

Understanding the politics of the budget: What drives change in the budget process?

This briefing has been written principally for advisers and managers in DFID who work with partner countries to strengthen public financial management and accountability systems, including through budget support. Others in DFID, partner countries and development agencies might also find it useful.

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Introduction

1. The purpose of this briefing note is:
 - to distil the findings of political analyses of the budget process in developing countries;
 - to highlight why a good political understanding of the budget process is important to improve aid effectiveness, particularly in the context of poverty reduction budget support (PRBS);
 - to suggest entry points for donors to engage with the politics of the budget and strengthen domestic demand for accountability in public finances; and
 - to provide operational guidance on how to undertake politics of the budget reviews.
2. This briefing note is largely based on evidence drawn from case studies commissioned in 2004 (Ghana, Malawi and Mozambique). It does not seek to provide a one-size-fits-all toolkit to be rigidly applied, as realities differ from one country to another and each country exhibits a unique combination of strengths and weaknesses. Budget reform initiatives, too, vary in scope, sequencing and speed. Lastly, while this briefing note focuses on national-level budget politics, understanding the politics of budgeting at the local level and the interaction between the two levels is critical.
3. The briefing note is structured in four main sections:
 - **What are the key findings?**
 - **Why does better political understanding matter?**
 - **How do political factors affect budgetary systems?**
 - **Why and how to undertake a politics of the budget review?**

1. What are the key findings?

4. A political understanding of fiscal governance and public budgeting is important to:
 - appreciate how political factors and governance dynamics influence the prospects for pro-poor change;
 - encourage and support “good enough” reforms in public financial management and accountability (PFMA);
 - identify drivers of pro-poor change, strengthen checks and balances and support demand for good financial governance from within and outside government;
 - improve aid effectiveness by informing country strategies and managing portfolio risk, including Country Assistance Plans (CAPs), Country Governance Analyses (CGA) and Fiduciary Risk Assessments (FRAs); and
 - assess the quality of financial governance and identify and mitigate political and fiduciary risk when providing PRBS.

5. **Why is budget reform so difficult to achieve?** Political governance and budget politics affect the functioning and reform of public financial management systems. The studies of Ghana, Malawi and Mozambique highlight an important gap between formal systems and informal practices, such as clientelism, patronage and rent-seeking. They reveal that dysfunctions and distortions occur at all stages of the budget process.

6. **Why does political economy matter?** The studies' findings emphasise that the budget is a political process, rather than a purely technical one. Politics make a difference. It is not possible to separate technical budget reforms from the wider governance environment required to make them work and the political system in which they are embedded. Effective reforms are those that are technically sound, administratively possible, and politically feasible. Budget politics drive public budgeting and shape the rules of the budgetary game, including the ownership, timing and sequencing of reforms and government's commitment to them.

7. **Budget politics offer both challenges and opportunities.** Getting the politics right is central for ensuring developmental success. Politics is not only a risk to mitigate but also an opportunity to seize.¹ Understanding the politics of the budget therefore helps improve aid effectiveness. In particular, political and electoral cycles often shape the policy space for reform.

8. **What explains change?** Political economy factors affect the trajectory of change and the credibility of governments' commitment to reform. The studies underscore that demand for better governance and greater accountability is a key driver of change in budgetary systems. This demand emerges from both the formal institutions (parliaments or supreme audit institutions) and informal mechanisms (civil society, media and citizens). However, budget institutions are often weak and ineffectual. They can be circumvented or subverted. Formal institutions can only be effective if informal institutions reinforce, rather than undermine them.

9. **How does change occur?** The studies suggest that incremental reforms are more likely to be more successful than "big-bang" approaches seeking to transpose models from abroad. Realistic reforms based on "good enough governance" are often "second-best solutions" seeking to "get the basics right first." Pursuing a large number of reforms simultaneously, without considering their technical feasibility and political viability is likely to fail. There is often limited policy space and technical capacity within partner governments to manage complex processes of reform. The forces favouring the status quo also need to be considered.

10. It is therefore important to:

- identify the formal rules and informal practices shaping the budget process and the institutional and political contexts in which budgetary systems are embedded;
- assess the trajectory of change and the agents of change in the budget process; and

¹ As the Secretary of State stated: 'Politics matters. Politics changes things. And it is democracy that makes politics possible.' Hilary Benn, Secretary of State for International Development, Better Aid Needs Better Politics: DFID's role in Making Governance Work for the Poor, Speech at Demos, Westminster Hall, London, 23 October 2006.

- ensure that budget reforms are adequately prioritised, realistically sequenced and tackle the root causes of weak public budgeting.

11. **What can donors do?** Donor support has traditionally focused on the machinery of government within the executive branch. While these efforts should be continued, they ought to be complemented by efforts to strengthen domestic budget accountability.

- Donors can play an important role to encourage transparency, participation and accountability in public budgeting, by supporting meaningful and regular reporting, timely disclosure of financial information, publicly-available audited financial statements, citizens' external scrutiny or participatory budgeting.
- Donors need to be much more aware of the political economy factors which influence the behaviour of partner governments, including the potential impact of their own behaviour on domestic processes. This is particularly important in aid dependent countries where donors are key actors in the budget process. Aid dependency can have the perverse effect of emphasising partner governments' upward accountability to donors over their downward accountability to citizens.

12. **Understanding political risk is particularly important for budget support.**

Where we are considering PRBS, with funds passing into and through national systems, more robust political analysis is critical to gauge the influence of informal institutions and clientelism on formal budget processes. The joint evaluation of general budget support recommended donors improve their understanding of the influence of political factors on budgetary processes and, therefore, budget support and fiduciary risk (IDD et al. 2006).

13. **Politics of the budget reviews help identify and support drivers of pro-poor change in public financial management.** The case studies underscore the primacy of domestic politics in explaining public budgeting and budgetary reform. Donors can encourage reform by supporting domestic processes and building on what works. However, understanding the political economy of budget reform is not enough. A challenge for donors, reflected in the case studies, is how to translate greater understanding into practical engagement with the politics of reform.

Key messages

- The budget is a political process, rather than a purely technical one.
- Political governance affects the functioning of public financial management systems and the sustainability of budget reform.
- Strengthening domestic budget accountability and stimulating demand for change are key ingredients of successful reforms.
- Incremental reforms are likely to be more successful than "big bang" approaches seeking to transpose complex models but failing to consider political and technical feasibility.
- Politics of the budget reviews help identify key challenges and opportunities for pro-poor change in public finance.
- Sound public financial management systems are a major concern of donors; understanding political risk is particularly important in the context of direct budget support.
- Our appreciation of the political economy context of budget support can add value to multilateral lending and improve aid effectiveness.

