

**Research Summary 28: IDS Working Paper 311  
'Aid, Rents and the Politics of the Budget Process' (2008)  
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*This paper is published under the Centre for the Future State, based at the Institute of Development Studies. Below is a summary of research findings. Further details are available at:*

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*The analysis presented in this paper provides insights into the way non-tax resource flows (from aid and natural resource exports) interact with political and budget institutions to shape budget outcomes.*

## **Introduction**

This paper presents a framework for analysing the impact of political and budgetary institutions and non-tax resource flows on the quality of budget outcomes in both aid-dependent and resource-dependent countries. The quality of budget outcomes or 'budget governance' is understood to include governments' ability to sustain fiscal discipline, make efficient use of government spending, and represent the preferences of the median voter; however given data limitations this paper focuses on the first (governments' ability to produce sustainable fiscal balances over time). A new dataset was developed for this paper, containing 47 low and lower middle income countries whose economies depend on aid or natural resource inflows, over a period of twelve years (1995-2006). The data contains indicators of macro economic performance, political institutions and good governance scores, budget norms and processes, and non tax revenues, including aid and natural resource flows.

## **Framework of Analysis and Determinants of Budget Governance**

The budget process is, by definition, a highly contentious policy arena where diverse political actors converge to address distributional conflicts through institutionalized and repeated interactions. Distributive concerns about resource allocation are especially relevant where governments benefit from non-tax sources of revenue such as rents from natural resource exploration and different kinds of aid flows. While there are considerable differences between these two sources of revenue, they both erode governments' incentives to remain accountable to their citizens' policy preferences and spending priorities (Moore 2006). They also contribute to eroding "horizontal" accountability between the executive and other government branches, as governments have greater incentives to make discretionary use of unearned revenues, bypassing the effective checks and balances from control authorities and opposition parties.

The existing literature highlights two main explanations for the relation between budget processes and budget outcomes. Political economy approaches have focused on the impact of domestic political institutions and budgetary procedures in shaping budget outcomes (e.g. the effects of different electoral systems and political parties on fiscal discipline). A second explanation looks at the impact of exogenous resource flows such as resource rents or aid flows on budget processes and outcomes. Their nature, and the fact that they are often substantial, may reduce the government's need for directly taxing its citizens, and therefore expand executive authority at the expense of political accountability. The so-called 'resource curse' has been widely documented, showing that resource-rich countries are often marred by authoritarian regimes, corruption and inefficiency, and poor growth and macroeconomic

imbalances. The presence of resource revenues, then, interacts in important ways with political and budget institutions and processes to determinate budget outcomes.

The framework attempts to draw together these various factors and dynamics. The general socio-economic and political background, the more specific nature of political and budgetary institutions (from electoral systems to party structures, from division of powers on fiscal matters to rules governing transparency and access to information), and the existence of resource flows from aid or natural resources all interact to determine the quality of budget outcomes. The framework proposes that sound budget governance is the result of the formal and informal dynamics taking place within the budget process, and this process is shaped in turn by the interaction between budget actors, political and budget institutions, and external resource flows including oil and aid. Unlike existing approaches, this framework goes beyond partial associations between the variables of interest and focuses instead on the interaction and interdependence of political and budgetary variables, by looking, for example, at the interaction between formal and informal rules, or the roles of domestic and international actors. .

### **Preliminary Findings**

Given the colossal challenge of collecting complete and reliable data for the countries of interest, the empirical part of the paper remains a work in progress. Nevertheless, some preliminary findings help clarify the links between strong executives and budget outcomes in aid and resource dependent economies. Established findings for rich countries show that stronger executive power is associated with improved fiscal outcomes. By contrast, this analysis suggests that in the context of aid dependent and resource rich countries, politically uncontested executive authority has counterproductive effects on fiscal balances. Moreover, increased levels of political (partisan) competition have a moderating impact on the size of deficits. Finally, aid flows and resource revenues seem to have opposite impacts on fiscal performance, with resources improving the likelihood of obtaining fiscal surpluses and aid flows increasing the likelihood of deficits. Stronger executive power is associated with improved fiscal outcomes in resource dependent countries, but at the expense of political competition and the rule of law. By contrast, aid dependent countries tend to have poor fiscal performance even when (and perhaps because) the executive has considerable powers over the policy process.

### **Implications for Policymakers and Future Research**

For donors, the findings point to the need for more focus on stronger accountability mechanisms in aid dependent countries where donor-supported executive action goes largely unchecked. They also need to take the possible negative impacts of aid dependency more seriously. Of interest to policymakers more generally, the paper also offers some empirical evidence to support the claim that natural resource rents tend to erode democratic competition and accountability in developing countries.

There are two specific consequences of this study for future research. The statistical significance of some political variables, such as the strength of the executive in the policy making process, call for further research. It will be relevant to explore whether greater executive discretion can indeed improve fiscal performance but at the expense of reduced party competition or erosion of checks and balances.

A second implication is the need for much more systematic international efforts to collect reliable, detailed data on key variables that is comparable across countries. Specifically, there is a need to revise and improve the validity of existing instruments intended to improve the efficiency and accountability of public finances such as the PEFA assessments (Public Expenditure and Financial Accountability).