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The Political Economy of Policy Reform:
Issues and Implications for Policy Dialogue and Development Operations

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EXECUTIVE SUMMARY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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ABBREVIATIONS

AAA	Analytics and Advisory
AFR	Africa Region
CAS	Country Assistance Strategy
CGAC	Country Governance and Anti-Corruption
CFA	Communauté financière d'Afrique - West African CFA franc (XOF)
CSO	Civil Society Organization
DEC	Development Economics Department
DPL	Development Policy Lending
EAP	East Asia and Pacific
ESW	Economic and Sector Work
ETW	Energy, Transport and Water Department
EXT	External Affairs Department
FGD	Focus Group Discussion
GAC	Governance and Anti-Corruption
IDA	International Development Assistance
IPO	Independent Private Operator
IEF	Infrastructure Economic Facility
IMF	International Monetary Fund
M&E	Monitoring and Evaluation
MTEF	Medium Term Expenditure Framework
MWWP	Municipal Water and Wastewater Project
OED	Operations Evaluation Department
OPCS	Operations Policy and Country Services
OPM	Oxford Policy Management
PAD	Project Appraisal Document
PE	Political Economy of reform
PPIAF	Public-Private Infrastructure Advisory Facility
PPP	Public Private Partnership
PPI	Private Partnership in Infrastructure
PRSC	Poverty Reduction Strategy Credit
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and Social Impact Analysis
QAG	Quality Assurance Group
SAR	South Asia Region
SDV	Social Development Department
SWAp	Sector Wide Approach
TA	Technical Assistance
TTL	Task Team Leader
WTP	Willingness to Pay

1. INTRODUCTION

It is widely recognized within the international development agencies that understanding the political context of reform processes is important for engaging effectively in policy dialogue that promotes policy change[1]. It is also recognized that a failure to anticipate political and institutional challenges is often a chief cause of unsuccessful policy reform processes. This study addresses the following questions: Why do policy reform processes sometimes stall, stop, reverse, or go off track despite their content, design and implementation appearing technically sound? What can be done to mitigate this? Why does the reform get tabled? Why do reforms that were designed to benefit poor and vulnerable groups, fail to achieve this goal? Are some stakeholders deliberately blocking the process because they stand to lose from the reforms, or see opportunities for further benefits if the content is changed? If this is the case, are they right in their assessment? Or is there friction in the legislative process because some stakeholders weren't invited to the decisive policy formulation roundtable? Could it be that the reform is based on a blueprint from a different country and has not been tailored to the context? Or perhaps the reform sequence is 'out of sync' with other processes in that society.

The study addresses these issues by examining the experience of operational teams from the World Bank, working on policy reforms and programs in the agriculture and water sectors, and by drawing on expertise of other development practitioners in bilateral development organizations, public and private sector, and academia. Development practitioners often possess a deep understanding of how a sector in a country works, and of the political economy context. This knowledge is rarely captured and shared, either because of lack of time, or because of the sensitivity of the information. The present study aims at capturing and synthesizing the experience of operational teams working in complex political economies. From this, it aims at providing a systematic approach to the analysis of the political economy of policy reforms. While the study focuses on the experience of World Bank task teams in engaging in reform processes, the intention is to distil from this experience a conceptual framework and analytic approach which will assist a wide range of development practitioners in engaging effectively in dialogue to promote policy reform.

The purpose of the study is to provide guidance to development practitioners in assisting partner countries to initiate debate and steer through reform processes that lead to more equitable development outcomes. The specific objectives of the study are to: a) unpack the "black box" of political economy by applying a social analysis framework to the study of stakeholder interests, incentives, institutions and risks; and b) illustrate "what works, why and how" for a better understanding and management of political economy issues in reform design and implementation.

From the perspective of equity and poverty reduction, stakeholder influence and interests, and associated power relations, determine the distribution of costs and benefits of agriculture and water sector operations among different social groups which are competing over resources, goods and services. From a policy perspective, stakeholders influence decisions of *whether* and *how* the challenges in reforms of agriculture and water sector are addressed in national development strategies, and in subsequent policy development and implementation.

[1] "Understanding socio-economic and political factors to impact policy change" (World Bank 2006 f) provides an overview of approaches to understanding the political dynamics of development co-operation, including the 'Drivers of Change' approach piloted within DFID, Sida's 'Power Analysis', the Country Social Analysis Framework developed within the World Bank, or the German development approach that focuses on develop partner countries' negotiating capacities through long-term assignments of its advisors into partners' institutions.

The new "international aid architecture" of country-driven development strategies under the Paris Declaration[2], has opened up institutional space for a more reflective lending approach that considers the political economy risks to sustainable and effective policy reform and which adopts a more nuanced perspective on the notion of "country ownership" of reform. A World Bank review of lending practices[3] states:

> *"Careful review of the country's political economy and of stakeholders' concerns is required to identify the scope for a sustainable reform program. Given the complexity of country situations, such an assessment goes beyond a simplistic notion of ownership that presupposes a uniform government position or a full consensus. It would not be sensible to suppose that all recipient countries are functioning democracies, respond to the interests of the majority of the population, avoid elite or foreign-interest capture, and maintain a stable course on reforms. A realistic assessment of ownership relies on the government's track record of reform and acknowledges the political economy dimensions that reforms may be owned by some constituencies and opposed by others who stand to lose from them."*

The recognition of the importance of the political economy context for reform is accompanied by a growing emphasis on effecting policy change through dialogue and consensus building rather than through the use of somewhat blunt and often ineffective conditionality instruments.

For the purposes of the analysis presented here, **'political economy' is understood as the study of the interactions between political processes and economic variables.** A political economy lens can help us to better understand the dynamics of policy reform processes. Stakeholders' interests and the power relations between social actors obviously influence their support or opposition to the reform. The sequencing and timing of actions associated with policy reforms can also determine the level of tension and conflict, the duration, and ultimately the success or failure of reforms.

The World Bank, working with other development partners, has developed a repertoire of tools for institutional, political and social analysis of policy reform[4]. **Poverty and Social Impact Analysis (PSIA)**[5] is an essential policy analysis instrument for assessing the impact of the potential reforms on poverty and social outcomes. PSIA methods are also very useful for analysis of the political economy. Through PSIA, one can examine both the risks *to* a reform process, and the political economy risks *of* policy reform to equity outcomes. For example, a review of 23 PSIA exercises carried out in the agriculture sector concluded that in many instances social analysis had played a major role in uncovering political economy risks, and in providing practical strategies to handle or mitigate these risks[6]. Most of the risks identified were related to elite capture and control of rents, but in some cases, the risks of conflict between different government agencies, and lack of 'buy-in' from key stakeholders were also significant to determining outcomes. The PSIA approach, that combines analysis with policy dialogue, provides the conceptual and operational grounding for the present study.

This paper is built on primary and secondary data from World Bank operational experiences in two sectors across several regions. The two sectors also illustrate the two different primary channels for World Bank lending, development policy lending (which supports processes of policy change) and investment lending (which supports specific projects). In respect of agricultural liberalization, the study looks at development policy loans in four detailed case studies and four briefer case presentations. In respect of public-private partnership in water supply and sanitation, the study examines investment projects through four detailed case

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[2] The Paris Declaration, endorsed on 2 March 2005, is an international agreement to which over one hundred Ministers, Heads of Agencies and other Senior Officials adhered and committed their countries and organisations to continue to increase efforts in harmonisation, alignment and managing aid for results with a set of monitorable actions and indicators.

[3] Koeberle et al., 2005.

[4] See, for example: the SDV's Tools for Institutional Political and Social Analysis of PSIA Sourcebook (Holland, 2007)

[5] The PSIA approach was jointly developed within the Bank by the Social Development Department and the PREM Poverty Reduction Department, with collaboration from a range of bilateral development partners, such as UK DFID and German Development Cooperation (see www.worldbank.org/psia/ for more details).

[6] World Bank, 2006e

studies and four briefer examples. Existing material was used, but the interviews with operational task team members provided the essential insights into the political economy issues in each of the case studies.

The case studies were selected as a purposive sample according to the following criteria: a) sectors where political economy issues have markedly influenced national reforms and development partners' support; b) cases where the reform process has raised complex and important operational political economy issues that the literature has highlighted, and operational sector specialists have identified c) positive and negative operational experiences with handling political economy issues in reform processes; d) a good range of examples of different reform contexts by region and sub-region; and e) a balance between different World Bank lending instruments (half the case studies deal with development policy loans, and half with investment operations).

Table 1: Overview of case studies and examples per sector and lending instrument

	Agricultural liberalization ***Development Policy Loans***	**Public-Private Partnership in Water Supply and Sanitation –** ***Investment Projects***
Country Case studies (elaborated)	• Burkina Faso, cotton sector • Senegal, groundnut sector • Tanzania, crop board reform • Indonesia, rice tariff reform	• Jordan, Amman water supply • Albania, water sector reform • Argentina, water supply and sanitation services reform in Salta Province • Bolivia, La Paz and Cochabamba water supply.
Country Case examples (brief)	• Malawi, ADMARC reform • Chad, cotton reform • Mozambique, cashew nut sector reform • Mexico, agricultural reform	• Ghana, urban sanitation • Ghana, water sector reform • Vietnam, rural water supply • New Delhi, water sector reform

The structure of the report is as follows: Section 2 summarizes the approach taken in this work to political economy. Section 3 illustrates the study's analytical staring point. Section 4 summarizes aspects of agricultural and water supply reform, and discusses the political economy issues that are particular to those sectors, focusing on the following four questions:

- What are the most significant political and political economy risks to policy reform?
- Why do these variables operate in a given country and sector context?
- How do these variables impact policy reform processes and outcomes?
- How could these variables be addressed through effective management of political economy risks and opportunities?

Section 5 concludes by pulling out a number of operational implications for development practitioners in relation to managing political economy risks and opportunities in policy reform.

2. DIMENSIONS OF POLITICAL ECONOMY

2.1 Defining the Concepts

The term **political economy** is subject to multiple understandings. Its origin can be found in the work of Adam Smith's Wealth of Nations, of David Ricardo and Karl Marx. In this body of work, the term referred to the *conditions of production organization in nation-states* or what today is understood as 'economics'. Today, the term is defined as ***analysis that studies the linkages between politics and economics***, drawing on theories of economics, law as well as political and social sciences. Economic theory traditionally focuses on market decisions, where voluntary exchange leads to Pareto efficient[7] outcomes. The decisions that political economy focuses on are those where the market does not produce these desired outcomes — for example, in the case of over-exploitation of land/resources due to unclear tenure — as they are influenced by political and not economic considerations. Hence agreements on rules that govern the voluntary exchange are needed, such as property rights or crop rotation regulations. Different disciplines such as psychology, international relations, law or ecology have incorporated the meaning of political economy to study the interactions in their respective disciplines. Ecologists, for instance, think of ways to change market incentives to address environmental sustainability concerns.

The most common way of approaching political economy in development work tends to be from either an economic perspective using rational choice-based models, or from a political scientific perspective through power-based models. **This work is based on the power-based approach**. Since the power-based perspective is strongly linked with the economic models and a substantial number of development studies in political economy build on those, we will briefly outline the main analytical arguments to frame our discussion of the political economy of reform.

(a) The rational choice perspective on political economy

The rational choice approach leads economists to investigate the conditions under which rational individuals are willing to cooperate in collective action problems. This implies the analysis of *institutions*, defined here as *formal and informal rules underlying political powers, bureaucratic agencies or social and private organizations*. It also implies giving recommendations to improve institutions to guide individuals' behavior and exchanges so that they can still maximize their own benefit without harming other individuals and the environment[8]. The most important relevant streams of work in economics are: the theory of the development of institutions[9], the agency theory of bureaucracy[10], and rent seeking in public choice theory[11].

This perspective tends to inform the way that economists tackle political economy challenges such as the impacts of decentralization on power relations[12], public spending reforms in favor of powerful middle-classes at the expense of less-powerful groups[13], institutions and growth[14], principal-agent problems (e.g. in voucher

[7] Pareto efficiency is achieved when resources are allocated to maximise benefits to all individuals, but without making any individuals worse off in the process.
[8] Moe, 2005
[9] e.g. North and Weingast, 1989; Buchanan, 1987
[10] Niskanen, 1994
[11] Mueller, 2003
[12] Besley et al, 2005
[13] Keefer and Khemani, 2005; Rudra, forthcoming
[14] North, 1990; Rodrik 2004; Keefer and Knack, 1997; Keefer, 2004

systems for education[15]) and how rent-seeking of vested interests influences public investment, again in favor of some at the expense of others[16].

(b) A power-based approach

Critics of the rational choice perspective on political economy raise the question how and especially by whom institutions are built and can be re-built. They question the capacity of this kind of political economy analysis to engage effectively with political dimensions of policy issues and thus to inform decision-making[17]. Critics argue that institutions are consistently created by powerful interests that favor the better-off, while "losers" remain in their original state or end up even worse-off, especially in countries with "weak" governments. Even an alternative approach built on Coase's theorem[18], they argue, does not solve the incentive problem. Under this approach inequalities in results of policy interventions are addressed through a bargaining process in which winners of policies have to compensate losers to arrive at a Pareto improving outcome. This assumption is questioned by critics such as Moe[19], who argue that there remains little incentive for actual compensation since winners do not depend on the losers' support to push a reform through.

The power-based model emphasizes that cooperation (as is assumed in rational choice models) does not always lead to beneficial outcomes for all. Instead, institutions might be persistently created in favor of powerful interests. Similarly, North[20] argues while the 'right institutions' may yield economic growth, rulers might often tend not to choose such institutions, but rather those that favor their own interests. Following this power-based view of political economy, some political scientists[21] have argued that power is a missing perspective in the rational choice approach. They emphasize the potentially destructive nature that power can have and therefore suggest integrating 'power' into the rational choice perspective. Moe[22] argues that this might require only a shift in perspectives and analytical adjustment, instead of a new theory of political economy.

2.2 Approach Taken

The power-based model forms the basis of the political economy of reform approach taken here. It draws upon economic, social and political theory in order to understand how political, economic and social actors, institutions and processes influence each other. This model in turn facilitates an analysis of how political economy factors constitute risks or opportunities for country-driven and country–owned change through development intervention. The approach will look at how actors use their position to protect or strengthen their political or economic interests. It can reveal the conditions and processes under which political actors or political entrepreneurs maneuver within institutional contexts to build coalitions, negotiate, build consensus, and bargain to generate new policies, new legislation, and new institutions.

Political economy analysis has been widely and increasingly applied to policy reform. Grindle and Thomas[23] for example, categorize policy reforms and define policies in terms of their costs and benefits. They ask: who wins, and how broadly or narrowly are those benefits distributed? Who loses and where are those losses concentrated? Secondly, they also stress the context of policy reform, asking: what is the impetus and motivation for reform and how do political interests, that surround reform decisions, play out? In more recent work supporting DFID's 'Drivers of Change' initiative, Grindle[24] develops stakeholder and institutional assessment

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[15] Gauri and Vawda, 2003
[16] Keefer and Knack, 2007
[17] Frey, 1994
[18] see Moe, 2005
[19] Moe, 2005
[20] North, 1990
[21] e.g. Bates, 1989; Levi 1988; Moe, 2005; Olson, 1993
[22] Moe, 2005
[23] Grindle and Thomas, 1991
[24] Grindle, 1999

matrices to assess the interests of actors and the institutional context of policy reform. The analysis of stakeholders examines their priorities, motivation, resources, degree of influence, and actual and potential alliances. The analysis of institutions investigates the level of access that different actors have to the policy reform's institutional context, the "rules of the game" that operate in this context, the distribution of resources of power/influence, and the degree of importance of the institutional context to the outcome of the policy reform. Levi[25] examines the conditions under which citizens have the incentive to comply with, or disobey the demands of democratic governments. One of her main findings is that citizens tend to comply if their personal costs are not higher than the expected benefits and also, if they find the government trustworthy[26].

Theorists of policy reform are only too aware of the significance of context for determining policy reform progress and outcomes. Pierson and Myles[27] highlight the importance of existing policy arrangements as sources of incentives and constraints to change. Grindle and Thomas[28] suggest that the length of time needed to implement a reform also has an important influence on the reaction generated to it. Bonoli[29] finds that greater concentration of political and institutional power is more likely to incline governments to pursue radical policy reforms, while it also increases possibilities of electoral defeat and popular protest. In contrast, in situations where power is fragmented, governments are compelled to pursue reforms through negotiation and by providing what could be quite substantial 'quid pro quos'. In this way, reforms are more likely to be accepted, but they are likely to emerge with content that is considerably different to that originally envisaged.

In addition to a focus on institutions and actors, political economy analysis can also be applied to the *process* of policy management. Brinkerhoff and Crosby[30], for example, emphasize the significance of ownership and dialogue, which are important process factors that become central to the effective management of policy reform.

Beyond the management of political economy risks *to* successful policy reform, a political economy perspective can also be brought to bear on the political economy risks *of* policy reform to equity outcomes. It does so by assessing the likely impact of policy reforms related to institutions, actors and processes in any given instance on power relations and the distribution of benefits. Will the reform process centralize power and authority thus creating opportunities for elites to capture benefits in ways that were not anticipated? The institutional constraints to progressive changes in power relations can be mapped across economic, political and social spheres of life[31]. Economic constraints include rules that restrict access to markets, land, labor opportunities and credit. Legal constraints cover systems of property rights that favor specific social groups, or the persistence of corrupt or unequal practices by police and judiciary. Political constraints comprise less-than-democratic processes, such as clientelism, intimidation or censure that give rise to "thin" forms of democracy and deny poor people a political voice. Finally, social constraints include forms of inequality rooted in class, race, gender or patron-client relations.

2.3 Political Economy of Reform and PSIA

The conceptual framework for the political economy of sector reform presented in this paper builds on over six years of Poverty and Social Impact Analysis (PSIA) experience, where institutional, political and social analyses across several sectors and regions have been applied. The use of PSIA to examine changes in power relations is outlined in the World Bank Sourcebook of 'Tools for Institutional, Political and Social Analysis of

[25] Levi, 1991
[26] See also Braithwaite and Levi, 1998
[27] In Pierson, 2001
[28] Grindle and Thomas, 1991
[29] In Pierson, 2001
[30] Brinkerhoff and Crosby, 2002
[31] Alsop et al, 2006

Policy Reform'.[32] PSIA can be used as one possible tool to analyze political economy issues[33], but not every PSIA has to automatically include a political economy analysis. A recent review shows the usefulness of PSIA in the agriculture sector to evaluating the influence of local level power relations on poverty and social outcomes (see Box 1). The conceptual framework for this study, introduced in Chapter 3 below, aims to build on this experience by providing a systematic framework for the incorporation of political economy issues into Poverty and Social Impact Analysis.

Box 1: PSIA and distributional equity in agricultural sector reform

A recent review of twenty three PSIA studies in the agriculture sector examined the contribution and experience of conducting social analysis as a part of multidisciplinary poverty and social impact analyses of agricultural reforms. The review found that efficiency and performance were the most common motivations for implementing agricultural reforms, although distributional impacts and equity concerns were also mentioned as significant drivers. Stakeholder analysis conducted for these PSIAs was effective in analyzing the social fault lines amongst rural communities of consumers and producers and unpacking the power relations between different interest groups. The stakeholder analysis helped identify likely winners and losers while broadening perceptions of who might have an interest or stake in reforms. The analysis revealed that much behavior under policy reform was based on capture and control of rents. Also, in many cases, the analysis gave better insight into the relationship between the political interests of elites and their influence on the reform proposal, showing how political forces could slow down the reform process. The PSIA process helped identify institutional weaknesses that could hamper successful implementation of a reform. A key concern of several PSIAs was the response of the private sector to the declining role of the state, particularly in agricultural marketing.

In the most effective cases, PSIAs both identified and helped the process of managing political economy risks by prompting changes in the design or timing of the proposed reforms. In particular, the early and inclusive involvement by the stakeholders with most at stake had a significant impact on design and ownership. The findings of this report suggest that the political economy of reform processes should be a major focus for social analysis methods and practice in the next generation of PSIAs.

Source: World Bank (2006e). "Stakeholder, Power relations and Policy Dialogue; Social Analysis in Agricultural Sector Poverty and Social Impact Analysis", Washington D.C., World Bank, November

2.4 Demand for the Analysis of Power Relations in Practice

In 2004, the Operations Evaluation Department (OED) of the World Bank hosted a Conference on the Effectiveness of Policies and Reforms[34]. A key finding was that **reforms are never linear and that sustained reform is 'more like a marathon than a sprint in nature'**. This finding emphasized the process aspect of reforms. In a process, selectivity, timing, and sequencing matter a great deal. The conference also confirmed the intuitive insight that home-grown reforms have a greater chance of success than externally imposed ones. One key recommendation that holds for all development partners, was to be patient, as reforms may take longer than planned and often run into unexpected obstacles. Development partners should persuade rather than prescribe, pay more attention to social and environmental impacts and negative impact mitigation measures, carry out better risk analysis and management, and should encourage ownership. In 2005 the World Bank's Operations Evaluation Department evaluated the Bank's development effectiveness[35]. The evaluation found that even the best technocratic designs can wither in infertile political soil and therefore that development partners need to pay much more attention to the political economy involved in their work. The political risks, costs, and benefits, as well as the economic implications of proposed reforms must be assessed. Cus-

[32] The other PSIA 'transmission channels' are employment, prices, access, assets and transfers and taxes (seeHolland, 2007)

[33] Others, for instance are, SIDA's Power Analysis, DFID's Drivers of Change, the German Development Corporation's institutional and capacity development approach, and the World Bank approaches to political (economy) analysis in regard to growth, governance, and equitable and sustainable development through its Institutional and Governance Reviews (IGRs), Country Governance Assessment Processes (CGAP) or Country Social Analysis (CSA).

[34] Conference on the Effectiveness of Policies and Reforms. World Bank Headquarters, Washington DC. World Bank Operations Evaluation Department, 2005

[35] World Bank, 2005b

tom-fitting reform interventions to the political economy are as important as custom-fitting reforms to the real economy:

> *"Reforms work if you have a good sense of who the winners and the losers are, and if you have a good platform for dealing with the negative impacts of policy changes […]. Economists like to look at the net welfare gain in societies, whereas politics is about winners and losers."* [36]

The political economy work presented here complements an increasingly important agenda within international development debates on good governance[37]. Within the World Bank country-level Governance and Anti-Corruption work, encompassing both national and sector institutions, is a key part of this. Policy discussions are geared to promoting and monitoring institutions that enforce good governance, for instance strengthening sectors to promote accountability and probity through citizen empowerment. The political economy approach presented here — by systematically combining an operational approach towards equity with power-based models of change — incorporates governance concerns into an understanding of how to promote pro poor policy reforms.

[36] Danny Leipziger, speaking at the PREM Knowledge and Learning Forum 2007: How to Reconcile Economics and Politics?, World Bank, Washington DC, April 16, 2007

[37] see e.g. World Bank, 2007a; 2008a

3. UNDERSTANDING THE POLITICAL ECONOMY OF REFORM

A political economy perspective, as outlined above, requires an operationally-useful conceptual framework that emphasizes the importance of context, power, institutions, actors, and processes. These contextual elements need not be seen, however, simply as risks or blockages to effective policy reform and improved distributional equity. Instead, they can be seen as opportunities if addressed proactively. In this way, the recognition of power imbalances and the policy reform goal of distributional equity need not be irreconcilable. While powerful stakeholders, acting out of self- interest, can impede the progressive allocation of resources and entitlements, the poor as a constituency can be empowered through information and access — thus becoming an effective actor in ensuring accountability and in determining the outcome of policy reform process. In operational contexts of institutional reform, this implies the need for country and reform-specific strategies and policies in order to create or "progressively realign" institutions to encourage policy reform and distributional equity. [38]

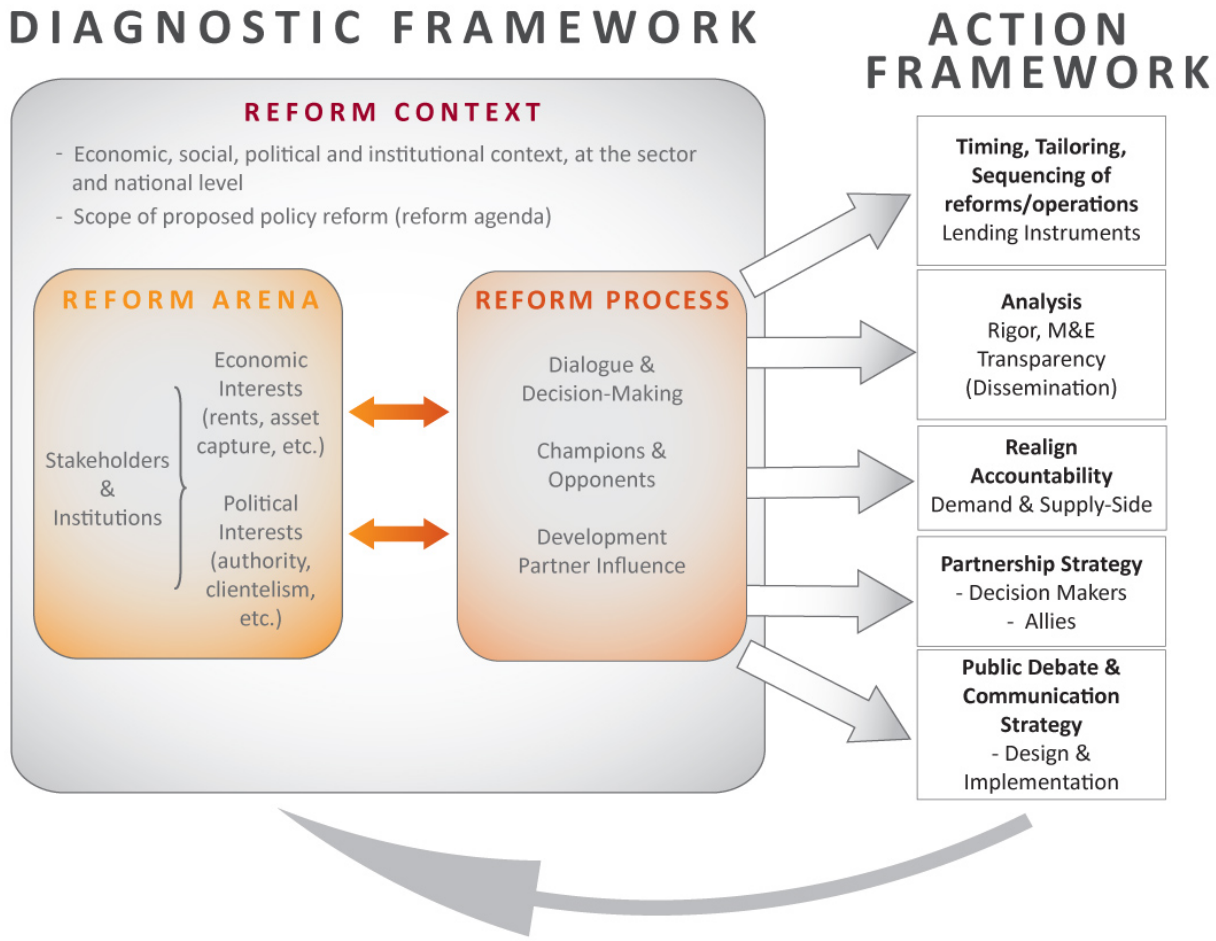
The framework proposed in this study is to a significant degree based on the social analysis approach developed for Poverty and Social Impact Analysis (PSIA)[39] and further expanded through the Tools for Institutional, Political and Social Analysis (TIPS)[40]. It was developed inductively from operational experiences of to provide concrete, contextual examples of identifying and managing the political economy of agricultural and water sector reforms at the disaggregated level. This three-pronged, systematic and integrated approach of analysis, process and action is geared to jointly address both the analytical and operational concerns of development interventions: improved distributional equity, ownership, and sustainability of policy reforms and operations. The framework builds on an overall distinction between the reform context, the reform arena and the reform process. The reform context refers the deeper social (including ethnic cleavages), national political and historical institutions which affect the sector under consideration. The reform arena is shaped by sector stakeholders, institutions, and their economic and political interests. The reform process consists of dialogue and decision-making, champions or coalitions of change, and the influence that donor agencies and external actors have in the reform and operation. The following framework was developed to organize the information derived from the case studies, and ultimately, to assist development practitioners to more systematically identify and manage political economy dimensions of reforms and operations. The content of the different elements is further explored in the following sections.

[38] See Ahrens, 2002; Rodrik, 2002

[39] World Bank, 2003e or visit www.worldbank.org/psia

[40] Holland, 2007 or visit http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALDEVELOPMENT/EXTTOPPSISOU/0,,menuPK:1424015~pagePK:64168427~piPK:64168435~theSitePK:1424003,00.html

Figure 1: A Conceptual Framework of the Political Economy of Reform



Source: Authors' compilation

3.1 The reform context — macro context and scope of reform

The reform context includes the country's and sectors' socio-economic, political, cultural and historical characteristics. The context description and analysis should take into account relevant elements of the political economy in terms of social and economic inequality, property rights, power relations, social organization (including kinship systems, ethnic groups and traditional authority), regional disparities, systems of exchange and markets, the state apparatus, and the political parties, institutions and powers. Such a consideration links the sectoral focus with the institutional and decision-making context at national level. A key issue in many instances is the availability of rewards for clients and constituencies of powerful political actors through the functioning of sector institutions.

The reform context also includes more specifically the scope of the reform agenda itself — what are the key policy changes that are being proposed? What are their objectives? Who tabled these reforms? How do they support the political objectives and repertoires of the stakeholders who are sponsoring them?

Development agencies have developed tools for analyzing the country and reform context that are highly applicable here. The tools include the Sida's Power Analysis, DFID's Drivers of Change, or the World Bank's Country Social Analysis (CSA). These approaches are described greater detail in the TIPS Sourcebook.

3.2 The Reform Arena — Institutions, Stakeholders, Economic and Political Interests

The notion of a reform arena[41] as used here comprises the institutions that govern relations and behavior and the stakeholders with their economic and political interests that mediate policy reform.

Institutions are the societal "rules of the game" that shape and constrain human interaction and individual choices. Institutions can be a *formal* set of rules such as a constitution, a political regime, executive-judicial relations or elections. Institutions can also be *informal* rules — the norms, cultural practices or habitual ways of doing things that frame social behavior and interaction and that encompass social hierarchies, patron-client relations, and various forms of rent-seeking. Institutions provide the context that affects the behavior of stakeholders involved in the policy decision-making process, implementation and impact/outcome. It it also crucial to understand *who* can influence or change institutions, both de jure and de facto.