2. Why does better political understanding matter?

14. **Sound budgetary systems are crucial to make progress in reducing poverty and tackling inequality.** They are central to governments' ability to deliver services and reduce poverty. They are also critical to fight corruption and build effective states with the necessary degree of capability, responsiveness and accountability. Public budgeting is a central function of the state and the budget process involves a wide range of stakeholders beyond government, including parliament, oversight agencies, civil society and donors. Better political understanding of budget systems can thus help to:

- improve aid effectiveness and
- assess gaps in budget practices.

2.1. Improving aid effectiveness

15. **Effective public financial management systems are essential to improve aid effectiveness.** Robust financial management and accountability systems are critical to ensure that aid resources are used effectively for the purposes intended. The White Paper of 2006 underlines the governance dimensions of aid delivery and the need for a more political understanding of the determinants of aid effectiveness. It calls for more robust assessments of the quality of governance through periodic Country Governance Analyses (CGA) and acknowledges the disruptive effects of political and corruption risk.

16. **Better analysis of political risk is required.** The Joint Evaluation of General Budget Support noted that political governance is a key risk to the effectiveness, predictability and sustainability of budget support (IDD et al. 2006). However, while there are many technical analyses of PFMA systems, political economy analyses of budgetary processes remain underdeveloped. More robust political economy analyses help assess the feasibility of reform, government commitment to reform and the degree of fiduciary risk, including corruption risk.

17. **Within DFID, the quality of the budget process is central to our approaches to conditionality, budget support and fiduciary risk.** Adequately understanding the political economy of budget reform is particularly important to the development of country strategies. Politics of the budget reviews are useful tools for monitoring political risk, designing programmes to mitigate fiduciary risk and preventing corruption. They are also important to gauge the credibility of partner government's reform programmes and the trajectory of change in public finance reform. These are central dimensions of our approaches to conditionality (2005, 2006) and budget support (2004) and are essential to deliver aid effectively.

18. **Harmonising diagnostic work is important to promote donor harmonisation and alignment.** Un-coordinated and un-prioritised donor intervention can rapidly lead to reform overload. The multi-donor Strengthened Approach to Public Expenditure and Financial Accountability (PEFA) adopted in 2005 provides an approach for assessing the quality of public budgeting in partner countries and

harmonising donors' approaches to PFMA reform around a common diagnostic of the key challenges in PFMA reform.²

19. **Understanding the political economy of public budgeting is critical to DFID's assessment of fiduciary risk.** While PEFA assessments help identify weaknesses (answering the “what” question), they provide less insight into the structural causes of budgetary dysfunctions (the “why” question) and how these can be tackled (the “how” question). To satisfy DFID fiduciary risk policy (2004), PEFA assessments should be complemented by an assessment of the political context and institutional environment affecting public financial management, in order to:

- gauge the risk of corruption and political capture;
- assess the credibility of partner governments' reform programmes; and
- evaluate the trajectory of change in PFMA systems.

20. **DFID appreciation of the importance of political economy factors can add value to multilateral budget support.** Budget support is often provided in conjunction with development partners through multi-donor trust funds or as co-financing of multilateral loans and credits. Increasingly, DFID provides budget support in conjunction with the World Bank and the value DFID PRBS adds is often framed in terms of its ability to tackle political economy issues. As we increasingly channel resources through multilateral organisations, this influencing role is likely to prove critical.

21. For example, in the resource-rich Andean countries, DFID works with the Inter-American Development Bank to improve its understanding of the political economy of the budget process. In Malawi, the politics of the budget review has informed the assessments of the donor budget support group. Following the May 2004 elections, the new finance minister was determined to anchor fiscal discipline and the formal budget process has been much more relevant ever since.

2.2. Minding the gaps

22. **Politics matter in understanding how budget institutions work in practice and how they change over time.** There can be a significant gap between formal processes and informal practices, between the formal rules of the budget process and the informal institutions shaping budget outcomes. The studies on Malawi, Mozambique and Ghana, identify important deviations between the approved budget and actual expenditure. For example, volatility in the disbursement of funds has important implications for the delivery of social services, in particular in health and education.

23. Power and politics explain what has been described as a “budgetary façade” (Killick 2004) or a “deceptive mirage” (Pradhan 1996). What matters is the interaction between formal and informal institutions, whether they support each other or neutralise one another. Table 1 below provides a conceptual model to think about the interactions between formal and informal institutions to explain effective governance

² See: www.pefa.org.

Table 2: Interactions between formal and informal institutions

| Outcomes | Effective formal governance | Ineffective formal governance |
|--|-----------------------------|-------------------------------|
| Convergent objectives between formal and informal institutions | Complementary | Substitutive |
| Divergent objectives between formal and informal institutions | Accommodating | Competing |

Source: Adapted from Helmke and Levitsky 2004.

24. **The study on the politics of the budget in Malawi argues that the budget process is a “theatre” that masks the real distribution of public spending** (Rakner et al. 2004). Sound formal rules and procedures are in place, but are distorted by informal practices which determine the actual distribution of budget resources. The budget provides the illusion of rationality, partly to please foreign donors. More, the incentives of the main stakeholders (the bureaucracy, the government, the legislature, civil society as well as donors) undermine, intentionally or unintentionally, formal institutions at each stage of the process. Table 2 provides illustrative examples of disconnect between the formal and informal institutions at different stages of the budget process in Malawi.

25. **Unpacking the lack of political will require an understanding of the politics of the budget.** Lack of “political will” is often identified as a major cause of reform failure. However, this recognition often reflects an insufficient appreciation of the political economy of policy reform, both its design and its implementation. Dysfunctions in PFMA systems are often the result of political failures, as much as technical weaknesses. Technical capacities and political incentives interact to explain the functioning of budgetary systems. Box 1 illustrates the influence of patronage and clientelism on the governance of the budget in Ghana.

Box 1: Ghana’s budgetary façade

The study on the budgetary system in Ghana revealed a “democratic deficit” in the budget process which is described as a “ritualistic façade” characterised by large deviations between budgeted expenditures and actual spending. This created systemic biases, permitting large leakages, with deviations in social spending being particularly acute.

Systemic failures were seen to be the result of a conjunction of factors, including:

- the centralisation of budget formulation within the executive and a consequent lack of transparency;
- the lack of institutionalisation of the review and negotiation of the budget between the executive and legislative branches; and
- the inability of Parliament to exercise effective control and oversight due to factors such as limited time, weak technical capacities and partisanship.

