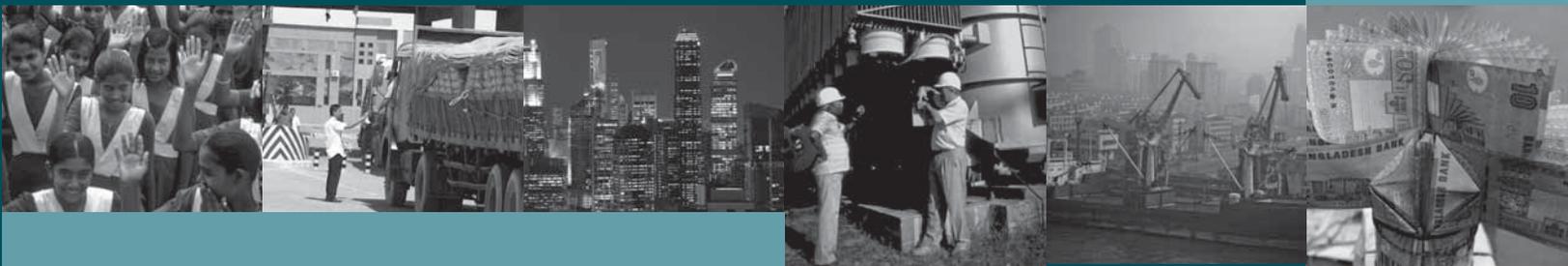


# Guidance Note



## Use of Political Economy Analysis for ADB Operations



# **Guidance Note**

## **Use of Political Economy Analysis for ADB Operations**

June 2013

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# Contents

List of Table and Boxes	iv
Abbreviations	v
Introduction	1
What Is Political Economy Analysis?	3
What Is the Value Added of Political Economy Analysis?	5
Using Political Economy Analysis to Inform ADB Operations	7
Working with Others	18
Follow-Up	19
Appendix: Other Donor Approaches to Political Economy Analysis	20

# Table and Boxes

## Table

How Political Economy Analysis Can Inform ADB Operations	7
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## Boxes

1 The Political Economy of Economic Reform in the Pacific	10
2 The Political Economy of State-Owned Enterprise Reform in Kiribati	11
3 Sample Questions for Conducting Sector-Level Political Economy Analysis	12
4 Political Economy Analysis: Informing the Philippines Country Partnership Strategy	14
5 Sample Questions for Preparing Policy Reform Interventions	15
6 Political Economy of Reform: Case Studies of Policy-Based Lending Operations Supported by ADB	16

# Abbreviations

ADB	–	Asian Development Bank
CPS	–	country partnership strategy
DFID	–	Department for International Development of the United Kingdom
DMC	–	developing member country
ERD	–	Economics and Research Department
FCAS	–	fragile and conflict-affected situations
GTZ	–	German Society for Technical Cooperation
IAD	–	institutional analysis and development
OECD-DAC	–	Organisation for Economic Co-operation and Development - Development Assistance Committee
Sida	–	Swedish International Development Agency
SOE	–	state-owned enterprise
TA	–	technical assistance
USAID	–	United States Agency for International Development



# Introduction

Political economy considerations have an impact on economic development. Political economy analysis can strengthen the diagnosis of development problems, assessment of risks, and the design of more effective support, leading to better development results. While important for all developing member countries (DMCs), political economy considerations especially matter in DMCs classified as fragile and conflict-affected situations (FCAS).<sup>1</sup> Political economy analysis is not new to the Asian Development Bank (ADB). In 2002, ADB’s Economics and Research Department (ERD) published a paper identifying a set of core concepts that reflect key “political economy” factors shaping the policy reform process that can assist in guiding the policy-based lending design process.<sup>2</sup> This was followed by political economy studies undertaken by ADB’s operations and knowledge departments, a selection of which is documented in subsequent sections. Much of this work is consolidated and synthesized in an ADB publication that aims to present an understanding of political economy factors that shape actual outcomes, and to simplify the complexities of policy reform and the supporting loans and technical assistance (TA). Case studies are presented to highlight applications of ADB operational experience in Southeast Asia and, more recently, evaluations of ADB’s support for reforms in the Pacific, which includes a number of FCAS.<sup>3</sup>

The purpose of this document is 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. The second section provides a brief description of what the term “political economy analysis” means, followed by a short summary of the value added of this type of analysis in the third section. The fourth section presents an overview of how political economy analysis can strengthen ADB’s operations at the country, sector, and project levels and includes as well some guiding questions for analysis and examples of ADB political economy analysis studies. The fifth section identifies some important considerations for working with other partners and the final section offers suggestions for staff follow-up to ensure that the benefits of political economy analysis are well documented for future reference to build on.

Political economy analysis can strengthen the diagnosis of development problems, assessment of risks, and the design of more effective support, leading to better development results

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<sup>1</sup> ADB’s current list of 11 FCAS includes 10 DMCs in the Pacific: Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Solomon Islands, Timor-Leste, Tuvalu, and Vanuatu; the other being Afghanistan. Pacific DMCs are categorized as FCAS due mainly to their fragile characteristics (i.e., remoteness, natural resource constraints, and small size of their economy), while Afghanistan is included due to conflict in the country.

<sup>2</sup> G. Abonyi. 2002. *Toward a Political Economy Approach to Policy-Based Lending*. ERD Working Paper No. 14. Manila: ADB.

<sup>3</sup> G. Abonyi, R. Bernardo, R. Bolt, R. Duncan, and R. Tang. 2013. *Managing Reforms for Development: Political Economy of Reforms and Policy-Based Lending Case Studies*. Manila: ADB.

While a single framework for political economy analysis is not presented in this guidance note, the principles, sample questions, and references to past studies are intended to provide staff with guidance that can be flexibly applied either to (i) separate stand-alone studies or (ii) existing diagnostic frameworks. Examples of other development partner political economy approaches can be found in the appendix.

