

# *Aid, Resource Rents and the Politics of the Budget Process*<sup>i</sup>

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## ABSTRACT

This paper analyzes the combined impact of political, institutional and budgetary procedures on budget outcomes in aid- and resource-dependent countries. The main concern of this analysis is to look into two dimensions of good budget governance: the extent to which fiscal balances are positive and sustainable over time, and the extent to which budget allocations are efficiently spent to achieve development outcomes. The paper builds on a new dataset containing a total of 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 variables collected include macro economic indicators, indicators on political institutions and good governance, on budget processes and institutions, and on resource dependency. The empirical section identifies some trends that qualify conventional beliefs about the importance of executive power on the budget process and helps identify some arenas where more empirical and conceptual research is needed to understand the political factors underlying the budget process and producing budget outcomes.

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## **INTRODUCTION**

The study of the political determinants of fiscal performance is a rich area of work that has received important contributions from different research traditions. The general principle that “budget politics matter” converges around the idea that a country’s budget process is a key policy arena, where distributional conflicts are manifested and resolved through repeated and predictable interactions between political actors and their legal-institutional environment. The political dimension is especially relevant where governments benefit from non-tax sources of revenue such as rents from natural resource exploration and different kinds of aid flows. The presence of such large, sometimes discretionary windfalls, potentially distorts the redistributive effects of budget processes and limits accountability. These views have been adopted and discussed in several development agencies including DFID’s briefing note summarising the results of a limited number of ‘Drivers of Change’ studies looking at the politics of the budget (DFID 2007), ODI’s concept notes on the politics of Public Financial Management reforms (de Renzio and Fritz 2005) and General Budget Support (GBS) (Evans 2006), IDS’ work on the link between taxation, natural resource curse and state capacity (Rosser 2006), and the IADB’s work on the political economy of the budget process (Mejia Acosta 2007).

Existing work reflect two major trends in scholarly traditions that do not necessarily relate to one another. On the one hand, there is a major concern on the part of domestic policymakers, donors, and development agencies to understand the political factors behind the budget process in order to contribute to aid effectiveness and promote sound public financial management reforms. Some of that work has either been country specific, and focused on the efficiency of aid flows and resource rents, and the roles of international aid agencies (de Renzio 2006). Recent evaluations of GBS programmes in seven countries (IDD and Associates 2006) and of capacity building efforts in Africa (Levy and Kpundeh 2005) have raised relevant shortcomings around budget reforms and domestic accountability, but failed to address underlying questions of the political determinants of these shortcomings. The other trend, inspired in comparative political economy approaches tend to focus on specific aspects of the budget process, namely budgetary institutions (Scartascini and Filc 2004), budget accountability (Santiso 2006), political institutions (Stein et al. 1999), and constitutions (Persson and Tabellini 2005). While the first type of analysis tends to focus on the expected effects of institutional reforms based on country experiences and case studies, the second tradition tends to develop large-N comparative approaches looking at the impact of political institutions and budgetary procedures on fiscal performance, but paying limited attention to causal links in country specific circumstances. This paper seeks to begin closing the conceptual gap by defining and measuring some political economy concerns in a large N comparative analysis.

This paper analyzes the effects of political actors, institutional constraints and budgetary procedures on budget outcomes in aid- and resource-dependent countries. Budget outcomes are defined and measured taking into account a broader governance perspective: the extent to which fiscal balances are positive and sustainable over time, and the extent to which budget allocations are efficiently spent to achieve development outcomes. The paper builds on a new dataset containing a total of 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 variables collected include macro economic indicators, indicators on political institutions and good governance, on budget processes and institutions, and on resource dependency.

Although the empirical part of this paper is still a work in progress, some preliminary findings challenge the conventional assumption that strong executive authority has a positive effect to produce fiscal discipline. The paper finds that politically uncontested executive authority actually has counterproductive effects on increasing deficits in the context of aid dependent and resource rich countries. Moreover, increased levels of political (patron) competition have a moderating impact on the size of deficits. A second finding is that aid flows and resource revenues seem to have opposite impacts on fiscal performance, with resource revenues improving the likelihood of obtaining fiscal surpluses and aid flows increasing the likelihood of deficits. These results however, must be interpreted with caution as we have only been able to measure the impact of resource revenues as a share of total revenue, and aid flows as a share of GNI, but more work needs to be done to collect data and gauge for the impact of alternative sources of revenues –including tax revenues- and different aid modalities. A third significant finding is the reported positive impact of a professionalised government bureaucracy for improving the efficiency of budget allocations.

This paper is divided into five main sections. The first one proposes a framework for interpreting the inter-relation between aid-dependency (or resource-dependency) and political and budget institutions. The second part outlines the criteria utilised for focusing on a sub-set of aid- and resource-dependent countries which form the object of this study; the third section offers a thorough review of available data sources on the different components of the framework, discussing the collected data and their usefulness for cross-country analysis and comparative research. The fourth and final section provides some regression analysis of the interplay between political institutions, budget institutions and dependence on aid and/or natural resource revenues. The final section summarises findings and discusses the significance of the findings for future research and policy implications.

### **TOWARDS A FRAMEWORK TO ANALYSE THE POLITICS OF THE BUDGET PROCESS**

The budget process is, in its essence, a critical mechanism by which state actors decide on relevant ways to effectively extract and reallocate resources from society. The ability to extract taxes from its own people – as opposed to relying on other sources of revenue – is a critical moment marking the birth of the modern state. Tax collection also has direct implications on the quality of representative democracy, since it makes governments more accountable to the preferences of payers; by contrast, accountability is likely to suffer when government finances do not depend on taxpayers' contributions but rather benefit from external aid flows or natural resource rents (Gervasoni 2006, Moore 2004).

The analysis of budget processes seeks to understand the capacity of the state to aggregate diverse preferences, address distributive conflicts, protect the most vulnerable, enforce contracts over time, and remain accountable to the will of the people. A framework for analysis must identify not only the dimensions and variables related to the outcomes of budget processes (our dependent variable), but also at the factors shaping and influencing the quality of those outcomes. For the purposes of

this analysis, the dependent variable is broadly defined in terms of improved budget governance. According to Schick (1998a), there are three main desirable elements of budget governance: (a) aggregate fiscal discipline, or the aim of keeping the balance between revenues and spending; (b) allocative efficiency, or the objective of focusing spending on high priority areas and on more effective programs; and (c) operational efficiency, or the need to ensure value for money and a maximisation of impact.

These definitions allow us to look for variables that can operationalise them. Much of the literature on fiscal policy and fiscal behaviour relies on quantitative measures of budget outcomes linked to a narrow focus on fiscal discipline such as low levels of fiscal deficits or government debt. These variables can be used as indicators of budget *sustainability* or of aggregate fiscal discipline. Allocative and operational efficiency, on the other hand, can both at least partly be captured by focusing on indicators related to the *effectiveness* of public spending in developmental terms, for example looking at per capita income levels, poverty rates or human development results (e.g. measured through the Human Development Index). These two dimensions of budget outcomes, focusing on fiscal deficits and the Human Development Index, are the ones that we will utilise as dependent variables for the data analysis in the latter part of this paper.