Fiscal transparency was further hampered by the inadequacy of flows of information and the general culture of secrecy that existed within the public bureaucracy. Consequently, external scrutiny by civil society and civic demand for accountability were limited.

Source: Killick (2004, 2005)

Table 2: Formal and informal institutions shaping the budget process in Malawi

| Formal institution | Informal institution | Outcome |
|--|---|---|
| Budget formulation | | |
| <p>Ministry of Finance (MoF) conducts hearings where ministries and departments present their goals, objectives and activities and indicate priorities based on the PRSP.</p> | <p>An informal process that ignores the MTEF begins as line ministries inflate resource bids to MoF to receive a minimum requirement as it is known that MoF cuts budget even if appropriate budgets are submitted. Due to limited resources, the reallocation is done by some members of the cabinet. Technocrats know that even if they present accurate technical proposals, the president and cabinet may change them.</p> | <p>A budget that reflects political interests rather than a pro-poor focus of the PRSP.</p> |
| Budget adoption | | |
| <p>Budget & Finance Committee (BFC) and National Assembly approve budget. BFC scrutinises key expenditures for adequacy and prioritisation. It makes a report with recommendations for discussion by the National Assembly in plenary session.</p> | <p>MoF submits budget proposals shortly before presentation, knowing that the BFC and National Assembly have insufficient time to scrutinise the proposals. MoF wins the MPs vote by including allowances and benefits which accrue upon passing the budget. BFC struggles to scrutinize the budget in that short period of time without in-house technical support. Pre-budget consultations occur but there is not enough time for consultation with civil society.</p> | <p>Budget is passed without adequate assessment, particularly the match between stated economic and fiscal policy statement and budget estimates. The role of parliament and civil society is often ineffective.</p> |
| Budget execution | | |
| <p>Once monthly appropriations have been declared, the allocation of resources is carried out by MoF's Resource Allocation Committee. Allocations should be based on the priorities of the approved budget</p> | <p>President and Minister of Finance have power to allocate resources, as the Cabinet Committee on the Economy rarely meets. Some departments overspend and get more resources including state presidency and the police. At this point, controlling officers (Budget Director) cannot counteract political influences to keep the allocations in line with the voted expenditures.</p> | <p>Political and personal interests and lack of commitment of top leaders lead to sectoral allocations that are neither pro-poor nor pro-growth.</p> |
| Budget oversight | | |
| <p>The parliamentary Public Accounts Committee (PAC) receives Auditor General's report and scrutinises it for transgressions and evidence of waste. PAC can summon any person named in the NAO report to demand explanations for waste and non-observance of the law. PAC can recommend sanctions but is not empowered to take action.</p> | <p>PAC does not have technical support to thoroughly scrutinise public accounts and investigate waste. Since PAC does not itself effect sanctions, its recommendations can easily be ignored by those empowered to take such action. PAC has had to scout for and depend on donor support. Committees members are not mandated by law to meet at specified times and thus tend not to meet if there are no allowances.</p> | <p>PAC is a statutory oversight body but has not received an allocation from the parliamentary vote for its meetings. The Committee's dependence on donors may create perceptions that it is answerable to donors. Its links with civil society are weak.</p> |
| Civil society | | |
| <p>Civil society is not specifically identified in the budget law, but neither is it barred from participating in the budgeting process. The organic budget law provides for MoF to publish economic and fiscal policy statements, quarterly budget implementation progress reports, national government accounts, annual audit reports. Civil society</p> | <p>Civil society lacks knowledge of its rights to financial information and has limited capacity to scrutinise public finances. A few civil society organisations based in urban areas have picked up budget issues but tend to lack legitimacy in the eyes of government because they are mainly donor funded.</p> | <p>Civil society is not complementing the work of the PAC and NAO by bringing citizens demand for economic accountability.</p> |

| | | |
|--|--|---|
| organisations can report evidence of waste of public resources to Treasury. | | |
| Political parties | | |
| Political parties need to be registered but have no formal statutory role in the budget process. Parties have manifestos although these are not widely shared. Budget process and economic accountability issues were not central concerns in the 2004 manifestos. | Cabinet is usually selected by the President from his own party without any approval from the Public Appointments Committee and tends to pursue the ruling party's agenda. In election years, the budget tends to be weighted heavily in favour of activities that further the interests of the ruling party or favour its constituency. | The lack of distinction between party and government leads to public resources flowing into the party structures. Weak parties, with limited ideological distinctions, weaken the opposition's oversight of the budget. |

Source: Rakner et al. 2004

26. **Conversely, political factors can determine the feasibility of budget reforms and their likely success.** For example, South Africa introduced an MTEF in 1998 as an instrument for policy prioritisation and political negotiation between competing demands from sectors. Its relative success is partly due to the fact that policy-makers realised that, rather than a purely technical instrument, the MTEF provided them with a tool for regaining political control of the budget process.

27. A failure to adequately understand and plan around the underlying institutional environment in which budgetary systems are embedded is likely to lead to disappointing results, with only the symptoms rather than the causes of poor performance being addressed. Section 3 explores in more detail how political factors affect budgetary systems and the policy implications for donors wishing to support reform.

3. How do political factors affect budgetary systems?

3.1. Power, politics and public budgeting

28. **Power relations shape budget processes and political incentives explain the disjuncture between formal rules and informal practices.** We need to understand better the real incentives of the various actors, as sometimes poorly functioning systems suit powerful people very well. Not all good things go together, they don't necessarily reinforce each other, some budgetary weaknesses are more amenable to swift progress than others, especially in the short run, and small successes can quickly degrade.

29. While technical improvements can help resolve capacity constraints, political incentives often explain why technical resources are not deployed effectively or used responsibly. In turn, political incentives are shaped by the nature of political systems, the degree of political competition and the breadth of political accountability. What accountability mechanisms are particularly suitable for coping with the reality of the political economy, vested interests and power differentials?

30. Key questions (Hydén 2006) include:

- Who sets the agenda?
- Who gets what, when and how?
- Who knows whom, why and how?

31. **Power relations and political dynamics determine how budget decisions are made and how policy is implemented.** Political incentives affect the process of making and implementing budget policy. The budget is the result of political negotiations that reflect underlying power struggles between competing social forces. The exclusion of the poor from these processes is a defining trait of social exclusion. Sida (2006) is developing a tool to analyse power dynamics, which could be usefully applied to PFMA.