# What Is Political Economy Analysis?

There is no single conceptual framework for political economy analysis. The following definition by the Organisation for Economic Co-operation and Development–Development Assistance Committee (OECD-DAC) is useful in capturing the essence of some of the main elements:

Political economy analysis is concerned with 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.<sup>4</sup>

This definition draws particular attention to *politics*, understood in terms of contesting and bargaining between interest groups with competing claims over rights and resources. However, it is equally concerned with the *economic processes* that generate wealth and that influence how political choices are made. In reality, these processes are interrelated and the dynamics influence development outcomes.

Political economy analysis helps development partners understand what drives political behavior, how this shapes particular policies and programs, who the main “winners” and “losers” are, and what the implications are for development strategies and programs. Specifically, it is concerned with understanding

- the *interests and incentives* facing different groups in society and how these generate particular policy outcomes that may encourage or hinder development;
- the role that *formal institutions* (e.g., rule of law, elections) and *informal social, political, and cultural norms* play in shaping human interaction and political and economic competition; and
- the impact of *values and ideas*, including political ideologies, religion, and cultural beliefs, on political behavior and public policy.

Political economy analysis helps us to understand how incentives, institutions, and ideas shape political action and development outcomes in DMCs. This can be extremely useful when thinking about the feasibility of policy reform and

Political economy analysis helps development partners understand what drives political behavior, how this shapes particular policies and programs..., and what the implications are for development strategies and programs

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<sup>4</sup> See “political economy” at <http://www.oecd.org/dac/governance/politiceconomy> for OECD-DAC definition.

institutional change, the contribution that ADB and other development partners can realistically make, and the risks involved.<sup>5</sup>

While ADB has no formal definition, political economy has been referred to as “the interrelationship between political and economic processes and institutions, particularly as related to policy issues, interests, decisions, and reform implementation.”<sup>6</sup> A political economy perspective signals the central role of politics and institutions throughout the policy reform process. Reform involves politics, because it requires collective choices in an environment characterized by conflicting perceptions and interests, with no simple unifying incentive scheme for resolving such differences. Policy reform also takes place in a world of institutions that condition the initiation, design, implementation, and sustainability of such reforms.<sup>7</sup>

It is important to note that while ADB’s Charter<sup>8</sup> explicitly excludes political activities and considerations in ADB operations, this does not preclude ADB from using political economy analysis to inform country, sector, and project-level operations. Politics in this context refers to contesting and bargaining among interest groups with different perceptions of their respective claims and rights to resources. A better understanding of the perceptions of the relevant stakeholders in a change process will enable ADB to strengthen its facilitation role for supporting country-led reform.

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<sup>5</sup> This and the two preceding paragraphs draw on Department for International Development (DFID) of the United Kingdom. 2009. *Political Economy Analysis How To Note: A DFID Practice Paper*. London.

<sup>6</sup> See Chap. 1 “A Framework for Political Economy of Policy Reform and Policy-Based Lending” by G. Abonyi in Abonyi et al. (2013), footnote 3.

<sup>7</sup> D. Rodrik. 2003. Growth Strategies. CEPR Discussion Paper No. 4100, October.

<sup>8</sup> ADB. 1965. *Agreement Establishing the Asian Development Bank*. Manila.

# What Is the Value Added of Political Economy Analysis?

Political economy analysis can help achieve the following:

- contribute to a shared understanding within country teams of the political context and how it affects country strategies and operations;
- identify interests pursued and power for influencing key stakeholders;
- inform better policy and programming, through the identification of feasible solutions to development challenges;
- support risk management and scenario planning by helping to identify the critical factors that are likely to drive or impede significant change in the future; and
- broaden the scope for dialogue with development and country partners around key political challenges and opportunities at the country and sector levels.

Political economy analysis has often been viewed as primarily concerned with identifying obstacles and constraints. However, increasingly, it is being used to identify opportunities for leveraging policy change and supporting reform. By better understanding the political constraints that DMCs face, ADB can work more effectively with them to identify reforms in key priority sectors that are more likely to work; sustainable reform is about achieving the possible, rather than being preoccupied with the “theoretically optimal.” This type of analysis can help foster country ownership and contribute to improved prioritization and sequencing of reform efforts. As well, if political economy dimensions are considered in the design of ADB operations, there is greater likelihood of sustainable outcomes in the long term.<sup>9</sup> ADB’s experience and growing consensus suggest that a deeper understanding of the political economy aspects and of the drivers of conflict and fragility is crucial for effective country programming and operations in FCAS.<sup>10</sup>

By better understanding the political constraints that developing member countries face, ADB can work more effectively with them to identify reforms in key priority sectors that are more likely to work

<sup>9</sup> This and the preceding paragraph draw on DFID (2009), footnote 5.

<sup>10</sup> See footnotes 4 and 5; World Bank. 2011. Operationalizing the 2011 World Development Report. Washington, DC; AusAID. 2011. *Framework for Working in Fragile and Conflict-Affected States: Guidance for Staff*. Canberra. ADB is developing an operational plan on FCAS that specifies the requirements for political economy analysis to improve the effectiveness of FCAS operations.

A political economy perspective signals the central role of politics and institutions throughout the policy reform process

Policy reform<sup>11</sup> involves many groups and individuals with a stake in the reform process and its outcomes, with government playing a key role as the formal initiator and implementer of reforms. Perceived government commitment to reform, and its credibility over time, has a central role in the policy reform process. Government commitment, in turn, is shaped by political economy factors that play a critical role in generally structuring policy reform. A political economy perspective signals the central role of politics and institutions throughout the policy reform process.

Reform involves politics, because it requires collective choices in an environment characterized by conflicting perceptions and interests, with no simple unifying incentive scheme for resolving such differences. Policy also takes place in a world of institutions that conditions the initiation, design, implementation, and sustainability of such reforms.

