents a set of studies on various aspects of the political economy of the Pacific island economies, including attempts at policy and institutional change (ADB, 2011).

Though it has not been possible to identify whether the ADB now routinely conducts PEA analysis the emerging research suggests a shift towards greater use of PEA by the ADB, including in relation to economic reform.

## **4. Case studies**

### ***Bangladesh (Drivers of Change, Institutional Governance Review)***

Dahl-Østergaard et al. (2005) argue that the DFID Drivers of Change study had an impact on the design of DFID's new Country Assistance Plan (CAP). The CAP adopted the PEA study's recommendation that DFID should engage more directly with the political process, and with a wider range of potential change agents, including think tanks, the media, and the private sector. This was followed through at the level of sector programmes. Specifically, Dahl-Østergaard et al. (2005) argue that a project to help make the regulatory environment more conducive to private investment was clearly influenced by the DOC approach.

Dahl-Østergaard et al. (2005) also argues that the World Bank Country Assistance Strategy (CAS) was influenced by the Bank's Institutional Governance Review (IGR). The IGR meant that the CAS recognises that accelerating and broadening growth depends on mobilising political will to overcome vested interests blocking reform, and gives prominence to governance and institutional factors.

### ***Kenya (Power Analysis, Drivers of Change)***

SIDA's Power Analysis study resulted in a debate within the SIDA Nairobi office about the need to revisit the importance of growth for poverty reduction and governance (Dahl-Østergaard et al., 2005).

The DFID Drivers of Change (DOC) study helped DFID assess what was feasible in relation to EPS reform for their Country Assistance Plan (CAP). The DOC study identified the fact that patronage is the basis of politics and business in Kenya and that this was thus a major risk factor for reform (Dahl-Østergaard et al., 2005). The PEA study assessed DFID's ability to influence this as 'low' and this was taken account in the CAP. The PEA study has also influenced sector studies which look at the political economy factors shaping the policy environment for agriculture and private investment; it has also stimulated support for the Kenya Revenue Authority.

### ***Nicaragua (Drivers of Change)***

A 2009 DFID How-to-Note cites Nicaragua as an example of how PEA studies have helped donors promote pro-growth coalitions (DFID, 2009). Working with the World Bank and the Inter-American Development Bank, DFID undertook PEA to better understand the political constraints and institutional blockages to pro-poor growth. The study found that the dynamics between the government, donor community and private sector were creating a weak investment climate. Consequently a new programme was designed to help overcome a number of the identified constraints, which helped to create the conditions for a more constructive dialogue between government, the international financial institutions and the private sector. The Note argues that this led to noticeable improvements in the business climate for small and medium-sized enterprises.

### ***Nigeria (Drivers of Change)***

In Nigeria, between 2003 and 2005 DFID undertook a large-scale and costly series of around 60 PEAs, of highly variable quality, but together creating a basis for understanding political dynamics and its implications for development outcomes (Duncan & Williams, 2010). Since then PEA has been generally adopted within the DFID Nigeria office, and amongst the teams implementing DFID's programmes. Duncan and Williams (2010) argue that it has consequently become a routine part of their way of working.

There has been a particularly dramatic shift in DFID's strategy and programming in Nigeria where a number of new programmes have been initiated since the 2003-05 Drivers of Change (DOC) studies. This includes a focus on core economic management functions and governance at the federal level, a new round of state level programmes and a scaling up of initiatives aiming to promote voice and accountability. The latter include the Enhancing Nigerian Advocacy for a Better Business Environment programme. Duncan and Williams (2010) argue that the use of PEA is evident in the preparatory documentation for these programmes, the selection of particular activities and in monitoring and evaluation frameworks.

### ***Somalia (No tool listed)***

The World Bank's Private Sector Development programme for Somalia includes supporting a political economy study of Somaliland, amongst other activities (Somalia PSD Donors Working Group, 2012a). This study looks to examine the political economy drivers in Somaliland and to provide policy makers with (i) an assessment of the landscape of private enterprise in Somaliland, including formal and informal actors;



(ii) to gain insight into the strengths and weaknesses of Somaliland private sectors looking particularly at the factors that can promote its growth and employment generation; and (iii) the role of trust, identity and ethnicity in business transactions (Somalia PSD Donors Working Group, 2012b). As of July 2013 a final report was not publicly available. It is also not clear what PEA tool, if any is being used for the analysis.

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