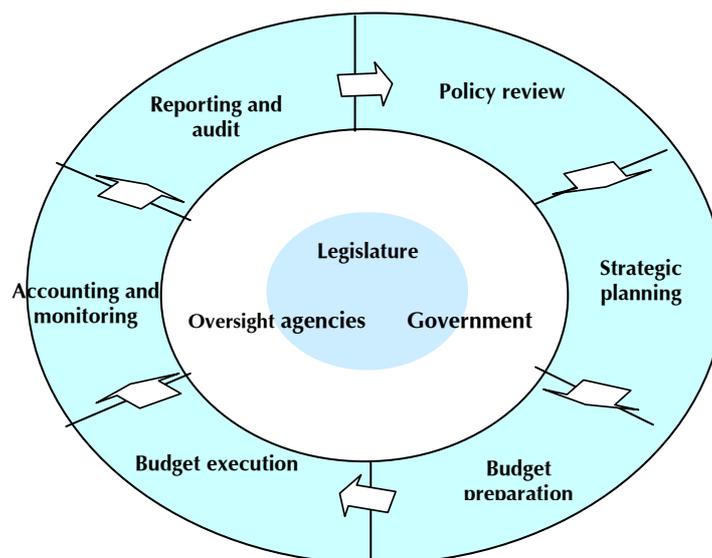
32. **Exploring the governance of public finances.** The budget can be approached from two different angles, as a process and as an arena.

3.2. The budget as a process

Analytical framework

33. **The budget is a dynamic process.** Public budgeting refers to the structures and procedures through which decisions are made and implemented regarding the allocation and management of public resources. A complete budget cycle (see Figure 1) usually lasts three years. In any given moment, three budget processes are underway simultaneously (i.e. planning for the year to come, implementation of the current year's budget and reporting and auditing on the previous year), multiplying the interactions.

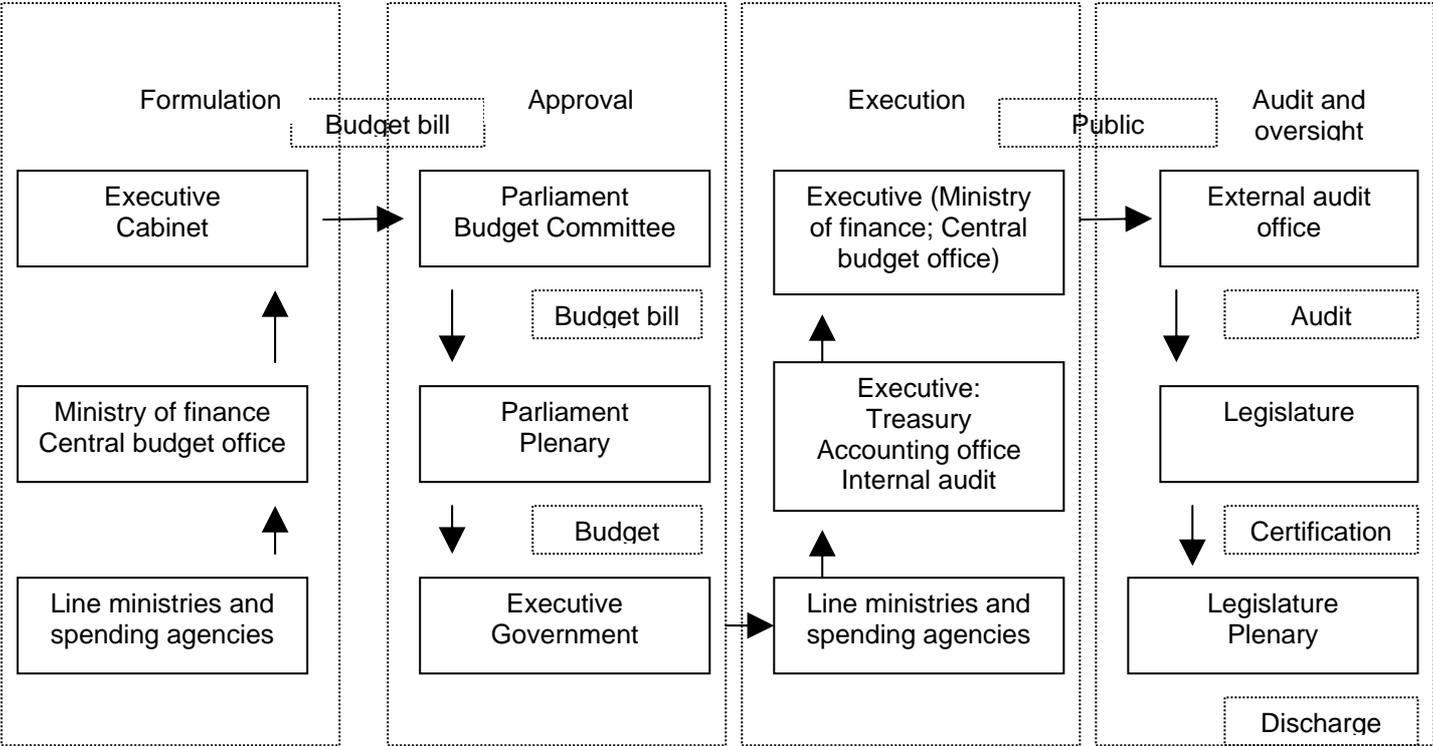
Figure 1: The budget cycle



34. **The budget is a complex system.** It is a process which involves different actors at different stages (formulation, adoption, execution, audit and oversight) and in inter-locked sub-systems. Budget sub-systems include planning, programming,

treasury, cash management, public procurement, central oversight, internal control, government accounting, external auditing and legislative oversight.

Figure 2: The budget system



35. **The budget process has to accommodate a range of competing demands and is subject to inherent tensions.** The main objectives of public financial management systems are to achieve aggregate fiscal discipline, operational effectiveness and allocative efficiency. For example, budget theory and evidence suggest that fiscal discipline is best achieved by centralising the budgetary system in the executive branch under the tight supervision of the Ministry of Finance and its central budget office. However, excessive executive discretion in public budgeting tends to hamper fiscal transparency and financial accountability. It weakens external scrutiny and legislative oversight, and limits opportunities for citizen participation.

36. The challenge is to retain the advantages of strong executive authority while providing the institutional checks and balances that ensure accountability and reduce the risk of corruption. Box 2 describes some of the systematic complexities which can affect revenue estimates.

Box 2: Politics of revenue estimates

Executive-legislative relations in public budgeting are complex and shaped by local incentives. In general, legislatures cannot increase aggregate spending. However, there can be loopholes, allowing them to increase expenditure if they identify additional sources of revenue to finance it.

In Nicaragua the legislature has revised the government’s revenue estimates upwards for the past four years. The executive had intentionally underestimated tax revenues to have greater discretion in their use at the end of the fiscal year and to avoid constitutional rules allocating fixed percentages of total revenues to certain sectors (universities and the judiciary). In 2005, the legislature adopted a new organic law rationalising the process.

