

**Research Summary 28: IDS Working Paper Series
'Aid, Rents and the Politics of the Budget Process'
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This paper analyzes the government's ability to produce and implement high quality budget outcomes in the context of aid dependent and resource dependent economies. The paper makes a large data collection effort to assess the impact of diverse political institutions, budgetary reforms and non tax revenue flows on budget governance.

Introduction

This paper analyzes the effects of political actors, institutional constraints and budgetary procedures on budget outcomes in aid- and resource-dependent countries. The analysis focuses on dimensions of budget governance, that is, the governments' ability to produce sustainable public finances over time, make efficient use of government spending, and represent the preferences of the median voter. For this paper, a new dataset was developed containing 47 low and lower middle income countries whose economies depend on aid or natural resource inflows, over a period of twelve years (1995-2006). The data contains indicators of macro economic performance, political institutions and good governance scores, budget norms and processes, and non tax revenues, including aid and natural resource flows.

Framework of Analysis and Determinants of Budget Governance

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

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

by authoritarian regimes, corruption and inefficiency, and poor growth and macroeconomic imbalances. The presence of resource revenues, then, interacts in important ways with political and budget institutions and processes to determinate budget outcomes.

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

Preliminary Findings

Given the colossal challenge of collecting complete and reliable data for the countries of interest, the empirical part of the paper remains a work in progress. Nevertheless, some preliminary findings help clarify the links between strong executives and budget outcomes in aid and resource dependent economies. While the empirical evidence from OECD countries suggests that stronger executive power is associated with improved fiscal outcomes, we find that this relationship also applies to resource dependent countries, but the effect is reversed when it comes to aid dependent countries, that is, aid recipient countries tend to have poor fiscal performance even when (and perhaps because) the executive has considerable powers over the policy process. Furthermore, findings suggest that strong presidents may be associated with improved fiscal performance in resource dependent countries but at the expense of political competition and rule of law. In other words, the paper lends some empirical evidence to the claim that natural resource rents tend to erode democratic competition and accountability in developing countries.

Future Research

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

A second implication is the need to revise and improve the validity of existing instruments intended to improve the efficiency and accountability of public finances such as the PEFA assessments (Public Expenditure and Financial Accountability).