There are, however, other possible relevant dimensions for study, which include ideal characteristics of budgets such as *credibility*, *accountability* or *representativeness*. The notion of representativeness, or the extent to which budget allocations represent the preferences of the majority of the people, can be observed for example by looking at the changes in per capita sub-national spending, controlling for disparities in poverty and population (Mejia et al. 2006). To measure the coherence and credibility of government policies, Knack et al. (2003) proposed a 'budget volatility' indicator which looks at the variability over time of budgetary allocations. Finally, other indices and assessments such as the Open Budget Index, the Global Integrity Index, the Public Expenditure and Financial Accountability (PEFA) framework and the World Bank's Country Policy and Institutional Assessment (CPIA), which we will look at in more detail below, try to capture not only of the nature and quality of budget processes, but also of specific outcomes related to the functioning and effectiveness of budget accountability mechanisms, such as parliamentary oversight, audit functions and civil society involvement.<sup>ii</sup>

Once the various ways of defining and measuring budget outcomes are identified, the proposed framework looks at the various factors influencing such outcomes. The 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. Examples of such approaches look at the effects of different electoral systems and political parties on fiscal discipline, the impact of government cabinets and legislative coalitions, and the impact of budgetary norms and procedures on budgets (Alesina et al. 1999, Hallerberg and Von Hagen 1999, Scartascini and Filc 2004). The fundamental claim coming from this literature is that political institutions that tend to centralise decision making ability in the hands of fewer policymakers are likely to induce more fiscal discipline than those institutions encouraging wider participation and inclusion of diverse interests. This literature, however, is not sensitive to the fact that in many developing countries, reforms that promoted greater centralisation of the

budget process in the hands of the executive, *without ensuring adequate mechanisms for accountability*, may have increased executive discretion for political gain at the expense of fiscal performance.

A second explanation looks at the impact of exogenous resource flows such as resource rents or aid flows on budget processes and outcomes. Both resource revenues and aid flows can be considered as ‘sovereign rents’ (Collier 2006) or ‘unearned income’ (Moore 1998), given that they mostly accrue to governments and they are generated by foreign actors (oil companies or donor agencies). 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 (Moore 2004). 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.

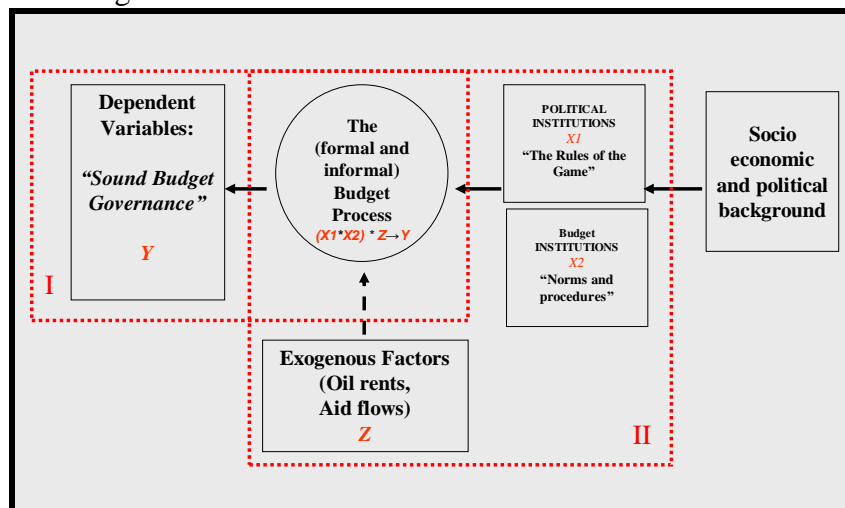
Aid flows have often been considered similar to oil (Moore 1998, Therkildsen 2002, Collier 2006), leading to worries that aid dependency can have a negative impact on budget governance. In the words of Auty (2007:1), “foreign aid shares with natural resource rent [...] the property of being a large revenue stream that is detached from the economic activity that generates it, and elicits political contests for its capture”. International aid agencies provide financing for a large proportion of public spending in a number of low income countries, through modalities such as projects, budget support and debt relief. At the same time, however, they seek to improve budget governance by enhancing the state’s capacities to plan, prioritise and manage public resources to strengthen fiscal performance and achieve long term poverty reduction. This is not true for natural resource revenues, which accrue directly to governments with no additional conditions and little accountability. As a matter of fact, as we will see below in more detail, the evidence on the potential negative impact of aid is less clear cut than in the case of resource rents. As Collier argues, contrary to resource rents, “aid comes with various donor-imposed mechanisms of scrutiny, which may [...] substitute for reduced pressure from citizens” (2006:1485). Nevertheless, the fact that aid flows can shift the balance of power within government agencies to increase the executive’s discretionary authority and spending power, while at the same time distorting domestic accountability mechanisms (de Renzio 2006) should not be overlooked. Ultimately, the degree to which natural resource rents, and to a certain degree aid flows, impact on budget governance will probably depend on their interplay with other characteristics of the political and institutional environment described in this section.

The framework presented in Figure 1 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, or the ‘soundness’ of budget governance. The way in which this happens is still an often unclear and under-researched matter, as within the budget process formal and informal norms and practices constitute the ‘black box’ that largely determines budgetary outcomes.

In other words, the proposed framework aims at adopting a general equilibrium approach to explain 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 (see Figure 1, insert I), 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 (see Figure 1, insert II). Unlike existing approaches, this framework goes beyond bi-variate or partial associations between the variables of interest but rather offers a dynamic approach to explaining interaction and interdependence. The framework takes into account the interaction between formal and informal rules and practices, and seeks to combine the analysis of domestic and international factors. 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.

The next section discusses separately the meaning and proposed impact of the three main independent variables: political institutions, budget institutions and external flows including aid and natural resources, with the purpose of developing testable research hypotheses.

Figure 1. The Budget Governance Framework



Source: Adapted from Spiller and Tomassi 2003

### ***Political institutions***

For the past two decades, political economy approaches have made an explicit effort to understand the roles and incentives of political actors and their contribution to the policy process given a set of formal institutional constraints (Alt and Lowry 1994, Persson and Tabellini 2001). The underlying premise is that electoral and party system rules determine different configurations under which policy coalitions are formed. In the budget process, political agents would seek to maximise the gains from cooperation (i.e. seeking budget allocations for their constituencies), while minimizing the associated costs (i.e. avoiding tax burdens or transferring them to non constituents). Political institutions can also play a role creating (dis)incentives for cooperation (i.e. before or after new elections), or implementing and enforcing policy

agreements over time (i.e. through the roles of the bureaucracy and an independent judiciary).

Broadly speaking, political institutions in democratic settings can be grouped under two governance models. The first type, emanating from a Hobbesian tradition, seeks to privilege the will of “the majority of the people”, by delegating decision-making abilities to a centralised authority. The alternative or consensus model, emerging from a social contract tradition, defends the principle that decision making should be made by “as many people as possible”, therefore privileging the notion of representation over resoluteness (Lijphart 1999). Translating this distinction to the study of fiscal outcomes, findings suggest that a greater concentration of political authority in the hands of the executive, tends to produce more disciplined budget outcomes than institutions which favour greater dispersion of power (Alesina and Perotti 1994, 1996; Alesina et al. 1999; Hallerberg and Marrier 2004; Scartascini and Olivera 2003). For example, majoritarian electoral rules tend to reduce the participation of diverse policy actors while making elected officials more accountable for policy decisions adopted (Persson and Tabellini 2001). Similarly, two party systems tend to produce greater fiscal discipline than multiparty democracies since they contribute to reduce the bargaining costs of assembling budget coalitions. In the context of a presidential regime, a two party system tends to induce lower fiscal spending and more fiscal discipline compared to instances of unified government (Alt and Lowry 1994). Political cooperation around budget outcomes is negatively influenced by the presence of electoral cycles. Vote seeking politicians tend to favour greater government spending before an electoral event, and postpone fiscal adjustment until after the elections (Drazen 2000, Persson and Tabellini 2005: 253). A non-trivial consequence is that budget coalitions produce sustainable outcomes over time when individual politicians enjoy lengthier mandates.