A common distinction is made between *institutions*, which provide the rules, and *organizations*, social, political or economic, which are bound together to achieve common objectives within those institutional constraints[42]. However, institutions are embedded in society and are in many cases found to be closely linked to organizations. 'Institutional reform' therefore most often entails a change in values and rules as well as organizational restructuring. It must also be remembered that this definition of institutions does not highlight the ways in which rules are in practice generated, followed and contested. There is no society where rules are automatically obeyed, rules are always challenged[43], therefore it is also important to consider the incentives affecting the actions of key players in the reform arena.

Stakeholders are individuals, communities, groups, or organizations with an interest in the outcome of an intervention, either as a result of being affected by it positively or negatively, or by being able to influence the intervention positively or negatively. Stakeholders have **diverse interests** which sometimes change in the course of a reform process, either due to the reform process itself or due to changes in the general reform environment. Different stakeholders may be governed by competing sets of formal and informal institutions so that concepts of "playing the same game with the same rules" may be incorrect. In reality, players lobby and negotiate policy change to promote their specific interests, using information asymmetries, unequal power relations, and identifying "windows of opportunity" for their timed actions.

Stakeholders have different levels of interest and influence in different stages of the policy process. Those that have a significant role in policy design, for example, may be much less involved in policy implementation. Similarly, influential stakeholders whose support for the policy decision is crucial are not necessarily important for the actual implementation.

Decision-making is a result of negotiations between different stakeholder interests, power relations, incentives and usage of formal and/or informal institutions. It is influenced, for instance, by access to and use of information, power relations, perceptions, the timing of policy discussions and by the level and inclusiveness of public debate.

3.3 The Reform Process — Partnership, Participation, and Leadership

The reform process refers to change through information flows, voice and public debate, prompting the question: Who sets the agenda, and how and when are proposed policy changes communicated, by whom

[41] See Jordan and Richardson, 1987
[42] North, 1990
[43] Balandier, 1972

and to whom? [44] The reform process is characterized by stakeholder interactions over time and by the different modes of interactions.

Partnership as a mode of interaction is more than participation and refers to two or more partners agreeing to share certain rights and responsibilities, though not necessarily in an exactly symmetrical manner. Partnership between aid recipients, and development agencies is at the core of the Paris Declaration[45]. The spirit of partnership in a policy reform process within a country implies that stakeholders have real influence as well as responsibilities, in a mutually agreed upon framework. It also implies more disclosure of information and transparency about decision-making between government, donors, private sector and civil society - and in a decentralized context also a sharing of power both vertically (between central and sub-national government levels) and horizontally (across different ministries).

Process includes supply-side and demand-side actions, with the aim of developing coalitions for change. The supply side refers to state institutions acting pro-actively or reactively, while the demand side includes citizens as consumers and producers. Partnerships with and between stakeholders through ongoing policy dialogue must actively be sought starting at policy design and including government (local and national), civil society, private sector and donor agencies. State institutions take a lead in developing and implementing policies. They are responsible for providing public goods and services and allocating resources for these activities. The "voice" of civil society on the demand side depends on many factors, including on an enabling environment (e.g. the national political context as for instance decentralization or federalist structures), a tradition of participation and the capacity of civil society organizations to structure and articulate their demands. Both the demand and supply side are necessary for effective participation and must be balanced.

Policy design and implementation are rarely linear and coherent processes. Policy reform is often complex, multi-directional, fragmented, frequently interrupted and unpredictable. This implies that a successful policy reform does not simply depend on designing good policies, but upon managing their design, implementation as well as responding effectively to stakeholder concerns, and impacts. The new flexible and contextual approach to policy reform may require developing pragmatic, second- or third-best answers that collaborating agencies and stakeholders can agree upon, rather than "perfect solutions". Policy reform is not only technical but political. It requires technical solutions that are accompanied by processes of consensus-building, communication, participation, conflict resolution, compromise and adaptation[46].

Participation[47] is a crucial component of the policy process; it can be essential as the means to broadening democratic deliberation of policy reform within a country. Participation is often named as a key component of the democratic governance of public policy and can serve different instrumental objectives in the policy process, including aims of increasing the legitimacy, ownership, effectiveness, efficiency and sustainability of policy reforms.

Effective dialogue, public debate and risk management promote ownership, and help build the conditions for forming coalitions to support policy change. Communicating proposed policy changes and outlining reasons for the intended reform can provide the starting point for a public debate and initiate the participation of stakeholders in the decision-making process at an early stage. This can contribute to an early identification of risks to reforms and operations, enabling the design of adequate risk management strategies, which may include compensatory measures for groups that stand to lose. It also provides the opportunity to

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[44] The issue of agenda setting has been elaborated by Kingdon (1984) through convergence of streams of problems, policies, and politics, or Schattschneider's (1960) mobilization of bias, where "some issues are organized into politics while others are organized out" (p. 71)

[45] "The Paris Declaration on Aid Effectiveness: Ownership, Harmonisation, Alignment, Results and Mutual Accountability", High Level Forum, Paris, February 28-March 2, 2005

[46] Brinkerhoff and Crosby, 2002

[47] The World Bank *Participation Sourcebook* (World Bank, 1996) defines participation as "process through which stakeholders influence and share control over development initiatives and the decisions and resources which affect them".

address different opinions, concerns and opposition as part of a more inclusive policy debate. This work, however, also acknowledges that not all policy reforms lend themselves to advance public debate. Instead of a 'one-size-fits-all' approach to dialogue and public debate, the study stresses the need to tailor engagement to the country- and reform context.

Leadership aspects of reform processes are essential, but are often not explained or covered much in political economy literature[48]:

> *"Leadership permits the opening of institutional opportunities that can generate further cycles of policy formulation and implementation and institutional renewal. The way in which windows of opportunity and leadership create virtuous cycles of reform is little understood and difficult to explain"*[49].

The relevance of leadership to policy reform can be seen in the way that leaders engage with often-competing stakeholder interests and encourage behavioral and institutional change that can bring more equitable policy outcomes. "Policy champions" or "agents of change" play a crucial role in policy reform. They commit themselves to the reform agenda, mobilize coalitions to support the reform, negotiate effectively with opposition and often provide a vision of a more equitable future that all stakeholders can buy into.

Finding appropriate mechanisms and behaviors for international development agencies to engage in the policy debate is crucial. The influence of development partners on national debates varies across countries. This is in part due to the different lending environments in low-income and middle-income countries, and relative dependence of the recipient government on aid flows. It also depends, however, on whether the partner sees itself as a catalyst in national reform processes, or as an outside player that dominates the reform process with externally imposed blueprint solutions. Conducting analytic work to understand the social and political context can be important in making donor agency staff more sensitive to the incentives and constraints which affect their counterparts in partner governments. In most situations donor agencies support policy change through the medium of a primary partner institution in government. Understanding the range of action of the key counterparts, and the tools they have at their disposal to build coalitions for change, is therefore essential to effective work to promote policy change.

The conceptual framework (as outlined in Figure 1) provides the structure for the analysis of the case studies presented here. As outlined in Chapter 1, the study tests and further develops these concepts through a focus on two sectors and two lending instruments across several regions, thus capturing a broad spectrum of operational issues. In respect of the first sector reform area — agricultural liberalization — the study looks at development policy loans in four detailed case studies and four briefer examples. In respect of the second sector reform area — public-private partnership in water supply and sanitation — the study examines investment projects through four detailed case studies and four briefer examples. The elements of the conceptual framework under the right hand column of Figure 1 ('Action Framework') are picked up in our concluding chapter on 'Operational Implications'.

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[48] Grindle, 1999

[49] Inter-American Development Bank, 2006

4 . POLITICAL ECONOMY OF SECTOR POLICY REFORMS

This section draws on a number of interviews conducted with World Bank task team leaders and other key informants along with a review of key literature. These provided the starting point upon which the conceptual framework, presented above, had been developed. The discussion follows the categories of the framework presented above, with cross-references to the case studies. For each case study, a matrix is presented which summarizes the reform context, the reform arena and the reform process. A read across the matrix shows how the interests of actors and operation of institutions relate to the political and economic interests at play. The matrix also highlights whether there were any champions of change motivated to influence reform discussions and progress and to what extent the process of reform was able to unsettle or support stakeholder positions and drive institutional change. The section attempts to help development practitioners to answer the following four questions, as mentioned in the introduction:

- What are the most significant political and political economy risks to policy reform?
- Why do these variables operate in a given country and sector context?
- How do these variables operate and impact policy reform processes and outcomes?
- How could these variables be addressed through effective management of political economy risks and opportunities?

4.1 Agricultural Sector Reform

4.1.1 Reform context

It is widely recognized that making agriculture work for development requires supportive political economy conditions. Public policy in the agriculture sector has in many contexts been characterized by subsidies, protection and state interventions in markets and production chains. Reform proponents have been promoting a market-driven, state-assisted, civil society-influenced agricultural sector grounded in technological and institutional innovations. Managing the political economy of agricultural reform while maintaining an open mind to competing policy prescriptions that lay claims for growth and equity requires a continuous learning approach.

Agricultural sector reform is about efficiency and distributional equity

Governments have traditionally intervened in agricultural markets in order to improve sector coordination and efficiency and, not least, for political and historical/cultural reasons. Today, almost all countries in the world, including most high income countries, have forms of agricultural protection and subsidies with, reform proponents argue, often huge costs to the rest of the economy. Two reasons for this, especially in developing countries, are the rising rural-urban income gaps, which can result in severe political tensions, and the demand for cheap agricultural products by urban populations. States with weak fiscal capacity are strained in meeting both the demand for transfers to address the income gap and the demand for cheap products. This makes agricultural policies in developing countries highly politically sensitive. Agricultural sector reform aims at enhancing efficiency and reducing the cost to public agencies. Reforms involving withdrawal of marketing boards and other parastatal agencies aim at creating an environment which will foster the development of private competitive markets in agriculture and marketing. Reforms are also motivated by fiscal sustainability concerns in cases where parastatals are a financial drain on public agencies[50].

Discussions regarding the distributional impacts of agricultural sector reform are generally based on assumptions that enhanced rural productivity will increase incomes and well-being, with positive knock-on effects for

[50] For example, of the total food subsidy of the central government to the Food Corporation of India in 2001, 57 percent represented the costs of holding stock (Lundberg, 2005). In some cases, such as in Lint, Coffee and Produce Marketing Boards in Tanzania in the early 1990s, such unsustainable inefficiency led to collapse and bankruptcy.

local economies. Liberalization and private sector participation is predicted to increase farmer incomes through enhanced competition, more effective input and output marketing, and price rewards for quality produce. Thus, three main areas of reform intervention can be distinguished[51]:

- Prices: liberalizing prices for inputs and outputs, eliminating subsidies, removing trade restrictions with the aim of allowing domestic prices to reflect world prices. The case of rice tariff reform in Indonesia illustrates this.
- Quantities: removing regulatory controls and other quantity restrictions in input and product markets, allowing the private sector to participate, removing restrictions on movement of goods (for example, export bans), and relaxing quotas and licensing arrangements; and
- Institutions: restructuring public enterprises and eliminating or restricting (usually to information provision and the maintenance of strategic stocks) the role of marketing boards[52], and improving regulation through performance contracts. The cases of cotton sector reform in Burkina Faso, groundnut sector reform in Senegal and crop board reform in Tanzania analyze reforms of marketing boards, while the case of the cotton sector reform in Burkina Faso is an example of introduction of a performance contract.

The significance of the reform context to groundnut sector reform in Senegal illustrates the importance of understanding political economy linkages to broader historical institutional, political and macro-social characteristics (see Box 2). Where this is the case there may be considerable resistance (sometimes in a covert form) to technically driven policy reforms which aim, for example, to reduce public funding of parastatal or publicly-owned companies. The feasibility of reform under these conditions will often depend on the extent to which principles of transparency and oversight by legitimate democratic institutions can be strengthened both within the sector, and in country-wide governance systems.

[51] Lundberg, 2005.

[52] This restructuring will often have significant direct impacts on prices for consumers and producers, for example in cases where governments previously controlled prices through parastatals (Lundberg, 2006).

Box 2: Peanuts, politics and the state — the political economy of agricultural marketing in Senegal

Groundnuts were at the centre of the cash economy of Senegal from the early colonial era, with heavy investment by the state in developing production as the backbone of a monetized economy. From the colonial era on the rewarding of political allies was among the major functions of the groundnut marketing system. The various Islamic brotherhoods and marabouts were instrumental in the spread of groundnut production, and were granted extensive tracts of land for this purpose. After independence the government steadily increased its control over the sector by promoting state-linked co-operatives as the cornerstone of the production system. In 1966 a new public agency, the Office National de Coopération et d'Assistance pour le Développement (ONCAD) was created and given a legal monopoly over the marketing of groundnuts. During the 60s and much of the 70s the economy continued to be heavily dependent on groundnut exports and French support. From the 1980s on the IFIs played an increasingly important role, and sought to implement a program of adjustment policies which aimed, inter alia, to: increase rates of indirect taxes; increase input prices and reduce producer prices for groundnuts; make operation of marketing agencies more efficient; limit the growth of public employment. In the mid-80s ONCAD, performing poorly and laden with debt, was disbanded and its functions divided among other organizations, Groundnut marketing was transferred to SONACOS, a firm jointly owned by the government and private oil processing firms.

One of the features of the groundnut marketing system was its use to distribute benefits during election years. Village level co-operatives and the input supply and crop purchase arrangements that supported them were pillars of the system which provided political support to successive regimes from the 60s through to the end of the 90s. Attempts by the World Bank to push through orthodox 'privatization' measures in relation to SONACOS in 1996 and 1998 were frustrated as the political economy conditions were not yet ready to allow for an adequate level of government support. Although SONACOS was finally sold in 2005, the legacy of the unsuccessful privatization attempts in the 1990s contributed to slow progress in this area.

The key lessons from this experience for donor action in relation to sector reform are:

- A major issue delaying reform in the sector was a lack of consensus on the impact on poor farmers. The Bank should have undertaken analytical work on these issues sooner, given the importance for rural livelihoods.
- Understanding the macro political context can be very important. Sector institutions can be critical to the political support base of key organizations, through employment, provision of subsidized services, or straightforward monetary incentives. The links between clientelist dynamics in the sector and in the national institutions need to be understood in order to carry out an effective policy dialogue.
- If clientelism is deeply embedded within the sector, and closely linked to powerful national interests, then attempting to push through reforms which have a purely technical rationale is unlikely to be effective. Instead, a strategy is needed which will steadily reduce the scope for patronage through a range of sector or national measures. At the sector level these might include strengthening corporate controls and management systems. At the national level this is likely to mean a range of measures to promote transparency and accountability, including strengthening the following key areas: internal and external audit functions; the capacity in media and civil society for policy research and advocacy; parliamentary oversight functions; public financial management systems.
- Patrimonial dynamics in national politics may simply be beyond the reach of development dialogue. There are cases where donor agencies have to wait, and make sure that they do no harm and do not impede progress within the country's own systems of accountability and governance.

Sources: Interviews with World Bank staff, Gray (2002)

Institutional reforms are central in policy reform

Agricultural reforms remain an important part of national strategies, featuring strongly in most Poverty Reduction Strategy Papers (PRSPs) in those countries that have prepared such. PRSP-era reforms in agricultural markets are likely to focus on institutional issues of governance and performance, particularly on deregulation, support for the private sector, and on risk management through insurance. Direct interventions, that characterized the structural adjustment years, are less on the agenda today. This means that the reform of institutions is now a particularly significant element of overall policy reform in the agricultural sector, with policy reformers looking more practically at enabling the environment for institutions that lead to efficient

and inclusive markets. Similarly, the WDR on Agricultural Development[53] highlights the relevance of political economy issues and the potential for policy reform to create space for bottom up voice and mobilization.

> *"To use the new political space created by democratization and decentralization and exercise political voice, smallholders and the rural poor need to form more effective organizations. To strengthen capacity for policy implementation, countries have to identify the combination of demand-side and supply-side governance reforms that best fit their specific conditions. Sound agricultural development strategies require stronger capacity for policy analysis and evaluation, and a commitment to evidence-based policy making".*[54]

Institutional reforms in the case study examples mostly focus on marketing boards and other parastatal or quasi-governmental organizations that intervene directly in agriculture. Parastatals continue to dominate food markets in Africa, particularly in Francophone Africa and to a lesser extent in Southern Africa. The Agricultural Development and Marketing Corporation (ADMARC) in Malawi, the Food Reserve Agency in Zambia, and the Grain Marketing Board in Zimbabwe, for instance, are still heavily involved in domestic food markets.

Table 2 illustrates the key criteria through which the political economy aspects of the agriculture sector case studies have been assessed, and which in turn served as heuristic tool to inductively develop the political economy framework, presented in Chapter 3.

[53] World Bank 2008d
[54] World Bank 2008d, p 265

Table 2: Agricultural sector reform case studies against political economy management criteria

Case Study	Reform Context	Reform Arena				Reform Process		
	Scope of reform discussions	**Institutions**	**Stakeholders**	**Economic interests**	**Political interests**	**Dialogue and Decision-Making**	**Champions (change agents)**	**Bank's influence**
Burkina Faso, cotton sector	Privatization of state-owned company SOFITEX. Decision to exploit less-developed cotton areas and revoke monopoly of cotton company. Privatization was initiated slowly from within starting with producers taking up a third of SOFITEX' capital in 1999.	Vertically integrated institutions organized through SOFITEX (distribution, procurement, R&D, transport, ginning, marketing etc.). This institutional model lacks institutional transparency; open to corruption and protection of individual political interests.	Director General (DG) of the cotton company: had an interest in success of reform (high prices in zones, stable sector). Head of farmers union widely recognized and supportive (farmers owned major share of SOFITEX). Minister or Commerce was largely undecided and got involved at a late stage.	Reform was expected to increase rents for farmers, SOFITEX and government (via taxes).	Political interests were not evidently driving the reform process beyond a recognition of the political capital to be made from stronger predicted agricultural performance.	All key stakeholders were all closely involved in the reform discussions, which enabled a consensus-driven approach to reform.	Minister of Finance and Director General of SOFITEX as "pragmatic champions" driving the reform process once it was under way. SOFITEX was taking a key role in the reform process which contributed to building trust among many actors.	General limited donor involvement. Bank's sustained engagement in long-term dialogue brought influence over reform.
Senegal, groundnut sector	Privatization of state-owned company, SONACOS, which was the leading operator in the groundnut business. Groundnut production / marketing has benefited from state support and protection (cheap credits, subsidized seeds and fertilizers).	The sector operates institutionally to distribute cash income to rural sector during the electoral cycle. Privatization has not been accompanied by private sector institutional change - no private sector engagement in input supply, commercialization or marketing as expected.	Minister of Agriculture opposed privatization. Limited trust of Ministry of Finance in SONACOS' capacity. Religious organizations have a significant influence in groundnut sector	Some political actors were believed to profit from arrangements financially.	Close connection of the political cycle with groundnut production: (e.g. distribute cash income to the rural sector).. SONACOS was also believed to be used to maintain political support base.	Lack of consultation and participation during the PRSP process and subsequent reforms.. Skepticism towards further liberalization supported by unfavorable distributional impacts for poor farmers.	No influential champions of change identified	Climate of distrust between World Bank/IMF and the Government due to two failed privatization attempts in the 1990s.
Tanzania, crop board reform	Government Task Force established to review performance of crop boards (successors of marketing boards) to address agricultural market distortions after liberalization in 1990s. PSIA reviewed crop board roles and funding to produce crop-specific reform options rather than implement prescribed measures.	Governance and performance of crop boards has a high profile, dominated by powerful interests. Liberalization created institutional vacuum, with slow private sector participation. Many smallholders were without input/output markets, while crop boards engaged in marketing (buyer of last resort). Crop boards were not downwardly accountable to their constituents in the crop industries.	Stakeholder and institutional mapping helped to identify opponents and supporters of reform. Crop Boards were in favor of the status quo. Technical level: Task Force (Ministry of Agriculture Ministry of Cooperatives) supported reform. Political level: Ministry of Cooperatives: opposed reform, Ministry of Agriculture supported reform.	Crop Boards drew revenues from industry (e.g. cess, licenses, property), but were only accountable to Ministry of Agriculture, and feared loss of relevance, and power over industry with increased private sector participation.	Skepticism towards market economy and adherence to socialist principles and traditions in parts of government and small-holder producers. Government motivated by populist concerns about the interests of favored constituents.	Early and continuous stakeholder consultation. Government and donors promoted reform ownership and broadened support for policy change. PSIA as joint study between Government (Task Force), EU and WB , and support from two universities; approach enhanced reform ownership.	The Government (Task force and political level in Ministry of Agriculture) and donors (EU, WB) were broadly supportive of reform and acted as change agents	Crop board reform was included in the PRSP (rural and agricultural sector strategies) and in a donor supported Poverty Action Framework.
Indonesia, rice tariff reform	The government expressed an interest in raising tariffs on imported rice. Bulog (the public agency) advocates increasing the import tax on rice from the current Rp 450/kg to Rp 750/kg. A PSIA was conducted to look at reform options and predicted impacts.	In 2000, Bulog's monopoly on rice imports was abolished, but still dominates with 75% total imports. Legislative elections in 2004 brought in a "pro poor, pro-growth" program. No mechanism exists to systematically link sectoral approaches to poverty into an overall framework of macro-economic policy analysis. In this vacuum, policy making remains institutionally controlled by powerful interests	Government bodies advocating a high tariff (Bulog, Ministry of Agriculture) were found more powerful within government than those which advocated a low tariff, or no tariff at all (incl. Ministry of Economy and BAPPENAS, national planning board). The Poverty Reduction Committee (KPK) was responsible for the PRSP but could not be mobilized effectively to act on the basis of the PSIA findings.	The PSIA does not articulate whether and how stakeholders' support for reform is being influenced by rent seeking behavior.	Beyond confirming the politicized nature of policy making in Indonesia, the PSIA does not articulate whether and how stakeholders' support for reform is being influenced by political vote-seeking behavior.	There was limited dialogue around the PSIA process.. A workshop was held in mid-October 2002 to provide a forum for discussion of results of the CGE modeling and the overall analysis of the PSIA outputs. While there was good attendance from academics, and donors, fewer stakeholders from Government and civil society attended than anticipated.	The donors struggled to mobilize champions of evidence-based policy making. The entrenched positions of the stakeholders were not unsettled by the PSIA. The Indonesia PSIA had limited success with the 'reference group' made up of civil society and government to champion the PSIA and ensure the results were taken up.	Limited influence as Indonesia is not eligible for PRSC or PRGF mechanisms. IMF blamed for continuing poor economic performance following the 1997 economic crisis. PRSP preparation was not linked to IDA access, thus not a prerequisite for CAS preparation.

4.1.2 Reform arena

An institutional vacuum can be created when reform processes towards privatization of public services or liberalization of previously state-controlled markets are started too early or without adequate process planning. An example of this, and how the Bank addressed the problem, is the agriculture reform process in Malawi (see Box 3 below). If the public sector ceases to provide services in a situation where the basis for private sector participation, such as credit markets and contract enforcement measures do not exist or are dysfunctional, the consequences for the people dependent on those services can be severe. Markets, to the degree they appear, may be distorted with for example private monopolies or they may simply be inadequate for rural producers in terms of logistics.

Reforms often have direct impacts on the preservation and allocation of rents and therefore directly challenge vested interests. For example, removing a government's control over prices, leaving price setting to market forces, will remove the indirect taxation of producers through holding prices below the market level. This can at the same time undermine the rent seeking position of interests within parastatals as their mediating role is eroded by the introduction of market forces. As has been observed "Many reforms are designed to reduce or eliminate the rents accruing to small groups of privileged interests. However, these are precisely the policies that are most likely to be fought by the groups that have relatively more influence on the process."[55]

Institutions: The challenges of transition

Pressure to undertake agricultural reforms can build up in different ways. Institutions, such as land tenure and agricultural marketing systems, are the product of historical factors and conscious policy decisions over time. As local and global conditions change, the performance of these institutions may be affected. Moreover, evidence may emerge that particular institutions are inefficient or inequitable, thus prompting political pressure for reform — both internally and externally.

Government-controlled agricultural marketing systems, which may have been established to generate revenues for government or to protect producers from perceived exploitation, have over time become loss-making, unresponsive to changes in the market, and skew functioning of market/industries to reward quality produce with higher prices. Continuing subsidies to loss-making entities maintain inefficiencies and divert government budgets from other priority expenditures. Unresponsiveness has knock-on effects on the efficiency of the entire agriculture sector and represents a major obstacle to agricultural growth.

Because vertically integrated agricultural systems in primary agricultural economies have such huge economic and political institutional significance, a technocratic approach to reform will always be unlikely to succeed. Reforms threaten long-standing institutions and affect the distribution of rents and power. In the case of the Burkina Faso cotton sector reform, for example, the vertically integrated institutional model of agricultural production and distribution operates relative effectively, but is associated with public monopoly, a lack of transparency and the possibility of corruption and protection of individual political interests. The controversial nature of these reforms within popular debate presents additional political risks to governments, with the threat of political resistance and social tensions. These tensions may constitute a political threat for national governments and make them less likely to engage in reforms[56].

A particular challenge to marketing board reform is the modification of institutional functions which can occur in a transition of ownership — including formal and informal duties and responsibilities. For example ADMARC in Malawi supplies significant services to rural areas, prompting fears that private operators might be unwilling to take over this service provider role, leading, in the absence of alternative forms of public or parastatal provision, to rural market failures and social externalities (refer Box 3).

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[55] Lundberg, 2005

[56] World Bank, 2006e

Box 3: Evidence-based Policy Making: Malawi ADMARC Reform

Since the late 1980s, agricultural markets in Malawi have undergone several reforms. Prices for agricultural produce and inputs have been liberalized to allow for private-sector participation, as have agricultural marketing services. The state's Agricultural Development and Marketing Corporation (ADMARC) was restructured and it sold off many of its assets and began closing some of its unprofitable markets. However, private traders have not uniformly stepped in where ADMARC's state market presence was removed. Significant controversy surrounded subsequent recommendations to reduce ADMARC's marketing role further, and possibly to sell off a considerable portion of its marketing infrastructure. First, the government and civil society expressed concern about the existence of market failures in remote areas, noting that if these remote markets were closed because they were inefficient, it would be unlikely that they would be replaced by private traders because transportation costs are high relative to the return on maize sales. There was also concern that ADMARC fulfilled an important service by maintaining adequate food storage for preventing shortages during the lean seasons. In addition, the government had concerns about the political implications of closing down ADMARC's markets because the public perception of ADMARC's importance in agricultural marketing and food security was much higher than its actual importance.

Given the sensitivity of the issue and the potentially massive impact on the poor and vulnerable groups in Malawi, a PSIA was undertaken in 2001/2002. The PSIA revealed that private traders, both large-scale and small vendors, were progressively replacing ADMARC as buyers/sellers of crops, especially in markets with well-developed infrastructure. Large-scale traders were few, and specialized mainly in the purchase of cash crops. Small-scale unlicensed traders were many and provided an accessible marketing channel for buying and selling of maize in the rural areas. These small vendors had to some extent bridged the gap left by ADMARC's inability to provide reliable and efficient marketing services.

However, ADMARC markets in rural areas appeared to play an important role as distribution networks for affordable maize in the lean season and in times of famine, in providing benchmark prices, in providing a reliable source of inputs, and in the purchase of crop produce from farmers. Even in areas where private traders were particularly active, notably border markets, the withdrawal of ADMARC might have had negative consequences for food security and regular access to inputs. Maintaining ADMARC in its current form, however, was wasteful as its services were not required in less remote areas of the country where private sector activity was already well established. On the other hand, completely eliminating ADMARC facilities would ignore the fact that well-functioning market institutions and infrastructure did not exist uniformly throughout the country.

The PSIA partly addressed the objections to privatization raised by government and civil society. The study also increased awareness of the emphasis placed by the World Bank on maintaining social services and to address market failures in remote areas. The findings were widely debated early January 2004, with broad participation by civil society and donors. Not to postpone negotiations for a new World Bank credit, the government decided to repeal the ADMARC Act prior to wide dissemination of the findings of the PSIA. Although the repeal of the Act did not in itself introduce any changes to the operation of ADMARC, in the absence of a clearly articulated government plan for ADMARC reforms it raised wide concerns across civil society. The findings of the PSIA were subsequently incorporated into the new World Bank Structural Adjustment Program, approved in April 2004. The upshot is that the restructuring separated ADMARC's social and commercial functions so that they are managed by separate institutional entities with lean organizational structures. In line with this agreement, the government has recently set in motion the process to restructure ADMARC.

Source: Kutengule, Milton, and Antonio Nucifora and Hassan Zaman. 2006. Malawi. Agricultural development and marketing corporation reform. Coudouel, Aline, Anis Dani and Stefano Paternostro. *Poverty and social impact analysis of reforms.* Washington D.C.: World Bank

At the micro-level, local institutions can be replaced by powerful rent-seeking actors imposing new institutional arrangements and distorting the intended impacts of reform. Political economy analysis at the micro level can test assumptions about the distributional benefits of reform and identify risks and opportunities at the local level. For example, in remote areas that are not serviced by private traders farmers can be left without access to input and output markets (market closure), or private traders can fold increased transport costs into farm gate prices thereby lowering farmers' income, or private sector monopolies can emerge.

In Senegal, following the dissolution of the state-owned groundnut purchasing agent SONAGRAINES, private speculators took advantage of government cash advances distributed under a new "farm gate" marketing system. Private agents were able to buy the crops at less than the official price, instead proposing to pay cash for a small portion of the crops and giving 'vouchers' for the rest. Farmers who tried to sell directly in local markets were confronted with representatives of the same speculators who brought down their product prices still further. Most of those left holding 'vouchers' could not get paid since many private intermediaries had vanished. The impact on the local economy and on household welfare was devastating.

In the case of rural social institutions, these are often underpinned by power dynamics based on hierarchical age, ethnic and gender relations, which in turn mediate poor people's livelihoods and access to resources under policy reform. Understanding the ways in which such power structures affect the functioning of local institutions (such as co-operatives, markets, and households) is important for a full appreciation of the likely impacts of reform measures.

Actors and their economic and political interests

A range of actors is involved in reforming agricultural markets. In addition to the marketing boards and government ministries, departments and agencies, stakeholders include private traders, small farmers (sometimes organized in a union-type organization), civil society organizations, and donor agencies.