Politics and institutions play a critical role in shaping reforms as they move through various stages of the process. This process, in turn, conditions policy reform in terms of what it is (i.e., reform measures that are selected and their design) and what it does (i.e., the outcome and impact of such reform measures). The stages of the policy reform process comprise the following:

- **Sharing a view.** Requiring stakeholders to have a collective understanding of the current situation.
- **Initiating reform.** Getting issues on the policy agenda for priority attention.
- **Managing the complexity of policy issues.** Giving both policy issues and associated actions tangible shape through the design of specific reforms.
- **Endorsing reform.** Approving reform measures, leading to issuance of related implementation guidelines and allocation of necessary resources.
- **Implementing reform.** Undertaking reform actions and implementing change.
- **Sustaining reform.** Ensuring that reform measures endure over time.

In practice, the stages of the process are more iterative than sequential given their interplay with the politics and institutions involved in the reform process, which is where the importance of the political economy perspective arises.

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<sup>11</sup> This and the two subsequent paragraphs on policy reform draw on Abonyi et. al. (2013), footnote 3.

# Using Political Economy Analysis to Inform ADB Operations

The following table summarizes how political economy analysis can strengthen country and sector analysis to better inform ADB’s operations through country partnership strategy (CPS) formulation, project design, and policy dialogue:

## How Political Economy Analysis Can Inform ADB Operations

Tasks	Conventional Analysis	Insights from Political Economy Analysis
Country-level analysis	Static, descriptive background on country governance systems.	The country analysis seeks to capture the overall governance situation and the main political economy drivers, including institutional and power dimensions, and distributional issues. The analysis should bring out key political economy dynamics, rather than provide a static picture only.
Growth diagnostic assessment	Diagnostic tools identify specific factors or “binding constraints” that hold back growth in different contexts and at different points in time.	The deeper causes of failure to address the known binding constraints to growth are identified. On this basis, growth policies take into account feasibility or include actions to strengthen pro-growth coalitions. Dimensions such as who pays taxes, competition, and distribution issues should be considered.

*continued on next page*

Approaches to challenges, such as major inequalities in income and/or wealth distribution, or country contexts where sustainable change seems beyond reach, can benefit from country-level analysis

Tasks	Conventional Analysis	Insights from Political Economy Analysis
Sector analysis	Poor service delivery outcomes are attributed to a range of technical, financial, capacity, and organizational weaknesses within the sector concerned.	Key stakeholders and the most influential actors should be identified and consideration given to what their interests and incentives are, and how do these shape overall dynamics of the sector, including the feasibility of proposed policy reforms.
Country partnership strategy (CPS) formulation	Priorities for CPSs are determined based on economic, sector, and thematic diagnostic assessments, in the context of Strategy 2020.	Priorities reflect a deeper understanding of what interventions are likely to work, given prevailing interests and incentives. CPSs also consider which interventions might help to shift incentives in a positive development direction.
Project and program design	Political risks affecting project success are relegated to the “assumptions” column in the design and monitoring framework, and revisited only if the intervention fails.	Interests and incentives, especially those created informally, are explicitly addressed in project design. Interventions may seek to transform incentive structures, or work around them, but never ignore them.
Policy dialogue	Policy dialogue is formal and conducted at “arm’s length.” It focuses on normative governance standards, without reference to the deeper processes that underlie performance.	Dialogue with partners is sensitive to the underlying causes of good and bad governance. This enables closer working relationships, and greater directness and mutual respect.

Source: Adapted from Table 1 of Department for International Development (DFID) of the United Kingdom. 2009. *Political Economy Analysis How To Note: A DFID Practice Paper*. London.

## Country-Level Analysis

Country-level analysis<sup>12</sup> is valuable where there is little prior political economy analysis, and especially when ADB is considering operations in a new country, or reentry into a country after a long absence. It is particularly relevant in DMCs where political stability is a concern, since this will often have profound effects across policy areas and sectors, in FCAS and DMCs with subnational situations of conflict or post-conflict. Approaches to challenges such as major inequalities in income and/or wealth distribution, or country contexts where sustainable change seems beyond reach, can benefit from country-level analysis. When new

<sup>12</sup> This section draws on V. Fritz, K. Kaiser, and B. Levy. 2009. *Problem-Driven Governance and Political Economy Analysis: Good Practice Framework*. Washington, DC: World Bank.

challenges arise, such as post-election violence, which may require a review of ADB's portfolio and assistance modalities, country-level analysis can better inform difficult programming decisions that may be needed. This analysis is also crucial to informing a differentiated approach in FCAS and other DMCs with subnational situations of conflict or post-conflict.

Country-level political economy analysis should consider the specific issues and country circumstances, and could broadly cover the following:

- Foundational dimensions, such as the role of religion, relationships among different ethnic groups, the role of external forces, and the nature of the political regime form an important backdrop against which development policies need to be understood.
- Historical factors and how these influence the current political and economic landscape of the country should be captured.
- In conflict-affected situations or DMCs with serious interethnic and/or interregional tensions, it is essential to understand how the tensions have evolved over time and to clarify key implications for ADB programming (such as whether and how to operate in certain regions).
- A map of key institutional structures, including the constitutional system and actual functioning of checks and balances, and key features of the public sector and the state's sources of revenues, should be drawn up. This should include a macro-level discussion of the formal and the actual "rules of the game" (i.e., the degree to which clientism pervades public life).
- It is important to consider the main stakeholders relevant for country-level analysis—key political and economic power holders—as well as crucial groups such as political parties, business associations, unions, or religious groups (depending on the country context and the focus of the analysis).