Conversely, in Brazil, the federal government has tended to over-estimate fiscal revenues in order to have greater discretion in budget cuts and re-allocations. In Brazil, the federal government has discretion over which legislative amendments are executed. It has used this tactic quite effectively to assemble ad-hoc coalitions of support to adopt important reforms in the legislature.

Policy implications

37. **The role of the Ministry of Finance is pivotal.** Reform is often led from the Ministry of Finance and its central budget office, as “guardians of fiscal discipline” and drivers of the modernisation of budgetary systems. Budget support shifts power relations within government between the finance ministry and spending ministries and help enhance internal accountability within government. However, as the case studies highlight, finance ministries are often weak. They do not necessarily have the political power to prevail over politically connected sector ministries and must often confront powerful vested interests.

38. **Not all governance deficits in the budget system can or need to be tackled at once.** For partner governments, it is important to “get the basics right” first (Schick 1998) and sequence reforms in realistic stages, for example by focusing on key budgetary sub-systems. Donors should avoid being over-ambitious and promote incremental rather than transformational approaches to PFMA reforms, as Box 3 illustrates. “Good enough reforms” are those that are politically feasible and realistically sequenced (Grindle 2005). Understanding the political economy is crucial for designing realistic, incremental and sequenced reforms.³

Box 3: MTEF in Malawi

Realistic sequencing and political feasibility matter. For example, in Malawi, a MTEF was introduced in 1995 originally in pilot ministries and with a relatively high degree of sophistication. Its effectiveness as an instrument to plan and prioritise public spending was enhanced when it was extended across government with a lesser degree of sophistication. However, as the study of Malawi shows, informal practices undermine the formal stages of the MTEF process and, as a result, budget formulation has little resemblance to the actual allocation of resources, thus approximating a theatre. The study concludes that the formulation and use of policy frameworks guiding the budget process are shaped by the limited commitment by policymakers and the myriad of *clientelistic interests* that come into play.

39. **Budgetary institutions cannot be strengthened in isolation.** It is important to understand the interdependencies that exist between budget sub-systems. The case studies show successful PFMA reform can only be achieved in conjunction with broader public sector reforms. For example, low bureaucratic capacity hinders public budgeting, including expenditure control and internal accountability. The case of Ghana underlines that civil service reform and pay-incentives play a major role in the reform of public budgeting (Killick 2004, 2005). Ultimately, the case study of Ghana suggests that resolving the budget’s “democratic deficit” is intimately linked to the expansion of democratic governance.

40. **Avoid easy fixes through institutional transplant.** Beware of universal recipes. Strategies aimed at transposing institutional models are likely to fail if they do not consider the conditions that make them work. Budget institutions are embedded in a country’s institutional history and political trajectory. Thus, rather than seeking to transplant “best practices” from abroad, planners should consider “best fit” approaches to achieve “good enough” reforms and gradual improvements.

41. **Achievements can be reversed.** Reform is not a linear process. Achievements can be reversed, circumvented or neutralised. Pro-reform coalitions

³ More guidance on sequencing PFMA reforms can be found in DFID *Briefing Note on the Platform Approach* (July 2005). See: www.dfid.gov.uk/aboutdfid/organisation/pfma/pfma-briefingplatform.pdf

vary over time and during the budget cycle. It is thus critical to engage with a wide range of stakeholders, overlapping processes and intertwined systems and encourage greater demand for better governance and greater accountability.

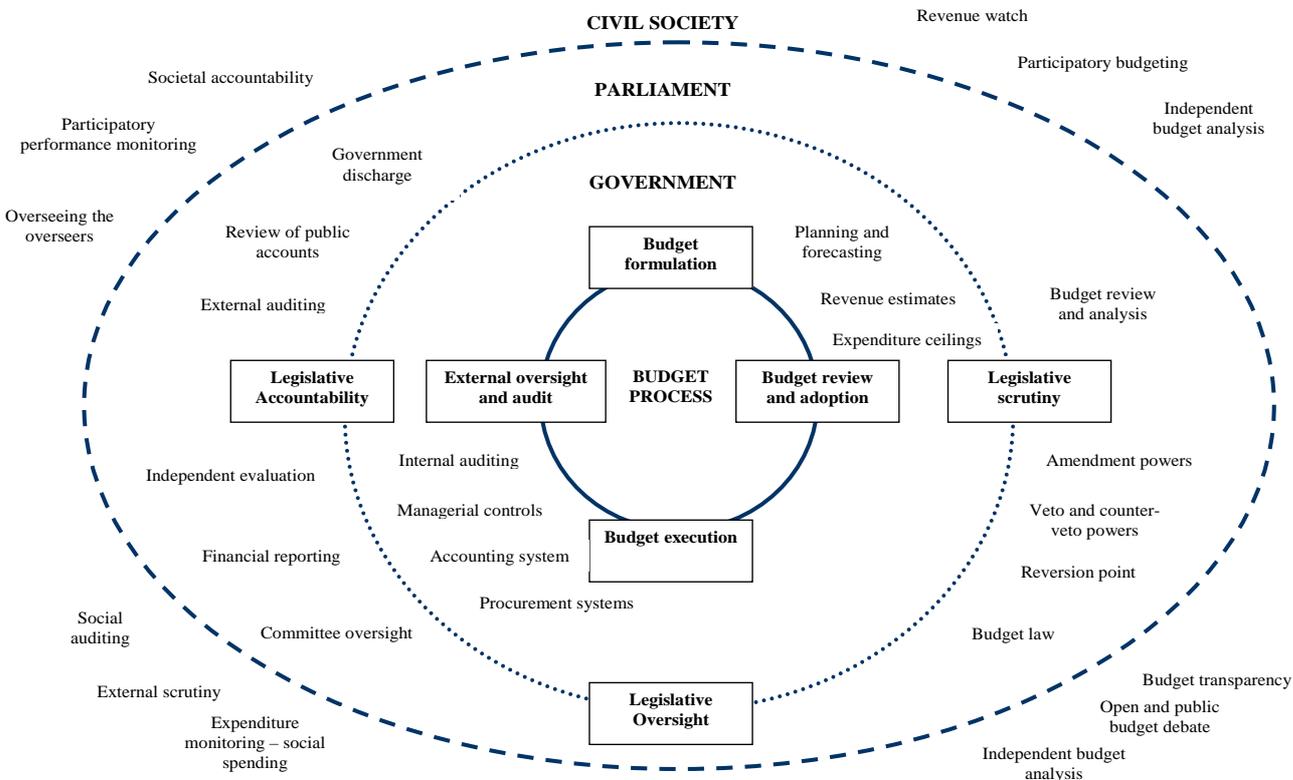
3.3. The budget as an arena

Analytical framework

42. **The budget is an arena of political confrontation between competing interests.** The outcome of this confrontation largely explains whether and how poverty reduction gets budget priority (Norton and Elson 2002). Achieving sustainable budgetary reform requires engaging with a broader set of formal actors and informal arenas beyond government, each with different powers and capacities to influence the budget. Figure 3 illustrates the many actors in the budget arena.