Marketing boards have traditionally been important instruments for political clientelism, particularly in the run up to elections. Marketing boards are not inherently opposed to liberalization, but their attitude towards reform is contextual. They consider their own future roles and powers and those of other players, policy alternatives, institutional relations with Government and the perception of international organizations and donors. Furthermore, the interests and influence of individuals in the boards or government, plus their income sources, accountability and organizational status (public, quasi-government, or industry regulators) are factors determining how marketing boards respond to policy reform proposals.

Options for liberalization and privatization can be hampered by the reluctance of politicians to relinquish control over public or parastatal companies (see Box 4 for an illustration of this in the cotton sector in Chad, and the Tanzania case study in Annex 1). Also the case of the groundnut sector reform in Senegal, illustrates a political economy where the state-owned company played its traditional role as an instrument to distribute cash income to the rural sector during the electoral cycle to enhance political support by rural voters.

Box 4: Managing the political economy of reform through PSIA in Chad

Reform Arena: The Government of Chad adopted a reform program in the cotton sector in 1999, to complete a reform process that was launched already in 1986. The objective was to improve the income of cotton farmers and enhance their efficiency in cotton production through the liberalization of the sector, including the privatization of the parastatal *Cotontchad*. Aware of the difficulties in implementing similar reforms in other African countries, the Government approached the World Bank for assistance in analyzing the likely poverty and social impacts of the proposed reform. A preliminary stakeholder analysis based on interviews with members of civil society, academics, retired *Cotontchad* employees, and intellectuals showed that while the Government was clearly interested in improving the efficiency of the sector, it did not want to lose its hold over cotton production. The president as de facto owner of *Cotontchad* was openly opposed to the privatization. He was supported by the French who still held a consistent number of shares of the parastatal and effectively maintained a monopoly for the supply of inputs and credits.

World Bank's approach to the Reform Process: Once familiarized with the main political economy issues, the controversy around the reform, and the real stakes at play, the World Bank team opted for an approach that would rely on informal yet legitimate sources of information, and to proceed in a low-key manner. The team decided not to conduct a self-standing political economy analysis as this might have triggered negative attitudes and reactions against the entire PSIA exercise. Instead, a preliminary analysis was conducted in-house by the Bank team during mission travel and through key informant interviews. An international consultant and a local consultant then conducted a more in-depth stakeholder and institutional analysis that investigated potential constraints and opportunities that could influence the progress of the reform process and its intended outcomes. This political economy analysis early in the project proved to be essential in order to tailor the World Bank's support to the Government's reform needs.

Source: World Bank. 2003c; Authors communication with PSIA TTL.

Notwithstanding the ideological stance or legitimate arguments of politicians against privatization, this position can be based on rent seeking or political clientelism. Withdrawal of state intervention in agricultural markets often threatens opportunities for rent seeking amongst a range of stakeholders. Parastatal agencies are obviously often direct losers in a liberalization process. Understandably they are reluctant to reform themselves out of the income, privileges and

rents that come with the job[57]. In general, parastatals may lose rents when their functions change from direct intervention to providing information and regulation. In Tanzania, the crop boards, and the political level of the Ministry of Agriculture and Food Security and the Ministry of Cooperatives opposed the reforms that would reduce their controls over private agents and require greater accountability to producers in service delivery. The study realized that more direct engagement with stakeholders at the political level could have reduced some of the delays in the subsequent policy decisions on reform design and implementation[58].

Rent seeking may not be a significant issue from the perspective of equity or growth objectives - the cause of small inefficiencies. However, it can get out of hand and bring about structural collapse, as the Indonesia rice sector case illustrates. "Bulog", Indonesia's state marketing board, achieved remarkable success in making the country self-sufficient in rice production, and arguably stimulated rapid economic growth through intervention in input, credit, and output markets. By the 1980s, however, Bulog's mismanagement and corruption had become widely recognized.

Governments are obviously motivated by the interests of the powerful constituents. For politicians, agricultural reform is often a balancing act between the needs and interests of urban consumers and rural producers. Agricultural reform proponents seek to shift the balance in favor of small rural producers by removing what they see as price distortions that subsidize urban consumers. But since urban consumers are often better organized and more influential than rural farmers, politicians can be reluctant to redistribute rents away from the urban constituency. This prompts governments to keep prices of agricultural products low thereby taxing producers directly or indirectly[59].

Powerful interests can block price reforms based on the likely shift of rents, even in the face of a large number of reform supporters and/or compelling evidence that reform is a good thing. Two of the cases provide examples:

- In Indonesia, a PSIA was conducted to generate evidence on the likely distributional impacts of an increase in the rice tariff. A computable general equilibrium (CGE) modeling exercise concluded that a tariff increase would have a net negative impact on poverty as rural producers and laborers were net consumers of rice. Nonetheless the state commodities logistical agency "Bulog" and the Ministry of Agriculture supported the policy.
- In Mozambique, cashew nut processors and their urban workforce were major opponents of reform, contributing considerably to the failure of some key aspects of the reform despite much support within Government, and arguably to the detriment of a voiceless constituency of small farmers (refer Box 5).

Box 5: Powerful opposition to cashew nut sector reform in Mozambique

The cashew sector is a major cash crop in Mozambique. It is the main source of income for over one million peasants who grow cashews and sell them either to domestic processors or to traders, who export them for processing abroad. Cashew production dropped dramatically during the country's civil war (1982-1992), experiencing a further drop in 1997, mainly due to bad weather. In its 1995 Country Assistance Strategy (CAS) Report, the World Bank required Mozambique to liberalize cashew marketing and exporting in order to satisfy the "base case" conditions and qualify for approximately $400 million of loan assistance. It was assumed that the liberalization would increase the producers' share of the export price, farmers' income, increase cashew production, and enhance export value. In reality, the gains from the reform were offset by efficiency losses that have resulted from the idling of processing plants, which led to widespread unemployment. In contrast to the expectations, a large number did not find employment, contributing to the overall failure of the reform. While part of the failure can be attributed to technical matters, such as pricing signals, political economy issues are frequently cited as main reasons for the disappointing outcomes of the liberalization. Powerful urban and industrial interests — processors and their urban workforce — had been joining forces against the World Bank, the government, and a much larger but voiceless constituency of small farmers. Liberalization was bitterly opposed by some parts of the local cashew-processing industry, which employed about 10,000 people. The processors waged a well-organized political and mass media campaign, in alliance with the anti-government press, claiming that export tariffs on raw cashews were insufficient to protect their livelihoods. Moreover, the liberalization of the sector was perceived as World Bank policy, i.e. something the government had to do because it was required for IMF and World Bank lending rather than government priority.

[57] Lundberg (2005) notes that for this reason it may be necessary to directly compensate those who are laid off by the dissolution or privatization of parastatal agencies, even if the prospects for subsequent employment are good.
[58] Government of Tanzania and World Bank, 2004
[59] Lundberg, 2005

Lacking credibility due to popular perception that this was a policy foisted upon it by the World Bank and IMF, the Government struggled to "sell" the liberalization by disseminating reliable data and encouraging debate. Had this opposition to the reform been anticipated, compensatory mechanisms could have been worked out beforehand. Seminars and public information campaigns might have helped to build support for the government's position, illustrating the advantages of liberalization for the rural poor, and demonstrating that the reform policy is mindful of the long-term interests of all parties in the sector.

Sources: World Bank (1998); McMillan et al (2002).

4.1.3 Reform process

The reform process is understood as the forms of participation, communication and decision making through which policy reform is negotiated and implemented. The quality and extent of dialogue is crucial, as is the sequence and timing of actions. Equally important are the human agents, the presence of champions of change, and their actions.

Dialogue

The interests of actors and operation of institutions often overshadow the technical or economic case for reform. Stakeholder interests are keenly defended and embedded institutions are resistant to change. The reform process unsettles the status quo, realigns interests and challenges existing institutions.

The way reform options are introduced and discussed influences whether and how they are contested and, in successful cases, ultimately resolved. For example, if civil society is excluded from the policy process it can oppose reforms on the basis of an expectation, which may be groundless, that existing livelihoods and entitlements will be threatened. Of course civil society may also oppose reform because it is in fact poorly conceived or implemented by government and donors – in which case a process of dialogue should help to rectify these problems. The cases illustrate the potential value, in terms of reform outcomes, of a longer-term process of engagement on reform.

- In Burkina Faso, with a favorable political and macro-economic environment, all key cotton sector stakeholders, were closely involved in the reform of the sector, which enabled a consensus-driven approach to reform that was sufficiently flexible to accommodate the interests of the various stakeholders involved.
- The Tanzania PSIA of crop board reform tackled vested interests by embedding the study in a process of active policy dialogue, coalition building and reform ownership, from the study's design stage through implementation to dissemination.
- The high levels of protests that accompanied Mexico's agricultural reform of the maize sector were addressed constructively through ongoing policy dialogue which resulted in a political solution and policy change (see Box 6 below).

Champions of change

The case studies underline the significance of "champions of change", in the form of individuals and alliances that can foster "coalitions for change" and maneuver between political-economic vested interests to reform a sector. Champions of change for one reason or another have an interest — or can be persuaded that they have an interest — in the success of a policy reform and have been shown to be very influential in supporting change. In the Burkina Faso case, the Director General of SOFITEX, the national cotton company, proved to be crucial to the success of the liberalization by seeking consensus with the Government (he was former Deputy Minster of Finance) and by creating a relationship of trust with the producers and other actors.

Box 6: Agricultural Reform in Mexico

Throughout the 20th Century, maize held a special importance for the Mexican economy. Tortillas, made from maize flour, were an important staple and a primary source of calories and protein for many Mexicans, especially the poor. Maize, produced for sale or consumed on-farm, served as the foundation for rural livelihoods in much of Mexico over many generations and is therefore closely tied to Mexico's cultural heritage. More recently, the effects of decades-old policy reforms are changing the role of maize in Mexican society.

Those reforms are closely tied to the role of CONASUPO, a Mexican agriculture parastatal that regulated many important food-crop markets in Mexico. The parastatal was established in 1965, but its antecedents go back to the 1930s. From that time, state regulatory activities in agricultural markets increased continuously until the debt crisis of 198260. By the 1980s, CONASUPO managed markets for barley, beans, corn, oilseeds, rice, sorghum, wheat and powdered milk. A common pan-Mexican price was established annually for many crops, international trade was restricted, and CONSASUPO served as a buyer of last resort. CONASUPO managed the storage and transport of many crops as well. At the same time, CONASUPO was charged with keeping food prices affordable and subsidies were paid out to maize millers and other processors to keep consumer prices low. These twin objectives proved tricky, since higher farm prices mean more costly subsidies.

A reform process, which would ultimately lead to the demise of CONASUPO followed an oil boom in 1982, an ensuing debt crisis, and from 1988 a period of market-based reforms. The CONASUPO reforms accelerated in the period immediately before and immediately after the launch of the North American Free Trade Agreement (NAFTA) in 1994. The government started a phased withdrawal from key commodity markets and by 1990 CONSASUPO ceased operations in oilseed markets and consumer subsidies on wheat bread were dropped. By 1991, price supports for nine field crops were eliminated, and CONASUPO operations were limited to beans, maize and powdered milk. A program to privatize CONASUPO storage facilities began as well. Even so, government interventions did not stop entirely, and a new agency, ASERCA, offered targeted marketing subsidies in key areas.

Public engagement in the debate around these large-scale reforms was high, featuring lobbying on issues such as the price of farm equipment, and protests from impacted communities. Politically, all discussions became focused on NAFTA, as fears mounted that Mexico would be flooded by less expensive maize (and other products) from the US. The US did not flood the Mexican maize market, however, because the structure of NAFTA ensured that trade reforms would come slowly to maize, beans and other key crops (the Treaty allowed for initially high tariffs and low import quotas, designed to protect domestic markets) and because the peso underwent a significant devaluation in 1994, shifting the terms of trade in favor of Mexican agriculture. Around the same time, the government began PROCAMPO, a program that delivered direct income payments to farmers in lieu of price supports. Moreover, much of the yellow maize coming into Mexico from the United States was taken up as feed for a growing poultry and hog production, leaving the food markets to domestically produced and consumer-preferred white maize.

Still, with the passage of time, links between the Mexican and US maize markets have strengthened and prices have become more closely tied. More significantly, the decades-long process of market reform has brought about changes in agricultural markets and in labor markets that encourage scaled-up agricultural operations and non-farm income activities over traditional labor-intensive farming practices. Incomes outside of agriculture are generally higher and many households have been able to take advantage of new opportunities. Even so, not all households are well-suited to change; nor are some traditional approaches. Protecting vulnerable households and preserving cultural heritage are therefore important components of Mexico's reform policies.

Source: Authors' interview with task team.

The World Bank's influence

The Bank has experienced many frustrations with effecting change in the agriculture sector when the benefits of the proposed reforms, in terms of growth and poverty reduction, often seemed so apparent to Bank task managers. The historical use of conditionality instruments has resulted in many frustrations for task managers, as in the case of Mozambique (Box 5).

[60] Much of this section draws on Yunez-Naude, Antonio. 1998. "CONASUPO: The Dismantling of a State Trader", unpublished.

Bank influence has proved most successful where it has entered into long-term dialogue as part of the reform process. This was the case in Burkina Faso, where the cotton sector was privatized and liberalized in close collaboration of key stakeholder that enabled a consensus-driven approach to the reform between Government, Bank and other stakeholders. The pace of reform was gradual, a clear statutory framework was created by government that allowed the privatized cotton company to invest in research, extension, and equipment over the long-term, and all key stakeholders were closely involved from the beginning. Equally important are communication within the donor community and the value to reform progress of IFIs and donors "singing from the same hymn sheet". An example is the Senegal groundnut sector case, where distrust between World Bank/IMF and the Government due to two failed privatization attempts in the 1990s was combined with a lack of cooperation between major donors involved in the sector. There was a lack of consultation and participation during the PRSP process and subsequent reforms were hampered as a result.

The significance of in-depth political economy analysis informing Bank behavior and influence in this sector emerges strongly through the case studies. In the case of cotton sector reform in Chad, for instance, the political economy analysis early in the project proved to be essential in order to tailor the World Bank's support to the Government's reform needs. In Tanzania, the Bank used the empirical evidence of the political economy and distributional impact analyses to stimulate the debate on crop board reform and address powerful interests that opposed reform and defended the status quo. The analyses influenced the Bank's policy and budget decisions of its third and fourth Poverty Reduction Support Credit (PRSC3, PRSC4). In Madagascar, elements of the Country Assistance Strategy (CAS) design were built on the recognition of the need to understand the political economic context of reform, rather than treating political variables as exogenous. The World Bank country team commissioned a senior, locally-respected, independent research team to investigate the nexus between governance and politics (see Box 7 below). The study found that the President's political support base was narrowing and identified a personalization of policy issues as an issue, with the reform agenda too closely tied to a specific individual.

Box 7: Political Economy of Reform in Madagascar

The World Bank has worked with the Government of Madagascar to develop a Country Assistance Strategy (CAS) that will provide a roadmap for the strategic focus of World Bank support over the next three years (2007- 2010). Madagascar is at a critical point in its history, as it has emerged from decades of authoritarian rule into a democratic governance system seeking liberal economic norms. This transition provides both opportunities and risks.

A World Bank Country Assistance Strategy Retreat identified multi-sectoral efforts, particularly, governance, as an area in need of greater attention and improvement. In order to facilitate this process, the World Bank country team commissioned a study of political economic context of upcoming elections (Marcus and Randrianja, 2006). The report was concerned with how effectively citizens and internal stakeholders are engaging the policy-making process. It considered how the current Malagasy social and political context affects governance (for example, for the efficient and equitable delivery of public services) and explored whether there is space for open debate and participation in policy-making. In order to address these questions this report undertook a political analysis of institutions in relation to democratic and governance goals, looking especially at the ethnic make-up and nature of political parties, coalitions and alliances that support or reject reforms, and state-civil society engagement.

The report draws out nine primary conclusions about governance and political challenges, and proffers recommendations for the Bank about particular areas where it may be well-placed to help resolve them, including recommending the promotion of good governance through support to popular accountability mechanisms. The analysis concludes that the relationship of the executive with other branches of government, including those with lower levels, and the quality of relationship between the state and civil society, government and opposition as critical dimensions of governance that require further attention. The report also argues that Madagascar's weak civil society, nascent electoral system, inchoate political parties, combined with informal coalitions and alliances within the government, and divided views about reforms make governance and democratic reforms vulnerable.

Source: Marcus, Richard R. and Solofo Randrianj. 2006. Madagascar structural political analysis as an input for a Country Social Analysis and Country Assistance Strategy. Prepared for the World Bank AFT: ESSD 2. Washington D.C.: World Bank.

4.2 Water Supply and Sanitation Reforms

The focus in this section is on reforms towards increasing the scope of private sector participation in water service provision[61]. Public-private partnerships (PPP) vary in scale and scope, ranging from long-term concessions to so-called "soft" forms of service and management contracts[62]. Rather than juxtaposing privatization and public ownership, reforms of water services exhibit varying degrees of public and private management. Under PPP, reform discussions focus on technical issues (such as service provision and tariff setting) and on the type of utility management[63] that governs the service provision.

Although the case study focus of this section is on water supply, much of the discussion and analysis is relevant for sanitation too, being part of the water supply-sanitation nexus. According to current estimates, over 2.6 billion people do not have access to basic sanitation and hygiene. Following a 2005 World Bank study[64], global investment will have to increase to at least US$ 2 billion to meet the MDG target. However, there is on-going concern that governments, at many levels, are not devoting enough attention and resources to sanitation services. While there are no general figures showing on- and off-budget expenditures in that sector at regional levels, evidence at the country level illustrates that investments and expenditures in sanitation are very low compared to those for water supply and other infrastructure services. Additionally, existing sanitation investments and service provision are not always pro poor. Efforts to increase access in service provision can benefit better-off urban residents at the expense of urban poor, slum dwellers, or the rural population. On the other hand, there is general consensus and evidence on the economic and health benefits of adequate sanitation services. Many documents suggest that governments' limited sanitation expenditures are determined largely by political, rather than technical or economic constraints in the context of competing demands for resources.[65]

The World Bank has a sanitation-related portfolio of US$2.6 billion, with sanitation lending currently representing 35 percent of the Bank's Water Supply and Sanitation (WSS) Sector Board Lending. Investments are lowest, however, in those regions arguably with the greatest needs, Africa and South Asia. The World Bank is also committed to "traditional" urban sewerage and wastewater treatment, which is not inherently well targeted to meet the needs of those without access to sanitation[66]. Key questions for sanitation are how to increase investment into the sector and provide sanitation services that are more pro poor, which are not only technical but more often political economy issues[67].

The 2006 World Bank study on lessons of infrastructure[68] identifies two political economy challenges for the Bank in regard to private participation in infrastructure. The first challenge is that governments are reluctant to charge tariffs that cover costs, and the second is the need for a fuller understanding of the factors that influence how public opinions are shaped regarding World Bank operations. The study recommends that *"be-*

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[61] The World Bank and other development organizations have carried out a substantial number of studies and analytical work on water supply and sanitation reforms and reforms of utilities in general.
[62] See Ringsok et al, 2006 for a more detailed discussion of types of water supply contracts.
[63] Privatization in the sense of sales of public assets is not on the policy agenda, having been carried out previously only in the United Kingdom and Chile.
[64] Kolsky et al., 2005
[65] See Kolsky et al, 2005 and UNDP, 2006
[66] The Bank faces a number of internal and external constraints to developing sanitation projects, and has established a Sanitation, Hygiene and Wastewater Advisory Service to facilitate the planning and implementation of sanitation and hygiene projects or components (Kolsky et al, 2005).
[67] To further investigate this, the Bank is conducting a comprehensive multi-disciplinary analysis on the 'Political Economy of Sanitation', combining the perspectives of sanitation, social development, and economics. This work will include country level applied analyses and an overview report which is expected by the end of 2009.
[68] See World Bank, 2006b

fore reforms are launched, extra attention should be given to (a) analyzing who will win and who will lose; (b) reducing the risks of corruption; and (c) understanding public perceptions and adopting a communications strategy"[69].

4.2.1 Reform context

A shift from mega-concessions to management and lease contracts

During the 1990s, private sector participation was promoted widely as the solution to water sector problems in developing countries, providing expertise and investment to rehabilitate infrastructure and expand coverage. Between 1990 and 2005, private investors committed US$50 billion to more than 380 water infrastructure projects[70]. Between 2000 and 2007, there was a surge of new private water operators from developing countries, with 250 new entrants into the market, according to a forthcoming study on 15-years' lessons of urban water Public Private Partnerships[71]. There are now 160 million people served by private water operators in developing countries, up from an estimated 96 million in 2000. Out of this 64 million net increase, 90% correspond to contracts signed between governments and national operators. Increased local service provision changes the political economy of the water sector, as social accountability and public perceptions change. In the past, services were often provided by international or (multi)national companies which tended to be unaccountable to their customers who in turn may have often perceived the provider's operating principles to be biased towards profit-maximization rather than adequate service provision. While regional or local private providers still work on a commercial basis, their accountability to customers and customers' willingness to pay for their services both seems to be higher. Among the factors driving success of local PPP's are responsible behavior towards local populations and keeping up dialogue with local governments, thus ensuring local preferences are met[72].

Since 2001, large investment projects have declined markedly in the face of hesitancy in financial markets and the impact of financial crisis in East Asia and Argentina. So the "era of mega-concessions" seems to be over, while those remaining concession projects — such as in Colombia, Malaysia and Peru - are more likely to be based on a mix of public and private financing. During the same period from 2001 to 2007, the number of water sector projects has actually increased. Many of these new projects take the shape of PPPs in management and lease contracts, and new operations are designed that run across the entire spectrum of public-private partnerships in infrastructure provision[73]. PPP arrangements vary and include:

- **Concession contracts** for complete private sector coverage of operation and maintenance (O&M) and infrastructure investment, recovered through consumer tariffs;
- **Lease-affermage contracts** in which the private operator generates an operating surplus sufficient to cover their remuneration, while the government covers investments;
- **Management contracts** in which the private operator covers O&M, and government covers investments, with O&M recovered through tariffs and investment via taxes and donor funds; and
- **Public service provision**, with O&M and investment funded by government. — covered by tariffs, taxes, and donors.

PPP arrangements allow private operators to focus on improving operational efficiency and viability while leaving public authorities responsible for raising investment financing, which it can often obtain on better terms from donors[74]. This shift has also allowed a broadening of focus from high density urban water projects (with a premium on extending services to the urban poor) to include low density, low income "greenfield" rural projects where development impacts are high. It is now recognized that rural communities

[69] World Bank, 2006b
[70] Marin and Izaguirre, 2006
[71] World Bank, 2008b
[72] Pers. Comm.. with Sr. Water and Sanitation Specialist; World Bank in 2008
[73] World Bank, 2006b; Bhatia and Gupta, 2006.
[74] Marin and Izaguirre, 2006

are willing to pay for and manage water supply and sanitation services when offered choice and voice in the design of delivery and financing mechanisms[75].

The Bank's strategy: transparency, contract enforcement and improved performance

The Bank's approach to improving water supply and sanitation services acknowledges the significance of an institutional enabling environment for sector effectiveness. The four-pronged World Bank Water Sector Strategy includes an emphasis on institutional strengthening for improved service quality and delivery:

> "[…] *where developing countries have steadfastly pursued sound policies and created supportive and sustainable institutions, they have made remarkable progress in expanding the reach of water and sanitation services*."[76]

When this strategic vision is operationalized through PPP in water supply and sanitation reform, the Bank emphasizes principles of transparency and contract enforcement, underpinned by improved contractual and regulatory frameworks[77]. The rationale is that a contract with a private sector operator reduces opportunities for "top slicing" and becomes more transparent to monitor and enforce. At the same time, performance is expected to increase as incentives shift, with utility providers becoming more accountable, commercially oriented, creditworthy, and customer-focused[78].

Table 3 illustrates the key criteria through which the political economy aspects of the water sector case studies have been assessed, and which in turn has served as a heuristic tool to inductively develop the political economy framework, presented in Chapter 3

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[75] World Bank, 2004e

[76] World Bank ,2004e

[77] See Baietti et al, 2006 for a fuller discussion.

[78] World Bank, 2004e

Table 3: Water supply and sanitation reform case studies against political economy management criteria

Case Study	Reform Context	Reform Arena				Reform Process		
	Scope of reform discussions	Institutions	Stakeholders	Economic interests	Political interests	Dialogue and Decision-Making	Champions (Change agents)	Bank's influence
Jordan, Amman	Management contract to improve the performance of urban water supply. Previous projects failed to improve sector performance and efficiency.	Institutional context of water reform dominated by Water Authority of Jordan (WAJ), a statutory body with financial and administrative autonomy. Institutional shift through incentives and sanctions bundled up in performance-based contract.	Water resources development and management are vested in the WAJ, No structured identification of opponents or supporters of reform. Evidence that non-payers among middle-class opposed reform.	Opposition to reform from non-payers who will lose out on benefits of more effective management as they (being illegal consumers) will be cut off from network.	Although the performance improved considerably, the water authority still believes that private management is not solution to Amman's water problem and will attempt alternative public management.	Limited dialogue and information dissemination to address bad reputation of private management.	Highly politically influential Monarchy keeping reform on track despite often changing ministers.	Bank used a relatively small and "expensive" (IBRD) contribution of $55 million within an overall donor package of $255 million to "buy a seat at the table" and provide technical support.
Argentina, Salta Province	Concession contract awarded in Salta province in 1999, after international tender.	Concession of the state water companies to Provincial executive Branch of Government, 1996 Political and macroeconomic crisis, followed by civil unrest (2001). Background of failed PPP attempts in the region	Pro-reform provincial government. Some local governments were opposed to the concession but the provincial government engaged them directly in talks and turned the situation round. MECON, S.A., a local construction company, won the concession in partnership with the public utility of the state of Parana in Brazil, so developing itself into a strong and committed local utility provider.	Rents protection did not play a major role in blocking reform progress.	The provincial government realized the political currency to be gained through a progressive and developmental intervention in infrastructure provision.	Reform was seen as a collaborative effort to between provincial and local governments, civil society and the concessionaire "make things work".	Provincial government as steady and continuous supporter of the reform effort – even in the times of crisis in 2001.	No World Bank involvement.
Albania	Decentralization and public and private utility management. Political pressure to address urban water sector issues. Implementation of 2002 Decentralization law incomplete and slower than expected.	Decentralization expected to bring institutional transformation through changes in incentives and accountability, but will take time & water sector reform is dependent on this	No interests in local Gov'ts to take over utility assets unless they have confidence in the policy environment and future investment (current uncertainty due to incomplete decentralization on roles, investment volumes and timetable of asset transfer). MoPW and MoI each want to keep control over future investment funds. Local gov'ts are reluctant to take over unprofitable or insolvent utilities. Utilities benefit from status quo.	Reform aversion in Gov't: central level: no decision yet which ministry will control investment funds after decentralization is implemented; local gov'ts are reluctant to take ownership of utility assets. Utilities have no incentives to reform as they receive operating subsidies from central gov't.	Some central government entities resist decentralization due to loss of power and decision-making. in the water sector. Local governments in cities with public utilities have been conservative on tariff increases because of concerns over public reaction.	Civil society involved through participation in Social Assessment during project preparation. And can engage directly with utility managers through Consumer Panels. Communication campaigns. Demonstrations against tariff rises without quality improvements in 2003.	The MOLGD demonstrated strong commitment to pushing through reform. Government will look to scale up elements of this four-city pilot with private utility management to the national level.	Reform included in PRSP; supported by Bank's Municipal Water and Wastewater Project (2003), and scaled up through DPL (2007). Bank marshaled evidence via a water sector PSIA (linked to MWWP) that supported debate on different sequencing and pacing of reform; is part of analytical underpinnings of DPL (2007).
Bolivia, La Paz and Cochabamba	Reforming government capitalizing state enterprises. Water supply and sanitation rehabilitation for three municipal utilities; poor performance in La Paz and Cochabamba, so President pushed 30-year concession management contracts for these municipalities.	Institutional context characterized by political interference in tariff setting, keeping tariffs unsustainably low. Private sector participation overturned under popular protest, prompting re-nationalization.	Municipal utilities privatized by pro-reform municipal governments. Opposition from middle class consumers, informal water vendors and poor consumers facing high connection charges.	In Cochamabamba, the exclusive transfer of water services to the concession holder jeopardized important vested interests, including truck vendors and cooperatives who no longer had a source of water for their business.	Political interference in concessionaire tariff setting due to concerns over popular reaction. President cancelled La Paz concession in 2005 in the face of widespread civil unrest. Opposition to water resource investment in Cochabamba forced a climb down and cancellation of the concession by the Mayor	From 2001, Civil society opposition to the concession was powerful and well –organized prompting a government climb down. In Cochambamba, tariff increases by the concessionaire sparked "war over water" forcing tariff reduction.	Pro-reform actors in national and municipal government initially successful in pushing through reform.	In 1991-1997 the Bank funded a $35 million urban water rehabilitation credit for the utilities of three major Bolivian cities: La Paz, Santa Cruz, and Cochabamba. Condition of loan was a tariff increase to sustainable levels.

4.2.2 Reform arena

Institutional reform in the case study examples was intended to fundamentally shift elements of authority and accountability away from large, centralized inwardly-accountable public authorities to smaller, decentralized outwardly-accountable private operators. Water provision then relies, in theory, on the water consumers that are paying tariffs and who can hold service providers accountable and demand performance improvements directly from them.

Because water supply is an essential public good, the politics around it are often forceful. For example, politicians will try to retain control of tariff setting, sometimes based on legitimate social concerns, other times to please their constituencies. Private sector vendors will resist an expanded and more reliable water network coverage that will be bad for their business. An important supply-side political economy aspect of urban water supply and sanitation is that investment requirements for source development, mains, and sewerage and treatments plants will typically be substantial and have long-term effects on finances as well as on general urban development issues.

Institutions: Changing incentives and accountability

In many countries urban water supply management and tariff setting has been controlled by a central agency or utility. Introducing PPP management contracts that also bring tariff reform entails a shift away from reliance on taxes and donor funds to income from utility customers. Some reformers find that costs for service provision should be fully recovered through tariffs, and that all consumers must be tariff-paying utility customers[79]. If politicians are reluctant to raise tariffs due to political reasons, the consequences for water supply sector reform can be terminal if not combined with other measures, such as improvement in collection rates and enlargement of customer base by charging all consumers (including those that are exempted, such as public institutions); decrease in unaccounted for water; and improvements in service quality such as increased service hours.