## Growth Diagnostic Assessment

CPS preparation must be informed by inclusive growth diagnostics. The diagnostic study identifies binding constraints that limit growth and policies to alleviate them. However, even technically sound policy prescriptions can fail because of lack of effective political support. A political economy approach can help identify how to overcome particular economic constraints given the prevailing political reality. For example, a growth diagnostic may indicate that inadequate and unreliable electricity supply is the most important binding constraint to growth. This may be caused by pricing policies and weak management within the public power companies. Political economy analysis might show that these problems relate to systems of political patronage governing access to subsidized power and protected public employment. The analysis might go on to identify ways in which new institutional arrangements and "second best" policies could be designed to mitigate the impact of patronage politics, or ways in which relevant interest groups from the private sector or civil society could become better organized to demand reform. In this way, political economy analysis can help to (i) improve our understanding of the

political obstacles and opportunities for growth, (ii) enhance dialogue with the government around policy options for delivering improved growth, and (iii) inform medium-term strategies of engagement with civil society and the private sector to help overcome growth constraints.<sup>13</sup>

ADB's study on the political economy of economic reform in the Pacific, prepared for the Pacific Approach,<sup>14</sup> considered the intersection between economics, politics, and culture in each Pacific country, 10 of which are categorized as FCAS (footnote 1 and Box 1).

### Box 1 The Political Economy of Economic Reform in the Pacific

In late 2009, the Asian Development Bank (ADB) launched a new Pacific Approach, a framework for its role in the development of its 14 Pacific developing member countries (DMCs), 10 of which are categorized as fragile and conflict-affected situations (FCAS). The Pacific Approach requires a high level of understanding of the political economy of each DMC. For its assistance to be most effective, ADB should have a good appreciation of how economics, politics, and culture interact within each country. The study was prepared as background for the Pacific Approach, comprising a set of studies by researchers who examined the political economy of the Pacific DMCs within different disciplinary frameworks. Some studies looked at why economic reform attempts are, or are not, successful. Others investigated how politics, economics, and culture interact to discourage change, lead to poor governance and growth, or encourage corruption. The study was set within the context of the recent global interest in understanding the political economy of economic reform in developing countries. It confirmed many of the conclusions that have been drawn from research in this area and provides additional insights on the political economy challenges of economic reform. The report pointed to ways in which ADB and other development partners can use this knowledge to provide more effective assistance to the Pacific DMCs.

Source: ADB. 2010. *The Political Economy of Economic Reform in the Pacific: Executive Summary*. Manila. <http://www.adb.org/publications/political-economy-economic-reform-pacific-executive-summary>

At the request of the Government of Kiribati, ADB funded a study on the political economy of the country's state-owned enterprise (SOE) reform. This study revealed how the prioritization, sequencing, and nature of SOE reform are greatly influenced by the political economy (Box 2).

<sup>13</sup> Example taken from DFID (2009), footnote 5.

<sup>14</sup> ADB. 2009. *ADB's Pacific Approach, 2010–2014*. Manila.

## Box 2 The Political Economy of State-Owned Enterprise Reform in Kiribati

The study reported the results of an investigation into the social, economic, political, and institutional factors that encourage or impede inclusive economic development in Kiribati and hamper the capacity development needed to overcome obstacles to that development. The institutional analysis and development (IAD) framework of Ostrom et al. (2001) served as the analytical framework for the investigation. The framework proved to be an effective way to explain group behavior that influences a country's economic development. The investigation centers on the reasons for the difficulties that the government faces when it tries to privatize public enterprises and develop the private sector.

The IAD framework was used to examine the social, economic, political, and institutional factors that have stymied privatization and private sector development in Kiribati. Following this, various measures that could encourage capacity building and economic reforms were examined. Finally, the study summed up the outlook for reform in Kiribati and recommended ways to improve the outcomes of development partner projects and programs in the country. The IAD methodology was also used to develop a capacity-building framework for technical assistance to improve the availability of accurate and up-to-date financial information for a multiyear budgeting framework for Kiribati.

Sources: E. Ostrom, C. Gibson, S. Shivakumar, and K. Andersson. 2001. An Institutional Analysis of Aid, Incentives, and Sustainability. *Studies in Evaluation 02/01*. Stockholm: Sida; ADB. 2009. *Kiribati's Political Economy and Capacity Development*. Manila. <http://www.adb.org/publications/kiribatis-political-economy-and-capacity-development>

## Sector Analysis

Sector analysis can play a major role in assessing the readiness, interest, and time involved in institutional change. Many attempts at reform, at both the macroeconomic and sector levels, are less than successful because proponents misunderstand the foundations of a market economy and the basics of an institutional reform process. Policy operations and the responsibility of governments to implement often far-reaching reforms require careful assessment of the capacity to adapt and the willingness and incentive to change. Sector analysis provides an opportunity to (i) update the understanding of domestic institutional arrangements and the political and policy development process, (ii) assess the time and resources needed to effect change and develop capacity, and (iii) minimize efficiency losses.

Overall, the determination of what the policy and institutional constraints are, including binding constraints, should be the task of sector diagnosis. Carefully done, this should include not only a descriptive review of what is going on in a sector, but also an analysis of why things are going on as they are, and of what alternative measures can be taken to improve the prevailing policy and institutional context. This requires a good understanding of the workings of the economy and the sector. Appreciating the distinction between price and market reform issues on the one hand, and institutional reform issues on the other, which second-generation reforms typically address, can also be crucial in comprehending the context of specific types of reform and probable response, timing, and sequencing issues, as well as possible outcomes. The timing and sequencing of policy changes should be anchored on a rigorous sector diagnosis.

Sector analysis can play a major role in assessing the readiness, interest, and time involved in institutional change

Almost all sector tools involve an initial mapping of key stakeholders. Once the key stakeholders have been identified, the next step is to identify the most influential actors, their interests and incentives, and how these shape the overall dynamics of the sector, including the feasibility of proposed policy reforms. Some key questions to consider when conducting political economy analysis of a sector are highlighted in Box 3.