Exploring beyond the sphere of democratic institutions alone, there are certain state capacities that have an impact on the nature of the budget process and the quality of budget outcomes. The first relates to the State’s capacity to effectively carry out budget decisions, usually through a professional, independent and merit-based civil service. A highly skilled bureaucracy within the line ministries, planning office and tax authority can contribute to more transparent and efficient (well targeted) budget outcomes. A closely related element is the extent to which the state can monitor and enforce existing budget contracts, through a strong and independent judiciary. Although many other agencies are actively involved in monitoring and overseeing the implementation of budget outcomes, the judiciary has a direct sanctioning role during the budget process and upholding the rule of law. For example, a legal system that remains free from political influence has a greater legitimacy to enforce fiscal responsibility laws and sanction defections. In both cases, the presence of high corruption levels in a given country, for example in the form of patronage-driven or rent-seeking networks, suggest that the state is also poorly equipped to implement and enforce quality budget outcomes. The impact of these political institutions and state capacities are further discussed and operationalised in the following section, and empirically tested in later parts of the paper.

### ***Budget institutions***



As Aaron Wildavsky noted in a seminal paper back in 1961, “perhaps the ‘study of budgeting’ is just another expression for the ‘study of politics’” (Wildavsky 1961:190). In this sense, budget institutions can be considered as that sub-set of political institutions which shape and regulate the process of generating and allocating public resources for carrying out government functions broadly conceived. Budget institutions therefore incorporate the formal system of actors involved in the budget process, their respective roles, and the division of power and responsibilities that determines how governments raise and spend funds. The main actors include the executive, from Cabinet to specific ministries and agencies, the legislative, including its committees dealing with budgets, sectors and public accounts, and other accountability actors including inspection and audit institutions, civil society actors and the media.

Existing work has illustrated how specific budget rules that account for a more hierarchical budget process contribute to greater fiscal discipline (Alesina et. al. 1999; Scartascini and Filc 2004, Samuels 2003, Von Hagen 2002). These include, for example, a greater level of centralisation of the budget making process in the hands of the executive, the presence of caps on expenditure or constraints to limit ability of parliaments to generate new spending lines, the elimination of off budgetary items, and a greater level of budget transparency. At the same time, however, research carried out on the role played by parliaments (Wehner 2004; Wehner 2006) in the budget process highlights the important accountability function that they perform, and how their impact depends on other characteristics of the political and institutional environment in which they act.

Campos and Pradhan (1996) look at how institutional arrangements in different countries affect incentives that govern the size, allocation and use of budgetary resources, with the aim of assessing the strengths and weaknesses of different systems in terms of maintaining overall fiscal discipline, allocating resources to priority areas, and achieving operational efficiency. For the three low-income African countries analysed (Ghana, Malawi and Uganda), they find that donors have a strong influence on budget institutions. While providing positive incentives for short-term fiscal discipline, donors imposed spending cuts that undermined prioritisation and promoted fragmentation of budget systems through multiple projects. The lack of adequate systems for transparency and accountability, moreover, undermined the credibility of the budget and the predictability of flows of resources to line agencies.

Another important factor shaping budget outcomes is the interplay of formal rules and informal practices in budget processes, which is particularly pervasive in poor countries with limited capacity and low levels of democratic consolidation (Rakner et al. 2004). As noted in the DFID briefing note on “understanding the politics of the budget” (DFID 2007:6), “what matters is the interaction between formal and informal institutions, whether they support each other or neutralise each other”.

Despite various past attempts at characterising budget processes and institutions, there exists no agreed framework for doing so. Recent comparative work, carried out by a consortium of donors, has led to the definition of a framework for assessing the performance of budget systems, based on a set of indicators. The Performance Measurement Framework developed by the PEFA (Public Expenditure and Financial Accountability) Secretariat identifies the critical dimensions of performance of an

open and orderly PFM system along a series of dimensions, including: (a) credibility, (b) comprehensiveness and transparency, (c) policy-based budgeting, (d) predictability and control in budget execution, (e) accounting, recording and reporting, and (e) external scrutiny and audit.

These dimensions focus on the technical and institutional basis for sound budget governance, and can be useful in attempting to capture the complex inter-relations depicted in our framework, assisting in building an understanding of the influence of political dimensions on budget processes and outcomes, moving beyond mere description to a consideration of the roles, interests and incentives of the different actors involved in budget -making, and the ways in which they interact to determine budget outcomes. PEFA assessments have been carried out in more than 60 since 2005, but their results still do not constitute a fully consistent and comparable cross-country dataset.

### ***Aid, Resource Rents and the Budget Process***

#### Aid dependency

Aid dependency has been defined in a number of ways (Lensink and White 1999, Riddell 1996, Lancaster and Wangwe 2000). According to Brautigam (2000:2), it corresponds to “a situation in which a country cannot perform many of the core functions of government, such as operations and maintenance, or the delivery of basic public services, without foreign aid funding and expertise”. According to this definition, aid dependency therefore goes beyond the measurement of the percentage of national income or public expenditure financed by external assistance, but incorporates issues linked to capacity and institutional strength. Somewhat worryingly, and contrary to expectations that aid dependency is a temporary phenomenon, the overall number of aid dependent countries (measuring aid as a percentage of GNP) has seen an increasing trend since 1975, although it seems to have levelled off in more recent years.

Academic research has focused extensively on aid’s impact on macroeconomic variables such as economic growth and poverty levels, but aid’s impact on governance and institutions has not yet received as much attention. While Goldsmith (2001) finds a weak but positive linkage between aid and democracy levels, much of the limited literature on this topic tends to find that aid has a negative effect on governance in aid dependent countries. Knack (2001) and Brautigam and Knack (2004), for example, show that higher levels of aid dependency cause a deterioration in the quality of institutions. The work of Nicolas van de Walle (1999, 2005) also documents how, especially in African countries, countries that receive high levels of aid tend to see not only economic stagnation, but also be fraught by political problems and government ineffectiveness.

Some of the main explanations for this negative impact can be found both at the macro and micro level. At the macro level, aid provides a “soft budget constraint”, limiting the accountability of the government to domestic actors and creating a moral hazard problem, whereby governments receiving large amounts of aid may engage in riskier fiscal behaviour, knowing they are likely to be bailed out. In particular, the literature underlines two aspects of the linkages between aid dependency and fiscal behaviour. The first aspect relates to aid’s impact on domestic taxation, assuming that

aid-dependent countries will use aid to reduce their reliance on domestic taxation, preventing countries from reaping the ‘governance dividend’ that comes from the social contract that is implicit in the generation of tax revenues (Moore 2004). Yet, there is little clear evidence of a negative impact of aid on taxation (McGillivray and Morrissey 2001, Gupta et al. 2003, Fagernas and Roberts 2004).