Centralized public water agencies or utilities can resist tariff reform because of an aversion to accountability to the customers, which can be the result of various things, including tradition, perverse incentives, etc. For example, accountability relations emerged as a key issue in the Delhi case where accountability and contract enforcement were notably absent, and on a smaller scale in the Burkina Faso case study:

- In Delhi, the parastatal Delhi Jal Board (DJB), created in 1998, is the primary provider of piped water supply and sewerage services, serving a total of 1.5 million water connections and an estimated 1.3 million sewer connections. In the early 2000s, DJB performed poorly by any standards: water was supplied intermittently (despite ample production capacity) and was of poor quality. DJB operation indicators were all extremely weak and revenues were insufficient to cover operating costs, let alone capital expenditures. DJB relied heavily on Government financial support for both recurrent and capital expenditures. The Bank, approached to finance a water supply and sanitation project, was ready to support a minimal reform based on: (i) an improved accountability framework through the unbundling of the functions of regulator, financier, owner of assets and provider of service — hitherto concentrated in the hands of the state government; (ii) the contracting of operation and maintenance in pilot zones to professional operators; (iii) more transparent financial transfers based on actual outputs in terms of improved service; and (iv) a gradual move towards full cost recovery. But the project ran into trouble for a number of reasons: little political and staff buy-in, a vocal campaign by anti-reform groups against the deployment of foreign consultants, and fears among middle-class residents about tariff hikes, with each of these fueling the others. Eventually, this led to the government deciding to shelve the project.

[79] However, a point of debate is whether the cost of service provision includes depreciation of head works and replacement costs.

- In Ouagadougou Burkina Faso, (as in many poor cities) many families depend upon on-plot facilities (pit latrines and septic tanks) rather than sewers to meet their sanitation needs. Such onsite facilities require periodic emptying ("desludging"), usually provided by the informal sector. Although sludge can be rich in disease-causing organisms, the workers and owners of sludge emptying trucks have little or no incentive to carry sludge long distances to the central treatment works - instead, sludge is dumped in the nearest ditch or watercourse, with the consequent risks of disease transmission. For this reason, the sanitation department of the National Water Agency has been exploring both the construction of decentralized sludge treatment works, and the use of financial incentives, to create conditions where it is both financially and practically easy for the informal sector to "do the right thing" and deliver the sludge where it can be treated and rendered safe. [80]

An example of institutional change in a context of decentralization is Albania's water sector reform.

- In Albania, the government embarked on decentralization to improve the effectiveness and efficiency of water supply and sanitation service provision. The 2002 National Law on Decentralization mandates local government with the provision of water and sanitation services and tariff setting authority, but reform progress is slower than expected. Reasons include: an uncertain policy environment (with incomplete information about new roles and responsibilities for both central and local government); unprofitable water companies; and a political tussle over the control of future investment streams between the ministry responsible for decentralization and the line ministry for water supply and sanitation. As a result it became necessary to clarify provisions for asset transfer, financial viability, and the legal framework to ensure the success of the water sector reform. Decentralization, which entails fundamental changes in institutions, incentives and accountability, will take time and the water sector reform process is dependent on this.

The Albania case study, along with the case of provincial reform in Argentina discussed below, highlights that the changes in central-local government relations in a decentralization process is an important starting point for institutional change in both central and local sector agencies. However, an example of the complexities involved in establishing functional PPPs in a context of urban decentralization is the case of public toilets in Ghana (Box 8). Here the establishment of appropriate public sanitation was blocked by a combination of institutional inertia, decentralization without fiscal decentralization, privatization of small, but only semi-independent public services, political patronage systems, and rent-seeking behavior.

[80] Personal communication with Senior Water & Sanitation Specialist, ETW, World Bank in 2008

Box 8: "Toilet wars": urban sanitation services and the politics of public-private partnerships in Ghana

In Accra and Kumasi in Ghana public toilets consistently have been poorly managed and the site of local political conflicts — toilet wars — despite efforts at franchising them and community management. Despite nearly 20 years of experiments with various forms of public toilet management by political groups, to community businesses, to direct management by the Sub-Metropolitan Districts the actual situation had not changed much as of early 2003.

By the mid-1980s, there were 384 and 400 public toilets in Accra and Kumasi respectively, used by 38 per cent of the population in Kumasi, and 25 per cent in Accra (all in the poorest areas). At that time, structural adjustment started rationalizing the public sector work force, affecting sanitation laborers who used to clean the toilet facilities. District and Metropolitan Assemblies were mandated to collect user fees for the cleaning and maintenance. However, a high number of public toilets lacked adequate financing or fee income for maintenance. Problems were exacerbated by the continuing funding crises and never-ending retrenchments in the decentralized government system. This reinforced the appeal of a franchising or contracting-out policy to relieve local government authorities of the maintenance burden and offer prospects of an improved revenue stream.

PPP policies began in the 1990s and toilet management and maintenance were formally "privatized" in 1994. Franchising and sub-contracting of revenue-earning public services became extremely popular with the newly elected local political elites. They had potential for boosting public revenues. They also rapidly became prizes in the political patronage networks of the city governments. The franchises involved revenue-sharing agreements between the franchisees and the Sub-Metropolitan Districts (SMDs), and remained one of the few sources of revenue still under the control of the latter. SMDs now rely on the toilets for around 60–70 per cent of their total revenues — which nevertheless remain totally inadequate. Contracts were supposed to be given to registered local companies with demonstrated capacity, but in practice beneficiaries have tended to be the Assembly Members. Often they used front companies which were "community businesses" employing local people. Many were former leaders of Committees for the Defense of the Revolution (CDRs) from the 1980s, who continued to be dominant in local politics – which were (and remain) officially "non-party". "Toilet wars" erupted when new generations of Assembly members challenged the dominance of the old CDR leadership. Public toilets became politically protected business opportunities which, like taxis or bars in other cities, were given out as political favors. Privatization led to a decline in the power of officials and increase in the power of politicians and contractors, who now form a nexus of patronage relations that it is hard for officials to challenge.

From 2000 onwards, the new government's policy emphasizes "real", transparent and competitive privatization, in contrast to the franchising policies of the 1990s. Two new Metropolitan Chief Executives for Accra and Kumasi were appointed, hoping that this would ensure implementation of the radical privatization policy. But this brought the new Chief Executives into conflict with established local political networks, even within their "own" party. Full scale political conflicts developed between Assembly Members and the Chief Executives, principally over their stated intention to introduce full transparency into the tendering procedures. The arrival of new cohorts of elected Members simply produced new, often violent conflicts between former and new Assembly members deriving from "direct action" takeover battles for physical control of the toilets between groups associated with different Assembly Members.

Community groups in the poorest districts were frequently created by or dependent upon local politicians and in some cases were part of an urban "political machine". Thus the normal logic of electoral politics, where politicians are punished for poor performance when they don't bring government jobs and amenities to their localities did not operate. Instead, the privatization of the revenues generated by essential public services such as public toilets was siphoned off by politicians who either owned or protected them, in order to buy the support of crucial opinion leaders and community "vote-brokers". The actual performance of the service becomes less important than the privately distributed pay-offs it generates. The lack of party competition in Ghanaian local government also reinforces the power of well-connected politicians to punish community groups who step out of line, as well as to reward those who accept the benefits on offer. So the public toilets continue to remain overflowing and unemptied for months on end.

The political power of elected members and city officials, community politics and the patronage opportunities offered by this form of privatization are inextricably linked and cannot be "depoliticized", least of all at the community level. It is only when these realities are recognized that different and perhaps more effective policies can be developed.

Source: Based on excerpts from "Toilet wars": urban sanitation services and the politics of public-private partnerships in Ghana by Joseph Ayee and Richard Crook, IDS Working Paper 213, December 2003.

Actors' interests and influence: political and economic interests

Opposition to water sector reform often comes from the urban middle class who benefits from existing subsidies. It is not uncommon that 30-35 percent of connected users pay below the cost price for water. In Honduras, for example, decentralization of the non-functioning national water utility caused active opposition amongst different stakeholders, notably the middle class[81]. Since the urban middle-class is an important constituency for some politicians, they work to keep their tariffs low. Thus political obstacles to reform are often bound up in a "socio-political contract" between governments and vocal and influential middle-class constituents. An interesting discrepancy between "willingness to pay" for water versus "unwillingness to charge" is found in many cases. Willingness to pay studies conclude that poor consumers are willing to pay for piped quality water, as they often already pay more for non-networked water if they are not connected. However, governments' frequent reluctance to charge higher tariffs is based on political pressures to keep tariffs artificially low. Lack of political will to impose tariffs that cover operation and maintenance costs can also be due to perverse incentives or patronage as illustrated in the La Paz case study where political interference in concessionaire tariff setting derailed a process which had been extending coverage to poorer parts of the city.

These concerns can influence decision-making and actions by bureaucrats, who may avoid unpopular policies, such as raising tariffs and enforcing collections, in order to retain their positions. In other cases political interference is more direct. A recent study on well-run public companies examined water utility management in Mexico, where the utility was very well run and getting better, before the mayor changed and threw out all the staff, at which point its performance began to deteriorate[82]. This is why utility managements and especially regulators should be legally independent entities with at least some financial independence.

In some countries, the water service agencies and utilities are overstaffed, like many other government agencies are[83]. Public sector unions then typically oppose reforms to protect the jobs of their members. In this context, a major discussion point between the Bank and borrowers, that is outside the scope of the present study, is the financing arrangements for the typically very substantial financial burden of compensation for lay-offs.

Public institutions, such as schools, hospitals or military bases are often exempted from paying their water bills and politicians can be reluctant to abolish such exemptions, on various grounds. If the ministry of local government, for example, through the water utility enforces bill collection from the ministry of energy, it can expect a similar treatment from the electricity company, and being short of funds to pay for years of arrears, it may experience being without power. Instead public institutions are sometimes seen to make 'debt swaps' between for example the water and the electricity utility, or the water utility and the telephone company. However that is not always possible, for example if a decentralization process has changed responsibilities and transferred liabilities from central government agencies to local governments. In the Albania case, one reason why local governments are reluctant to take over asset ownership of water utilities is that many have electricity debts that had been incurred by central government, but that would need to be serviced by local governments if they accept the asset transfer. These very real problems should be transitional, but they point to the importance of sequencing, timing and coordination of reform interventions in any particular sector.

On the positive side, political interests can also present opportunities for institutional change, if motivated by improving coverage and development outcomes, or by the realization that price increases can bring better quality services which can give political returns. Politically-driven change can break the cycle of opposition to reform, unsettle institutions and bring about change. The Salta Province concession in Argentina illustrates this well.

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[81] Personal communication with Senior Water and Sanitation Specialist, ETW, World Bank (2008)

[82] Kingdom, 2006

[83] In Teguciculpa, Honduras, for example, 1,100 people are employed in the sector when the ideal number would be closer to 300 people. Personal communication with Senior Water and Sanitation Specialist, ETW, World Bank in 2008.

In Argentina[84], the Salta administration, with one of the poorest of Argentina's 22 provinces, was motivated to water sector reform by concerns of coverage and public health. It used imaginative means in its role as the concession granting authority to change the institutional set up in a way that would progress towards universal coverage. Water Sector Reform in Salta started after the provincial legislature delegated the power to define the rules and procedures to concession state water companies to the Provincial Executive branch of government in March 1996. Under the Argentine legal system, provinces have the authority to delegate responsibilities for water and sewage service provision to municipal authorities, yet neither the regulatory framework nor the concession contract provided for the involvement of local governments. Undaunted, the provincial administration developed a transaction strategy, that was designed to build bridges between the municipalities, user organizations and the concessionaire. Salta Province learned from the failures of mega-concessions in Latin America in the 1990s. As a result, coverage increased from 76 percent to 96 percent for water supply and from 54 percent to 84 percent for sanitation, while the number of municipalities served by the concessionaire was increased from 43 at the beginning of the concession to 56 in 2005. The achievements made toward the objective of universal coverage are notable in part because the concession took place in a poor province, and because it survived a major economic crisis in the country.

Economic rent-seeking behavior can be a significant factor in water supply and sanitation reforms. Examples abound. In an institutional context with low transparency, poor contract enforcement and weak accountability, large investments provide opportunities for "top slicing". Poorly monitored tariff streams can be diverted. Illegally connected customers can pay utility staff to avoid being cut off. Approaching and working with these incumbents can be challenging, and some may actively block reform.

Economic interests at the micro level center on rent seeking in non-networked areas mediated by powerful stakeholders aggressively defending their interests, sometimes with "mafia-type arrangements"[85]. Private water vendors make a living out of selling water at ten times the unit price. In some instances, the staff of the non-functioning utility sell water illegally to vendors. In Karachi, for example, utility staff are not working effectively and are operating an informal system, while in May 2004 in Chennai, no water was distributed formally, but there were 11,000 tankers distributing water in the city.[86]

The playing out of these economic interests can have positive and negative implications for the poor. In Delhi, tariffs are purportedly set at low levels to "protect the poor against large water bills". But the DJB water bill is only part of the water budget of households who typically spend about 1.5 times its amount on "substitutes to piped water investing and operating boreholes, pumping, storage and disinfection equipment". Indeed, the poor and in particular the slum dwellers suffer most from the bad service that results from the low tariff and as they cannot finance construction and operation of such substitutes and often have to supplement their meager allocation of piped water from expensive private vendors.

Through decentralization and social mobilization, the number and type of stakeholders that exert their interests and influence in the reform increases, institutional arrangements change, accountabilities shift and the complexity of design and implementation of water sector reforms increases. For instance in Albania, decentralization gave local governments the sole mandate to provide water and sanitation services. However, a major stumbling block to the water sector reform has been the political economic risks posed by diverging interests -within and outside government- including central government resistance to relinquish authority, and the reluctance of many local governments to take over water utilities that are unprofitable, and indebted or insolvent. Additionally, the water sector witnessed changes in number, type and size of private service providers in recent years. There is a growing number of local and regional companies, from developed but also increasingly from developing countries, and of small-scale or informal providers that operate in the water supply and sanitation sector[87]. This calls for innovative and flexible approaches to lending and non-lending activities by the Bank.

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[84] Saltiel and Maywah, 2007.
[85] Personal communication with Senior Water and Sanitation Specialist, ETW, World Bank in 2008
[86] Personal communication with Senior Water and Sanitation Specialists in ETW and SAR, World Bank in 2008
[87] World Bank, 2008b

4.2.3 Reform process

The complexities of political economy of reform in the water supply and sanitation sector highlight the need to tailor analysis to the country and reform context. Secondly, it calls for a flexible and pragmatic process approach.

Dialogue and Decision-making

Civil society organizations (CSOs) are very involved in the water supply and sanitation sector in many countries. The "water as a human right" debate has motivated advocacy CSOs in Ghana, Bolivia and elsewhere to raise legitimate concerns regarding water supply accessibility and affordability under reform processes (see Box 9 for an account of these issues in Ghana). CSOs, being part of society – both local and global - naturally have their own internal tensions. Shifting alliances, for example between global public sector unions, the social justice movement, former service delivery NGOs turning to advocacy (e.g. WaterAid, Oxfam), and local consumers' associations are commonly seen.

Box 9: Civil Society Organizations in the Water Sector Reform in Ghana

In 1995 the Government of Ghana (GOG) began stakeholder consultations to examine options for reforming the country's urban water supply sector. Poor financial and commercial performance meant that the sector was unable to generate enough revenues to sustain itself. Only 51 percent of the urban population had access to improved water supply. The most pressing problems were a lack of entrepreneurship in management, high levels of non-revenue water, poor billing collection, and weak financial management. Starting in 1998, the Government undertook broad stakeholder consultations that included CSOs, donors, the Ghana Water Company and civil society. The outcome was a recommendation that a private sector option should be examined for the urban water sector. Eventually a management contract was considered.

Given the long period it took to get the management contract to bid, the government saw communication as an important component of implementation, and hence a communications strategy was developed based on solid research. A household survey showed that consumers were more concerned about water availability (41 percent) and water quality (32 percent) than price (5 percent). Eighty-one percent responded that unreliable water availability was the biggest problem with their water supply. The majority of respondents felt that both local and international private sector participation benefits Ghana (86 percent), and 81 percent anticipated positive impacts as a consequence of Private Sector Pparticipation (PSP) in Ghana's water sector. However, 33 percent of the respondents considered the government to be the most trusted party to manage and operate water delivery systems. The government was aware of the challenge to broaden the PSP debate and communicate key decisions to its citizens, as well as to the active NGO community in the country. Negative media coverage both domestically and internationally, and vocal opposition from civil society groups, highlighted legitimate concerns about profiteering of the private sector and access for the poor.

The Ghana Water Project then launched a Public Education and Communication Program. A Water Communications Committee, made up of managers of various water-related entities, was established to coordinate and ensure consistency of messaging. The Program consisted of three parts: (i) community rallies for Resident Associations; (ii) tailored workshops and presentations to media, Members of Parliament, NGOs, women's groups, labor unions and religious interests; (iii) production and dissemination of TV documentaries and radio talk shows. A public debate ensued between the NGO-sponsored National Coalition Against Water Privatization and a pro-PSP coalition inclusive of resident associations, professional associations, and individual citizens. The latter marched in the street urging the government to speed up implementation of PSP reforms. A management contract was signed in November 2005 with a consortium of private companies to manage the country's largest 84 urban water systems.

Legitimate citizen concern continues to encourage transparency and public oversight of the contract to ensure quality of service. Communications is now the responsibility of the consortium. It remains to be seen if they have the capacity to manage the communications challenges they continue to face, while remaining accountable to consumers so that communication means more than simply an effective marketing tool.

Sources: Communication *for Water Reform: A Guide for Task Team Leaders*, DevComm, World Bank; "Ghana Water Restructuring Project: Public Opinion Poll Findings", PowerPoint presentation, World Bank, June 2004; *Communications Strategy for the Ghana Urban Water Project – 2005*, Communications strategy, World Bank.

In some cases, and ironically in the eyes of pro-reformers, the interests of rent-seeking stakeholders can coincide with the actions of civil society groups against reform. In Bolivia and in other cases, civil society has opposed both tariff increases, drastic staff reductions and exclusion of the poor and criticized the assumed

high profit for the private sector. A lot of the criticism was directly aimed at the World Bank which was seen as forcing privatization.

This shows the importance of public perception for the reform design, implementation, and evaluation. Lessons from two decades of infrastructure reform identified this as a particular political economic challenge[88]. Perceptions are not only based on empirical evidence, but also on the way reform issues are debated, decided, implemented and evaluated. This calls for public debate of reform options that not only consults, but actively engages civil society, ideally at design stage. During the decision-making process, it then requires a systematic process to address concerns that civil society has with the design, implementation or sustainability of the reform.

Dialogue can be improved through evidence-based approaches that move beyond the ideological rhetoric over private sector participation. From a pro-reformer's perspective it is not so easy, however, to demonstrate that higher tariffs will lead to a higher level of service, especially in areas which are already connected to the water supply system. Consumers experiencing relative deprivation understandably can become quickly aggrieved if service does not improve when prices rise, as the case of tariff increases under pilot PPP in Albania illustrates[89]. If the quality of services deteriorates after the PPP has been put in place, consumers are likely to complain, which of course is their legitimate right. However, the issues of 'price-to-quality of services' relative to other public services, and the pricing structure and tariff increase amplitude can have drastic effects, especially in a volatile political environment, as illustrated by the La Paz case.

- In Bolivia, a state-of-the art poverty-focused management concession in La Paz extended the network to poorer consumers in La Paz and El Alto and built in long-term pay back for connection fees. Within three years, water coverage had increased to almost 100 percent, and within five years, sewerage coverage rose to 76 percent. At the end of 2000, more than 80 percent of new water and sewerage connections had been made in the cities' poorest areas. However, support began deteriorating once the connection fee was increased for new consumers in 2001 through political interference and in the wider context of national unrest over gas tariffs. Civil society opposition, mobilized by a neighborhood councils network under organization of president Abel Mamani, was so successful that the President of Bolivia cancelled the La Paz concession in 2005 and Mamani himself was later that year appointed Minister of Water.
- The Salta province concession in Argentina demonstrates that it is possible to move to a more institutionalized form of participation in water sector reform. The unique structure of the Salta concession promoted a reform arena of collaboration and partnership between the provincial government, the concessionaire, the regulating agency, municipalities and citizens throughout the concession process. In the context of widespread regional opposition to privatization in Latin America, the achievements made toward the objective of universal coverage are notable in part because the concession took place in a poor province, and because it survived a major economic crisis in the country.

Champions of change

As in the agricultural sector, the "champions of change" factor is important in water supply and sanitation reforms. Identifying such champions is an integral part of managing political economy constraints in reform processes. It is worth remembering that champions might be placed well outside the agency or even the sector in which reforms are being planned or implemented. In Amman, Jordan, despite a relative high turnover in cabinet posts[90], the water sector reform process had continuous support from political actors. The monarchy sanctioned and championed reforms and was a crucial actor in their preparation, design and implementation. Similarly, powerful stakeholders at the macro level are not necessarily influential in reform implementa-

[88] World Bank, 2006b

[89] This refers to an assessment in late 2003. As part of the ongoing reform process supported by the MWWP, improvements in water supply have occurred in Fier, Saranda and Durres over the last 4 years under the management contract.

[90] Ministers last for an average of eleven months and there have been seven Ministers of water over the past 7-8 years.

tion; as evident from the Delhi case, recognizing this distinction therefore ensures that "one speaks to the right people"[91] and that the appropriate arguments are used with different interest groups.

- In Delhi, the DJB Deputy Chief Executive Officer, mandated by the state government of Delhi, assembled a small team of reform oriented DJB staff to actively design the reform and initiate a broad consultation on its objectives with key stakeholders, including politicians, DJB management and staff, the media, customers and slum representatives. But they may have underestimated: (i) the capacity of groups within the Government and DJB to derail what by Indian standards was an innovative reform that would have shifted the focus from the delivery of additional water supply and sanitation infrastructure (the preferred and familiar model) to the managerially more challenging improvement of the water supply and sanitation service ; (ii) the determination of vocal groups within the civil society to obstruct a reform for which World Bank support had been requested, and their successful fear-mongering about lack of transparency and alleged tariff hikes; and (iii) the support by better-off customers for a reform that they were led to believe, by the negative publicity, would result in higher water bills for them. In retrospect, the consultation might have been broader and earlier in the design process, and the communication more strategic and proactive.
- In Salta province, Argentina, the provincial government did not give in during many critical moments, especially during the macroeconomic crisis when opponents to the concession called for its cancellation. The provincial administration's commitment ensured continuity and coherence in the reform process. In the context of broader social upheaval and widespread protest elsewhere in the region over privatization of water services, incentives were in place for the agencies involved to craft and implement a reform that would contribute to social cohesion rather than division. Through the reform, the provincial government hoped to unite and solidify its power base among a diverse group of political parties and social groups. The stability and steadfastness of the provincial government has been a key factor in maintaining the concession's success.

The influence of the World Bank

The influence of development partners in the water sector is changing and in some cases gaining traction as it becomes more flexible and process-oriented. The Bank's 2002 Action Plan brought about a policy change, discussed above[92], and reflected in a recent publication on "Infrastructure: Lessons from the Last Two decades of World Bank Engagement."[93] This signaled important learning and represented something of an admission that "we were wrong on water sector reform"[94].

Amongst government partners, the Bank has a greater opportunity to be seen as a useful catalyst in the reform process rather than resisted as an outside player imposing an external blueprint solution. This sea change has also been well-received by CSOs, impacting partnerships and sector dialogue. For example, on occasion, CSOs have aligned with the Bank against domestic incumbent interests.

As part of these newly-stated commitments to flexibility, the Bank has also learned that reform processes can benefit from an incremental approach. In Vietnam, when city water riots tipped the politicians into action, an incremental approach to institutional reform was adopted. A small part of the water supply systems in two cities was improved before attention moved to the next area. This has taken several years and highlights that even with the best intentions, one cannot turn things around overnight. The approach taken by the Bank in both the Vietnam and Cambodia water sector projects was to engage directly with the beneficiaries, and through this demonstrate to the politicians that there was support for the investment at a given tariff level.

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[91] Personal communication with representative of PPIAF, World Bank in 2008

[92] See also Marin and Izaguirre, 2006

[93] World Bank, 2007a

[94] World Bank, 2006b, Personal communication with Senior Water and Sanitation Specialist, ETW, World Bank in 2008

Box 10. Demonstrating viable tariffs and meeting water needs in Vietnam – rural water supply

Despite Vietnam's sustained growth in recent years and a major reduction in poverty, more than 400 out of 627 district towns (with population ranging from 4,000 to 50,000) lack any form of piped water supply, and residents must rely on untreated well or river water. Provincial water companies responsible for serving district towns have only limited resources which they tend to focus on major cities.

In 2002, the World Bank's Public-Private Infrastructure Advisory Facility (PPIAF) provided a technical assistance grant of US$ 406,000 to pilot a new way of providing water supply to two district towns. The aim was to test the viability of a new approach to delivering financially sustainable, customer-focused services — a demand-driven approach in which each community would determine the best way to deliver services for which its residents were willing and able to pay. As the project owner, the provincial water company would select a contractor through a competitive process. That contractor would carry out the detailed design work on the water supply system, construct the system, and then operate the system for a specified lease period.

At the heart of the pilot initiative was an extensive effort to engage the communities and other stakeholders, using a range of tools. These included socioeconomic surveys alongside surveys to assess demand, willingness to connect, and willingness to pay. The consultation process also included discussions of two customer-oriented issues. First, the communities had a choice of two household connection options, one requiring that customers pay an up-front connection charge and then lower rates for water, and the other involving no connection charge but higher rates. Both chose the second option. This option also included a minimum consumption charge for each connection equivalent to five cubic meters a month, a mechanism to demonstrate potential customers' commitment to using the service once connected, raise confidence and reduce the commercial risks for the operator. Second, the communities, understanding that prices would increase over time as a result of inflation, were asked whether they preferred annual but smaller price increases or less frequent (such as every three years) but larger price increases. Both communities opted for annual increases, and this choice was incorporated into the project design. After the bidding process, the contracts were awarded to local private providers in both pilots in January 2006. These operators — currently in the construction phase — are expected to begin delivering water to consumers by January 2007.

Source: Kingdom, Bill and Paul Reddel. 2006. Meeting water needs in Vietnam. How engaging communities can help lead to viable projects. *Gridlines* No. 10. PPIAF. Washington D.C.: World Bank.

The Bank has also shown that it can help to marshal evidence that will bring influence over reform discussions and decision making. The Bank's engagement in Albania's water sector reform through the Municipal Water and Wastewater project, the Public Expenditure and Institutions Review and a water sector PSIA helped to influence the sequencing and pacing of the reform, and informed the Bank's design of a Development Policy Loan (2007).

In contexts where the Bank does not have a seat at the table as a lender on water reform, it has on occasion been able to influence the reform process. In the Amman Jordan case, for instance, the Bank was able to maximize its influence in a context where it was seen as a lender of last resort. In this case, the Bank used a relatively small and "expensive" (IBRD) contribution of $55 million dollars within an overall donor package of $255 million to "buy a seat at the table", creating a forum for it to share its expertise, and contribute to the design of the reform package.

5. OPERATIONAL IMPLICATIONS

"We often compare inefficiencies we observe in the world with the theoretical functioning of private markets, yet markets are not perfect because they are victim to political interference (…). We need to analyze better who benefits from the public or private provision of services (…) and then break this down by constituency in order to build political coalitions for reform"[95]

This section explores and flags issues related to the management of political economy of policy reforms. It illustrates the ways in which a political economy analysis can be translated into actions which help to improve the effectiveness, sustainability and poverty focus of reforms and operations. It corresponds to the right-hand column ('Action Framework) in Figure 1.. The section has been developed inductively from operational experiences, drawing on discussions with Bank task managers in policy and operational departments, as well as the case studies and other material collected. Data collected through this study point to four operational implications that development practitioners in both partner countries and development organizations may find useful to consider in the design of policy options and operations :

1) the importance of understanding and monitoring the political economic context;
2) linking more systematic evidence generation with more effective negotiation and communication strategies;
3) realigning the "accountability framework" for reforms and operations; and
4) reflecting on the way the donor community in general, and the Bank in particular, engage in reform processes.

5.1 Understanding and monitoring the political economy context — implications for action

Reflective political economy assessment and comprehensive analytics

It is clear that political economy dynamics present a very real barrier to pro poor change and reform in both sectors explored in this paper. It is also clear that the operational task leaders of development organizations, who lead on reform dialogue and design of operations, generally are aware of the importance of power relations and have a keen sense of political economy issues (although a thorough analysis of "winners and losers" in reform processes is by no means always evident). Operational development practitioners however, are hampered by the sensitivity of political economy knowledge in an ostensibly technical relationship with the client government. As one key informant put it: "Task leaders[96] have a tremendous amount of tacit knowledge regarding political economy, which is a world away from university papers. But they can't write down that knowledge for obvious reasons, so it becomes very difficult."

Despite these intrinsic difficulties, the importance of assessing stakeholder interests, influence and incentives, and of examining formal and informal institutions emerges strongly in this review. When such an analysis is done well, by development practitioners in partner countries or development organizations, it informs an understanding of the drivers of both support and opposition to specific reforms, and the rationales behind it. When this analysis is introduced adequately into a partnership-based reform debate, it provides development practitioners with the basis on which they can negotiate, argue for evidence-based policy making and challenge the positions of incumbents.

[95] Witold Henisz, Associate Professor of Management at Wharton School of the University of Pennsylvania, speaking at the launch of the publication "Infrastructure: Lessons from the Last Two Decades of World Bank Engagement.", World Bank, March 20, 2006, Washington DC

[96] The term 'Task Leader', 'Task Team Leader' or TTL is commonly used in the World Bank to denote the professional responsible for managing a development operation.

Staying engaged in dialogue for a flexible partnership with decision-makers, supporters and opponents

Good political economy analysis generally encourages development practitioners to be flexible in their negotiations with decision makers, supporters and opponents in the public and private sectors and civil society. A pragmatic and context-specific approach and flexibility in the management of operations, reform processes, and dialogue are likely to increase the positive outcomes on reform and operation. Some aspects of development practice (e.g. a tendency to seek 'best practice' models from other countries and advocate that they be applied without sensitivity to the local context) can work against the required flexibility.