### Box 3 Sample Questions for Conducting Sector-Level Political Economy Analysis

**Roles and responsibilities.** Who are the key stakeholders in the sector? What are the formal and/or informal roles and mandates of different players? What is the balance between central and/or local authorities in the provision of services?

**Ownership structure and financing.** What is the balance between public and private ownership? How is the sector financed (e.g., public and/or private partnerships, user fees, taxes, donor support)?

**Power relations.** To what extent is power vested in the hands of specific individuals or groups? How do different interest groups outside the government (private sector, nongovernment organizations, consumer groups, the media, etc.) seek to influence policy?

**Historical legacies.** What is the past history of the sector, including previous reform initiatives? How does this influence current stakeholder perceptions?

**Corruption and rent-seeking.** Is there significant corruption and rent-seeking in the sector? Where is this most prevalent (e.g., at point of delivery, procurement, allocation of jobs)? Who benefits most from this? How is patronage being used?

**Service delivery.** Who are the primary beneficiaries of service delivery? Are particular social, regional, or ethnic groups included and/or excluded? Are subsidies provided, and which groups benefit most from these?

**Ideologies and values.** What are the dominant ideologies and values that shape views around the sector? To what extent may these serve to constrain change?

**Decision making.** How are decisions made within the sector? Who is party to these decision-making processes?

**Implementation issues.** Once made, are decisions implemented? Where are the key bottlenecks in the system? Is failure to implement due to lack of capacity or other political economy reasons?

**Potential for reform.** Who are likely to be the “winners” and “losers” from particular reforms? Are there any key reform champions within the sector? Who is likely to resist reforms and why? Are there “second best” reforms that might overcome this opposition?

Sources: J. Moncrieffe and C. Luttrell. 2005. *An Analytical Framework for Understanding the Political Economy of Sectors and Policy Arenas*. London: Overseas Development Institute; V. Fritz, K. Kaiser, and B. Levy. 2009. *Problem-Driven Governance and Political Economy Analysis: Good Practice Framework*. Washington, DC: World Bank.

Following the completion of the analysis, it is important to consider where the potential entry points for ADB engagement might be and how an intervention might be appropriately sequenced to deliver the best results. This requires an assessment of the feasibility of objectives in relation to sector reform and options for working with reform champions, where they exist, or a broader constituency of interest groups outside government,<sup>15</sup> where they do not. While the operational implications will not always be clear, having mapped the sector and analyzed the key political economy trends, ADB will be in a better position to design sector interventions that are technically sound and politically feasible. For capacity development interventions to strengthen sector performance, a tool for scanning the institutional and political economy context can be used to enhance the realism and relevance of capacity development interventions in a sector by doing a quick scan of significant factors that enable and/or constrain the capacity and performance of sector organizations.<sup>16</sup>

## Country Partnership Strategies

Political economy analysis can help create a better understanding of the environment in which country operations take place and in which strategic results are being pursued. It also helps to spell out crucial governance and political economy risks, especially in FCAS. This can be valuable for creating a shared understanding of the environment across the country team and for agreeing with Management and peer reviewers on country programs and/or specific operations that are realistic and feasible. Political economy analysis can also help preserve and transmit such an understanding when there is personnel change.<sup>17</sup>

In addition to informing country team members, political economy analysis should be used to draw implications for the design of CPSs and related operations. In many instances, these implications are aimed at adjusting strategies and/or operations to an existing space for change. This could include influencing the CPS in terms of priorities, and in terms of defining feasible reforms and entry points, as well as proposing new monitoring components with results and indicators that are particularly relevant from a political economy perspective, for inclusion in country and sector results frameworks. Political economy analysis can be useful at any point in the CPS process, but the value added is enhanced if it is done upstream at the time when the CPS initiating paper is prepared. Discussions with senior management at this stage will ensure that concerns about potential sensitivities can be taken on board early. At this point, it is important to clarify the potential for progress across the priority sectors identified for the CPS, and how this package of operations could be enhanced, based on the country team's deeper understanding of the political economy dimensions. The upstream analysis should enhance the design of operations, in terms of the what and the how; help anticipate problems that are likely to emerge during project implementation; and

Political economy analysis can be useful at any point in the country internship strategy process, but the value added is enhanced if it is done upstream at the time when the initiating paper is prepared

<sup>15</sup> ADB. 2012. *Strengthening Participation for Development Results: An Asian Development Bank Guide to Participation*. Manila. Staff can refer to the recently updated guide at <http://www.adb.org/documents/strengthening-participation-development-results-asian-development-bank-guide-participation>. It has tools for strengthening ADB and DMC engagement with civil society organizations.

<sup>16</sup> ADB. 2011. *Practical Guide to Capacity Development in a Sector Context*. Manila.

<sup>17</sup> Often, new staff will need several months to understand the political economy of a country. Even a brief analysis can substantially accelerate this understanding, and it can also help to set the political economy problems perceived in a particular area into the wider country context.

provide space to think ahead about how to manage them. The Philippines country team has been proactive in considering political economy dimensions during CPS preparation (Box 4).

#### Box 4 Political Economy Analysis: Informing the Philippines Country Partnership Strategy

The Philippines Country Partnership Strategy (CPS), 2011–2016 was prepared by a multidisciplinary team, drawing on economic, sector, and thematic studies; two country team retreats; and the country assistance program evaluation assessment of past operations.<sup>a</sup> The critical development constraints study by the Asian Development Bank's (ADB) Economics and Research Department served as the cornerstone of the country analysis and also informed the preparation of the government's Philippine Development Plan, 2011–2016 launched in May 2011.<sup>b</sup> The study includes an analysis of "Governance, Institutions, and Political Economy" looking at issues such as political stability; corruption; legitimacy; inequality, poverty, and the middle strata; and the allocation of political power. It also identifies conditions in which change might occur.<sup>c</sup> The political economy analysis was further expanded by reviewing recent studies by eminent authors on political economy.<sup>d</sup> Building on these and other diagnostics, the Philippines CPS sharpens the focus of political economy dimensions in assessing development performance, problems, and opportunities. It recognizes that "the Philippines' complex political economy results in impediments that are likely to impact on the pace and quality of reforms."