43. **Reforming the budget process is not only about promoting change, but also overcoming resistance to change.** The budget creates winners and losers. Potential losers inevitably resist the reorientation of public expenditure and defend the status quo. They usually have vested interests and great influence over the allocation of resources. The case study of Ghana in Box 4 shows that rent-seeking and patronage are the strongest impediments to change.

Figure 3: The budget arena



Source: Santiso 2006.

Box 4: Incentives against change in Ghana

The Ghana study found that successive governments had not been very interested in change. The democratic deficit of the budget was tolerated and hard to tackle due to patronage-driven politics and the clientelistic nature of the state. The resources of the state were used to build support and reward supporters, for example through public sector job allocation. At the same time, the ritual of the formal budget process was maintained to keep the façade of a rational process for allocating, spending and accounting for public resources. The study concluded that electoral pressures within a competitive political system offered the best prospect of gradual change, which would allow the budget process to close the gap with the democratisation process.

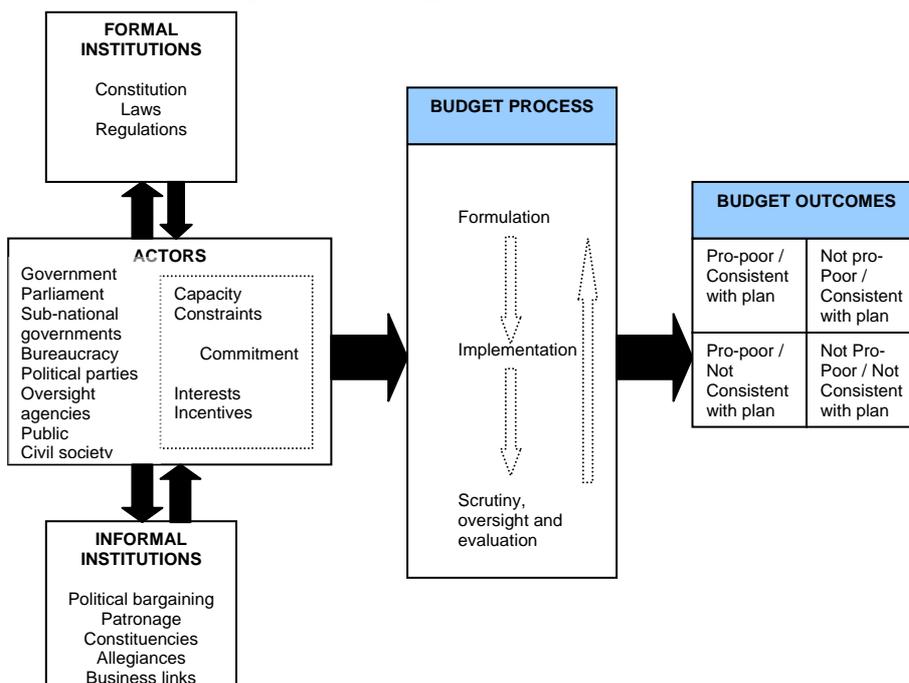
Source: Killick (2004, 2005)

44. **The interactions between actors and institutions define the budget arena.** Each actor is motivated by a different set of incentives and capabilities and faces different interests and constraints. These repeated interactions occur during the different stages of the budget process and are repeated every year.

- The behaviour of agents is determined by their interests and capacities, which, in turn, shape their influence on and leverage over the budget process.
- Institutions, formal and informal, define the rules of the “budgetary game,” providing incentives and imposing constraints on the behaviour of budget actors.

45. **These interactions can result in process and outcome failures.** Process failures are related to the making and implementation of budget policy. Outcome failures are those related to budget performance and fiscal outcomes. Figure 4 provides a framework to think about these interactions and Box 5 illustrates these interactions in the case of Mozambique.

Figure 4: Budget interactions



Source: Rakner et al. 2004.

Box 5: Mozambique

The Mozambique study underscored that the interests and capacities of the principal actors both influence and are influenced by institutional weaknesses.

- Within government, the primary motivation of politicians was to maintain the state apparatus and to attract donor support, in the context of a poorly staffed and rewarded civil service.
- Within the executive, the finance ministry was weak in relation to sector ministries and off-budget donor funds further weakened this.
- Separation of party and state was weak and weakening and Parliament, as an institution, was still developing.
- As a result, the opposition had little capacity and incentives to develop policy alternatives and influence budget planning.
- The low tax effort and weak tax base meant that the fiscal pact between the state and society had not consolidated into a social contract and, therefore, little pressure for improving service delivery.
- Donors can undermine domestic accountability for example through their strong link with the executive and off-budget funds which have limited legislative scrutiny.

The study concluded that change could only be gradual. It recommended promoting greater demand for accountability, strengthening the role of parliament and enhancing the engagement of civil society, including professional associations and the media.

Policy implications

46. **Encourage demand for accountability and strengthen checks and balances.** The case studies reveal common flaws in budgetary systems, in particular weak checks and balances and feeble domestic demand for change. They stress that improving technical capacity of supply-side institutions within government is unlikely to be sustained if there is no demand for better governance and increased accountability from outside government, including oversight agencies, civil society and parliaments. Encouraging external scrutiny of the budget process is likely to provide impetus for reform.

- Entry points for improving the demand for accountability include both formal checks and balances (internal control systems, supreme audit institutions, parliamentary oversight committees) and informal mechanisms (civil society, media, political parties, professional bodies and interest groups).
- Similarly, improving the synergies between formal and informal oversight mechanisms can help improve accountability (e.g. interactions between civil society and supreme audit institutions, or between parliaments and supreme audit institutions).

Box 6: Improving the governance of the budget in Malawi

The Malawi study recommended strengthening the demand for accountability by:

- (i) improving the quality and availability of financial information to monitor public spending;
- (ii) strengthening the capacity and incentives of parliament to oversee public finances;
- (iii) enhancing the capacity of the supreme audit institution;
- (iv) fostering constructive dialogue with civil society at different phases of the budget process; and
- (v) improving the transparency of both formal and informal budgetary processes.