For instance, the World Bank does country level analytical work in order to inform its dialogue with governments. This dialogue needs to be sensitive to the ever-changing political economy and to the fact that different stakeholders may be governed by competing sets of formal and informal institutions. As actors lobby and negotiate policy change to promote their specific interests, they may "play the same game but with different rules" given information asymmetries and unequal power relations. This supports the case for using detailed stakeholder and institutional analyses to identify interests and degree of support for, or opposition to reform and operation (see Table 5 in Annex 1 on Agricultural sector reform). A continuous and objective engagement in the policy dialogue helps to detect changing dynamics in the policy environment. It also helps to build trust and willingness for collaboration to negotiate reform options that are feasible, acceptable, and locally owned. Development partners are exploring different ways of communicating with government, stakeholders and the public, which is particularly challenging in regard to the political economy of reforms.

Discussions with operational staff during this study have raised the question of whether Bank lending instruments and procedures are sufficiently flexible. World Bank operational managers are frequently faced with having to resolve two often competing demands, i.e. project disbursement on the one hand, and sustainability of reforms and operations on the other. With a shift in aid instruments from projects to Sector-Wide Approaches and DPLs in countries and sectors where this is feasible, there can be more time and breathing space for ongoing dialogue and "course corrections". However, in the case of classic investment projects, process management is more challenging, as the basic design has to be determined before board approval, while the project itself may have a duration of five to six years.

5.2 Managing risks by linking more systematic analysis with more effective policy dialogue and communication

Generating and communicating robust and objective evidence

Evidence-based policy making can reduce the risk of ideological capture or resistance to policy reform. This is well illustrated by the evidence-based approach of the agricultural market reform in Malawi (Box 3) and the Albania water sector reform process.

Information, negotiation, and dialogue are prerequisites for participation and public debate. Policy changes and the reasons for, and implications of, the reform or operation should be generated with a broad range of stakeholders, and communicated to them and the public. Such information can provide the starting point for public debate and initiate an upstream and two-way dialogue with stakeholders on policy design and implementation. This can identify obstacles, including concerns that can turn into risks to reform at an early stage. This allows for the integration and accommodation of the different opinions and perceptions into the policy reform process.

Lessons can be learned from the civil unrest in Bolivia that derailed the water reform process. Notwithstanding the substantive issue of whether or not there were genuine grievances, the lack of an active communication strategy was a major cause of the problems. The socially and politically volatile Bolivian context fostered misinformation that was used for individual and political gain, with no mechanism in place to counteract it. The Bolivia case demonstrates the need in policy reforms for conducting social assessments that identify and address stakeholder perceptions and concerns already at project design stage, for setting up participatory

mechanisms and for pre-planning media and public information campaigns. In Malawi, the government's decision to repeal the ADMARC Act prior to a wider dissemination of the PSIA findings, and Government's failure to articulate its reform plan for ADMARC, has raised wide concerns across civil society.

Involving stakeholders in the policy debate and building coalitions for change

Apart from a commitment to information-sharing in order to promote transparency, a two-way flow of communication with stakeholders is key during the negotiation process for reforms or operations for practical reasons. When stakeholder concerns are proactively addressed during the policy debate and directly integrated into operational design, the risk of significant opposition can be reduced. The study found that participation, dialogue, and the building of 'coalitions of change' (as well as direct response to concerns and opposition) are essential elements that can make or break a policy reform process or operation.

"Policy champions" or "agents of change" play a crucial role in policy reform, especially in regard to addressing opposition based on rents. They can mobilize and broaden coalitions to support the reform, deal effectively with opposition based on vested interests and often provide a vision of a more helpful future in order to help citizens cope with the transition.

Building effective, just-in-time M&E systems

A political economy perspective on policy reforms demands an operational focus on enhancing transparency and accountability in political decision-making. The World Bank has sharpened its operational focus on governance and social accountability in the wake of its three-pillared WDR 2000/1 strategy. The "Accountability Triangle", presented in the WDR 2004, provides a clear analytical framework for identifying entry points to generating transparency and accountability in practice.[97]

The "short route" to accountability brings citizens and providers together through participatory mechanisms that include water user associations and agricultural producer networks. Here much good work is being done by the donor community with country partners on identifying mechanisms for strengthening social accountability in service delivery. The "short route" can bring "quick wins". However, it can also be captured or compromised relatively easily in the absence of interventions that tackle the "longer route" of accountability through voice in policy making and the compact between policymakers and service providers.

Monitoring and evaluation (M&E) feedback is a powerful way of increasing voice and accountability. Experiences with national and local public policy monitoring, e.g., citizens report cards, provide a growing body of knowledge on operational ways to transform institutional structures that govern the policy process. M&E approaches involve creating new channels of information and spaces to deliberate on that information at the macro, meso and micro level, thus encouraging institutional realignments of policymakers, bureaucrats and citizens.

5.3 Realigning the "Accountability Framework" for Reforms

Interventions that address the "reform arena" by unsettling the institutional basis for political and economic (or rent-based) interests are an important element of reforms. A promising way of overcoming blockages to reform is to support policy design that increases accountability relations between government and citizens.

Organizational reform for downward accountability

Strengthening "downward" accountability relations between the state and citizens involves an "unbundling" of the various functions of policy making and policy implementation. This includes regulation, ownership of assets, operation of services and financing[98]. Creating different lines of accountability, backed by legislation and regulation, has the potential to reduce the political influence of local or central governments. This also

[97] World Bank, 2000/2001 and World Bank 2004e

[98] For a fuller discussion see Baietti et al, 2006.

helps to strengthen the voice of poor and vulnerable groups in the reform processes – as customers and taxpayers, they can hold service providers accountable for inadequate service provision. The emerging practice of the Country Governance and Anti-Corruption strategies (CGAC) illustrates political economy issues at country level, that allow the more recently started GAC analyses at sector level to filter through.[99]

The challenge in the agricultural and water sectors is to minimize negative political influence by separating it effectively from the management of agricultural or water sector service providers (whether public or private). A recent study on well-run public companies examined water utility management in Mexico. The utility was very well run and improved in performance, before the mayor changed along with all the staff, at which point the performance of the utility began to deteriorate[100].

Shifts in authority and power have fundamental implications for decision-making in policy reforms and operations. Decentralization is one of the most fundamental of such shifts, and it holds the potential for increased downward accountability. The Albania case illustrates how effective water sector reform is dependent on parallel decentralization processes, while the Ghana example (Box 8) shows how public-private partnership management arrangements in a decentralization context can be manipulated by vested interests.

Decentralization takes different forms in different countries. De-concentration of central government agencies is sometimes confused with the devolution of political power entailed by 'true' decentralization. Generically, the short term benefits of decentralization are that it brings choices closer to the preferences of the people, including the poor and previously marginalized groups; it allows for greater transparency in the inter-regional and local allocation of public resources; and it allows for local innovation in responding to the needs of the poor. In the long-term, decentralization promotes tax and policy competition across jurisdictions for mobile capital and people.

However, as with all major restructuring processes, the potential benefits are accompanied by significant risks - one being the risk of disruptions in the provision of public services. Short-term risks include the possibility of local elite capture; greater disparities in inter-regional transfers and fiscal capacity in the absence of fiscal equalization. Furthermore, a lack of clarity and awareness concerning roles and responsibilities may weaken top-down and bottom-up accountability mechanisms. Long-term risks are fragmentation of economies of scale and a failure to address or exacerbate disparities between lagging and advanced localities[101].

Mobilizing and empowering accountability from below through new forms of participation and partnership in reform

Complementing the state-driven (supply-side) reforms for greater accountability and transparency are bottom-up (demand-side) accountability initiatives from the private sector, civil society, and from ordinary citizens. Bottom-up accountability can be strengthened through participatory decision-making for resource allocation, formalizing service provider complaints systems and giving voice to consumers in regulatory oversight. This implies that the current decision regime in place (e.g. democratic, market-based, group-based collective decision etc.) is analyzed ahead of the dialogue process, in order to know whether the regime as such is changing or a change within the rule system is necessary.

This underlines the need for a stronger process approach in operations. Key informants in the present study stressed the importance of information and sound analysis that challenges incumbents' positions (see above). However, information dissemination must go hand in hand with actions that enable the institutional environment to empower people to hold public officials accountable. A consultative mode must move to an institutional transformation mode of operations, or as one key informant put it "turning 'voice' into results".

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[99] World Bank, 2007b
[100] Kingdom, 2006
[101] Kaiser, 2006 and World Bank, 2003e

This goes to the heart of the 'political economy-social mobilization' nexus: much of the operational work on social participation in infrastructure has focused on identifying "issues" and "consulting" with communities on plans. This implicitly vests policy makers and politicians with responsibility for "solving the problem identified" with little accountability to constituents. How can stakeholders act in concert to address those problems in a manner which better ensures sustained implementation of those solutions?

One way is through bottom up interventions in the reform arena, that involve identifying and strengthening "spaces"[102] for collective association and mobilization. In many countries public debate hardly exists, for example due to lack of communication infrastructure, or lack of channels for expression of public views and opinions. An enabling environment can be encouraged through top-down "invited" spaces that can be created through regulatory and procedural changes as suggested above. Top-down changes can be complemented by a more systematic attempt to engage with grassroots collective association and mobilization for institutional change. Such spaces can be identified and expanded through external support, allowing for newly empowered actors to challenge and change institutions.

Collective action is highly politicizing and space for interaction is often vulnerable to control from external or internal power interests. This makes an operational approach challenging for development organizations. However, sensitive interventions that "cultivate" spaces and collaborative processes are possible. Operational work can gain from analysis of how stakeholders are organized into consumer associations and other interest groups, and how institutional arrangements are structured so that stakeholders can participate in negotiations of the social contract and in ongoing implementation. Social analysis can elicit the type of information and technical capacities that is needed to move towards more institutionalized form of participation in policy reform in general.

5.4 Reflecting on the Way the Donor Community Engages in Reforms

Taking on board the issues of contextualization, pace and scope of the donor interventions in policy reform has implications for the way donors do business, how they construct incentives and measure success and how they evaluate their own performance. There are challenges to doing business differently; for instance, the need for more flexibility to adjust to an incremental and not always fully predictable reform process while also meeting the internal targets for timely and results-based interventions; innovative approaches to lending and non-lending activities including changes of decisions to lend and 'not lend' that more directly reflect in-country priorities, timetables, and implementation arrangements; more time for the preparation of an operation to allow task teams to stay engaged in the policy dialogue and listen to a broader range of stakeholder views, for instance through more programmatic approaches. Furthermore, it can be difficult to bureaucratically arrange stakeholder engagement for participation. It can be challenging to talk across compartmentalized governments to achieve cross-sectoral consensus and integration or to allow priorities and timetables for interventions to be determined by the reform deliberations in partner countries. However, as the need of reform ownership and sustainability become more recognized, development practitioners increasingly realize the significance of understanding and addressing the political economy of reform during the preparation of operations.

Tailoring and contextualizing reform efforts

The material reviewed for this study suggests that sound analysis of the reform and country-context, accompanied by on-going policy dialogue, can help development practitioners to better negotiate with partner countries in order to design and implement operations that are acceptable and tailored to local conditions, constraints and opportunities. Such adaptation can ensure availability of data and adequate time and resources that development practitioners can use for the policy dialogue, while still emphasizing rigorous analysis and the value of both ex ante and ex post analysis. Some of the case studies suggest that adjusting the sequence and pacing of the reform or operation could improve progress. For instance, improvements in service quality

[102] Also often referred to as "deliberative spaces"

and the collection ratio could be made a prior condition for gradual tariff increases in order to maintain consumer satisfaction. This could help address the issue of service operators arguing frequently that they cannot afford service improvements without first increasing the tariff; on the other hand, customers are either unable or unwilling to pay the tariff increases without visible service improvements first; and local governments are reluctant to increase tariffs due to political reasons. The Albania water sector analysis and studies of the power sector reform in several ECA countries[103] stress this point.

Timeframes for doing business

The study identified several issues that are critically important to reforms and operations, such as timing, continuous and open engagement in policy dialogue, patience and confidence-building, negotiation and concrete response to concerns and resistance, and talking to a broader range of stakeholders than has traditionally been the case (such as ministries outside of the technical sector in question, and civil society). These findings are supported by other reviews, such as the OED review of Bank lending[104]. This concludes that although consensus building for reforms within a country can be slow and gradual, it creates a better basis for reform than radicalism imposed from outside.

Experience shows that the timing, sequencing, and selection of reforms are crucial, and these may be better determined by a country's political dynamics than by outside advice. With longer time frames, innovative ways of building awareness among stakeholders can emerge on the benefits that are associated with policy reform. For example, an operation can start by engaging directly with the beneficiaries to gather their perceptions on costs and benefits of the operation. Through this, development practitioners can demonstrate to politicians that there is support for investing in services at a given tariff level. Such incremental approaches can work as part of a long term strategy.

From lender with conditions to facilitator with influence

A more measured, process-oriented approach to lending has implications for project cycle disbursement pressure (linked to performance evaluations), and thus for development practitioners in their dealings with borrower countries. For the World Bank, its gradual shift towards sustained engagement with clients and development partners to foster reform ownership as catalyst, rather than drive a reform as an outside player through conditionality, is a way to increase credibility and influence. As the OED review of Bank lending practices argues, the World Bank should be able to reduce lending and shift to a more long-term consensus-building approach if the reform context requires it.[105]

5.5 Concluding Remarks

It is important to acknowledge some limitations of the material presented here. The experience drawn on in all the case studies is from one institution – The World Bank. We have attempted to draw out general lessons for the practice of international development agencies (aimed predominantly at multi- and bi-lateral public agencies); we believe that the material here makes an important contribution to the evolving understanding in this agenda due to the general dearth of 'policy ethnographies' of the kind presented here. But further development of knowledge in this area would clearly be helped by similar consideration of the role of political economy analysis in other agencies. Secondly, the political economy of reform framework, which was developed inductively from operational experiences, will have to be applied to policy reforms and operations across several sectors so that it can be further refined and tailored to different contexts. Thirdly, the perspectives presented here were retrospective, and drawn predominantly from members of World Bank task teams. An enhanced understanding would be provided by a longer-term process of action research which engages at the country level with reform processes from inception onwards, and has access to the full range of relevant

[103] Lampietti, 2007
[104] World Bank, 2005b
[105] World Bank, 2005b

stakeholders. The study presents a solid basis and framework for a future program of work which can address these issues.

By way of conclusion, this study has identified **four key issues** which raise questions for further analytical and operational work.

The first issue relates to the importance of objective, timely and **demand-driven analysis**. This concern raises two questions for further work:

(i) What level of analysis is needed in view of required timeliness and what cost-efficient methods can be used to provide on-time input to reform dialogue and operations?
(ii) How can sometimes sensitive or controversial findings be presented and fed into the reform process and into operational design and implementation (and what is the role of public debate in this process)?

The second issue concerns the significance of a **sustainable process of policy dialogue** among practitioners in both donor agencies and national policy communities Questions for follow-up work include:

(i) What are the key elements of an effective policy dialogue with a broad range of stakeholders?
(ii) What processes are useful to initiate, and sustain active policy dialogue during and after the design and implementation of reforms and operations?

The third issue centers on the potential for political economy analysis to inform strategies for **institutional transformation**, including empowering forms of bottom-up institutional accountability. Here the questions for follow up work are:

(i) How can political economy analysis feed into strategies to enhance the accountability of public policy and public institutions?
(ii) How can political economy analysis help in the development of strategies for institutional change, including the mobilization of bottom-up pressure for change and top-down transfer of decision-making?
(iii) Which current institutional settings, operational mechanisms and incentive systems within development organizations need to change to allow for enhanced partnerships to build coalitions for change?

The fourth issue relates to a broader concern with the role of **political economy analysis in good development practice**, including the promotion of equitable outcomes through policy reform. This concern prompts the following questions for follow-up analytical and operational work:

(i) How can the proposed framework be refined and further developed? How do other development partners and partner countries approach the issues of political economy of reform at country level, and what are their experiences?
(ii) How can an enhanced understanding of political economy processes at sectoral and national level best inform policy dialogue related to the design of more equitable and sustainable operations and policy reform?

To take forward this work it will be necessary to move from analysis to action and providing more concrete guidance of how to conduct political economy of reform work. This will involve testing the framework (Figure 1) that has been developed inductively from experiences of World Bank operations and refining it as a practical tool for development interventions. The work will be disseminated to development practitioners (from development organizations and partner countries) through various dissemination events and publica-

tion (hardcover and website), through case-study specific dissemination via selective operational engagement (as appropriate), and through the piloting and up-scaling to other sectors and countries. This should help development practitioners in both, donor agencies and national policy communities to design and implement sector policy reforms and operations which are more robust, pro poor, country-owned and effective.

ANNEX 1. AGRICULTURAL SECTOR REFORM

1.1 Cotton sector reform in Burkina Faso

Background

Before and after independence from France in 1960, the cotton sector has consistently been viewed as the main driver of Burkina Faso's development. With cotton as the leading cash crop, overall poverty reduction depends considerably on the performance of the sector. Today, cotton accounts for 55 percent of total export revenue and is the major source of income for 200 000 farmers[106].

Burkina Faso is a politically stable country, led by President Blaise Campaoré since 1987. His legitimacy was confirmed by parliamentary elections in 1997, the presidential elections of 1998 and municipal elections of 2000. Paramanga Ernest Yonli has been Prime Minister for six years, during which period the Minister of Finance and Minister of Agriculture have remained in post.

The cotton sector is organized under a vertically-integrated model, as in many other countries in West Africa inherited from the colonial administration. The national cotton company, SOFITEX, was established in 1979,[107] its functions including distribution of inputs, promoting and procuring cotton, conducting research and development, transport, ginning, exporting cotton, selling seed on the local market, managing credit and producing seed.

This vertically-integrated model has advantages and disadvantages. On the one hand, inputs are available for producers under advantageous credit terms, the purchase price of inputs is lower due to economies of scale, the flow of materials and information are continuous and changes can be made rapidly as the different actors can easily be coordinated within the same company. On the other hand, this model is also associated with public monopoly, a lack of transparency and the possibility of corruption and protection of individual political interests.
Cotton production has always been in the hands of small producers, organized into Village Groupings (GV), and then from 1996 into Groups for Producers of Cotton (GPC) that assumed a growing number of functions. The producer organization is structured around representations at departmental, provincial and national levels. The National Union of Burkina Faso Cotton Producers (UNPCB), set up in 1998 under a charismatic leader, is the GPC umbrella organization that co-ordinates various initiatives for its members.

Cotton sector reform

Aid levels as a proportion of GDP in Burkina Faso are nearly four times higher than the average for Sub-Saharan African countries – 15.5 percent of GDP in 1998, compared with the 4.1 percent regional average[108]. Burkina Faso's decision-making process can be characterized as a relatively consensus-driven way of decision-making by the government in general, but with donors as influential stakeholders. Aid coordination under the Poverty Reduction Strategy Paper (PRSP) of 2000 is led by the Government and is working well. By linking the PRSP with the medium-term expenditure framework (MTEF), the government has provided enough fiscal security for donors to increase budget support and decrease project-based lending and aid.

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[106] IFPRI, 2006
[107] SOFITEX was established by three shareholders: the state of Burkina Faso (65%), DAGRIS, previously the CFDT (Compagnie Française pour le Développement des Fibres Textiles, 34%) and a local bank (1%).
[108] World Bank, 2003c

The international financial institutions have supported market liberalization in Burkina Faso as in other Western African countries. By liberalizing the market it was hoped to stimulate competition by allowing new domestic and international firms to enter the market. In line with this argument Burkina Faso's PRSP envisaged the restructuring of the cotton sector and the "dilution" of SOFITEX's monopoly through:

- Gradual liberalization of the sector by encouraging the entry of new companies and greater competition, which would tend to raise both output and farm-worker income;
- Improved regulation of the sector and of SOFITEX performance by introducing State-SOFITEX performance contracts, which would set output targets for the company and guarantee farmers an internal pricing system more in line with external market conditions.

Already in 1998/99, SOFITEX was partially opened to private capital investors, allowing cotton producers to obtain 30 percent of the capital and two seats on the company's board of directors. This meant the state was no longer the absolute majority shareholder. In June 2000, the producers obtained the majority on the board with 7 of the 12 seats – continuing the process that was started in 1998, thus changing the dynamics and the structure of the sector considerably. This process not only increased the direct interest of producers in the financial stability of the cotton company but also resulted in the adoption of a price mechanism that has allowed SOFITEX to operate without structural losses.

In addition to breaking up SOFITEX's monopoly in the sector, the reform aimed to improve cotton exploitation in all areas of the country. This involved transferring SOFITEX assets in two cotton-producing areas in Burkina Faso, the Centre and the East.

SOFITEX, the Farmers' Union and the Government were, for different reasons, mainly supportive of this reform process. Although SOFITEX had doubts about the success of the reform – mainly due to a fall in cotton prices – it became one of the main stakeholders to support it. A failure of the reform would have discouraged producers, left the cotton sector unstable and created discontent within the farmer unions. Thus SOFITEX had a strong interest in the success of the reform process once it was underway. It was also agreed with Government that the money from the transfer of assets would not go into Government coffers but instead to the ginning factories and to overall investment in the sector. With the prospect of collecting sales tax, the Government agreed to the deal. With producers owning a large amount of shares in SOFITEX, the Farmers' Union also had a strong interest in a successful restructuring of Burkina Faso's cotton sector. Moreover, the Terms of Reference were designed in a way which allowed the Farmers' Union to retain minority shares in the private company.

This alliance of support for reform generated a consensus-driven process. The stakeholders agreed, for instance, not to change the pricing formula (that used a long-term average base price) and not to do away with a bonus which was paid according to the previous year's performance. With the old formula staying valid, SOFITEX guaranteed to pay the bonus for the previous year even in the two privatized zones and thus provided fair conditions for new companies to enter the market.

The Director General for SOFITEX, in place since 1998, was able to encourage a shift in the organizational and management culture of the cotton company. While seeking consensus with Government over important decisions, SOFITEX gradually moved away from direct Government influence and established itself as independent player outside the political sphere.

This change of culture was demonstrated clearly during the bidding process for the assets in the two privatized zones. The Director General closely watched the short listing of interested companies and supported the careful selection of, mainly international, companies which he believed had sufficient capacity to facilitate a strengthening of the cotton sector in the two zones.

The World Bank was not directly involved in the selection process and accepted the leading role of the Government and SOFITEX, this despite voices from within the World Bank that criticized the close involvement of SOFITEX in its own privatization. Only in one instance did the World Bank step forward from its role as an observer and provider of analytic feedback and took a more active stance. During the Cabinet's approval of the pre-selection of bidders the process had come to a standstill because of a dispute about the short listing process. In the context of its poverty reduction strategy credit (PRSC) approval process, the Bank entered into dialogue with the Government and convinced it to stick to the already engaged technical process and conclude the selection of the bidders. The challenges to the short listing process were resolved by the Minister of Finance through an arbitration committee for procurement confirmed that the technical bidding process was consistent with procurement rules. As a result, although the financial bidding got delayed, the overall bidding process was concluded and the sale of SOFITEX' assets in the two zones yielded a much higher price than the minimum price set beforehand.

Thus, the process of opening the less-developed cotton zones in the centre and the east to new investors, which got under way in 2001, was concluded in 2004 with the sale of ginning plants and exploitation rights in those two zones. The FASO cotton company was selected to manage the central region and the Gourma cotton company (SOCOMA) to manage the eastern region. In September 2004 in Bobo-Dioulasso, a memorandum of understanding (MoU) was signed by the government, the cotton companies (SOFITEX, FASO Cotton, and SOCOMA), and the National Union of Burkinabe Cotton Producers (UNPCB). The two new cotton companies have gone into operation in their respective regions and each has had to negotiate with SOFITEX regarding the specific conditions governing oversight and management of these regions. A government body, the permanent secretariat charged with monitoring the liberalized cotton industry, was assigned the task of ensuring compliance with the provisions of the MoU. Starting with the 2004-2005 crop year, the cotton companies now each possess exclusive operating rights for eight years, renewable for a period, and under conditions to be set by the Burkinabe government.

Conclusion

The process of cotton sector reform in Burkina Faso was driven by complex political economy interests and tensions, but with positive outcomes. Although the sector had showed positive impacts on poverty reduction prior to reform[109], and while recognizing that cotton prices and cotton production in Burkina Faso are considerably dependent on the international cotton market[110], the reform's impact on the performance of the sector to date nevertheless seems favorable. Cotton showed an annual increase in output of 33.4 percent, from 480.000 tons in 2003 to 641,000 tons in 2004, which in turn contributed to a strong increase in exports[111] .

There are several lessons which can be drawn from Burkina Faso's experience of cotton sector reform. Privatization and liberalization must be conducted at a suitable pace and undertaken gradually. In Burkina Faso, the inclusive approach by SOFITEX towards the Farmers' Union and other interest groups at the end of the 1990s paved the way for further liberalization. Moreover, while donor support is important the role of the World Bank as observer – intervening only as the technical process was feared to fail – proved to be important to confirm the Government's leadership on the overall pace and extent of reform.

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[109] Supported by a stable macro-economic environment the incidence of poverty amongst cash crop farmers dropped by 10 points from 50.1 percent to 42.4 percent between 1994 and 1998, while the poverty level amongst food-producing farmers rose by 2 points over the same period. World Bank, 2003.

[110] A Poverty and Social Impact Analysis (PSIA) undertaken by the World Bank and the German Technical Cooperation (GTZ) on the Government's request used a poverty analysis and macroeconomic simulator (PAMS) to assess the development in poverty rates due to macro-economic factors, such as changes in the expert price of cotton. Essama-Nssah et al,, 2006.

[111] World Bank, 2006h

The key stakeholders – SOFITEX, the producers through the Farmers' Union and the Government – were all closely involved in the reform of the sector. SOFITEX, under the leadership of its Director General, emerged as one of the main supporters of reform. Despite the risks involved when a company privatizes itself this turned out to be crucial; opposition to the reform from the cotton company could have seriously jeopardized the liberalization process. SOFITEX was seen as fair actor in the process, establishing a relationship of "mutual trust"[112] between SOFITEX and the producers and, because of its international reputation as a commercially-run and professional company, attracting investors to the sector. Support from the Government and in particular the Minister of Finance enabled the reform to proceed in spite of problems encountered during the bidding process. Close involvement of all key stakeholders from the start enabled a consensus-driven approach to reform. Furthermore, the state over time has contributed to setting up a clear statutory framework that allows SOFITEX to invest in research, extension, and equipment over the long-term.

Finally, and crucially, the reform was undertaken in a favorable macro-economic and stable political environment with limited turn-over in key political positions which provided a favorable and "enabling" environment for sector reform.

1.2 Groundnut Sector Reform in Senegal

Background

Senegal's social progress since independence in 1960 has been relatively slow by regional standards. Senegal inherited, and continued to resource, a costly but influential elite civil service and secondary/ tertiary education system. Under the leadership of its first President, Léopold Sédar Senghor, the Senegalese state, its law, and its institutions were modeled closely on the French Fifth Republic. However, until 1974 political competition was severely restricted, and the first contested presidential elections took place only in 1978.

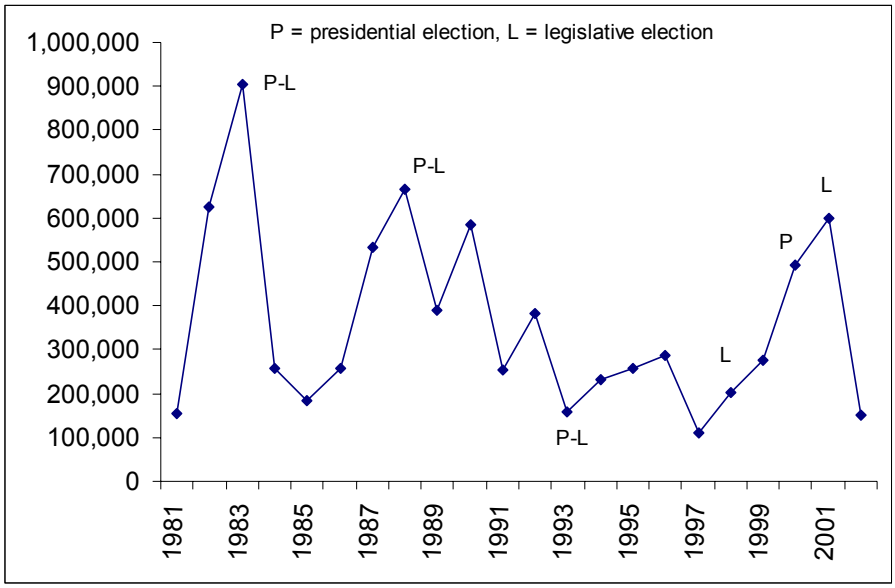
Senegal's economy since independence has remained characterized by a narrow agricultural resource base, dominated by groundnut production. Today, around 38 percent of cultivated arable land is used to produce groundnuts and the sector accounts for 75 percent of the national agricultural production, employing 50 percent of the working population. This makes Senegal the world's largest supplier of groundnut oil.

The political economy of the groundnut sector in Senegal is manifested in its traditional role as an instrument to distribute cash income to the rural sector during the electoral cycle. Trading and financial interest in groundnuts are particularly strong among the Muslim brotherhoods, notably the financially powerful Mourides with their spiritual capital in Touba, and management of the groundnut sector takes into account their influence on the rural electorate. Hence groundnut production moves with political cycles, with income distributed to the rural sector during the electoral periods through substantially increased parastatal purchases of groundnuts (see figure 2)[113].

[112] World Bank, 2003b

[113] The only exception is the 1993 elections, which took place under severe pre-devaluation pressures and in absence of external resource inflows.

Figure 2: Groundnuts purchased by SONACOS (metric tons)



Source: Walliser, Jan. 2003. What does alignment imply for IDA? Reflections on Burkina Faso's PRSCs. *Attacking Poverty Course*, April 9, Washington D.C.: World Bank

Twice, in 1980 and in 2001, the whole sector collapsed and needed large government cash infusions to survive. Despite its notionally declining importance as a share of GDP over the past two decades, the groundnut sector therefore continued to play an important role in government policies and spending priorities.