Issues highlighted in the CPS include (i) the weak link between economic growth and poverty, (ii) weak fiscal performance resulting in shortfalls in the provision of basic infrastructure and social services, (iii) limited competition and weak investment climate, and (iv) weak public sector management and judiciary.<sup>e</sup> As a result of the political economy analysis, the focus of the CPS was shifted toward greater investments in social sectors, revenue generation, policy-based lending in public sector management, and more intensive partnerships with civil society organizations and other stakeholders. The country team fully recognizes that change needs to be driven from within the country and that ADB can only assume a facilitating role. For that reason, intensive efforts were made to reach a shared understanding with key stakeholders on critical development constraints. The approach to base the CPS on findings of the political economy analysis was strongly supported by two internal and two external CPS peer reviewers.

<sup>a</sup> ADB. 2011. *Country Partnership Strategy: Philippines, 2011–2016*. Manila. The CPS was endorsed in October 2011. Several of the linked documents are being updated and are reflected in the list of linked documents included in ADB. 2012. *Country Operations Business Plan: Philippines, 2013–2015*. Manila. Appendix 2; ADB. 2008. *Country Assistance and Program Evaluation for the Philippines: Increasing Strategic Focus for Better Results*. Manila. Operations Evaluation Department, June.

<sup>b</sup> D. Canlas, M. E. Khan, and J. Zhuang, eds. 2010. *Diagnosing the Philippine Economy: Toward Inclusive Growth*. Manila: ADB; Government of the Philippines. 2011. *2011–2016 Philippine Development Plan*. Manila. Publicly released on 27 May 2011 and accessible through [www.neda.gov.ph/PDP/2011-2016/default.asp](http://www.neda.gov.ph/PDP/2011-2016/default.asp)

<sup>c</sup> See Chap. 10 by E. S. de Dios in Canlas, Khan, and Zhuang (2010), footnote b.

<sup>d</sup> P. D. Hutchcroft. 2010. Dreams of Redemption: Localist Strategies of Political Reform in the Philippines. In Y. Kasuya and N. G. Quimpo, eds. *The Politics of Change in the Philippines*. Manila: Anvil Publishing; M. Johnston. 2010. *Political and Social Foundations for Reform: Anti-Corruption Strategies for the Philippines*. Manila: Asian Institute of Management. Hutchcroft (p. 426) characterizes the system as a highly politicized "patronage-based state," which (i) occurs within settings that lack effective bureaucracies and/or well-institutionalized political parties, (ii) devolves important elements of state administrative functions to local power holders, and (iii) displays high levels of interconnectedness among the different territorial layers of government via a patronage system that has its apex in the national capital.

<sup>e</sup> While these core findings are reflected in the main text, more detailed findings of political economy analysis are reflected in several parts of the CPS, in particular in the summaries of the Economic Analysis, Poverty Analysis, Private Sector Assessment, Thematic Assessment: Good Governance and Political Economy, and the four Public Sector Management Assessments.

## Design of Projects and Programs

A well-prepared sector-level political economy analysis can usefully inform the design of policy reform programs, whether loans, TA, or policy dialogue. Guiding questions at this level become more specific to the anticipated scope of the intervention design. Box 5 presents sample questions for preparing a policy reform intervention.

### Box 5 Sample Questions for Preparing Policy Reform Interventions

- What are the boundaries of the proposed reform, as defined by key inputs, core activities, outputs, and associated outcomes?
- Given the above, who are the key stakeholders with an interest in the given reform, or who will be affected by and/or likely to affect the proposed reform measures in terms of its inputs, core activities, outputs, or outcomes?
- What must be assumed about the existing or future behavior and preferences of each key stakeholder for the reforms to be successfully approved, initiated, and implemented, and to lead to the desired outcomes?
- What specific elements of the reform are likely to lead to resistance or conflict, or result in perceived decreases in net benefits by particular stakeholders?
- Do these stakeholders have the power and means to influence, or even block, the reform process (e.g., initiation, endorsement, and implementation of the policy or specific reform measures), either individually or in coalitions?
- If yes, do the stakeholders have (or under what conditions are they likely to have) the incentive to do so?
- How can stakeholders with concerns be induced to support, or at least not oppose, the proposed reform measures? For example, how can the design of the reform be modified to account for differing needs and preferences not at present accommodated, while ensuring the basic contribution of the policy-based loan to policy reform?

Source: G. Abonyi. 2013. A Framework for Political Economy of Policy Reform and Policy-Based Lending. In G. Abonyi, R. Bernardo, R. Bolt, R. Duncan, and R. Tang, eds. *Managing Reforms for Development: Political Economy of Reforms and Policy-Based Lending Case Studies*. Manila: ADB. Chap. 1.