The second aspect has less to do with a direct impact of aid dependency on government fiscal behaviour, but is linked to the difficulties that aid dependent governments face when managing high and potentially increasing aid flows (see, for example, Heller 2005, Gupta et al. 2006, Foster and Killick 2006). Large and sudden increases in aid inflows in the form of foreign currency could provoke a ‘Dutch disease’ effect, causing an appreciation of the exchange rate and therefore harming the export sector. When aid flows are in the form of loans, they can raise concerns about debt sustainability. Aid flows are often unpredictable and volatile, and can therefore negatively influence macroeconomic stability, by triggering inflation, interest-rate and exchange-rate volatility.

At the micro-institutional level, aid can provide perverse incentives to avoid reforms, and undermine institutional capacity through fragmented and uncoordinated interventions (Morss 1984, Knack and Rahman 2004). In the words of Brautigam and Knack (2004:260),

“First, the way large amounts of aid are delivered can weaken institutions rather than build them. This can happen through the high transaction costs that accompany aid, the fragmentation that multiple donor projects and agendas promote, problems of “poaching,” obstruction of opportunities to learn, and the impact of aid on the budget process. Less directly, but just as important, high levels of aid can create incentives that make it more difficult to overcome the collective action problems involved in building a more capable and responsive state and a more effective foreign aid system.”

As indicated, budget systems are among the governance areas most prone to some of these negative effects. Large proportions of donor funding are kept ‘off-budget’, and therefore are not transparent and accountable, rendering the allocation of resources according to priorities more difficult, and creating a parallel ‘bargaining arena’ separate from the budget process. Given the large number of projects and programmes using parallel planning, budgeting, monitoring and reporting mechanisms, and government capacity to ensure efficient and effective delivery of public services is often undermined. Clearly, in this respect it is important to distinguish among the different modalities that are used in delivering aid. An important distinction is between so-called project and programme aid. Programme aid modalities, including sector-specific and general budget support, are partly intended to address some of the problems identified above, as they channel resources directly through the domestic budget, therefore utilising government capacity and government systems to implement activities. Project assistance, on the other hand, has traditionally utilised parallel mechanisms, thereby potentially exacerbating some of aid’s negative effects. Technical assistance, another modality through which donors contribute capacity aimed at strengthening government systems, has played an important part in supporting budget reforms, but often with disappointing results (OED 2005, de Renzio et al. forthcoming).

Recent years have seen considerable efforts to address some of these issues, in particular with the introduction of new programmatic aid modalities and with the adoption of the specific indicators and targets enshrined in the Paris Declaration on Aid Effectiveness. However, the effectiveness of such innovations still remains disputed (IDD and Associates 2006, de Renzio 2006, World Bank 2006, OECD 2007).

#### Resource rents

Low-income countries endowed with non-renewable natural resources also have a mixed track record when it comes to growth and development, with results that are more often than not gloomy. Numerous studies (Warner et al. 2005; Auty 2001; Collier and Hoeffler 2000; Collier 2005; ODI 2006 and Rosser 2006) have been undertaken to better understand why resource rich low-income countries perform badly from both economic and social efficiency perspectives. One dimension that is generating increasing attention relates to weak budget governance records (Eifert et al. 2003; ODI 2006). Findings suggest that resource revenues create disincentives for good budget governance and compound weak government capacity to manage windfall revenues.

The presence of exogenously determined resource flows in the form of non-renewable natural resources has a significant impact on the domestic budget process. Some existing studies have tried to measure the impact of oil and other natural resource flows for budget outcomes (Collier, 2005, Mejia Acosta et al. 2006). Arguably, managing oil revenues well is more or less the same as managing for other areas of the budget. Eifert et al. (2003) write that:

“Revenue streams can finance productive physical and social investment or fuel unsustainable consumption booms, which can lead to fiscal crises. On the positive side the financing can be used to improve public welfare outcomes through transparent distributional mechanisms, or they can create elite arenas of competition, or they can underpin kleptocratic governments. Negative outcomes associated with poor budget governance results because low income oil rich countries tend to have opaque, highly politicised fiscal systems that lack the checks and balances needed to ensure that resources are well employed and to provide the fiscal flexibility needed to adjust spending in line with changes in resources. On the other hand there are those governments who remain in power only to accrue rents from the oil windfall and who regardless do not even attempt to manage fiscal booms well e.g. the goal is appropriation and not financial management. In the context of weak rule of law, the presence of non-renewable resource revenues offer a wide margin for looting and corrupt government practices.”

Like in aid dependent countries, the weakness of resource rich states would also generate economic and political distortions that retard economic growth in the long run, even if they contribute to short-run booms. Lower economic growth, increased political instability and increasing poverty are other negative consequences (ODI 2006). At the same time, debility can be caused by weak government capacity, which can be compounded by the difficulties of managing the macro implications of large influxes of foreign currency. Managing revenues to reduce budget volatility and

stabilise budgets is notoriously difficult even in developed countries. A key issue for revenue management is to reduce the possibility of Dutch disease, an economic phenomenon in which the discovery and exploitation of natural resources results in the deindustrialisation of a nation's economy. The value of the domestic currency rises and domestic spending patterns and other internal resource allocation effects make tradable manufactured goods and other tradable sectors, such as parts of the agricultural sector, less competitive. Imports increase, exports decrease, productivity falls, and there is a shift away from the tradable to the non-tradable sector, e.g. construction (ODI 2006).

Oil and mineral exporters who have windfall revenues therefore need to consider a number of issues including: (i) how much to save for future generations, (ii) how to achieve economic stability in the face of uncertain and widely fluctuating oil revenues and avoid "boom-bust" cycles, and (iii) how to ensure that spending is of high quality, whether in the form of large investment projects, public consumption, or subsidies (Eifert et al. 2003).

### **COUNTRY SELECTION**

After having looked at what the literature says about the different components of our framework, and the ways in which they affect the quality of budget outcomes, the second part of this paper looks at the actual availability of data and information which can be of help in testing some of the propositions put forward in the literature, and look for initial evidence of the validity of the adopted framework. For this purpose, we decided to focus our attention on a specific set of countries, selected in order to include a cross section of aid and resource dependent countries at different levels of economic development. The selected countries meet the following criteria and fall above the following thresholds:

1. greater than 1,000,000 Total population in 2005
2. equal to Low Income or Lower Middle Income World Bank country classification (GNI per capita less than or equal to \$3,465 in 2005)
- 3a. greater than 25.0 % of aid in total government expenditure (both mean and median greater than threshold over 1995 - 2004), or (in case data are not available)
- 3b. greater than 10.0 % of aid in GNI (both mean and median greater than threshold over 1995 - 2004)
4. greater than 30.0 % of non-renewable resources (oil + gas + mineral + ores) in total exports (both mean and median greater than threshold over 1995 - 2004)

Definitions of aid and resource dependency are given in the following section. Given these criteria, the resulting group is constituted by 47 countries, as detailed in Table 1 in the Appendix. As can be seen, 12 of the countries are resource dependent, 33 are aid dependent and 2 are both aid and resource dependent. The average per capita income is US\$1,094 in 2005. 26 of the 47 countries are HIPC countries. 5 of the countries are from East Asia or the Pacific, 6 are from Europe and Central Asia, 6 are from Latin America and the Caribbean, 5 are from the Middle East and North Africa, 2 are from South Asia, and the remaining 24 countries are from Sub Saharan Africa, by far the largest group.