Groundnut sector reform

During the 1970s, a State-owned company, SONACOS (Société nationale de commercialisation des oléagineux du Sénégal), became the leading operator in the groundnut business. Through its affiliate, SONAGRAINES (Société nationale de graines), SONACOS bought groundnut production and transformed it into cooking oil and other products. During this period, however, Senegal became increasingly subject to tighter financial constraints. Droughts and sharp fluctuations in groundnut oil prices, declining soil fertility and rising oil import costs led to widening external deficits, while the government was unable to diversify the export base or attract significant foreign investment. In 1978 Senegal faced a major financial crisis as export earnings fell and continuing external imbalances led to a short-term stabilization program under pressure from the IMF and World Bank, since when financial programs with the IMF have remained operative.

Despite several reforms introduced since the mid-1980s and the dissolution of several parastatals associated with the groundnut sector, and despite the elimination of State subsidies for seeds and fertilizers, SONACOS continued to accumulate deficits, which were covered by the Treasury.

The electoral loss of President Diouf in 2000 broke the 40-year power-wielding cartel of Senghor's socialist party. The rise to power of the opposition under President Wade created new opportunities for change and reform. It also introduced, however, previously uncommon volatility to political decision making and economic management, with an unprecedented number of government reshufflings since 2001 and a festering conflict between President Wade and his former Prime Minister, Idrissa Seck.

Three Poverty Reduction Support Credits (PRSCs) are presently supporting the implementation of Senegal's Poverty Reduction Strategy (PRS), the first of which has been finished. Senegal's Poverty Reduction Strategy Paper (PRSP) covering 2003-05 included the privatization of SONACOS as one activity designed to contrib-

ute to wealth creation, one of the four "pillars" of the PRSP. The privatization of SONACOS and the elimination of specific protective taxes are the last major steps needed to fully liberalize the groundnut sector.

While the IMF was closely engaged with the reform attempts in 2001-02, the World Bank had largely taken a step back from several controversial structural reforms in the late 1990s after two failed attempts at privatize SONACOS in 1995 and 1999. Although in each case the Government brought SONACOS to the point of sale it rejected bids as unrealistically low. When the crisis erupted in the parastatals, a decision was taken by the World Bank — comforted by the existence of undisbursed loans that could help defray any financial crisis — not to engage in any lending for reforms until these reforms had indeed been implemented.

In 2001 — on the exact day when the groundnut production was supposed to start — the Government dissolved SONAGRAINES, which as a subsidiary of SONACOS had been active in the distribution of seeds and fertilizers and the collection of groundnuts. The overall picture on the motivation for this sudden action remains unclear. What has been characterized by some observers[114] and by the Government itself as "(IMF-imposed) forced liberalization of the groundnut sector" was, according to the IMF, initiated solely by the Government.

After the dissolution, a new marketing system, the "farm-gate system", was created in the groundnut sector, with private agents given a cash advance by SONACOS to collect groundnut production from more than 1500 collection sites. Many of these private agents, however, had limited financial means and many were pure speculators. The government's official price of CFA 120 was already CFA 25 less than the year before. Private agents were able to buy the crops at less than the official price, instead proposing to pay cash for a small portion of the crops and giving 'vouchers' for the rest. Farmers who tried to sell directly in local markets were confronted with representatives of the same speculators who brought down the prices of their product further. And most of those left holding 'vouchers' could not get paid, since many private intermediaries had vanished.

The impact was devastating. Without significant help from the state, households found themselves worse off. After intense pressure from farmer and civil society organization the Government drew up an Emergency Relief Plan, costing CFA 15 billion (US$23 million)[115]. While this drew attention to the seriousness of the situation in many rural areas in Senegal, the Minister of Agriculture, supported by farmers' organizations and many parliamentarians continued to blame the IMF and World Bank for the rushed privatization.

Subsequently, there was huge internal government resistance to the PRSP's proposed sale of SONACOS, in particular from the Minister of Agriculture. After extensive consultations, the Government agreed in principal to sell SONACOS. In spite of this agreement to continue the privatization there was no consensus on how this should be down. One of the main questions revolved around the pre-financing of the private buyer to pay for the groundnut crop. Against the background of the drought in 2003, SONACOS claimed it needed CFA 60 billion (US$92 million) to finance the campaign. Negotiations between the Minister of Finance and SONACOS thus occurred in an overall climate of distrust, with the Minister doubting SONACOS' ability to effectively organize the process without financial leakages. The process was characterized by limited influence of the Minister of Finance over reforms and Government unwillingness to address difficult and/or unpopular issues.

Finally, in 2005, the authorities sold SONACOS to the only bidder that made an offer. The government also suspended an import tariff on refined vegetable oil, in order to foster competition in the sector and reduce the price of a key staple for the poor[116]. While the IMF was involved in the organization of the bidding, the World Bank stepped back from the reform process which was, according to the Bank, insufficiently transpar-

[114] Dembele, 2003
[115] ibid
[116] World Bank, 2005c

ent and lacking a clear sector framework. Although the privatization of SONACOS was completed with the final transfer of assets in March 2005, some of the market liberalization was subsequently reversed. In view of the strong increase in vegetable oil imports since 2004, which has weakened SONACOS' financial situation and threatened its ability to buy the groundnut crop, the Parliament has adopted a law imposing import duties of 25 percent on palm oil imports and 15 percent on other vegetable oil imports for a temporary period of up to six years[117] . This protective measure was largely criticized by the Bank, as evidence suggested that it served to prevent rent-seeking behavior rather than to impact positively on the poor. In a subsequent development, the Government adopted a new protection law, that in contrast with the previous one, conformed with WAEMU and WTO agreements.

As outlined above the short-term impact of privatization on the poor in rural areas has been negative. Until now, however, the private sector has not engaged in input supply, commercialization, or marketing as expected. Data on income are scarce but the high incidence of poverty in rural areas suggests that reforms aimed at raising rural farm and off-farm incomes have been ineffective[118].

Conclusion

The political economy of groundnut production presented a significant fiscal risk for international financial institution activities in Senegal. Two failed privatization attempts in the 1990s created a climate of distrust between the Government of Senegal on one hand and the IMF and the World Bank in the other hand. Without an agreed framework for the process to privatize the state-owned SONACOS, the rapid dissolution of its affiliate SONAGRAINES in 2001 caused dislocations, including lack of access of farmers to critical inputs, which may have been mitigated by a more gradual and phased approach. The adverse impact on the rural population added to the existing skepticism towards a further liberalization of the agricultural market from Government, civil society and ordinary citizens. Moreover, the continuing existence of SONACOS allowed rent-seeking behavior by key Government and influential private actors. This combination of a widespread negative perception of privatization and rent-seeking behavior allowed for a powerful resistance to sector reform to emerge.

Several lessons can be learned from the attempts to reform the groundnut sector in Senegal[119]. A major issue delaying the liberalization of the groundnut sector was whether reforms would have unfavorable distributional consequences for poor farmers. The Bank should have undertaken analytical work on these issues sooner, given the importance of this sector to rural livelihoods. The study to analyze the distributional impact of reforms in the groundnut sector began late in the period and remains uncompleted.

Levels of collaboration and cooperation between donors affected the outcomes of reforms. When collaboration between major donors was good, the Bank was able to achieve better outcomes. In contrast, the relative lack of cooperation among major donors in the reforms of the groundnut sector during the 1990s sent conflicting signals to government and may have been an important factor in the lack of progress in the sector.

The World Bank's unwillingness to consider alternatives to the privatization of the groundnut sector in the 1990s contributed to the limited progress in reforming this sector. Recent changes in the World Bank's approach in the groundnut sector represent learning and appear to have improved prospects in the sector.

Finally, the Senegalese PRSP process and subsequent reforms were mostly characterized by a lack of consultation and participatory process[120]. Given the resistance to reforming the agricultural sector a broad consulta-

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[117] IMF, 2005
[118] World Bank, 2006f
[119] World Bank, 2006f
[120] Phillips, 2005

tion process at an early stage could have identified opponents to reform, provided much-needed information and contributed to building capacity for Government leadership on the privatization.

1.3 Crop Board Reform in Tanzania

Background

Agriculture remains the dominant sector in Tanzania's economy, accounting for about half the country's GDP and employing about 70 percent of the country's labor force. As nearly 90 percent of the poor live in rural areas, increase in agricultural growth is central to reducing poverty and enhancing growth. To achieve Tanzania's ambitious agricultural growth targets, agricultural trade, particularly in exports, will have to be increased, and a regulatory and institutional environment that supports growth need to be ensured.

Crop boards play a significant role in determining the production and investment environment of Tanzania's agricultural export crops for cashews, coffee, cotton, pyrethrum, sisal, sugar, tea, and tobacco[121]. With crop marketing liberalization, starting in the early 1990s, crop boards were expected to continue many of the regulatory, reporting, and service activities of the former marketing boards, but were not expected to be directly involved in marketing or production. As a transitional arrangement, however, the minister of agriculture was able to authorize crop boards to perform limited responsibilities for marketing when the private sector was not active.

The primary functions of the boards included improving quality and ensuring fair prices. Since their formation, however, crop board activities and performance varied, which raised concerns about their impact on industry performance. Stakeholders within the industry and outside observers have reported problems attributed to the current activities of the boards, including disruption of marketing and exports, costs in excess of services received, inadequate accountability to their constituents, and interference in growth of the private sector in marketing. At the same time, the boards are recognized to offer services that might not be provided by the private sector, particularly input supply for smallholders, and are perceived by some participants to provide protection against monopsonistic behavior by private marketing agents.

Boards are accountable to the Ministry of Agriculture and Food Security and financed by withholdings from the trade, rather than general revenues. More than 75 percent of their revenues come from cess and license fees, with the exception of cotton. Taken together, expenditures of the coffee, cotton, cashew and tea boards amount to about US$5 million annually, and much of this is attributed to administrative expenses.

The Reform — a PSIA to design various reform options

The government had prioritized a crop board analysis in Tanzania's 2001/02 Second Poverty Reduction Strategy (PRS) Progress Report, listing it as a key action in the PRS policy matrix 2002/3-2004/5. The Government's Rural Development Strategy and its Agriculture Sector Development Strategy, that provide the sector details to the PRSP, both emphasize the need to restructure the Boards. Consistent with the PRS, the donor supported Poverty Action Framework (PAF) matrix has as a policy benchmark to further review of the roles and funding arrangements of the Crop Boards, with reforms to the corresponding legislation envisaged in the outer PAF years.

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[121] Crop boards were formed after the liberalization of the early 1990s to replace their predecessors, the marketing boards, which had been created as monopoly public agencies to fulfil a range of marketing activities. In the first phase of reforms in the early 1990s, "marketing" functions transferred to cooperative unions. In a second phase, which began in 1993/94, the government eliminated the monopoly held by the boards and unions for export crops, allowing the private sector to compete with the unions in marketing

By 2003, Government, however, had not yet devised a crop board reform, but addressed the concerns instead with various actions, such as (i) redefining crop industry legislation to incorporate provisions for increased stakeholder participation (for instance, in 2002/2003 the Board of Directors of all Crop Boards were required by law to appoint stakeholders and the laws amended in 2001 for coffee, cotton, sugar, tobacco provided for establishment of stakeholders fora); (ii) making information more readily available to farmers and other key stakeholders; (iii) managing crop development funds; (iv) tax reforms to reduce or abolish taxes that are a burden to smallholder farmers; and (v) actions to curtail malpractices by private traders in the purchasing and selling of agricultural commodities[122].

In 2003, the Government requested support for further analysis of the crop boards in the forms of a poverty and social impact analysis (PSIA). The review of the crop boards was set as a prior action to PRSC-3. The PSIA was conducted jointly between the Bank, the Government Task Force (Ministry of Agriculture and Food Security (MoAFS), and Ministry of Cooperatives and Marketing), the European Union and the support from the University of Dar es Salaam and Sokoine University. The focus of the PSIA was to review the crop boards – specifically to assess the regulatory, service & revenue collection functions of boards, to analyze the institutional arrangements/ environments, and incentives in production and marketing of coffee, cotton, cashew, tea; and to propose options to reform the crop boards. The study approach was multi-disciplinary in design, analysis, and team. [123]

The analysis was conducted in a multistage process. It comprised a financial review of all eight crop boards, institutional mapping (via key-informant interviews and focus groups) of four crop industries and — in the case of coffee and cotton only — an additional benefit incidence analysis (via household survey with producers), an analysis of coffee auction data, and two stakeholder workshops[124]. The institutional mapping comprised institutional and stakeholder analyses. Its objective was to uncover the various interests, incentives voice and political power amongst the different actors, the nature of their influence on crop industry production and marketing and on outcomes (e.g. husbandry practices, processing, quality, prices received, industry development, and the nature and extent of influence of the crop boards.

The PSIA process was characterized by an early and comprehensive stakeholder dialogue and collaboration. Considerable effort went into obtaining agreement on study objectives, scope, and methodology to build ownership. During the design and implementation, the Bank and the EU worked closely with the government task force, a group comprising representatives of the Ministry of Agriculture and Food Security and the Ministry of Cooperatives, which was set up to review the crop boards. It proved essential that the stakeholder dialogue continued throughout the study and went beyond a mere dissemination of study results at the end of the PSIA.

Key study findings revealed (i) an institutional vacuum after liberalization with uneven private sector participation, and unfair trading, some re-regulation to increase the role of crop boards; (ii) crop boards mixed public and private activities and acts as both regulators and participants in markets, which makes them vulnerable to conflicts of interest; (iii) Boards are only accountable upward to MoAFS, but are financed entirely by their constituents in the industries and through property income; (iv) smallholders still do not fully recognize the pricing mechanisms and quality rewards; and (v) there is still low credit and input use, but emerging schemes, such as farmer groups, show potential. Specific impacts on different stakeholders could not be identified dur-

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[122] Especially in coffee, cotton, tobacco and cashew.

[123] This summary draws extensively on the PSIA report: Government of Tanzania and World Bank. 2004.

[124] The case study used mixed method (qualitative and quantitative) and sequenced data collection, to obtain detailed insights into the dynamics of the formal and informal institutional arrangements in the individual crop industries and crop boards. In September 2004, two 1.5-day workshops were carried out with coffee and cotton stakeholders, the two crop boards, and World Bank and EU representatives. Workshops aimed to validate key report findings, gain stakeholders' ownership of policy options, and produce a consensus among key stakeholders on viable changes to crop board acts, regulations, and activities of the coffee and cotton boards and their governance (including issues of finance and accountability). For more details see Beddies et al, 2006

ing the study period as the choice of reform options was subject to subsequent national debate. Overall impacts on producers are potentially positive; it is hoped that key outcomes of these reforms -improved access to market information, increased competition, and greater accountability of service providers - will potentially benefit smallholders as much as large producers. The impact on private traders, cooperatives, and processors is difficult to estimate without a decision on the reform option and a detailed analysis is provided elsewhere. The study showed that parts of government and small-holder producers are skeptical towards market economy and adhere to socialist principles and traditions. Hence, the crop boards and the Ministry of Cooperatives (at political level) opposed the reforms that would reduce controls over private agents and require greater accountability to producers in service delivery. At the political level, MoAFS was in favor of the reforms. At the technical level, the Government Task Force (MoAFS and Ministry of Cooperatives) supported the reform. Trader supported the reforms.

In regard to the options for crop board reform, the study showed that the crop boards are performing important public functions and providing some services that producers value and seek to continue. At the same time, the interventionist stance of the boards, particularly with the changes incorporated in the acts and amendments passed in 2002/03, handicaps traders seeking to respond as needed to rapid and profound changes in local and global markets. The traders' loss in foregone opportunities is passed to producers as constrained incentives. Reforms in the boards should be designed to retain the functions and services that stakeholders report as valued, to improve accountability and management so that services are provided more cost effectively, and to effect withdrawal of the boards from interventionist activities that distort the needed institutional evolution of Tanzania's marketing structures. The study developed three reform options in addition to a fourth option of "no change". Options 1 to 3 and the costs and benefits related to each option are summarized below (Table 4):

Table 4: Options for reform of the cashew, cotton, coffee, and tea board in Tanzania

Option	Benefits	Costs
Option 1: Publicly Financed with Redefined Mandate to Focus on Public Services	Saves the industries, and ultimately farmers about US$2.5 million annually which will be paid by other taxpayers. Adds more stability to financing of boards.	Possible lapse in provision of associated private support
Option 2: Privately Financed with Redefined Mandate to Focus on Associated and Jointly Provided Private Services	More accountability with the industry free to determine levy size based on effectiveness of the board Greater efficiency of resource use	Possible lapse in provision of key public services Possible capture by special interests within the Boards
Option 3: Jointly Financed with Provision of Associated Private Services and contracting for Public Services	Burden of private financing for public service provision reduced Provides accountability of the Boards to industry stakeholders Provides more stable financing for public goods Greater efficiency of resource use	Possible retention of de facto status quo despite decision to change Possible capture by particular interests within the Boards, as above

Source: Government of Tanzania, World Bank. 2005. Crop boards and the future prospects for agricultural exports of Tanzania. Volume 1: Main report. Washington D.C.: World Bank.

In September 2004, the study findings were presented in two stakeholder workshops, and the study was completed. In response, the Government decided to prepare a cabinet paper to assess the study findings, discuss the reform options, and prepare an action plan for the crop board reform. The initial deadline was set for March 2005, but this was delayed until June 2005. As the crop board review had been agreed among Government and Bank as a prior action of PRSC-3, a document that was presented to the board in July 2005, the delays in reform progress resulted in a reduction in the PRSC-3 envelope from US$175 million to US$150

million. The implementation of crop board reforms was monitored in PRSC-4; this included the issuing of a government circular in March 2006 that instructed the crop boards on the implementation of the reforms.

Despite some delay, this sensitive reform was implemented. One main step included the change in crop board financing from the original crop cess to budgetary financing. The change in the laws that govern the crop boards in line with the reform strategy is a further crucial step in the crop board reforms. Although Government had expected to amend at least two acts and present them to Parliament in November 2006, it subsequently decided to amend the laws of all crop boards and submit those to Parliament all at the same time. This meant that consultations with a wider range of crop boards and stakeholders had to be conducted in all crop board industries, ad that more time was required. It also meant that the submission of the amended laws for all crop boards to Parliament had to be postponed until November 2007.

The Bank accommodated this change in strategy, and made the consultations and signing of MoUs with the crop boards a prior action for PRSC-5, and the submission of the legislative amendments of all crop boards a trigger for PRSC-6. The slower than expected reform progress, however, highlights the political economy behind this sensitive reform calls for attention to government's reform ownership. The PSIA found that export crops, such as coffee, can be a lucrative business for a wide range of stakeholders, including public sector employees. As in many African countries, that are agrarian and plural society, political life is dominated by clientilist politics and clientilist political organizations[125]. Powerful interests, within and outside of the crop boards, defend the status quo that benefits them. Despite general political will for reform, actual commitment to a prompt reform implementation is less well established.

Conclusion

In Tanzania, public sector accountability still flows upward, not yet downward to its constituents[126]. Despite constitutional reform in 1995, Tanzania remains a one-party dominated state, ruled by CCM (Chama Cha Mapinduzi). Political parties are powerless and often only parties in name. Despite decentralization, local government lacks de facto autonomy. With a dominant executive, legislature, civil society and media remain weak. The demand side of governance is still not fully developed and respective institutions are not yet sufficiently independent. Parliament is gaining strength and builds its capacity as a watchdog over to oversee the executive, together with civil society and the media – all three institutions however can not yet enforce downward accountability[127]. However, even though Tanzania remains a one-party state, it has an institutionalized multi-party system, and decisions that are taken by the committees in the ruling party and the cabinet follow often intense debates[128].

By designing reform options for the crop boards, the PSIA contributed to the upstream policy dialogue on crop board reform. The continued dialogue and close collaboration among study partners across Government, EU and WB facilitated the process, and allowed for an open debate to develop different and challenging reform options. The study confirmed that policy reforms are ultimately political. It is important to acknowledge that stakeholder consultation, alliance with agents for change (Government Task Force and EU) and proactive integration of stakeholder concerns into the design of reforms are essential in an environment of vested interests that defend the status quo. Engaging these key stakeholders in the process of generating empirical evidence, debating it openly, and using it to inform policy options, can help to address the political economy of reform.

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[125] Barkan, 2006
[126] This was also referred to in Mukandala et al, 2005
[127] Mukandala et al, 2005
[128] Barkan, 2006

1.4 Rice Tariff Reform in Indonesia

Background

During mid-1997, Indonesia became engulfed in a devastating regional economic crisis. The Indonesian currency collapsed from near Rp 3,000 per US dollar in the second half of 1997 to Rp 15,000 by mid-1998. Inflation skyrocketed. The fall in GDP was accompanied by massive job losses as bankruptcies and cutbacks in production multiplied. This led to a sharp rise in open unemployment and underemployment. As a result, there was a significant increase in the number of people living below the poverty line and a marked deterioration in income distribution[129]. Poverty incidence increased from 11 percent in 1997 to 27 percent in 1999, with 55.8 million people living below the poverty line[130].

Advice given to Indonesia during the crisis by the IMF has often been blamed for ongoing poor economic performance. Although further loans were negotiated with World Bank and IMF, most of these were not taken up. Indonesia is not eligible for PRSC or PRGF mechanisms. In early 2003 Indonesia finalized its Interim PRSP[131], which provided a broad road-map and timetable for developing the full PRSP by May 2004[132]. However, increasing decentralization of decision-making, suspicion of international pressure for good governance and high levels of foreign debt make it difficult to gain government support for poverty reduction processes associated with the Bank and Fund.

The economic crisis at the end of the 1990s was followed by a domestic political crisis that was characterized by demonstrations, rioting and looting with ethnic and religious undertones and motivations. These led to many hundreds of deaths and further political instability. Suharto, president since 1965 when he had seized power in a violent military coup, was forced to step down on May 21 1998. Vice President Habibie was selected by the People's Consultative Assembly (MPR) as Suharto's successor and the first free and democratic parliamentary elections for several decades were held in 1999. The MPR selected Abdurrahman Wahid as President in November 1999 and replaced him with Megawati Sukarnoputri in July 2001. In April 2004 Indonesia held legislative elections and the first direct presidential election was also conducted in two rounds – retired General Susilo Bambang Yudhoyono (SBY) defeated Megawati Sukarnoputri in the second round on September 20 2004. After President Yudhoyono took office he quickly implemented a "pro-growth, pro poor, pro-employment" economic program. The current policy making environment is still challenged, however, by endemic corruption and by powerful interest groups and individuals.

Rice is a critically important food commodity for all Indonesians but especially for the poor, constituting 24.1 percent of their consumption. For the country as a whole, four out of five households are net consumers of rice, that is, they consume more rice than they produce[133]. Over the four years following the crisis of 1997–98 (1998 to 2001 inclusive), rice imports amounted to 9.1 percent of total consumption of rice. Indonesia is the world's largest rice importer, accounting for 18 percent of the world's total imports between 1998 and 2000.

Prior to the 1997/98 crisis Indonesia's rice imports were monopolized by a public agency, BULOG (Bureau of Logistics; *Badan Urusan Logistik*). Except for the periods of the 1973 commodity price boom and the 1997/98 exchange rate crisis, the real price of rice in Indonesia has been relatively stable, but its post-crisis level has been above its level over the previous three decades, even though international rice prices have declined relative to other traded commodities. From this it is apparent that the effects of BULOG 's market interventions were to stabilize rice prices relative to international prices at a level not significantly different from the trend level of world prices. With the exchange rate volatility of the crisis period, local currency prices of imported rice surged.

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[129] Perdana and Maxwell, 2004

[130] The poverty line is defined by as basket of food commodities and non-food basic commodities, with the overall poverty line estimated 30 cents US per person per day (urban), and 25 cents (rural).

[131] Government of the Republic of Indonesia, 2003

[132] As a blend country, Indonesia's PRSP preparation is not directly linked to IDA access and was therefore not a prerequisite for Bank CAS preparation. World Bank, 2003.

[133] World Bank, 2006k

In 2000, BULOG's monopoly on rice imports was abolished; however, the agency still accounted for around 75 percent of total imports. Private imports were subject to a specific tariff (rather than an *ad valorem* tariff) of Rp 430/kg, which in mid-2002 was around 25 percent of the import price. In addition, private sector rice imports were subject to 'red lane' customs treatment, meaning stricter standards of customs inspection than other food items, and were also subject to special import licensing requirements. In 2002/2003 a proposal was put before Parliament to increase the tariff by 75 percent, from Rp 430/kg to Rp 750/kg, raising the ad valorem equivalent tariff from 25 percent to about 45 percent[134]. Simplified, there were two main opposing arguments for and against rice import tariffs:

- some supported a high rice tariff policy since higher prices are associated with higher incomes for farmers;
- others believed that poor people are net rice consumers or buyers, who will suffer due to high rice prices.

Support for a tariff increase despite adverse effects on poverty — insights from PSIA

In parallel to these reform discussions a DFID-financed Poverty and Social Impact Analysis (PSIA) was undertaken in 2002/03 by SMERU, an Indonesian think tank in order to progress the debate by considering the impact of increasing rice tariffs on both consumers and producers[135]. The analysis adopted a methodology combining economic analysis, using a Computable General Equilibrium (CGE) model, with political analysis of decision-making and interests, using a Policy Interest Matrix (PIM).

Using existing qualitative and quantitative data on the effect of the economic crisis on the poor in Indonesia, the CGE analyzed the first and second round impacts[136] of price changes, by examining the way in which all producers and consumers respond to prices, predicting that:

- income poverty (as measured by the headcount index) will increases in both urban and rural areas, by 0.06 percent and 0.04 percent respectively;
- raising the rice tariff will increase poverty, but only slightly: the urban sector unambiguously suffers, while some rural households will benefit through farm profits and higher unskilled agricultural wages;
- the domestic price of imported rice will increase, followed by an increase in the consumer price, the cost of living and a minimal increase in the wages of skilled labor and a more substantive increase in the wages of unskilled labor;
- although the impact on poor households is not uniform, the losers will outnumber the winners.

In summary, the technical analysis from the CGE supported the opinion from other analytical work, which predicted that increasing the rice tariff would have a negative impact on poverty. The analysis concluded that it was not possible to justify the tariff increase by claiming that it would reduce poverty.

Given the results of the technical analysis the Policy Interest Matrix (PIM) was supposed to shed some light on the question of why the tariff was introduced and why serious thought was being given to an increase in the tariff. The PIM provided a summary of various institutional interests which influence rice policy. The matrix recorded for each of the key players: policy objectives (both explicit and implicit); the main rationale for their arguments; expected benefits (short, medium and long term); constraints identified by the player (short and medium term); transmission channel; nature of their interests; and their degree of influence. The matrix was filled in using published documents, stakeholder interviews, and focus group discussions with civil society stakeholders, government decision-makers and donors. Results for the key actors are summarized in Table 5[137].

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[134] Leith et al., 2003

[135] ibid

[136] While the CGE allows estimates in the changes to the poverty rates it is only of limited use for estimating the second-round impacts (i.e. raising wages in the rural economy) of an increase in the rice tariff.

[137] More details on how stakeholders' interests and influence can be mapped see in Holland, 2006.

In summary, the government bodies which advocated a high tariff (including BULOG, the commodities logistic agency responsible for rice, and the Ministry of Agriculture) were found to be more powerful within government than those which advocated a low tariff, or no tariff at all (including the Ministry of Economy and BAPPENAS, the national planning board). The Ministry for People's Welfare had made contradictory statements on the issue. Many donors generally argued against a high tariff, but lacked a strong influence on government.

A workshop was held in mid-October 2002 to provide a forum for discussion of results of the CGE modeling and the overall analysis of the PSIA outputs. While there was good attendance from academics, and donors, fewer stakeholders from Government and civil society attended than anticipated.

Conclusion

The PSIA demonstrated that while the results — in particular from the CGE model — did not justify an increase in the rice tariff as an effective way of reducing poverty, the policy had substantial support from different actors, highlighting the importance of the political economy of reform in determining policy decisions.

While the PSIA proved very useful in detecting the political economy in policy decision making in Indonesia, the final report highlighted some limitations. The short amount of time in which this PSIA had to be undertaken, limited the extent to which qualitative and quantitative aspects of the work could be sequenced[138] and pursued to maximum effect. Moreover, the "quick and dirty approach"[139] to the PSIA allowed a rapid stock-take of political interests but not a broader consultation which may have increased commitment to the PSIA process and the results. Due to the limited time available also links to the overall PRSP process were weak.

The Indonesia PSIA had limited success with the 'reference group' as suggested by the World Bank methodology, made up of civil society and government to champion the PSIA and ensure the results were taken up. Membership and commitment was sought from the members of the Poverty Reduction Committee (KPK), responsible for the PRSP, with agreements for involvement. The group members were invited to the final presentation of results, but few from outside academia and the donor community attended the October meeting as mentioned above.

After the finalization of the PSIA — and before a climate change to overall macroeconomic stabilization — the price of goods, including rice, decreased. Despite steady progress in reducing poverty, there has more recently been an unforeseen upturn in the poverty rate. This reversal appears to have been caused primarily by a sharp increase in the price of rice — an estimated 33 percent for rice consumed by the poor — between February 2005 and March 2006, which largely accounted for the increase in the poverty headcount rate to 17.75 percent. According to a comprehensive World Bank poverty assessment published in December 2006 the main reason for this drastic increase in poverty was the ban on rice imports, which came into effect in early 2004 and which was recently extended to December 2006. Taking up the rational of the PSIA the World Bank urges the government to remove the import ban on rice in order to lower the rice price and creating greater price stability[140].

However, despite evidence that the sharp surge in rice prices in 2005-06 (similar to the economic crisis in 1997/98) increased the total poverty rate, political interests, which are stronger than "pro poor" policy considerations backed by evidence, still press for increased tariffs and an import ban on rice.