A well-prepared sector-level political economy analysis can usefully inform the design of policy reform programs, whether loans, technical assistance, or policy dialogue

Political economy approaches can also be used to learn from past projects to strengthen future interventions. In Southeast Asia, ADB explored the political economy dimension of policy reform by developing a set of comprehensive case studies of ADB-supported policy-based lending programs in three countries: Indonesia, Thailand, and Viet Nam. The case studies were designed to present detailed stories about the policy reform process, focusing on the political economy dimension of reforms. The aim of each case study was to provide an account of a particular ADB program and place it in the specific and evolving reform context in which the program was formulated and implemented, describing the policy process involved. Since the context is crucial with respect to policy reform initiatives, the case studies provided narratives on local conditions and historical circumstances. The focus of the cases was on the interplay between ADB's program and the surrounding environment, with particular emphasis on the policy

Political economy approaches can also be used to learn from past projects to strengthen future interventions

reform process, and its political economy dimension. The basic purpose of the case studies was to find out why and how things happened, so that this knowledge can be used to better understand the policy reform process, in particular the role of political economy factors; and more specifically, to assist in the future planning and implementation of programs supporting policy reforms (see Box 6 for brief summaries of the cases studies).<sup>18</sup>

### Box 6 Political Economy of Reform: Case Studies of Policy-Based Lending Operations Supported by ADB

The purpose of the country case studies was to draw lessons that can assist in better understanding the policy reform process to lead to more effective preparation and implementation of programs supporting reforms. In order to help structure the case studies, a framework was introduced for the analysis of the political economy dimension of policy reform. The framework was proposed as a useful general tool, both for the ex post understanding of the political economy dimension of policy reform, and as an analytic tool for assisting in the ex ante design of specific policy reform programs and related policy-based lending.

**Viet Nam.** This is a case study of ADB's State-Owned Enterprise (SOE) Reform and Corporate Governance Program Loan that was aimed at supporting fundamental and sensitive reforms in Viet Nam's transition. It examines the context of SOE reform involving Viet Nam's unique, domestically driven process that shapes policy decisions; the design of the program; and key issues related to implementation and sustainability of selected core reform measures

See G. Abonyi. 2005. Policy Reform in Viet Nam and the Asian Development Bank's State-Owned Enterprise Reform and Corporate Governance Program Loan. *ERD Working Paper* No. 70. Manila: ADB. <http://www.adb.org/publications/policy-reform-viet-nam-and-asian-development-banks-state-owned-enterprise-reform-and-co>

**Thailand.** This is a case study of ADB's Agricultural Sector Program Loan (ASPL) that was aimed at supporting fundamental reforms in Thailand's agriculture sector and was initiated in 1998 in the midst of the Asian economic crisis. It examines the context of the policy reforms, the design of the program, implementation of selected reforms, and sustainability of the reform process particularly given the change in government during program implementation.

See G. Abonyi. 2005. Policy Reform in Thailand and the Asian Development Bank's Agricultural Sector Program Loan. *ERD Working Paper* No. 71. Manila: ADB. <http://www.adb.org/publications/policy-reform-thailand-and-asian-development-bank>

*continued on next page*

<sup>18</sup> For a more recent case study, see also ADB. 2012. *Political Economy of Rural Finance Reform in Nepal: ADB's Experience*. Manila. <http://www.adb.org/publications/political-economy-rural-finance-reform-nepal-adbs-experience>

*Box 6 continued*

**Indonesia.** This is a case study of ADB's Financial Sector Governance Reforms Development Program Loan to the Government of Indonesia. Launched in June 1998, the program was part of a multi-donor effort led by the International Monetary Fund to help Indonesia respond to the Asian economic crisis and undertake reforms in the financial sector. The design and implementation of the program took place in an environment characterized by an unexpected, deep, and sustained economic crisis, accompanied by social instability, and political and institutional uncertainty and change. Against this backdrop, the case study examines the context of Indonesia's policy reforms in the financial sector and the general design of the program. It touches on the implementation of selected reforms and sustainability of the reform process.

See G. Abonyi. 2005. Policy Reform in Indonesia and the Asian Development Bank's Financial Sector Governance Reforms Program Loan. *ERD Working Paper* No. 76. Manila: ADB. <http://www.adb.org/publications/policy-reform-indonesia-and-asian-development-banks-financial-sector-governance-reforms>

## Policy Dialogue

Political economy analysis can be conducted at the country, sector, or project levels, or for a particular policy or development issue or problem of strategic importance to a DMC. This type of analysis puts ADB in a much stronger and more credible position to engage with DMCs in policy dialogue, especially in areas of policy reform and change that may be critical, but sensitive. Political economy analysis should be viewed as a dynamic process rather than a static output. The measure of success is not the conduct of the study itself, but the extent to which findings are integrated into the CPSs and interventions result in development outcomes that make a difference. Ultimately, the analysis should contribute to improved results on the ground. Ideally, political economy analysis should form the basis for ADB's policy dialogue at all levels in our DMCs, including the central government, sector ministries, the local government, and other stakeholders, including civil society and private sector partners. It should become integral to the work of country and project teams, and especially resident missions, with knowledge being continuously updated over time and fed back into programming and project monitoring, including CPSs, country operations business plans, and country portfolio reviews.

Ideally, political economy analysis should form the basis for ADB's policy dialogue at all levels in our DMCs

# Working with Others

A key decision when taking forward a political economy analysis is whether to conduct the analysis as an independent study, to conduct an analysis jointly with other partners, or to rely on the work of other partners. Joint analysis can add significant practical value by helping to develop a shared understanding of the political constraints and opportunities. It can also provide the basis for joint action by identifying entry points for country partnership strategy (CPS) programming, and the risks of engaging in these areas. Where such analysis is readily available from other partners and is up to date, ADB may also consider relying on other partners' work.

The scope for engaging government and national partners in political economy analysis should be judged on a case-by-case basis. Trade-offs are always likely between openness and transparency on the one hand, and the quality and rigor of analysis on the other. In difficult political environments, full disclosure of findings may serve to undermine relationships and fuel tensions. However, in more permissive contexts, the benefits of working with national governments and other partners can often outweigh the costs.

Civil society organizations and the media provide important sources of information that can be incorporated into the analysis. They can contribute during consultations or field work, or be commissioned to gather data and conduct analysis. In environments where security is an issue, civil society organizations may be able to reach areas and groups that are inaccessible to ADB and other donors, and may be the most suitable partners to undertake the research. In such contexts, their analysis should be triangulated with other sources where possible.