The study noted that often the electoral cycle provides key opportunities for pushing through PFMA reforms.

47. **Developing the scrutiny role of parliament.** The budget is a key tool of parliamentary accountability.⁴ By providing a platform for open discussion on the budget, legislatures can help to broaden public debate on budget priorities. The review of the draft budget bill by parliament constitutes a key moment in the budget cycle and a key opportunity for public scrutiny and civic engagement. Information obtained by parliamentary committees can be useful for civil society if there is open media coverage of committee hearings. In Mozambique, budget support donors use government financial reporting to parliament to review progress and performance.

48. Parliament and its specialised legislative committees dealing with fiscal and financial matters are in a strong position to exercise oversight and demand accountability. The role of the budget, finance and public accounts committees can be pivotal, but they need to be adequately resourced and with the right political incentives. In some countries, a legislative budget office assists parliaments (Georgia, Nicaragua, Philippines, Poland, South Korea and Uganda).

Box 7: Supporting parliamentary oversight in Vietnam

In Vietnam, several donors, including DFID, support the strengthening of parliament's role in the budget process, through the Committee for Economic and Budgetary Affairs (CEBA). Launched in 2003, the project aims to strengthen the capacities of the National Assembly and local People's Councils (PPCs) to review the budget and oversee its execution. It also promotes inter-agency cooperation, supporting linkages between the State Audit of Vietnam (SAV) and the National Assembly. It is being piloted in 11 provincial People's Councils.

49. **Engaging political parties.** The role of the opposition is often critical to holding the government to account. In order to build effective legislatures, mobilising political power and increasing political competition is often more important than improving technical capacity. Technical capacity is likely to remain ineffectual if there is no political space for it to be exercised effectively.

⁴ There is increasing recognition on the need to work with legislatures to strengthen demand for accountability in public finances and strengthen checks and balances in public budgeting. FACT will be producing further guidance on how to work with parliaments to strengthen financial accountability.

50. **Supporting general audit offices.** The external auditing of public finances by an independent and specialised agency is a key component of a system of financial accountability. Parliamentary public accounts committees can exercise strong oversight of government if an effective general audit office supports them. However, as the case of Mozambique shows, relations between parliaments and general audit offices are deficient, reflected in the lack of follow-up to audit findings.

51. **Increasing budget transparency.** Fiscal transparency allows for greater external scrutiny and a responsive and informed society. It has both a supply and demand dimension. It requires improvements in the “supply” of financial information, in terms of quality, availability and reliability of government financial information through, for example, the introduction of integrated financial information management systems. It also necessitates greater “demand” for and access to financial information through, for example, freedom of information legislation anchoring the right to financial and fiscal information. Only a few countries in Africa, such as South Africa, have adopted such legislation.

52. **Strengthening civil society budget capacity.** The role of civil society is critical to enhance poor people’s voice and accountability in the budget process, in particular through the analysis and dissemination of budget information throughout the fiscal year. DFID supports the strengthening of civil society engagement in the budget process in a variety of ways, including through the International Budget Project (IBP). The role of civil society organisations in the budget is varied and multifaceted, encompassing:

- participatory budgeting;
- independent budget analysis, including review of budget proposals;
- participatory public expenditure tracking; and
- participatory performance monitoring and social auditing.

Box 8: Civil society and budget oversight

Civil society participation can occur at different stages of the budget process.

Revenue policies

- The Open Society Institute (OSI) established the Revenue Watch in 2002 to improve accountability in natural resource-rich countries. It currently supports initiatives in Azerbaijan, Georgia, Indonesia, Iraq, Kazakhstan, Kyrgyz Republic, Mexico, Peru and Mongolia.

Budget planning and execution

- Participatory budgeting in Porto Alegre, Brazil, started as a means for citizens to participate in budget formulation at the local level and then to hold the municipal government accountable for executing the budget.
- In Uganda, women parliamentarians, together with the NGO Forum for Women in Democracy (FOWODE), have joined forces to promote gender budgeting. This cooperation led to the passage of the Budget Act (2001), giving parliament greater oversight functions.

Public procurement,

- Procurement Watch Inc (PWI) in the Philippines was formed in 2001 to advocate for the new procurement law and to monitor enforcement of the law after it was enacted in 2003.

External audit and scrutiny

- In the Philippines, the Concerned Citizens of Abra for Good Governance (CCAGG) monitors government projects and conducts participatory social audits.

53. **Strengthening synergies between formal and informal budget institutions.** While challenging, strengthening the interfaces between auditors-general, parliaments, civil society and the media can provide a potent force for change. Effective links between auditors-general and parliaments are critical to ensure that government is held to account for the manner in which public funds are spent. Similarly, civil society can play a vital role in ensuring that formal oversight institutions effectively hold the government to account, thereby “overseeing the overseers.” In South Africa and Colombia, ‘citizen watchdog committees’ work with the general audit office to monitor public spending, oversee high risk projects and expose corruption.

4. Why and how to undertake a politics of the budget review?

4.1 Why undertake a review?

54. **Purpose and process.** Before embarking on a politics of the budget review, it is critical to clarify why such a review is being carried out and who to undertake it with. The ultimate purpose of the review will shape the process by which it is undertaken. Managing the political sensitivities of such a review and the trade-offs involved is important. Existing guidance on “drivers of change” analysis provides information on process issues.⁵

55. The purpose of the review can be internal, external or both, depending on the country context.

- **Internally focused assessments** are designed to deepen country offices’ understanding of the political economy of the budget process and inform country programming, including the choice and mix of aid instruments.
- **Externally focused assessments** are designed to encourage greater dialogue, build consensus on reform, and promote donor harmonisation. The dialogue process the diagnosis seeks to generate then becomes as important as the assessment itself.

Box 9: Purpose and impact of the review in Mozambique

In Mozambique, the review was originally designed as an internal exercise designed to inform DFID’s understanding of the political economy challenges of budgetary reform. It was subsequently disseminated more broadly in the public domain as an independent review to encourage a broader debate on the issues it raised.

The review has had an impact on country programming. The latest CAP, under finalisation, is giving more weight to the programme’s focus on strengthening domestic accountability and transparency. In 2006, a Civil Society Challenge Fund for Governance was established to support civil society and encourage greater demand for governance and accountability.

⁵ DFID How to Note on *Lessons Learned: Planning and Undertaking a Drivers of Change Study* (2005) and DFID Briefing Note on *Using Drivers of Change to Improve Aid Effectiveness* (2005).