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[138] It was concluded from the PSIA that lessons learnt from the CGE could have contributed to the analysis of the political interests and the institutional framework.
[139] Leith et al, 2003
[140] Aglionby 2006

Table 5: Policy Interest Matrix of key actors, Indonesia Rice Tariff PSIA[141]

Key players	Policy objective		Argument rationale	Benefits			Constraints		Transmission channel	Interests	Degree of influence
	Explicit	Informal		Short-term	Medium-term	Long-term	Short-term	Medium-term			
Bulog (the state commodities logistical agency)	high tariff, regulate imports	source of finance	protect local farmers from import dumping	stable rice market, domestic production	increase rice production increase farmers' profitability	self-sufficiency, control of rice economy	don't have control of policy, smuggling	tariff less binding, creation of black market	high price means higher wages for labor, benefit to farmers	source of income	high, linked to ruling party fund raising
Ministry of Agriculture	high tariff, encourage domestic prod. of rice, self-sufficiency	it is their job, perform based on agri. prod.	higher returns to rice farmers	maintain high income of farmers	more rice availability		none stated, unsure if it would encourage high wages			political, high tariff, local rice prod.	high (less than Bulog)
Bappenas/DAI (consultants)	no tariff, to maintain low rice prices	none, DAI represents US interests?	Java should diversify out of rice	low price benefits for poor	stable economy, food available	efficient resource allocation removes distortion, farmers will plant high-yield crop	sustainability of diversity		low price for rice	Pro free market, allied with int. community and World Bank	high, but declining
Ministry of Finance & Ministry of Economy	no tariff, to maintain low rice prices	No	Not having a rice tariff will help poor people	increase purchase power	flexibility to plant high-price crops, less dependent on govt.	better resource allocation	farmers will suffer in short term, employment problems	shortage of rice, no self-sufficiency	prices and wages	stabilized, lower price of basic needs	Ministry of Economy high, Finance high but less so, lower than Bulog
Ministry of Trade and Industry	no tariff, more open trade	lower direct/ indirect costs to industry, less politics	efficient resource allocation	low price eases pressure on wage demands	macro economic benefit		no power to enforce		low price for rice	industry/ prices, clean govt.	medium (less than Ministry of Agriculture) and declining
Min. for Peoples Welfare and Poverty Alleviation	Contradictory statements	None	low food price for poor	low price benefits poor						less burden on them!	high (more than Bappenas; some say no influence on tariff setting
Poverty Reduction Coordination Board	high tariff	None	protect agri. prod., increase productivity before industrialize	higher rural wage lowers poverty		high productivity in agricultural sector			price rise increase wages	maybe political ambition?	no (has no allies)
Ikhsan (University Researcher)	low tariff	Economic principles	high price bad for poor who are net rice consumers	low price helps poor	increased consumption					academic based on theory and data	medium (some access to key ministries and media
USAID, World Bank, IMF, ADB	no tariff	trade liberalization	increase welfare of world, high price leads to black market	cheap price helps poor	stabilize price	market efficiency, better resource allocation	not policy makers		like Bappenas	free trade	high (can block), usually informal
Producers, NGOs	high tariff	Business interest	higher prices protects farmers	benefit farmers		higher productivity	not part of government		high price means higher wages for labor, benefit to farmers		low but vocal
Governor of East Java	ban imports	Populist rent seeking	protect farmer interests	greater sales of domestic rice	higher incomes for farmers	expansion of rice production	not enforceable		blockages at ports, customs	election 2004	access to media and politicians

Source: Leith, Jennifer, Catherine Porter, SMERU Institute and Peter Warr. 2003. *Poverty and Social Impact Analysis*. Indonesia rice tariff.

[141] The following actors (policy preference in brackets) were considered to be the key stakeholders: (1) Ministry of Economy (low tariff), (2) Bulog (high tariff), (3) Ministry of Agriculture (high tariff), (4) Bappenas (no tariff).

ANNEX 2. WATER SECTOR REFORM

2.1 Water Sector Reform in Amman, Jordan

Background

Jordan is an arid country and water, in particular city water, is scarce and expensive. Traditionally, leakage and illegal connections have been high, while broken meters and "private arrangements" have resulted in inequitable access. In particular, the Jordanian army and well-off private consumers with very high water consumption have often been among those not paying for the water they used. Other households have been forced to buy water from truck suppliers at much higher prices.

Water resources development and management are vested in the Water Authority of Jordan (WAJ), established in 1988 as a statutory body with financial and administrative autonomy. Agricultural and municipal water has long been priced below cost. Investments have been funded by capital grants, many provided by aid agencies.

Jordan is a constitutional monarchy and has embarked on a political and economic reform program since King Abdullah has succeeded his father to the thrown in 1999. King Abdullah is known to support democratic politics, although his first years in office were characterized by an emphasis on economic progress and stability. The state, however, is still broadly perceived as non-transparent, unresponsive and unaccountable[142]. Given this distrust between the citizens and the state, the monarchy in Jordan is often seen as a continuous and stable factor to support economic reform programs.

The reform

In 1999, the WAJ agreed to delegate the operation and maintenance of Amman's[143] water supply to a private operator in conjunction with a World Bank loan of US$55 million. Other donors added a total of US$270 million to the sum.[144] The Bank worked closely with other donors to support the Government to prepare the grounds for reform.

A management contract had been prepared under Bank auspices in 1997-99 by a consultant team funded through technical assistance grants. The inspiration for this approach was the Gaza management contract that had been prepared in 1995-1996 and that was functioning well at the time. More specifically, there were three reasons for seeking private management of Amman's water supply sector[145]:

- Nine previous World Bank-financed projects had failed to significantly improve sector performance and efficiency;
- WAJ expected a private operator to improve quality and efficiency of service and, in particular, to reduce non-revenue water (NRW) that was estimated at about 50 percent;
- It was thought that a private operator would enjoy greater flexibility in managing staff, providing them with incentives, and in procuring goods and services, all of which would result in more efficient services.

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[142] International Crisis group, 2003

[143] In 2004, Amman had a population of close to 2.0 million. In the same year the country's average Gross National Income was estimated at US$2,140 per capita, with income levels in Amman likely to be higher.

[144] This demonstrated the relative importance of other donors, such as USAID and KFW, compared to the World Bank who is sometimes called "lender of last resort" in the region and therefore has only limited influence through, for example, conditionality to pressure for reform.

[145] Ringskog et al, 2006

The performance-based management contract was procured through international competitive bidding. The winning bidder's financial proposal was "risk averse", with a predominant annual fixed fee and a limited performance-based fee. The compensation after five years of the management contract would be 95 percent in the form of the fixed fee and 5 percent performance-based. The latter was tied to the incremental cash flow generated from operations from one year to the next. In addition, some 65 performance indicators were monitored under the contract, some of which were tied to penalty payments if objectives were not achieved. The contract was for an initial period of 51 months; it has been extended twice and is now scheduled to lapse on December 31, 2006.

Opponents to the reform, such as non-payers among the upper and middle class, claimed that the private operator would use they money for their gain, although in reality the money was going straight to the Government. The experienced operator dealt with this opposition by seeking transparency and by supplying documented evidence of reform effectiveness to Parliament.

Despite a relative high turnover in cabinet posts[146], the reform process had continuous support from those political actors. This support was sanctioned and championed by the country's pro-reform monarchy, which emerged as a crucial actor in the preparation, design and implementation of the reform.

Within the World Bank, political cover was provided from senior management for a relatively flexible and long-term preparation process on water reform in Amman. At this time, 1994-5, this form of private sector participation was one of the first of its kind and the first in the Middle East, so that considerable latitude was granted in the process. It is likely that Bank Task Team Leaders (TTLs) would have less latitude now in supporting reform in this way.

The impact of the reform process has been positive. The management contractor improved ten performance indicators[147] over a six-year contractual period, for example:

- Water supply coverage has risen from 90 percent to practically 100 percent;
- Sewerage coverage has risen from 69 percent to slightly above 90 percent period;
- Per capita consumption is estimated to have risen from 70 lcd to above 90 lcd;
- Continuity of water supply under pressure has gone up from a daily equivalent of less than four hours per day on average to above nine hours.
- The share of water supply accounts with operational water meters rose dramatically up from about 55 percent in 2000 to practically 100 percent in 2005.

While the overall improvement in service provision suggests a positive impact on the poor, there is no data or analysis to back up this inference.

Conclusion

A water supply and sewerage operator should be evaluated on its success in providing "efficient, sustainable service for all". After seven years of private management and despite major improvements in Amman's water supply, the WAJ still perceives, however, that the private management has not provided a sustainable solution to Amman's precarious water supply and wastewater challenges and believes that it would be worthwhile to attempt an alternative public management model. Similarly, the Ministry of Water and Irrigation (MWI) remains reluctant to allocating risks

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[146] Ministers last for an average of eleven months and there have been seven Ministers of water over the past 7-8 years.

[147] However, the management operator failed to match fully some of its contractual obligations and in particular the originally fixed target of halving non-revenue water (NRW). NRW dropped from 49 percent at the beginning of the management contract to 45 percent as of the latest estimate. It could be argued that the contractual halving of NRW from 50 to 25 percent in the scope of 51 months was unrealistic from the start. The fact that the original targets were relaxed without sanctions on the private operator shows that WAJ, as client, agreed with the need to adjust performance objectives (Ringskog et al, 2006).

to the private sector and seems to have made the decision to replace the present private operator by a publicly owned share company that would be responsible for operations and maintenance. As a lender of last resort, the World Bank is unlikely to be involved in the second stage of reform.

A number of lessons can be drawn from this experience. First, the sustainability of a private operator contract often depends more heavily on the political support that it enjoys over and above objectively measurable results of the contract. In this instance, the reform process was championed by a progressive monarchy with a strong influence on the political actors. After six years, however, WAJ does not expect further rapid improvements[148] from continued private management and will therefore attempt an alternative public management model.

Second, the Bank could have acted more to raise awareness and disseminate information on reform amongst the grassroots in order to promote dialogue and build consensus. This was an approach that was taken, for a time successfully, in the second generation of water sector reform in Gaza, although this was ultimately derailed by the political process. In Jordan, while the operator was fairly successful in using information provision and greater transparency to silence those opponents of reform who were claiming that money was used for private gains, the Government could have taken a more active role in supporting these efforts. For example, a baseline survey and subsequent impact assessment could have provided valuable objective evidence of the positive impact of water sector reform in a context where, despite the overall positive performance indicators, even the WAJ does not expect further improvement from the current arrangements.

2.2 Water Supply and Sanitation Services Reform in Salta Province, Argentina[149]

Background

A national public utility provided water and sanitation services to Argentina's main urban areas until 1982, when provincial governments acquired this responsibility. Under the Argentine legal system, provinces have the authority to delegate responsibilities for water and sewage service provision to municipal authorities, and each province has enacted its own legal framework to establish areas of priority and mechanisms for managing those. Provincial regulatory agencies, whose primary responsibility is oversight of private operators, were established. In the late 1990s and early 2000s, Argentina experienced a severe economic crisis, culminating in massive civil unrest, broad freezing of assets, and three presidential resignations[150].

Argentina's government is based on a federal system. Salta, located in the northwestern corner of the country, has some of the lowest development conditions and severe social problems relative to the country's 22 other provinces. According to Argentina's National Institute of Statistics and Censuses, 40% of all urban households, 50% of the province's total population, are poor.

Prior to the launch of the reform in 1997, water and sewage services were provided to 43 of Salta's municipalities by General Water Administrative authority of Salta (AGAS), a public, administratively autonomous entity. Province-wide coverage in that year stood at 72% for water and 63% for sewage. Areas served by AGAS featured 76% and 68% coverage for water and sewage respectively. Of the 25 thousand citizens not under AGAS' jurisdiction, small cooperatives and municipalities financed service. Low coverage rates are attributed to three primary factors. First, poor public sector management of AGAS can be considered a primary reason for these conditions. Additionally, investments in maintenance, rehabilitation and expansion of existing infrastructure were lacking. Also, several political groups encouraged residents, particularly in peri-urban areas, "to connect illegally to the network as a strategy to force

[148] The fixing of targets under a private management contract is difficult. There could be a temptation to set unrealistically rapid improvements in key performance indicators in order to facilitate the public acceptance of private management.

[149] Saltiel and Maywah, 2007

[150] Emergency legislation passed in 2002, when the crisis reached a crescendo, would impact existing concession contracts, but the Salta concession would ultimately survive this change.

the provincial water service provider to invest in network expansion." According to the forthcoming findings of an ETW flagship report , the switch to private operators in form of PPP's for water and wastewater services has increasingly taken place since the late 1980's and during the 1990's in Latin America being one of the regions with the biggest increase in PPP's. The ETW report shows that, contrary to public opinion, PPP's have been able to improve coverage, service provision and access for poor people on a rate-neutral basis since then. This trend resulted in an exponential growth of developing countries' population being served by the private sector: worldwide more than 250 PPP's were awarded in 61 developing countries serving an estimated 160 million people during the last 15 years. The supply side switched from being an oligopoly to a competitive market where several players compete for concessions on the local level.

Despite the major economic crisis suffered in Argentina during the end of the 1990's and be-ginning of 2000, the population having access to water provision has been steadily growing.

The Reform

Water Sector Reform in Salta started after the provincial legislature delegated the power to define the rules and procedures to concession state water companies to the Provincial Executive branch of government in March 1996. In December of 1996 the provincial government invited both international and domestic investors to bid for the purchase of 90% of shares of ASSA[151]. The remaining 10% of shares were distributed to employees through a special participation program. The concessionaire was selected in 1998 through an international public tender and the contract was finally awarded in 1999. Throughout the reform process and life of the ongoing concession, the continuity and coherence in the policies affecting the sector demonstrated the provincial administration's commitment to setting the groundwork for good services. According to the concessionaire, even during the peak of the economic crisis that affected the country, there was permanent support to make the contract sustainable, which was reflected in the overall collaborative effort between the parties involved and a clear decision among them to "make things work."

The Salta public-private partnership (PPP) was structured around four basic principles, defining the objectives of the provincial authority while creating incentives for the concessionaire by making goals and requirements more feasible within the given timeframe:

- Urban and rural areas were to be incorporated into the service area, with the objective of achieving universal coverage by 2015. This was in contrast to most concession contracts at that time which only covered urban areas.
- Improvement of public health standards through increased access to water would be a priority in the province. It was evident to the authorities that increasing water service coverage would contribute to improved health.
- Investments related to the provision of water were given priority over investments in sewage.
- Local water operators would be best given their understanding of on-the-ground social and political environments. Given the difficulties seen in other PPPs, special value was attributed to this type of operational knowledge.

This PPP covers all stages of water and sewage service provision: water extraction, potabilization, transport, distribution, and commercialization; and wastewater collection, treatment and discharge. The current concession service area covers the entire province of Salta despite the fact that the former state-owned company provided services to only 43 municipalities. By design, bidders were required to submit their investment plans with the goal of reaching universal access — even including isolated rural areas. In cases where service provision would be unprofitable, the concessionaire was allowed to propose special technical solutions to the regulator.

[151] Provincial Decree N° 2837. pers. com with Senior Water Engineer.

Though the regulatory framework was clear about vesting provincial governments with the power to grant concessions for water service provision, some of the municipalities opposed the idea of developing public private partnerships. In a strategic move, instead of forcing resistant municipalities to be part of concessions through its legal authority, Salta's Executive Power decided to conduct a series of public hearings with local authorities to discuss the benefits of incorporating their jurisdictions into the concession area. The newly created regulatory entity's Board of Directors played a key role by steering a number of meetings with municipal authorities and user organizations.

When the concession began, the actual service area was limited to the same 43 municipalities previously served by the former public utility. After the contract was granted, the concessionaire began to incorporate new municipalities in its service area by directly negotiating with the local authorities. In some cases, the concessionaire took the initiative to engage in negotiations with the municipality, while in others the local authorities approached the operator.

MECON, S.A., a local construction company, received the concession contract, in which the company bid an investment of US$ 97 million in the first 15 years. An industry leader in Argentina, the company, which already boasted a diverse portfolio of investments throughout the country, began pursuing new opportunities open to the private sector during the utilities reform process of the 1990s. In order to fulfill the technical assistance requirements contained in the bidding documents, MECON, S.A. signed a contract with the public utility of the state of Parana in Brazil (SANEPAR). This marriage facilitated, in part, the success of MECON, S.A. in winning the concession contract. In addition, over time it led to increased technical capacity within MECON, S.A. itself.

Box 11: Regulatory Principles in Salta, Argentina

The architecture of the concession incorporated a system of checks and balances that was intended to maintain a positive incentive structure, and foster cooperation, partnership, and trust, while allowing a certain level of flexibility so that momentum toward the objective of universal coverage could be sustained.

The main actors involved in the PPP are the provincial government (as the granting authority), Ente Regulador de los Servicios Publicos–ENRESP (as the autonomous, decentralized regulatory entity) and Aguas de Salta (as the concessionaire). As the granting authority, only the Provincial Executive Office is vested with the responsibility to make decisions regarding cancellation of the concession or renegotiation of its terms. Neither the regulatory framework nor the concession contract provided for the involvement of local governments. Therefore, a strategy was designed to build bridges between the municipalities, user organizations and the concessionaire. Through these arrangements, ASSA provides technical assistance (engineering, supervision, and general documentation for works needed) to municipalities, whereas the municipalities and user organizations provide unskilled workers and materials. Given that ASSA is required by the concession contract to reach universal coverage in the first 15 years of the contract, the in-kind contributions made by the municipalities and user organizations are recorded as loans to the company to be repaid using various mechanisms, such as: exemption from paying for service until the value of the contribution is covered, cancellation of previous existing debts with the company or provision of additional work for which customers would usually pay (for example, connections, meters, etc.).

The concession contract sets up criteria for regulation of the investments that are divided into two groups:

- *Works and investments to be funded via a tariff charge.* Tariffs should be sufficient to cover operating costs, amortization and return on investment.
- *Works and investments to be funded via other financing sources.* These would be financed by the provincial government during the first five years of the concession, after that period, the regulator would define a financing mechanism.

Under this contract the concessionaire has the right to determine the tariff based on covering (efficient) costs, and then transfer the benefits of an efficient operation to the consumers. The tariff regime promotes consumption metering, rejects the application of cross-subsidies, and establishes periodic tariff reviews every five years as well as extraordinary reviews in case there is a significant increase (more than 5%) in operating costs.

Ten percent of the customers' base (or 24,470 clients) are billed using the metered system. Since most clients pay based on a flat rate, there are no incentives to promote efficient water usage. One of the main reasons for the low meter coverage has been the fact that, in accordance with the concession contract, customers had to pay for the connection and the meter in order to be part of the new system. Since the renegotiation of the contract in June 2004, a new method was designed to increase the number of meters installed in order to increase the number of clients to be billed based on consumption. The provincial government and the concessionaire agreed to relieve the customers of these costs and launched an ambitious program (financed equally by both parties)

to install an average of 1,800 meters per month with the objective of reaching 90% meter coverage in 10 years. In 2005, over 15,000 new meters were installed bringing the total number of meters installed since the beginning of the concession up to 34,770.

The concession contract establishes that poor households are not obligated to pay the total amount of their water bills and that the province should cover the difference between the amounts paid by those consumers and the invoice for the service. This subsidy arrangement is funded entirely from the provincial government's budget. The concession contract allows for exempting the province from payment obligations originating in the subsidies by reducing the concessionaire's investment obligations proportionally.

An eligibility scoring system is the main instrument used for allocating subsidies. It produces a score (the ENRESP score) for each household applying for the subsidy, based on the answers to a survey submitted to the concessionaire. In order to monitor whether the subsidies are being appropriately awarded, the regulator has implemented an evaluation program through an agreement with the University of Salta. Based on a sample of households provided by the regulator, each month the University audits about 20 households that receive the subsidy.

Even though the concession contract does not specify annual coverage targets, the concessionaire is obliged to comply with the investment plan and time schedule submitted in the bid. During the periodic reviews, the concessionaire must prepare expansion and investment plans which are presented to the regulator for its approval. Once the investment plan is approved by the regulator, the terms of the investment plan become part of the concession contract and if the concessionaire fails to perform the investments as committed it is considered a serious breach of the contract.

The concession contract permits special treatment of "unprofitable" service areas. According to these specifications, the regulator may allow service provision under different standards in remote or isolated areas where service is deemed unprofitable. This is an innovative feature that solves some problems that arose in other concessions where uniform standards provided poor incentives for investment in poor areas and triggered endless legal disputes between the government and service providers.

In January of 2002, after weeks of turmoil including civil unrest, three presidential resignations and the freezing of bank account deposits, the National Congress passed Law 25.561 granting emergency powers to the President and authorizing the rejection of the Convertibility Law that had caused the peso to devalue by 70 percent. The Economic Emergency Law 25.561 authorized the Executive Office to renegotiate all contracts that involved provision of public services and prohibited the application of any clauses in existing concession contracts that allowed tariff readjustment based on procedures tied to foreign currencies. The Legislature of Salta adhered to the principles outlined in the National Emergency Law by authorizing the Provincial Executive Office to re-negotiate the concession contract with Aguas de Salta.

Except for the granting — in mid 2002 — of a 20 percent tariff increase that had been postponed since the beginning of the concession contract, all other aspects of the contract (investment plans, the metering program) endured a lengthy renegotiation process (generally conducted by the Joint ENRESP-Aguas de Salta Working Commission) that ended in June 2004. This two-and-a-half year long renegotiation process finally came to an end with an agreement in February 2004 on the following issues:

- The 5-year investment plan corresponding to the period 1999-2003 was considered closed.
- The parties agreed to renounce any claims arising from works related to the afore-mentioned period or from any other matter agreed upon in the renegotiation process.
- The Meter Installation Plan would be financed 50% by ASSA. (Previously financed directly by consumers, as described above.)

Conclusion

Privatization of water supply and sanitation services in Latin America reached its peak in the 1990s, albeit in the midst of much controversy region-wide. Concessions across the continent failed, often because they failed to establish coverage for the poorest citizens. History shows the case of Salta Province, Argentina, a case that incorporated lessons from these earlier failures, and one in which the World Bank was not involved, as a relative success unmarred by significant conflict. The achievements made toward the objective of universal coverage are notable in part because the concession took place in a poor province, and because it survived a major economic crisis in the country. The unique structure of the concession emphasized collaboration and

partnership between the provincial government, the concessionaire, the regulating agency, municipalities and citizens throughout the concession process.

Since the beginning of the concession (numbers reflect the time frame of 1998-2006 [152] and despite delays in the investment plan during the renegotiation period, a number of achievements have been made:

- Coverage increased from 76% to 96% for water supply and from 54% to 84% for sanitation;
- The percentage of population affected by service interruptions decreased from 32% to 8%;
- A 56% increase in annual billing from $ARG 33 million to $ARG 51 million;
- Revenue collection reached 90% by combined billing with the electricity distribution company;
- An increase in the total volume of water produced from 130 million m^3 per year to 165 million m^3 per year;
- Efficient treatment of 95% of wastewater collected;
- Customer service toll-free line with capacity to receive 300 calls per hour was established; and
- The number of municipalities served by the concessionaire was increased from 43 at the beginning of the concession to 56 in 2005.

The Salta water concession is an interesting PPP model that has survived both the 2001 macroeconomic crisis and the revision of private participation schemes in Argentina's public services. The main reasons for its success lie in a number of considerations embedded in the transaction process design as well as the government's continuous commitment to make the concession sustainable in the long-term (as evidenced by its willingness to provide political support from the beginning of the concession and throughout the life of the contract).

In the context of broader social upheaval, and having seen widespread protest over privatization of water services elsewhere in the region, incentives were in place for the agencies involved to carefully craft and implement a reform that would contribute to social cohesion rather than division. The stability and steadfastness of the provincial government has been a key factor in maintaining the concession's success. Through the reform, provincial authorities hoped to unite and solidifying its power base among a diverse group of political parties and social groups. Even though during many critical moments, especially during the macroeconomic crisis, opponents to the concession called for its cancellation, the provincial government did not give in.

A series of technical considerations such as the broadly appealing goal of universal coverage, contract flexibility and local government involvement contributed to the positive outcomes of this concession.
Achieving universal coverage was one of the sector reform process priorities that influenced the way the concession and contract were developed. The Provincial Government and the regulator have been consistent in maintaining the pre-eminence of this objective and their actions have supported the concessionaire in achieving it. On one hand, the Provincial Government contributes by co-financing the investing plan from its own budget; on the other hand, the regulator's decisions have facilitated the channeling of investments in a supportive manner.

The contract's flexibility has aided the concessionaire in achieving certain targets. For example, in the case of the obligation to supply non-profitable locations, the contract allowed the concessionaire to negotiate with the regulator on levels of service to be provided in those areas. The regulator now allows the provision of water under lower quality standards (e.g. fewer hours of service), which in turn has made feasible the incorporation of new properties into the supply network. The concession contract explicitly allows for its renegotiation and provides a framework that creates an enabling environment for collaboration between the concessionaire and the government.

[152] World Bank, 2007b

The engagement of local governments with the provincial authorities and the concessionaire has played a key role in the success of the contract. The development of a direct relationship between the concessionaire and local governments has contributed to improved understanding of the PPP across communities, and has furthered the acceptance of private sector participation in the water sector.

A clear indicator of this PPP's accomplishments is the financial health of the concession. The government commitment is evident from its continuous support of low-income customers through the direct subsidy scheme and its willingness to approve tariff adjustments that allow the concessionaire to reach financial equilibrium despite the political opposition for such moves. The concession's success also indicates that the general population is prepared to pay the cost of improved services provided there is clarity about the policies implemented by the government.

Finally, the provincial government's initiative to break the traditional paradigm of only allowing companies with significant previous experience in water service provision to compete in the bidding process has allowed a strong local utility services provider to develop. Although the company received technical assistance from a qualified regional water service provider in the first years of the partnership, it has developed its own know-how which has been a key factor in its success in obtaining a new concession in Argentina and, most recently, in Peru.

2.3 Water Sector Reform in Albania

Background

Although Albania has abundant water resources, its drinking water and sewerage infrastructure is considerably aged, damaged, and inefficient in both urban and rural areas. This results in real water supply deficiencies, primarily poor quality services (low hours of supply, low pressure, poor water quality) and low coverage (particularly rural water and rural and urban sewerage and Wastewater treatment). Within the ECA region, Albania ranges as low performer regarding of access to water supply and sanitation, efficiency and financial performance[153]. The reasons for this include poor management of utilities, insufficient investment, inefficiencies, and no incentive to change as subsidies reward inefficiencies, and utility ownership still remains with central government. The majority of utilities is under-financed and operates below cost recovery due to high technical and commercial losses (66%), poor collections, low tariffs, and inefficient management that is characterized by overstaffing, lack of metering, weak management systems. Due to poor management of resources, unsustainably low tariffs and a flat tariff structure, the sector had become completely unviable financially, draining public funds. Prior to the reform outlined below, access to water supply averaged only 2-4 hours of service per day, with many getting no water at all. Sewerage coverage stood at 50%. The poorest population groups were particularly affected, as their accessibility to water is lower and their cost of access is higher (in relative and absolute terms).

In 2001, the Government of Albania (GOA) outlined a "Strategy for Decentralization and Local Government" in its National Strategy for Socio-Economic Development (Poverty Reduction Strategy Paper, 2001). The Government included water sector reform in its PRSP to address *"the main sector issues, especially the central government's changing role from service provider to service regulator, and the need for greater cost recovery"*[154]. The water sector strategy aims to improve service provision efficiency and effectiveness, ensure access to basic infrastructure services, and improve the targeting of the poor. The 2000 Law on Decentralization (Law 8652) became operational in 2002 and gives local governments the sole mandate to provide water and sanitation services. Central government, through the Ministry of Public Works, Transport, and Telecommunications, however, continues to operate the assets of most of the utilities that serve two thirds of the population.

[153] World Bank, 2006
[154] IMF and IDA, 2002, p. 10

The Reform

The Government called for urgent water sector reform to provide equitable access to safe water at affordable tariffs.

Box 12: Albania's Water sector reform – PRSP Priority measures

(i) investments for the improvement and expansion of the water supply system and for the improvement of water quality;
(ii) rehabilitation of the sewage network;
(iii) cost recovery through tariff regulation, elimination of the illegal connections, reduction of losses in the network, accurate measurement of water consumption, and improvement of payments;
(iv) improvement of the sector management by transferring full water supply and sewage responsibilities to the local government, support for private sector involvement and encouragement to use alternative forms for the management of water supply systems, such as contracts for management or with concessions.

In the context of the decentralization process, special attention will be attached to increasing the participation of the community in the projects for improvement of water supply and sewage systems.

Source: Republic of Albania, 2001, p. 82

To implement the reform, specific attention is needed on both the fiscal/financial and the institutional aspects. Firstly on the fiscal side, the reform aims to remove the operating subsidy to force utilities to generate more of their own revenue. Own revenue can be increased by (a) reducing costs, and (b) increasing revenue. Currently, utilities have about 66% of non-revenue water. This is due to high technical losses and commercial losses — the later is either illegally tapped water, or more importantly, water that is not metered (customers are charged for 150 liters, but actually consume up to 600 liters per capita). The reform aims to reduce non-revenue water to reduce operating costs. With the savings in operating subsidy, central government can allocate funds for investment, based on improved performance. Hence, reducing costs entails the largest gain and is a key focus of the reform. Regarding revenue increases, the reform aims to first increase collection, currently at 70%, to improve services, and to increase tariffs at a later stage. [155]

Secondly on the institutional side, the reform introduces private sector participation to improve management, efficiency and incentives, and implements decentralization to improve incentives and enhance local accountability.

According to the Decentralization Law, water utilities, together with local governments, have the right to make all decisions on operations, investment, and tariff setting[156]. Central government is responsible for water resource management, water quality and regulation of water supply and wastewater services. Some reform progress has been made, including metering programs have started in a few cities; this shift away from flat-rate billing to allows consumption to be priced appropriately to provide water and wastewater services in a sufficient and cost effective way. Utilities are registered as commercial entities, but operate as state owned enterprises, and move towards eventual cost recovery, which implied an increase in water supply tariffs to reflect the true cost of water supply. Wastewater tariffs have been introduced. Parliament has passed the Law on the water bill as an executive title. Utilities have started to take legal actions against illegal consumers

[155] The national Water Strategy provides further details on the Cost Recovery Policy that consists of: (i) development of a phased cost recovery policy by local governments; (ii) introduction of a new subsidy policy for poor families; (iii) tariffs reflect the changes in utility costs; (iv) termination of cross subsidy between different customer groups; (v) move towards universal metering, and (vi) enforcement of fee collection. Additionally, the Water Chapter of the PEIR recommends in regard to tariff policy to: "Raise residential tariffs to cover O&M cost and depreciation, with the full cost of supply coverage (including the cost of capital) in the long-term. In parallel replace the current universal operating subsidy by a scheme that targets the poor possible by linking it to Ndihma Ekonomike.

[156] Republic of Albania, 1999

and non-paying customers in court and enforce disconnections with active support by the Municipal Police[157].