# Follow-Up

The staff should systematically evaluate the extent to which political economy analysis has informed improved CPS delivery and better results on the ground. They should also put together short case studies or stories highlighting what lessons have been learned and how the analysis has been used to inform day-to-day work. This will feed into an emerging body of evidence at both the country level and the sector level on the contribution of political economy work in improving development practice and outcomes.

# APPENDIX:

## Other Donor Approaches to Political Economy Analysis

### **The World Bank: Governance and Anticorruption Strategy**

The elaboration of the World Bank's Governance and Anticorruption Strategy presented a new opportunity to recognize the interrelationship between governance and political-economic conditions, as well as a need to have this relationship reflected in analysis and operations. Frameworks for using political economy analysis to enhance World Bank-supported strategies and operations have been developed, in particular, by two primary reports: *The Political Economy of Policy Reform* (PEPR) published by the Social Development Department in 2008, and *Problem-Driven Governance and Political Economy Analysis* (PDG) published by the Poverty Reduction and Economic Management Network in 2009. Although the former is primarily focused on the operational implications of political economy analysis for sector reforms (with agriculture and water given prime importance), the latter identifies principles for conducting and incorporating "Governance and Political-Economy" analyses in World Bank programmatic activities. Although they differ in terms of emphasis, their points of convergence are the common themes for a new (more pragmatic) type of political economy analysis.

World Bank. 2008. *The Political Economy of Policy Reform: Issues and Implications for Policy Dialogue and Development Operations*. *Social Development Department Report*. No. 44288-GLB. Washington, DC.

World Bank. 2009. *Problem-Driven Governance and Political Economy Analysis: Good Practice Framework*. Washington, DC.

### **Department for International Development of the United Kingdom: Drivers of Change**

Drivers of Change (DoC) is an approach developed by the Department for International Development (DFID) to address the lack of linkages between a country's political framework and development agency operations, focusing

primarily on the interplay of economic, social, and political factors that support or impede poverty reduction (DFID 2004). DoC focuses on power relationships and the institutional and structural factors affecting the lack of political will, based on a three-part approach that identifies structures, individual agents, and mediating institutions, and coupled with an emphasis on how to effect change.

DFID. 2004. *Drivers of Change. Public Information Note*. London.

DFID. 2009. *Political Economy Analysis How To Note: A DFID Practice Paper*. London.

N. Thornton and M. Cox. 2005. *Review of the Uptake of the Drivers of Change Approach*. London: Agulhas Development Consultants.

## Swedish International Development Agency: Power Analysis

The “power analysis” approach has been developed by the Swedish International Development Agency (Sida). It is based on the understanding that issues of power asymmetries, access to resources, and influence over politics must be addressed if poverty is to be reduced. Power analysis seeks to map the informal political landscape, including its rules and structures. It seeks to understand how development cooperation and donor activities are influenced by this landscape, and how the landscape of power shapes their activities. The approach is informed by a commitment to working toward “justice, equity, and organized redistribution of access to the welfare among the world’s people” (Sida 2005, p. 30).

Sida. 2005. *Methods of Analyzing Power: A Workshop Report*. Division for Democratic Governance. Stockholm.

## German Society for Technical Cooperation: Governance Questionnaire

The Governance Questionnaire was designed by the German Society for Technical Cooperation (GTZ) as a tool to analyze the political and institutional frameworks, actors, and relationships in a country. The aim is to help development practitioners produce better informed and more effective strategies for policy reform. As with DFID and Sida, the GTZ approach takes the view that political reform processes are strongly influenced by informal values, norms, customs, and processes, rather than by following formal rules. This is thought to apply particularly to new democracies or weakly institutionalized political systems. It also explicitly sets out to employ a multidisciplinary approach, combining political science, law, economics, legal anthropology, and empirical social research. The questionnaire does not aim to provide a comprehensive assessment, but rather to highlight important issues, facilitate debate, and stimulate further inquiry to inform decisions about how to support reform (Faust and Gutiérrez 2004).

J. Faust and M. Gutiérrez. 2004. *Governance Questionnaire: An Instrument for Analysing Political Environments*. Eschborn: State and Democracy Division, GTZ.

## United States Agency for International Development: Democracy and Governance Assessment

One of the earliest donor-based political assessments is the Democracy and Governance Assessment designed by the United States Agency for International Development (USAID) for assessing the state of democracy and governance in a country, and the prospects for their improvement. The framework “guides a political analysis of the country, leads program choices, and incorporates what researchers and practitioners have learned from comparative experience” (USAID 2000, p.1). It also aims to identify certain comparable elements of countries’ political economy and institutions and use these to inform a strategic analysis of how best to promote democracy. The assessment focuses primarily on developing the elements of liberal democratic government, that is, on “liberty, open competition, the rule of law, and respect for pluralism and minority rights” (USAID 2000). This approach is designed to provide an entry-point analytical overview for those considering actions to promote democracy in a given country.

USAID Center for Democracy and Governance. 2000. *Conducting a Democracy and Governance Assessment: A Framework for Strategy Development*. Washington, DC.

## Guidance Note

### Use of Political Economy Analysis for ADB Operations

Political economy analysis facilitates understanding on how incentives, institutions, and ideas shape political action and development outcomes in ADB's developing member countries (DMCs). These factors can inform assessments of feasibility of policy reform and institutional change, the contribution that ADB and other development partners can realistically make, and the risks involved. A political economy analysis can, therefore, strengthen the design of more effective support, leading to better development results. While important for all DMCs, political economy considerations especially matter in DMCs with fragile and conflict-affected situations. This guidance note develops a definition and parameters for political economy analysis to ensure consistency; and to guide country, sector, and project teams in the analysis.

## About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.7 billion people live on less than \$2 a day, with 828 million on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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