## **MEASURING DETERMINANTS OF BUDGET GOVERNANCE**

This section presents a critical review of available cross-country data to illustrate the relationship between aid and resource dependency, domestic politics, budget institutions and budget governance. The purpose is to develop a common set of indicators that are linked to the proposed analytical framework outlined in the previous section. The indicators are grouped along four dimensions: (i) macro economic indicators of budget performance (outcomes), (ii) political institutions and good governance data, (iii) budget processes and institutions, and (iv) aid and rent flows.

### ***Macro indicators***

Following the analytical framework, the paper uses two simple but conventional indicators of budget performance: fiscal balances as a proxy for budget sustainability and the Human Development Index as a proxy for budget efficiency. Both series are available on a cross-country basis; fiscal data are available for 31 of the 47 countries but not for the whole period, while HDI data are available for 45 countries with available data for 5-year intervals.

### ***Political institutions and good governance***

The amount and quality of data looking at democracy and governance indicators has dramatically improved in the last decade. As data became more publicly accessible, it has also improved the validation and methodological transparency of existing indicators. Some of the most comprehensive datasets to measure governance issues include the World Bank Governance Indicators (Kaufman, Kray and Mastruzzi 2006, and Kaufman, Kray and Zoido-Lobaton 2000), the Global Competitiveness Report – an experts' survey- (World Economic Forum 2004, 2005), and the Database on Political Institutions (IMF). Relevant measurements of democracy include the Polity IV dataset (Marshall, Jaggers and Gurr 2004), the Freedom House Political Rights and Civil Liberties (Freedom House), the *Patterns of Democracy* dataset (Lijphart 1999), the *Democracy and Development* data (Przeworski, Alvarez, Cheibub, and Limongi 2000), and the Economist Intelligence Unit Democracy Indicators (2006).

To assess the influence of electoral systems on the budget processes and outcomes, we looked at two indicators. The competitiveness of participation variable reports the degree of **citizens' participation** in political activities: competitive (5), transitional (4), factional (3), suppressed (2), repressed (1), or does not apply (0) (Polity IV 2004). The other indicator controls for the specific type of **electoral system**, depending on whether it is majoritarian (1), proportional (2) or mixed (3) (Database of Political Institutions, as cited by the Quality of Government Institute, Goteborg University 2006).

To measure the roles of political parties we look at the degree of **political competition**, which could be: Repressed Competition (1), Restricted Competition (2), Authoritarian-Guide Liberalisation of Restricted Competition (3), Uninstitutionalised Competition (4), Gradual transition from Uninstitutionalised Competition (5), Factional/ Restricted Competition (6), Factional Competition (7), Political Liberalisation: persistent overt coercion (8), Political Liberalisation: limited overt

coercion (9), and Institutionalised and Open Electoral Participation (10) (Polity IV 2004). The degree of **political fragmentation** is simply measured at this point by structure of the party system: multi party (1), two party (2), or dominant party (3) (Polity IV 2004).<sup>iii</sup>

We provide data on the **constraints on executive authority**, as a proxy to measure the executive's influence and discretion in the decision making process: Unlimited Authority (1), Intermediate Category (2), Slight to moderate limitations (3), Intermediate Category (4), Substantial Limitations (5), Intermediate category (6), and Executive party or subordination (7) (Polity IV 2004).<sup>iv</sup>

Other relevant indicators are collected to measure the capacity of the state to promote sustained cooperation over time, enforce contracts, and produce efficient outcomes. We include the **Corruption Perceptions Index**, which captures the perceived levels of government corruption, as determined by expert assessments and opinion surveys (Transparency International 2001-2006), and the composite indicator on **Control of Corruption** in the WBGI. This database also includes a measure of **government effectiveness**, which focuses on the civil services' ability to remain independent from political pressure, and formulate, implement and sustain quality public services (WBGI 2006).<sup>v</sup> Finally, we measure the presence of the **rule of law**, or the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence (WBGI 2006).

### ***Budget processes and institutions***

Data on budget processes and institutions, which are key for the purposes of this research, are the least readily available and reliable for a comparative cross-country analysis. While in recent years more sources of data have become available, often these have limited country coverage and do not stretch back in time. After looking at the various indicators available (see Table 2 in the Appendix), for the purposes of this paper we focused our attention on four indicators which provided the best avenue for assessing two main dimensions of budget institutions: their overall quality, looking at the way in which the budget process is organised, including the quality of the bureaucracy in charge of budget making; and the degree of transparency and accountability around the budget process.

#### **Budget quality**

The **CPIA** indicator on the '**Quality of Budgetary and Financial Management**', publicly available for all IDA countries for 2005 and 2006 only, rates countries on a 1 to 6 scale, looking at the extent to which there is: (a) a comprehensive and credible budget, linked to policy priorities; (b) effective financial management systems to ensure that the budget is implemented as intended in a controlled and predictable way; and (c) timely and accurate accounting and fiscal reporting, including timely and audited public accounts and effective arrangements for follow up. For practical purposes, this is the variable we use in our analysis, but we nevertheless report other indicators of budget institutions for which more data collection is required in the future.

The **ICRG** indicator on ‘**bureaucratic quality**’, available for a large set of countries and stretching back to 1980, rates countries from 0 to 4, with higher points given to countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services, are somewhat autonomous from political pressure and tend to have an established mechanism for recruitment and training.

#### Budget transparency and accountability

The **Open Budget Index** developed by the International Budget Project is drawn from a questionnaire with 122 questions on budget transparency and accountability, including the nature of the budget process, the content of budget proposals, access to budget information, legislative oversight and audit processes. It rates countries from 0 to 100, and is available for 59 countries for 2006 only. Similarly, the **Global Integrity** indicator on ‘**budget processes**’ looks at availability of budget information and at the functioning of budget accountability mechanisms. It is available for 43 countries for 2006 only, and again rates countries from 0 to 100.

All of the indicators above are based on so-called ‘expert opinions’, where individual experts or groups of experts carry out an assessment based on a common methodology, which then goes through a process of peer review in order to validate the findings and ensure consistency and cross-country comparability. For the four indicators above, the methodology can be considered reliable, except for the ICRG indicator, for which little information on the detailed methodology was available. Much more detailed, mostly qualitative information about budget processes and institutions is available through more in-depth country case studies such as HIPC Assessments, PEFA Assessments and Public Expenditure Reviews. These are not very well suited for cross-country analysis, but would provide a wealth of useful information for country case studies.

#### *Resource dependency indicators*

##### Data on aid

Data on aid are mostly collected through the Development Assistance Committee (DAC) of the OECD, which keeps a database of aid flows stretching back to 1960. While this is an internationally recognised and widely used database, it has the downside of including only limited information on multilateral flows to recipient countries, and its treatment of aid sub-categories is not always straightforward and fully reliable. The three indicators that were collected for this paper are specified below.

**Aid dependency ratios.** Aid dependency can be defined in a number of ways. The two most widely used indicators include net Official Development Assistance (ODA) as a percentage of Gross National Income (GNI) and net ODA as a percentage of total government expenditure. Following Brautigam (2000), countries that have received average (and median) net ODA flows of more than 10% of Gross National Income (GNI) over the period 1995-2004 are considered aid-dependent for the purposes of this study. As we are interested in the impact of aid dependency on budget governance, where available, we use a cut-off point of 25% of total government expenditure instead. We use the average and median over ten years because both the



volume and the long-term nature of aid dependency contribute to shape the institutional environment that we are interested in analysing.