To implement the strategy, the Government employs two parallel water sector reform models — one with *public utility management,* led by local governments; and one with *private utility management,* where private sector participation is piloted by the World Bank's Municipal Water and Wastewater Project (MWWP) in four cities[158]. The MWWP is funded by a $15 million IDA credit, plus $6.93 million from the Albanian Government and pilots the approach in the four cities of Durres, Saranda, Fier and Lezhe between December 2002 and 2009. The project's objectives are (i) to improve water supply and sanitation services in four participating cities, and (ii) to achieve financial viability in the water utilities by introducing a new incentive-based multi-city management contract approach that involves private sector participation. The project comprises a five-year Management Contract, Investment Fund, and Technical Assistance. The Management Contract[159] is based on a fixed fee, and a performance incentive fee that is linked to four indicators, that also act as performance improvement indicators:

(i) *safety and quality* through an increase of water quality analyses that meet faecal coliform standards;
(ii) *reliability* through increased number of hours of water supply;
(iii) *financial viability, efficiency and sustainability* through improved collection rate and working ratio; and
(iv) *service to the poor* through an increase in service of the total population (in service area) with a minimum of two hours of daily water supply, a lifeline of 20 liters free water per capita/ per day to mitigate the negative impacts of tariff increases on the urban poor.

The project further installs water meters to measure and bill for actual household water consumption.[160]. The operator has full responsibility for managing the investment program; operating the water supply and sewerage systems; developing and implementing the demand management program, including a public awareness campaign; and implementing improved commercial (billing and collection) and financial management systems. The project's investment fund finances works, goods, and services to improve the operation of water supply and sanitation services, and to achieve the performance targets in the management contract. The project's technical assistance helps to strengthen project implementation through a Project Implementation Unit, and consulting services for supervision of the management contract and audits, studies, and field investigations related to the Project. The government of Albania contracted *Berlin Wasser International* as the private operator, who took over utility management in the four project cities in September 2003. However, changes in operator management were necessary, and the operator did not start formally until June 2004.

To ensure civil society engagement during project design and reform implementation, several consultations were conducted, including a Rapid Needs Assessment (February 2000) and a Social Assessment (May-August 2000). This informed the project design through the creation of monitoring and evaluation measures for beneficiaries, Consumer Panels that allow a direct interaction between water-users and utility management; and public information campaigns by the private operator to keep citizens informed about water supply and sanitation services, tariffs, etc. During project implementation, this has been further developed, for instance, though the creation of water consumer associations.

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[157] There are some reports of cases where courts tended to postpone their decisions or where court decisions have not being executed

[158] Apart from the MWWP, the Bank also provides policy advice through a Development Policy Operation. Analysis of the sector has been done through the Public Expenditure Review (PER), Poverty and Social Impact Analyses (PSIAs) and Public-Private Infrastructure Advisory Facility (PPIAF)

[159] The four municipal service areas, with a total of about 350,000 inhabitants, were combined under one management contract to manage costs, and to make the contract large enough to attract highly qualified international utility operators. The utilities, however, remain distinct and separate entities, independent from each other.

[160] World Bank, 2002

Political economy risks to reform

One stumbling block to reform has been the political economic risks posed by diverging interests within and outside government, including central government resistance to relinquish authority. As a former socialist country with a centrally-planned economy, Albania's central government dominated planning and public works, while local institutions have traditionally been weak and un-empowered.

A Poverty and Social Impact Analysis (PSIA) was conducted during 2003-04 to examine the distributional impacts of the decentralization and water sector reform at the beginning of the reform and to set a baseline for future assessments[161]. The study examined the institutional changes that the decentralization reform entailed, and assessed the impacts that the associated changes in power relations between central and local government had on water tariffs, access, and subsidies. The analysis uncovered that the position and actions of key stakeholders regarding the reform create obstacles to its effective implementation. It further found that reform progress is slower than expected and is uneven. This is associated with political economy reform issues that stem from an **uncertain policy environment** due to incomplete information about new, decentralized roles and responsibilities, including the future control over investment streams; **water pricing; and unprofitable water companies**, and small companies with little capacity. Divergent interest exists horizontally between central government ministries, and vertically between central and local government[162]. For instance, within central government, there is some aversion to decentralization due to lack of clarity on the control over future investment streams. The Ministry of Interior (MOI) and the Ministry of Economy, Trade and Energy (MOTE) both want to retain such control after decentralization has been implemented, but central government has not made a respective decision yet – central government is allocating more funds for water and sanitation investment to local government through the Competitive Grant, and this is said to increase over the coming years. Loss of power and decision-making authority seems particularly challenging to the water sector line ministry, Ministry of Public Works, Transport and Telecommunications (MOPWTT). Many local governments do not want to complete the asset transfer, as utilities are unprofitable, inefficiently managed or insolvent. Tariffs cover 70% of operating cost, but only 70% are collected, which leaves utilities with a mere 49% of revenues (0.7 X 0.7) from its customers. As the paramount political economy issue, water pricing reflects the reluctance of local governments to charge higher tariffs to increase utility revenues, as this is politically not attractive with their constituents Further examples include[163]:

- MOPWTT, the line ministry for the water, does not advance the decentralized asset transfer as scheduled because it does not want to reduce its authority vis-à-vis local government
- MOI, the line ministry for decentralization, has been able to get a council of ministers' approval for the Water Decentralization Policy Paper, the implementation of the paper's recommendations does not receive the proper attention by MOPWTT or MOETE
- Local governments are reluctant to increase water tariffs due to political reasons, and are not yet fully exploiting alternatives to increase utility revenues, e.g. through decrease in non-revenue water via increase in collection rates, reduction of commercial and technical losses.

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[161] The study examined the four project cities of the MWWP in comparison with four control cities with public utility management., see also Co-Plan et al., 2004, and Beddies and de Soto, 2006

[162] Ministries have the following mandates: The council of ministers is responsible for the legal components of the reform, drafts and presents laws to parliament and issues bylaws. The line ministry of water, the Ministry of Public Works, Transport and Telecommunications (MOPWTT) designs the water sector strategy and policy, and is responsible for asset transfer to local government (only 9 out of 55 transferred at this point), the planning and distribution of investment funds, and the design of subsidy policy. The Ministry of Interior (MOI) is the main actor responsible for the decentralization reform, and was able to get the council of ministers approval for a Water Decentralization Policy Paper. The Ministry of Economy, Trade and Energy (MOTE) is responsible for transforming water utilities into shareholder companies, The Ministry of Finance (MOF) provides subsidies to the water utilities, most of which have inherited central government debts that have slowed down the asset transfer. MOPWTT, MOI and MOTE represent central government on the supervisory council of the water companies (all cities), and on the executive committee (project cities)

[163] These examples are findings from the MWWP PSIA, unless stated otherwise

- In an attempt to move the water utilities toward cost recovery, local governments in cities with privately managed utilities have increased tariffs. Local governments with public utility management, however, have pursued a more conservative approach to tariff increases due to perceived public pressure, and have lower cost recovery rates.
- Many local governments do not want to take over utilities that are unprofitable, and indebted or insolvent
- Owing to incomplete asset transfer and lack of ownership, local governments do not push utilities to increase tariffs to reach cost recovery
- Local governments will be gaining representation in the supervisory councils of the water companies, particularly in the cities with privately managed utilities under the Bank project. However, these councils still remain under the control of the central government, which retains a 2/3 majority, as MOPWTT, MOI and MOTE represent central government on the supervisory council of the water companies
- Local governments lack capacity in capital and project planning and in water resource management — all of which are essential for a tariff policy with cost recovery for utilities, affordability for customers, as well as for water conservation, quality service provision, and customer service measures. In cases where utility assets belong to more than one local government unit, local governments face additional challenges to set tariffs, for instance in Durres with regional (urban and rural) utility management.
- Utilities have no incentives to reform as they receive operating subsidies from central government, which has been increased five-fold over the last five years. Most utilities have inherited central government debts that have slowed down the asset transfer.
- Investments are financed through transfers from the central to local government, and the water sector's dependency on central government transfers has increased in recent years because of increasing electricity prices, which are driving up operating costs. [164]

The reaction of civil society to the reform process has also been a significant influence on progress and outcomes. The implementation of the decentralization and water sector reforms, however, sparked intense public debate. Civil society responded with demonstrations in Bathore, Tirana, in April 2003 against tariff increases without service improvement and continued inefficient utility operation. This debate on water tariffs and water supply and sanitation services gained further momentum during the run-up to the local government elections in October 2003.

The reform complexity becomes visible in another example: In May 2006, the Prime Minister decreed a full asset transfer from central to the local governments by December 2006. This, however, can only be achieved if the outstanding issues are resolved, such as the division of utility assets between multiple local government units, the constitution of the Supervisory Boards, future financing from central government, and central government support for the development of local capacity to assume their new responsibility.

As a consequence of the above mentioned issues, decentralization reform has advanced at two speeds. While progress has been made toward a reasonably strong legal framework for fiscal decentralization, implementation has fallen behind. Access to adequate water and sanitation services continues to be very low in Albania compared to other countries in the ECA region. The share of the Albanian population connected to the water supply network is estimated at 78% versus a 91% average in the region. These statistics are worse in regard to sanitation, with 49% of the population connected to a water-borne sewerage network, as compared to 82% in the region. The majority of the population has water less than 12 hours per day, and contamination and environmental health remain serious problems. It is further expected, that the increased water tariffs could have some adverse distributional consequences on different socio-economic groups and further en-

[164] The World Bank, 2006m

hance the large disparities in access to water between rural and urban households[165].

According to the mid-term review of the MWWP, however, significant improvements have been achieved in the four project cities. For instance, water supply was increased in Fier from about 6.2 to 11 hours and in Saranda from about 1.8 to 11 hours, and the collection and the working ratios show significant improvements in all 4 cities. Furthermore, the 4 utilities will be able to cover their cash operating expenses by project end, if tariffs and collection are increased as anticipated, and other measures implemented as envisaged. A lifeline subsidy was instituted, providing 20 free liters per person per day to the poor in order to protect them from overall tariff increases. Furthermore, public and local government participation has increased, leading to improved understanding and increasing consensus around reforms.

Conclusion

At present, the envisaged decentralization process remains constrained by the lack of local absorptive capacity as well as political and bureaucratic obstacles that hamper reform efforts. Incomplete decentralization, however, has proven to be one of the main obstacles to the water sector reform progress. For instance, utility asset transfer, financial viability, and the legal framework have become important factors for the success of the water sector reform. One crucial lesson is that decentralization not only entails fundamental changes in institutions, incentives and accountability that take time, but that it also conditions the progress of sector reforms, such as the water sector in this case.

The MWWP has applied lessons learned from earlier projects conducted in Albania and elsewhere, which proved relevant to this context. These lessons include:

- Politicization of tariff liberalization, staff recruitment and other administrative and financial matters undermine the potential for reforms and diminish improvements of service delivery; and
- Commercial and financial autonomy of water utilities is essential to reduce political interference in the day-to-day management of the water utility and to achieve the financial objectives

A lesson that goes beyond the sector is that the participation of local governments in project preparation and implementation is essential to establish ownership and commitment.

Findings from the PSIA baseline highlight the need for a sequenced reform implementation and detailed analysis of stakeholders, institutions, impacts and risks to improve reform progress. Data from all eight study sites suggest that improvements in service quality and the collection ratio should be made a prior condition for gradual tariff increases in order to maintain consumer satisfaction. The analysis suggests accelerating the completion of the meter installation program before further tariffs increases. Furthermore, utilities should further exploit other means to increase their revenues, such as reduce non-revenue water by reducing technical and commercial losses and increasing collections.

Looking forward, the government of Albania intends to scale up elements of this four-city pilot to the national level and the Bank contributes financing through a Development Policy Loan (DPL). As the reform process continues, further emphasis will be placed on phasing-out of the operating subsidy to the local governments, and introducing a performance-based element to the investment subsidy. In addition, social subsidy options for the poor will be considered.

[165] The World Bank, 2007c

2.4 Water Sector Reform in La Paz and Cochabamba, Bolivia

Background

In 1990, only 50 percent of Bolivia's urban population had access to water, while only one in three had access to sewerage. Quality of water supply was a serious concern countrywide, with contamination and frequent rationing being persistent problems. Consequently, enteric diseases had a high prevalence rate, contributing in turn to high levels of infant mortality.

Bolivia' history is characterized by exclusion and racism toward the majority indigenous population. Bolivia is a constitutional republic with a presidential system, but until 1951 only landowners possessed the right to vote, in effect excluding most indigenous peoples from the country's political processes. Additionally, narcotics production has been a key profit area for Bolivia's agriculture sector, creating a particular internal policy dynamic as foreign governments crack down on the drug trade. Tensions in the country have simmered just below the surface in this context.[166]

The World Bank was involved in financing three water projects in Bolivia in the 1980s and 1990s, which performed reasonably well though in the context of unstable macroeconomic conditions. The Government of Bolivia (GOB) subsequently approached the Bank seeking a more ambitious water supply and sanitation program. The Bank approved a $35 million project for an urban water rehabilitation credit for the utilities of three major Bolivian cities: La Paz (and its poorer sister city, El Alto), Santa Cruz de la Sierra, and Cochabamba, where combined over 60 percent of Bolivia's urban population resides. The project was active from 1991-1997[167].

Simultaneously, the GOB was implementing a reform agenda aimed at redefining the role of the state, attempting the capitalization of state enterprises in an effort to reduce the government's role in productive activities, and increase private investment. The poor performance of the water and sanitation sector, coupled with the perceived success of the capitalization program prompted the GOB to consider private sector participation in the water sector.

The Reform

A project to rehabilitate and expand existing water and sewerage services, transportation and distribution facilities for three urban water utilities, was appraised at $57 million, toward which the World Bank approved a $35 million IDA credit. The appraisal anticipated over 1 million project beneficiaries.

La Paz/El Alto and Cochabamba were each serviced by a separate and single municipal utility; SAMAPA serviced the former and SEMAPA serviced the latter. Santa Cruz de la Sierra was serviced by several water cooperatives, of which SAGUAPAC, a cooperative owned by its customers and the implementing agency for the project's Santa Cruz component, was the largest. SAGUAPAC had service and tariff structures that were

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[166] The World Bank's Country Social Analysis also highlights some of these issues.

[167] The objectives of the Major Cities Water Supply And Sewerage Rehabilitation Project (P006172) were to (a) Improve and expand water and sanitation services in the three major cities of Bolivia, mainly by (i) rehabilitating water production facilities and increasing water distribution capacity in La Paz to benefit 200,000 people, or 13% of urban population in 1995; (ii) constructing sewerage systems in the municipality of El Alto to benefit 200,000 people or 13 % of the urban population in 1995; (iii) installing water production and distribution facilities in areas currently not served in Santa Cruz to benefit 300,000 people or 35% of the urban population in 1995, and expanding sewerage systems for 30,000 people; and (iv) rehabilitating and expanding water production, transmission and distribution facilities in Cochabamba, to benefit 300,000 people or 50% of the population in 1995, with access to piped water and eliminating/reducing rationing; (b) Improve the operational efficiency and management systems of the three cities' water utilities; (c) Introduce a framework of sector policies and the institutional arrangements needed to accelerate the development of the water supply and sanitation sector countrywide; (d) Improve the institutional capabilities of central agencies for overseeing the water sector, mainly through the introduction of management systems; and (e) Improve coordination between the Bolivian authorities and donors in preparing and financing sector-wide projects.

more advanced than the other two utilities, though coverage and connections were lagging behind. While SAGUAPAC (Santa Cruz) had at a minimum routinely adjusted its tariffs to keep pace with inflation, SEMAPA (Cochabamba) and SAMAPA (La Paz/El Alto) were subject to greater political interference in their management decisions; as a consequence delays in tariff increases meant fees had been kept unsustainably low. Raising tariffs was seen by the government as a key issue for the reform process, as it was necessary to the sustainability of improvements. Thus, as a condition of loan negotiations, the two utilities had to increase their tariffs by 30% in the first year, and maintain their monetary value, adjusting for inflation regularly, for the life of the project.

Project performance in SAGUAPAC's (Santa Cruz) coverage area proved highly satisfactory, with all programmed work completed by the closing date in 1997. In contrast, SAMAPA (La Paz/El Alto) and SEMAPA (Cochabamba), because of political interference had barely begun to implement their project components. All three utilities managed to improve coverage and service improvements, but leakage rates deteriorated substantially under SEMAPA (Cochabamba). In contrast to the other two companies, SEMAPA (Cochabamba) also saw a significantly lower than projected rate of return – less than 1 percent, against the 15 percent originally expected.

The President of Bolivia, supported by the Mayors of La Paz and El Alto, and Cochabamba decided to seek private sector participation in both SEMAPA (Cochabamba) and SAMAPA (La Paz/El Alto) by awarding 30-year concession contracts with full operation/maintenance and investment responsibilities. In view of this, the World Bank decided to extend the project closing date of June 30, 1996 to December 1997 in order to help prepare the utilities for privatization. Contact was made with potential investors to raise interest. In an effort to build consensus among key stakeholders, consultations were held in parallel. The concessions of SAMAPA and SEMAPA proceeded at different paces. The concessions were prepared and bidding started simultaneously. However, the bidding process for Cochabamba was derailed, in turn impacting implementation as discussed below.

Concession of SEMAPA (Cochabamba)

In Cochabamba, due to severe water resource constraints, water resources management has historically been a politically sensitive issue. The popular mayor and potential presidential contender, Manfred Reyes Villa, had been very supportive of the concession concept. During the preparation of the first process, supported by the Bank, he processed a tariff increase of thirty percent, which was accepted by the users without opposition. He started to oppose the process, however, after learning that the Misicuni Project would not be implemented as the new water supply source of the city. By giving mixed signals on the merit of the potential concession, the mayor bolstered an opposition movement among the management of SEMAPA (Cochabamba). Villa's party stood in opposition to the current presidential administration.

The concession included investment to develop a new water resource for the city. Two potential schemes were considered: the Corani and the Misicuni. The Misicuni scheme, almost twice as expensive as the Corani, involved construction of a dam, hydropower facilities, and a water conveyance system. This technical solution to Cochabamba's water scarcity problem was pushed by the agricultural lobby. The Corani, the site of which was physically more close to the urban area, involved rehabilitation and expansion of existing facilities, rather than new construction. The Misicuni concept had been under development for 40 years, and over time gained substantial support in Cochabamba. After considering the environmental and financial costs of each, the Bolivian government decided to proceed with the less expensive Corani scheme. This decision was heavily and immediately opposed in Cochabamba. In light of this disagreement the mayor of Cochabamba filed a complaint against the project, which in turn led the Supreme Court to halt the bidding process.

The outgoing president revoked subsidies earmarked for the water development project before his departure. Within three weeks of its inauguration, the new government of President Banzer, the former opposition party restored the original board structure of SEMAPA (Cochabamba), took over the concession process, and rein-

stated the water supply scheme that included the development of the Misicuni project. The World Bank, which had expressed its concern with the expense and viability of the Misicuni scheme, decided not to renew the expiring IDA grant, effectively terminating its involvement in the Bolivian water reform program.

Aguas del Tunari, an international consortium under British leadership, submitted the only bid for the second Cochabamba concession process in April 1999. The company signed a 40-year concession agreement in September 1999 for provision of water and sewage services without significant experience in the region. The concessionaire was responsible for servicing SEMAPA (Cochabamba)'s significant debt. The concession contract gave the concessionaire exclusive rights to Cochabamba's water resources, and hence the right to require consumers to connect to the system. The complex tariff structure, which categorized nine types of users, included a mandatory minimum flat fee, and additional increasing rates based on water usage. An immediate tariff rate increase of 35 percent was adopted, with a further increase of 20 percent scheduled after the new Misicuni water supply system had become operational.

The SEMAPA (Cochabamba) concession was taking place in the context of other important changes that were causing stress and controversy in Cochabamba. First, a severe countrywide economic recession was contributing to a general sense of anxiety among the population. Second, a new water law was causing concern among small farmers (despite insistence from the government that the law would not impact them). Finally, coca farmers were experiencing a major loss of income in the wake of a successful coca eradication program, which was fostering enormous resentment. These grievances converged, and the water concession became a focal point for a popular movement. A citizens committee, Coordinadora del Agua, was established, taking on an advocacy role for concerned professional and civil society groups, and coca growers.

In Cochabamba, tariffs had to be sharply increased to cover the concessionaire's costs for the Misicuni project. Cochabamba's new tariff structure benefited some, mostly lower-income and small consumers, who saw relatively small increases in their water bills (some as low as 10 percent). The impact on the water bills of some high-income consumers was very large (in some cases exceeding 200 percent).

Water scarcity, coupled with poor public service provision and an absence of regulation had enabled the development of a distinctive local market for alternative supplies. When Aguas del Tunari received exclusive control of Cochabamba's water resources, this jeopardized important vested interests. The implementation of the exclusivity clause impacted three groups: high-income consumers (who had previously dug their own wells and installed their own holding tanks for a cheap personal water supply), small-scale providers (truck vendors and cooperatives now did not have a source of water for their businesses), and the poor (whose only option for supply now was to connect to the utility). The non-connected poor, in fact, would have gained from the concession as they paid to vendors much more than they would have paid in tariffs to the operator.

Although Cochabamba's tariff increases brought them more closely in line with the tariffs of La Paz/El Alto and Santa Cruz, public protests emerged, resulting in demonstrations, roadblocks, strikes and riots. In the spring of 2000, protests escalated into violence, and the media promptly dubbed the events in Cochabamba a "war over water". Protests spilled over to other Bolivian cities, including La Paz/El Alto.

Under intensifying pressure, the government signed an agreement with the Coordinadora, immediately reducing the tariff to 20 percent. Violence quickly escalated that same day as protestors took over the city of Cochabamba; clashes with police resulted in arrests, injuries, and deaths. The government made a series of decisions thereafter, and within days the responsibility of providing water services was returned to SEMAPA, after the concessionaire had operated for about 3 months. Since 2000, Cochabamba has once again been serviced by SEMAPA. According to figures obtained from the water regulator, SISAB, SEMAPA has approximately 9 employees per 1000 household water connections, (3-4 times the number of an efficient utility of the same size), non-revenue water in excess of 50% and less than 15 hours per day of supply (average, 2004). Given the unavailability of piped water supply in several parts of town, many poor users are forced to purchase water from water tankers at a ten-fold rate compared to the network-connected population. Further-

more, since 1997, when the Bank left, practically no investments have been made to improve water supply within the city. Of the city's population, forty percent (mostly poor) is not connected to the water supply system.

Almost $100 million was invested in constructing the Misicuni tunnel, which has since been completed but is not fully functional since it is not yet connected to a water supply source. It has been estimated that if the same amount would have been invested on water and sanitation infrastructure within the city, coupled with the development of the Corani water supply source, universal water supply and sanitation in the city would have been achieved.

While the failed privatization of SEMAPA has several causes, a key element in its failure involves the forced coupling of PSP with the Misicuni bulk water supply scheme, which necessitated tariff increases which were wrongly attributed to the "greed" of an international private operator.

Concession of SAMAPA (La Paz/ El Alto)

In La Paz and El Alto, consultations were held with neighborhood representatives, and two institutional changes were determined. The average tariff level was increased by 30 percent to ensure financial sustainability of the utility, and to raise funds for new investments in the system. Additionally, the tariff structure was adjusted, instituting increasing block volumetric tariffs for residential, industrial and commercial consumers. Within the residential rate structure, 4 consumption blocks were set-up with a large (30m3/month basic block for small consumers). Following implementation, the utility's revenue collection increased, while one in three consumers saw their bills decrease. The reform saw no major complaints from consumers.

An international bidding process was launched in April 1997, with the primary selection criteria focusing on the number of new water and sewerage connections the concessionaire could make in the first five years of the contract. In July 1997, the sole bidder, Aguas del Illimani S.A. (AISA, a consortium led by Suez of France (55.5% of shares), local shareholders (37%) and IFC (7.5%) signed a concession contract for a period of 30 years, building on its experience within the region. The concession was viewed as a state-of-the-art model, designed with the poor in mind. An innovative connection scheme was developed whereby poor families were given five years to pay for their connection charges. Secondly, customers could reduce connection costs further by contributing in-kind labor towards community works in their neighborhood. At the end of 2000, more than 80 percent of new water and sewerage connections constructed by the concessionaire had been made in the cities' poorest areas. According to figures provided by SISAB for 2004, coverage of water supply services in AISA's concession area stood at 98.7% (for La Paz and El Alto) while sewerage coverage stood at 91.1% (for La Paz) but only 60.5% for El Alto. These figures, however, masked two sets of unserved citizens: (i) those residing outside the concession service area; and (ii) those who reside inside the concession service area but were unable to connect due to high connection charges.

In 2001, five years into the contract, AISA stated that tariff increases were necessary to continue financing a strong investment program. A tariff review between AISA and the regulator was conducted, but the government appeared reluctant to increase tariffs — particularly because of the legacy of the Cochabamba experience. As a compromise, GOB authorized the increase of connection charges in order to finance the concessionaire's investment program. As a result, charges for new connections increased to relatively high levels, which prevented many poor users from connecting to the network. At the same time, tariffs for existing and new customers remained lower than the average for major Bolivian utilities[168]. These changes in connection fees occurred in the context of a sharp increase in El Alto's population as a result of rural to urban migration. While the affluent population resided in the La Paz valley, poor migrants settled on the mountain plateau of El Alto, often outside of the network and concession area.

[168] In 2004, the residential tariff for a monthly household consumption of 20m3, stood at 35 Bolivianos (= 0.22 USD/m3) while the average for major Bolivian utilities stood at 42.6 Bolivianos (0.27 USD/m3).

Unrest and instability increased across Bolivia during the second half of 2003 (precipitated by a debate about a proposal to export Bolivian gas to Pacific rim markets through Chile, a country with which Bolivia has a territorial dispute going back to the 19th century). President Gonzalo Sanchez de Losada was forced to resign in October 2003, and was replaced by Vice President Carlos Mesa. The political situation under President Mesa remained tense. The FEJUVE (Federation of Neighborhood Councils) of El Alto, became increasingly radicalized and drew increasing support from veterans of the Cochabamba "water war". FEJUVE El Alto took stands on workers' rights, and opposed gas exports and water privatization. On the issue of the concession, FEJUVE demanded a review of AISA's concession contract. Support from international NGOs mushroomed.

AISA secured a $3 million grant from the Swiss Cooperation Agency in a push to quickly expand coverage in El Alto. However, when progress was not immediately visible, the opposition saw an opening to contest AISA once again. FEJUVE continued to dispute connection charges and tariffs, and stated that 200,000 people remained unserved in El Alto. AISA declared that the actual figures of unserved households were only a fraction of FEJUVE's stated number, and that those households were located in peri-urban areas outside of the concession area. Nonetheless, AISA stated that efforts would be made to provide service to those households as well.

By December 2004, FEJUVE's movement continued to gain momentum, exploiting the Cochabamba experience and the popular discontent with El Alto's concession contract. FEJUVE encouraged customers to stop paying their water bills and threatened to launch civil strikes and road blockades if the GOB did not cancel AISA's contract. AISA, on the other hand, was initially slow to react to this popular challenge and ultimately lost support within the Mesa government by an ill-worded letter written to the President demanding government protection for AISA and its investments. The GOB increased petroleum prices in January 2005, which FEJUVE again heavily opposed. Faced with popular opposition in both the gas and water sectors, the GOB stood by most of its petroleum reform but issued a Presidential Decree on January 12, 2005, instructing the regulator to work towards the cancellation of the concession contract. Local groups claimed a "second victory" after Cochabamba. After Evo Morales was elected President in 2005, he appointed FEJUVE's leader, Abel Mamani as Minister of Water.

After nearly a year of negotiations with the new government, AISA handed over operations in La Paz and El Alto to a newly created "municipal and social" water and sewerage company on 3 January, 2007. For a transition period, shares previously held by private equity holders will be held in trust by Bolivia's National Fund for Regional Development (Fondo Nacional de Desarrollo Regional, FNDR). While Suez and its local partners will receive some equity compensation as part of contract cancellation, the amount is far lower than AISA's own calculations. During the negotiations, the government sought to buttress its case for cancellation without compensation by handpicking a local auditing firm to audit AISA's operations. A previous attempt to hire an experienced international audit firm under a competitive selection process ended in late 2005, when the selection process was cancelled under pressure from social movements. Under the terms of the contract cancellation, IFC, IDB and CAF (which had provided loans to Aguas del Illimani) will receive Bolivian government securities in place of AISA's debt obligations.

Conclusion

The ultimate failure of the two urban concessions of La Paz/El Alto and Cochabamba were prompted by a complex mix of political economy factors, misinformation and genuine grievances amongst poor consumers regarding service access.

Flexibility and innovation were key elements in the success story of increasing coverage in the La Paz/El Alto concession area in the early years of the concession. These practices focused on simplifying the household connection process, making this more affordable by extending payment periods and allowing payment in in-

stallments. Construction costs were kept low by economizing the use of materials and allowing households to contribute their labor in the connection of their neighborhoods. Support for the La Paz/El Alto concession began deteriorating once the connection fee was increased in 2001. This prompts future consideration of a tariff model that has proven useful in many African utilities, whereby connection charges are bundled into tariff charges so that households do not face prohibitive up-front costs that can discourage voluntary connection.

Bolivia's public utilities, including those that have been re-nationalized, have exhibited poor management, poor service, and highly politicized policies, demonstrating the limitations public entities can face in making policy changes in the context of such instability. Current circumstances in the country have generated a poor investment climate, and securing private financing for continued improvement of water services difficulties a remote possibility in the short and medium term.

Circumstances in La Paz demonstrate the risks associated with ideology-based conflict. Most of the population, including most of the users in El Alto, had been satisfied with the performance of the concessionaire, AISA, and opposed the termination of the concession contract. Some civil society groups opposed AISA and the current government ideologically. They strongly and universally opposed private sector participation, some have argued, without taking into consideration issues of performance or benefits to users.

The power of the grassroots movement in derailing private sector participation in the sector exemplifies the importance of contextual understanding and communications and information management in project implementation. These programs were conducted in a highly contextualized environment, which the concessionaires were not always familiar with, nor prepared to deal with. The absence of transparency and accountability in the socially and politically volatile Bolivian context fostered misinformation, and with no mechanism to counteract this, it created an opportunity for the perpetuation of misinformation for individual and political gain. The Bolivia case demonstrates the need for a pre-planned media and public information campaign, inclusive of ongoing consultations with citizens, to prevent "resolutely pro poor reforms" from being overtaken by concerns generated by misinformation. Most difficult to manage, however, is the wider context of intertwined grievances among the populace, suggesting an integrated communications program might be required in complex situations such as Bolivia's.

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