4.2 How should the review be organised?

56. A politics of the budget review can be organised in three key steps: (i) locate the key failures in public budgeting, (ii) assess gaps between formal and informal processes and (iii) identify levers and drivers of change.
57. **Assess where the key failures in the budgetary process lie.**
- Identify outcome failures: What is wrong?⁶
 - Locate process failures: How is it wrong?
 - Recognise institutional failures: Why is it wrong?
 - Distinguish symptoms from causes.
58. **Gauge the gap between formal rules and informal practices.**
- Analyse how the budget process should operate in theory, as defined by existing institutional arrangements and applicable procedural rules provided by the relevant legislation; and
 - Assess how the budget works in practice and explain the divergence between formal rules and informal practices, in particular in terms of enforcement, supervision, oversight and control mechanisms.
59. **Identify drivers of change at each stage of the budget process.** Key drivers at each stage include:
- during the formulation stage, the distribution of power in the cabinet, the role of the ministry of finance and the influence of sector ministries and spending agencies;
 - during the approval stage, the interactions between government and parliament;
 - during the implementation stage, the degree of executive discretion, the strength of operating systems, the reliability of internal control mechanisms and the breath of external scrutiny; and
 - during the auditing and scrutiny stages, the role of the general audit office and civil society, as well as the linkages between the general audit office and parliament, and between parliament and government.

⁶ PEFA's performance framework and indicators provide key information on weaknesses in terms of public finance outcomes. Other useful diagnostic instruments, where available, include: the IMF Review of Standards and Codes – Fiscal (ROSC), the World Bank Public Expenditure Reviews (PER), Country Financial Accountability Assessments (CFAA), Country Procurement Assessment Reviews (CPAR), World Bank – IMF HIPC Tracking Assessments and Action Plans (HIPC AAP), EC Audits, UNDP Country Assessment in Accountability and Transparency (CONTACT), and the OECD Budget Reviews.

4.3 How should the process be organised?

60. In undertaking drivers of change reviews of the budget process, critical issues to consider include whether and how to involve the partner government and other donors.

61. It is important to consider the following elements.

- **The actors involved in the budget process, directly and indirectly.** Robust stakeholder analyses are necessary. Key attributes of the actors in the budget process include:
 - their technical and political capacity to influence the process; and
 - their interests and motivations during the different stages of the budget process.
- **The formal and informal institutions shaping the “rules of the game” of the budget process during its different phases, including:**
 - the formal rules of the budget process, i.e. legal powers and procedural rules, These are usually contained in the constitution, the organic budget law, the financial administration law, the organic law for external auditing, the annual budget law and related legislation;
 - the institutional constraints imposed by the regulatory framework and governance context of the budgetary process;
 - the political incentives generated by the political system, such as the degree of political competition, the strength of the opposition, the functioning of the party system or the nature of electoral rules; and
 - the societal incentives affecting the culture of public administration, including the degree of civil society budget activism, the influence of patronage networks, and the prevalence of clientelistic practices.

62. **When undertaking a political economy analysis of the budget, process issues are central.**

- It is important to assemble a multidisciplinary team combining different disciplines and perspectives on public budgeting and political governance, including budgetary economists, political economists, and social scientists.
- It is important to consult and involve a broad range of stakeholders beyond the executive. The process of dialogue and consensus that the review helps generate is as important as the product. Box 9 provides an indicative list of stakeholders to consult.

Box 10: Key budget stakeholders

Stakeholders to interview include

- Ministry of Finance and key line ministries (ministers and senior civil servants), particularly those that spend the most, promote economic development, or manage social programmes
- Revenue authority and customs agency bodies responsible for raising revenue
- Local government representatives, including chief officers and local politicians, as well as representatives of local councils and regional assemblies
- Supreme audit institution, including the Auditor-General and any other senior directors
- Parliament, including speaker, senior politicians and officers, chairs of the finance, budget and public accounts committees, key sectoral committees, legislative budget offices (where they exist), as well as shadow finance ministers from opposition parties
- Anti-corruption bureau or commission, where applicable
- Representatives of private sector and state owned enterprises, including state development banks
- Representatives of civil society organisations, including professional associations, the specialised media, industrial and economic groups, trades unions, and NGOs, pressure groups and policy think tanks
- Other donors, including bilateral donors and multilateral development institutions (World Bank)

Where can I find more information?

Case studies

Case studies commissioned by DFID can be found at:

- Ghana:
http://insight/policydivision/default.asp?http://insight/policydivision/teams/segchange/Country_Work/Ghana/Draft300404_casestudy_budget.doc
- Malawi: <http://insight/policydivision/teams/faac/MalawiDOCJuly04box11.DOC>
- Mozambique:
<http://insight/policydivision/teams/faac/MozPoliticsoftheBudgetDec04box11.pdf>
- Malawi and Mozambique comparative analysis:
<http://insight/policydivision/teams/faac/IDSPoliticsoftheBudgetFinal23Mar05box11.DOC>

Further guidance

Further guidance on how to undertake a “drivers of change” analysis can be found at:

- DFID How to Note on Lessons Learned: Planning and Undertaking a Drivers of Change Study (2005)
http://insight/policydivision/resources/publications/publications/Lessons_Learned_DOC.pdf
- DFID Briefing Note on Using Drivers of Change to Improve Aid Effectiveness (2005)
http://insight/policydivision/resources/publications/publications/DOC_Improve_Aid_Effectiveness.pdf
- OECD DAC, Lessons Learned on the Use of Power and Drivers of Change Analyses in Development Co-operation - Final Report (Paris: OECD DAC Network on Governance, 2005).
- DFID How to Note on Country Governance Analysis (forthcoming).

DFID policies on conditionality and budget support can be found at:

- Partnerships for Poverty Reduction: Rethinking Conditionality (2005)
www.dfid.gov.uk/pubs/files/conditionality.pdf
- How-to-Note on Implementing Conditionality (2006)
<http://www.dfid.gov.uk/pubs/files/draft-implementing-conditionality.pdf>
- Poverty Reduction Budget Support (2004)
<http://www.dfid.gov.uk/pubs/files/prbspaper.pdf>

DFID guidance on budget support is contained in:

- How to Note on Managing Fiduciary Risk when providing Direct Budget Support (2004)
<http://www.dfid.gov.uk/aboutdfid/organisation/pfma/pfma-fiduciary-howtonote.pdf>
- Supplementary Note on Managing the Risk of Corruption (2005)
<http://www.dfid.gov.uk/aboutdfid/organisation/pfma/pfma-managing-corruption.pdf> and
- Supplementary Note on When to Perform Fiduciary Risk Assessments and Annual Statements of Progress (2005) <http://www.dfid.gov.uk/aboutdfid/organisation/pfma/pfma-when-to-fras.pdf>

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