**Programme aid as % of total aid.** We are interested in capturing the share of aid that is channelled using government systems, as this isolates aid components that are meant to strengthen domestic institutions by not bypassing them. There are different aid modalities that fall within the programme category. Balance of payments support, General Budget Support (GBS) and debt relief are the three main modalities in which we are interested, as they provide substantially untied support to the government budget. Certain kinds of sector support (e.g. SWAPs) would also fall within this broad category, but their varied nature and scattered reporting means it is difficult to gather reliable information. The DAC CRS database does have specific items for programme aid as a whole and some of its sub-components. Figures on GBS, however, are not necessarily very reliable, given the different definitions that different donor countries use in defining what counts as budget support. Moreover, the DAC data are only gradually catching up with some of the shifts in the debate which happened over the past few years.

**Donor fragmentation.** Another important explanatory variable which we include is the degree to which donor activities are fragmented, as this is likely to have an impact on government capacity and on the significance and institutional strength of the budget process. Following a number of authors (Acharya, De Lima et al. 2006, Knack and Rahman 2004 and Roodman 2006), and using the DAC aid database, we include a measure of donor fragmentation based on the Herfindahl Index, which corresponds to the sum of the squared shares of total aid received by each country in each year for each donor.

**Natural resource dependency.** Resource dependency can be measured by three primary methods: (i) non-renewable natural resources as a share of GDP, (ii) share of non-renewable resources in exports and (iii) share of revenue from non-renewable natural resources in total state revenue. For the purposes of this paper we focus on the second and the third measures. The data can be found in the World Development Indicators (WDI) dataset compiled by the World Bank.

#### **SOME COMPARATIVE STATISTICS**

The empirical analysis carried out as part of this work seeks to determine the impact of political, external and procedural factors on budget governance, in comparative and historic perspective. Table 3 (Appendix) provides a quick snapshot of the variables for which data were collected and a summary of comparative statistics. The cross panel time series dataset includes 47 countries over the period 1995-2006; thus the unit of analysis is a country per year for a total of 564 observations. As can be seen, for many variables coverage is much, much smaller, especially for most of the variables dealing with budget institutions, but also for data on government debt, the Human Development Index and electoral systems. Many of the variables are available for a small number of countries and for a limited number of years (See Table 3, Appendix for more details). This inevitably limits the scope and possibility of statistical analysis that can shed light on the relation between different sets of variables.

We use STATA's panel-corrected standard error estimation to address conventional problems associated with the use of cross-country pooled time series data.<sup>vi</sup> By using STATA's "hetonly" option, we have chosen to fix the most important problem, which is autocorrelation across, rather than serially within panels or contemporaneously in the whole sample.<sup>vii</sup> To further decrease the possibility of multicollinearity, we have standardised the independent variables (by subtracting the mean from each data point in continuous variables and recoding categorical variables around zero).

The first part of the results report regressions on two proxies of budget outcomes: budget sustainability (fiscal balance) and budget efficiency (human development index). The second part analyses the impact of budgetary institutions on fiscal performance and identifies some puzzling outliers that deserve further attention through case studies.

### ***Budget governance and fiscal discipline***

A first set of models looks at the combined impact of political institutions, aid and resource rents on a country's fiscal balance (See Models 1 to 3 in Appendix Table 4). Some political variables such as citizens' participation or the level of party fragmentation (not reported) have a very weak or non significant impact on fiscal performance. Model 1 shows that greater levels of executive influence or autonomy in the decision making process (i.e. fewer constraints on the use of executive power) have a negative impact on fiscal balances. This finding challenges the conventional wisdom that stronger executives are decisive for ensuring fiscal discipline. In the case of low and low middle income countries, unchecked executive authority may be actually counterproductive for fiscal discipline. This notion is corroborated by the fact that a greater presence of the rule of law is inversely associated with fiscal surpluses. In the context of unchecked strong executives, the presence of greater aid levels to a given country actually produces a backlash effect for fiscal discipline: aid is inversely associated with fiscal surpluses.

Model 2 illustrates the other side of the story: it suggests that a greater degree of political competition (more institutionalised and transparent) is significantly associated with better fiscal performance. Not surprisingly, the degree of political competition is strongly and inversely correlated with executive authority ( $r = -0.63$ ), thus the presence of a political opposition effectively appears to counteract discretionary executive power. This effect remains especially valid for low income countries. The negative impact of other factors, including rule of law and aid levels, on fiscal surpluses remains unchanged.

Model 3 looks at budget performance in aid and resource dependent countries. The most interesting finding is that aid flows and resource revenues have opposite effects on budget performance; while a larger share of non renewable resource revenues has a positive and significant impact on fiscal balances, the model suggests that greater levels of aid have the opposite effect. The significance and direction of this impact also appears to be relatively independent of other factors –and interactions– such as corruption (not reported in the model), or the quality of the bureaucracy in a given country. Most interestingly, the presence of political competition in resource rich countries appears to have the opposite effect on fiscal balances: a more competitive political arena has a strong and significant impact on fiscal deficits, perhaps because

the abundance of natural resources encourages rentier behaviour from opposition parties.

The reported models begin to show the combined impact of political players and institutions on budget outcomes. The variables analyzed (such as executive power or political competition) are mainly associated with the budget approval stage. More work is needed to collect relevant data to differentiate the factors that influence revenue collection –especially tax revenue- from those affecting government spending, especially in aid recipient and natural resource depending countries.

### ***Budget governance and performance indicators***

The second sets of models (4 and 5) seek to explain the determinants of budget efficiency measured by country performance according to the Human Development index (HDI). Model 4 suggests a negative even if small relationship between aid flows and development indicators, but a positive impact of professionalised government bureaucracies. The interaction term suggests that even in the context of a professionalised government bureaucracy, higher levels of aid would have a negative impact on development indicators. There is not enough data to test the impact of non renewable resource revenues on development indicators and this variable has been dropped from the models. Model 5 confirms the small negative impact of aid flows on development indicators. Although the existence of the rule of law is a favourable factor to explain improvements on HDI scores, this effect is overridden by the presence of aid (see interaction term). This relationship is unaffected by the presence of stronger executive authority, or greater political competition (not reported in this model).

The negative impact of aid flows on fiscal performance is a result that must be interpreted cautiously. In the first place, higher levels of aid are closely associated with low HDI (variables are negatively and significantly correlated at  $r=-0.5$ ), but pre-existing levels of aid flows (using a lagged variable not reported here) do not have a significant impact on HDI scores. Secondly, the aid variable needs further attention to include if available different aid modalities, as well as the impact of donor fragmentation. A similar consideration is relevant for disaggregating the impact of resource revenues on fiscal performance. Finally, a future analysis needs to take into account the time variable, as the budget factors discussed here may only have a significant impact on human development indicators after continuous interaction over time.

### ***Budget governance and budgetary procedures***

This section focuses on the **CPIA** indicator of ‘**Quality of Budgetary and Financial Management**’, which evaluates on a 6 point scale if a) budgets are comprehensive, credible, and linked to policy priorities; b) there are effective financial management systems to ensure budget implementation, and c) if fiscal accounting is timely reported and accurate. Given that we only have 36 data points for the year 2005 we have also included a dummy variable to indicate whether a country’s CPIA score is above or below the average. Rather than reporting regression analysis with a very small N, we explored two way associations (cross tabulations) between high or low CPIA scores (above or below the average of 3.2 points) and dichotomised variables

such as the presence of budget deficits, resource dependent countries, aid dependent countries, and high or low quality of bureaucracies.<sup>viii</sup>

The results suggest that the quality of budgetary procedures does not seem to play a significant role in preventing fiscal deficits. This finding remains unchallenged even when we control for aid dependent countries. A similar story is found when we look at the quality of budgetary procedures in resource dependent countries: higher CPIA scores are mildly associated with improved fiscal performance, but due to the poor availability of data, we cannot test for a causal relationship between CPIA and better fiscal performance.<sup>ix</sup>

A closer look at individual cases reveals some interesting inconsistencies when CPIA scores are compared with historical fiscal performance. Burkina Faso for example, has the worst fiscal deficits for a country with an above average score of 4. Mali is another example of a high CPIA score and a professionalised bureaucracy, but with negative fiscal performance. These institutional discrepancies that translate as empirical outliers suggest the existence of non institutional factors that are not captured by cross national data that may in fact shape the workings of the budget process. There is plenty of evidence showing that conventional rules or “parchment institutions” affect the budget process in important ways, but there are no systematic theoretical explanations for these irregularities. The cross national data is a useful starting point to chart deviations from theoretical expectations. Further case study work is needed to uncover the incentives that budget players have to disregard institutionalised budget procedures for political gain (Mali or Burkina Faso), or by contrary, the reasons why cooperative budget dynamics might take place over time despite the absence of a constraining legal framework.

## **SUMMARY AND CONCLUSIONS**

This paper is a first effort to address a conceptual gap in the study of the politics of budget processes in aid- and resource-dependent countries. This work makes three contributions to the field. First, it proposes and empirically tests a comprehensive theoretical framework of budget governance to look at the independent and combined impact of political, technical and exogenous variables on budget outcomes. The paper finds that politically uncontested executive authority actually has counterproductive effects on increasing deficits in the context of aid dependent and resource rich countries. Moreover, increased levels of political (partisan) competition have a moderating impact on the size of deficits. A second finding is that aid flows and resource revenues seem to have opposite impacts on fiscal performance, with resources improving the likelihood of obtaining fiscal surpluses and aid flows increasing the likelihood of deficits. These results however, must be interpreted with caution as we have only been able to measure the impact of resource revenues as a share of total revenue, and aid flows as a share of GNI, but more work needs to be done to collect data and gauge for the impact of alternative sources of revenues – including tax revenues- and different aid modalities. A third significant finding is the reported positive impact of a professionalised government bureaucracy for improving budget efficiency. The latter is measured by improvements along the human development index. This reported impact however is limited by the negative influence of aid flows on HDI scores. While the previous caveats and cautions apply regarding the different types of aid modalities, it is also important to improve the

validity of our measurement by testing alternative indicators of budget efficiency. In the current model, we have assumed that HDI scores would be a good indicator to assess the efficiency of spending allocations, but further work needs to be done to evaluate the impact of government investment by specific sectors like education, health or nutrition.

A second contribution of the paper is to develop a large scale data collection effort of cross-country time series data on political and budgetary institutions, aid flows and resource rents in aid dependent and resource rich countries. In the current work, we have chosen two intuitive and conventional variables of fiscal performance, but more work needs to be done to disaggregate the causal mechanisms and political dynamics leading to improved budget governance. One way to address this issue is by evaluating separately the impact of political institutions, rents and aid, on government spending decisions and on revenue collection. A complementary approach is to take a closer and more detailed look at cases where the existence of (favourable) institutional conditions for budget governance does not correspond with existing poor fiscal performance. Much of the analysis that can generate interesting and policy-relevant insights into the politics of the budget process in aid- and resource-dependent countries needs to be done at country-level, through case study work which can uncover specific information and generate more detailed data in order to generate the kinds of insights which can be useful in informing the policy choices of donor agencies and other actors alike. In particular, it would be relevant to measure the impact of different budgetary institutions on the quality of budget processes, especially before and after the adoption of public finance reforms. This is particularly important for donor agencies who increasingly support public financial management reform in these countries, and rely on domestic systems to deliver aid resources.

There are two concrete consequences of this study for future research and policy work. In the first place, the statistical relevance of some variables that confirm theoretical expectations (such as the role of strong executive authority) are encouraging signs to motivate further data collection and more rigorous testing. Thus, a first concrete implication of this study is the need to develop greater efforts at collecting reliable and comprehensive data on a number of key variables to study the politics of the budget process in low income countries. More and better quality data is needed to measure the impact of budgetary institutions on budget processes. Recent efforts have started to fill some of the gaps, but in a very haphazard way, covering a limited number of countries and limited periods of time, focusing on specific aspects of the budget process, and with methodologies that often lack rigour and prevent comparability. This observation calls for a much more serious and concerted effort, at international level, to collect information which is detailed and comparable, through exercises that can be repeated over time. In the case of Latin America, for example, budget surveys have generated a wealth of information which is being utilised for both research and policy. The same has not happened in Asia or in Africa, where most of the countries object of this study are located. While a number of efforts are under way, such as the development and deployment of the PEFA (Public Expenditure and Financial Accountability) methodology to assess PFM systems in different countries, the methodology does not easily allow for cross-country comparisons, and might be subject to modifications over time.

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**APPENDICES**

Table 1. List of Countries

Aid dependent countries	Resource Dependent	Aid + Resource Dependent
Afghanistan	Algeria	Bolivia
Albania	Azerbaijan	Zambia
Armenia	Cameroon	
Bangladesh	Colombia	
Burkina Faso	Congo, Rep.	
Burundi	Ecuador	
Cambodia	Egypt, Arab Rep.	
Chad	Iran, Islamic Rep.	
Congo, Dem. Rep.	Kazakhstan	
Eritrea	Nigeria	
Ethiopia	Peru	
Gambia, The	Syrian Arab Republic	
Ghana	Trinidad and Tobago	
Guinea-Bissau	Yemen, Rep.	
Kyrgyz Republic		
Lao PDR		
Liberia		
Malawi		
Mali		
Mauritania		
Mongolia		
Mozambique		
Nicaragua		
Niger		
Papua New Guinea		
Rwanda		
Senegal		
Sierra Leone		
Tajikistan		
Tanzania		
Uganda		

\* El Salvador, Georgia and Sudan are excluded due to unreliable data.

Table 2. Data sources on budget processes and institutions

Database	Source	Coverage of Budget Issues
Country Policy and Institutional Assessment	World Bank	Different indicators are linked to budget variables. These are: Fiscal Policy, Equity of Public Resource Use, Quality of Budgetary and Financial Management Systems, Efficiency of Revenue Mobilisation, Quality of Public Administration, Transparency, Accountability and Corruption in the Public Sector
International Country Risk Guide	Political Risk Services	Political risk ratings include dimensions on corruption, democratic accountability and bureaucratic quality.
Open Budget Index	International Budget Project	The questionnaire contains 122 questions on budget transparency and accountability, including the nature of the budget process, the content of budget proposals, access to budget information, legislative oversight and audit processes.
Global Integrity Index	Global Integrity	The Index includes scores on budget processes and on government accountability and corruption.
Global Competitiveness Survey	World Economic Forum	Survey include questions on corruption and government inefficiency.
Bertelsmann Transformation Index	Bertelsmann Foundation	The Transformation Index includes ratings on government's steering capability, efficiency in resource use, degree of consensus building and international cooperation.
HIPC AAPs	IMF/WB	Assessment of country systems on budget formulation, budget execution and budget reporting compared to best practice benchmarks.
PEFA Assessments	Various	The methodology covers the whole range of issues linked to budgeting and public finance management, including 3 indicators on donor performance related to predictability and provision of information to government.
Fiscal Transparency ROSCs	IMF	The questionnaire includes detailed information on budget processes and institutions, including execution, accounting and control.
Country Financial Accountability Assessments	World Bank	Information on the legal framework for PFM, decentralisation, the country's fiscal record and an assessment of PFM reforms.
Public Expenditure Reviews	World Bank	PERs look not only at PFM systems, but also at budget policies and issues of allocative and operational efficiency.

Table 3. Variable Codebook and Summary Statistics

Variable	Definition	Source	Obs	Mean	Std. Dev.	Min	Max
Gdp_pct	Rate of economic growth	World Bank	509	4.859311	7.154947	-31.3	106.28
Gdp_cap	Per capita income	World Bank	389	342.5017	223.732	56.52	996.95
debt_gdp	Government debt (%GDP)	World Bank	83	84.76422	54.15341	.21	247.38
bal_gdp	Fiscal deficit (%GDP)	World Bank	284	-2.55331	3.781759	-19.48	21.98
Hdi	Human Development Index	UNDP	127	.5300787	.1543779	.25	.81
Exp_gdp	Government spending (%GDP)	World Bank	291	18.23749	10.80544	0	42.83
cit_par	Citizen participation	Polity IV	427	2.779859	1.073919	0	5
Elec_sys	Electoral system	Dbase of Pol. Inst.	90	1.711111	.8244091	1	3
Pol_com	Political competition	Dbase of Pol. Inst.	257	.3378988	.2709522	0	.9
Pol_com2	Political competition	Polity IV	427	5.473068	2.752907	1	10
Pol_frag	Political fragmentation	Dbase of Pol. Inst.	355	.6521127	.4732563	0	1
exec_inf	Constraints on exec authority	Polity IV	427	3.796253	1.754454	1	7
corrupt	Corruption Perceptions Index	Transparency International	201	2.687512	.7815682	0	5.3
corrupt2	Control of Corruption	World Bank	322	-.7332919	.4151467	-2.13	.41
Gov_eff	Government Effectiveness	World Bank	327	-.6835168	.4582477	-1.96	.61
Rul_law	Rule of Law	World Bank	329	-.7729179	.4677502	-2.37	.43
Cpia_bud	CPIA Budget Indicator	World Bank	36	3.208333	.6587325	1.5	4.5
Bur_qual	Bureaucratic Quality	ICRG	395	1.376608	.7496826	0	3
open_bud	Open Budget Index	IBP	21	31.85714	16.68918	5	77
Bud_acc	GII Budget Processes Indicator	GII	17	62.85882	15.86474	36.8	89.1
Aid_gni	Aid dependency (ODA/GNI)	World Bank	461	12.7798	12.25824	-.08	98.54
Aid_exp	Aid dependency (ODA/ government expenditure)	World Bank	133	43.61857	52.9234	0	319.33
prog_aid	Programme aid (% total ODA)	OECD/DAC	363	20.97463	19.31104	0	93.49
Don_frag	Donor Fragmentation Index	OECD/DAC	363	15.57857	10.48097	6.03	90.19
Nnr_rev	Resource dependency (% revenue)	IMF	87	47.25874	20.80486	1.98	84.86
Nnr_exp	Resource dependency (% exports)	World Bank	109	68.01248	23.48861	14.69	99.67

**Table 4: Political Determinants of Budget Governance**

	DV: Budget Balance (as a share of GDP)			DV: HDI scores	
	Model 1 coeff. (S.E.)	Model 2 coeff. (S.E.)	Model 3 coeff. (S.E.)	Model 4 coeff. (S.E.)	Model 5 coeff. (S.E.)
Executive Influence	-0.547** (.29)				
Political Competition		.34** (.17)	-.24** (.10)		
Rule of Law	-2.34** (1.18)	-1.96** (1.04)			.06*** (.02)
Rule of Law* Exec. influence	-0.04 (.56)				
Low Income Countries		1.62* (.94)	-.810 (1.05)		
Non renewable Resource (% total Exports)			.06*** (.02)		
Non renewable Resource * Low Income countries			-.100** (.04)		
Aid levels (as % of GNI)	-0.29*** (.06)	-.34*** (.76)	-.04 (.05)	-.005*** (.009)	-.008*** (.001)
Quality of the Bureaucracy			.014 (0.69)	.06*** (.01)	
Qual. of Bur. * Aid levels (GNI)				-.003*** (.001)	
Rule of Law * Aid levels (GNI)					-.006*** (.002)
intercept	-4.10*** (.42)	-5.31*** (.84)	-1.90*** (0.63)	.51*** (.01)	.52*** (.01)
N	200	198	58	100	85
R <sup>2</sup>	0.258	0.292	0.348	0.404	0.331

All standard errors are heteroskedastic panel-corrected assuming no serial or contemporaneous autocorrelation. Standard errors reported in parentheses. Significance levels are indicated as follows: \*\*\*p<.01, \*\*p<.05, \*p<.1

## ENDNOTES

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<sup>ii</sup> While it would be problematic to include these further dimensions as dependent variables in the context of this paper, given that they somewhat overlap with one of the independent variables defined below ('budget institutions'), we still think that it's necessary to keep them in mind for purposes of further research. In particular, country case studies can generate additional data for these dimensions which is not readily available at a cross-country level, allowing to move beyond the limited view of budgets as purely fiscal instruments to more developmental ones, and from quantitative to more qualitative aspects of budget processes and outcomes.

<sup>iii</sup> The conventional measure for party fragmentation would be the effective number of legislative or electoral parties, but such data is inconsistently available for the countries of interest.

<sup>iv</sup> For future coding, an alternative assessment is the extent to which executives need to share power with the legislative branch (parliamentarism), and the level of territorial decentralisation (federalism), according to the Gerring, Thacker and Moreno theory of Centripetal governance (QoG 2006).

<sup>v</sup> For future coding, a more detailed assessment that disaggregates bureaucracy's career opportunities, compensation and meritocratic recruitment is offered by Evans and Rauch (QoG 2006).

<sup>vi</sup> The first issue is the potential presence of heteroskedasticity in the data, i.e. the error processes may differ from country to country; secondly, the error terms might be contemporaneously correlated, that is, the errors in one country at a specific time point might be correlated with errors in another country at the same time point; and thirdly, the danger of serial autocorrelation within countries (Harrinvirta and Mattila 2001: 509).

<sup>vii</sup> The observed results were comparable with those obtained by running a robust OLS regression.

<sup>viii</sup> The statistical results remain unchanged even when the 2005 value of CPIA scores is extended for the larger period of study of 12 years, for a total of 289 observations.

<sup>ix</sup> For brevity, we have not reported these non significant findings but the data is available upon request.