

## PFRC Guidelines: Political economy analysis for public financial management, including revenue mobilisation

*The importance of the particular context - historical, political, and geographical - in which a country decides to manage its public finances better cannot be stressed strongly enough. There are no magic bullets or cookie-cutter approaches to strengthening public financial management (PFM), and any attempt to import innovations that may have worked elsewhere should be carefully assessed and subjected to an on-the-ground "reality check..."*

*The fundamental constraint on improvement is not the absence of technical understanding or knowledge, or the lack of sufficient skills or capacity in the public sector - though these issues certainly need to be addressed during reform - but the absence of a supporting environment of political leadership, business processes and procedures, and incentives for change that make it possible to move forward in the first instance and to be sustained over time.*

The Emerging Architecture of Public Financial Management, IMF, 2013

This is one of a series of guidance papers prepared by the PFRC. The intention is to set out for partners the PFRC's expectations related to incorporating political economy analysis (PEA) into public financial management (PFM) and revenue projects ('Interventions') undertaken through the PFRC. These expectations are based inter alia on FCDO guidance<sup>1</sup>.

### 1. PEA Requirements

All PFRC interventions must be politically informed at each stage of the Intervention, from inception to completion and evaluation. This can be via an initial PEA Report and through regular and ongoing analysis ('everyday political analysis'), or initially can make use of existing analysis and regular and ongoing updates, depending on the requirements of each Intervention. PEA should not only explore the distribution of power, interests, and capability but also examine how these are shaped by intersecting social identities such as gender, race/ethnicity, class, geography, disability, age, and others. Projects must be sensitive to the uncertainties involved in complex change processes and their implications for politically smart and adaptive programme design and delivery<sup>2</sup>.

The exact requirements for PEA will be set out in an intervention's terms of reference – they will vary in depth and timescale depending on PEA already available for a given context. At a minimum:

- **Approach Paper:** during an intervention's inception phase an Approach Paper will usually be developed. The Approach Paper must demonstrate how PEA has informed the plans for intervention delivery to ensure feasibility of activities. The Approach Paper should identify the problems to be addressed and potential pathways for change by examining: (i) foundational factors; (ii) rules of the game (an institutional mapping); (iii) the power, interests and capability of key stakeholders; and (iv) consider gender equality and social inclusion (GESI) across all dimensions. (The extent to which the power, interests and capability of key stakeholders can be mapped out in the Approach Paper will vary but experience underlines that this is a critical input to early decision making on options for specific workstreams.)

<sup>1</sup> This guidance should be read in conjunction with the UK government's guidance on PEA: 'Understanding political economy analysis and thinking and working politically', FCDO, 2023

<sup>2</sup> Projects must be sensitive to conflict. There is a fundamental requirement for projects to do no harm. PEA is a lens that can and should be integrated with conflict analysis when relevant. This guidance does not cover conflict analysis.

- **Regular assessment:** regular updates of political economy and change space analysis will be required, including updates of power, interests and capability for each workstream, at least bi-annually but potentially more frequently, depending on the context, to ensure the Intervention approach and activities remain feasible and outputs have the desired impact.

For any additional workstream proposed during the implementation, a separate Concept Note will typically be prepared. The Concept Note should include assessment of change space (the power, capability, and interest of stakeholders) for the proposed new workstream.

## 2. Why PEA

Public finance is at the heart of politics: it determines who finances public expenditure via taxation (or not), and who benefits from public services and transfers (or not) and forms a defining feature of the political settlement. These distributions are never neutral: they reflect and reproduce patterns of privilege and exclusion, often along lines of gender, ethnicity and class. PFM systems can be shaped or subverted by informal power structures, elite interests and hidden norms. Understanding these dynamics, including how they intersect with historical patterns of exclusion, is key to designing effective, equitable, and sustainable reform. Including and excluding groups of stakeholders is central to building a social contract or resorting to more coercive politics. Annex 1 reviews the underlying objectives of public financial management.

Progress in strengthening public financial management has been slow and incremental in many countries and there has often been some regression after reforms are delivered. Deep and transformational reforms are rare, although some countries have made rapid progress.<sup>3</sup>

In providing support to the organisations that have responsibility for PFM and revenue - the ministries, departments and agencies, including in many countries a national revenue authority - it is relevant to ask whether the government has demonstrated a commitment to establishing sustainable and effective organisations. Weak organisations and weak systems frequently reflect weak effective demand for their outputs and the outcomes they are tasked with delivering.

PEA is undertaken for different reasons. It can be about providing contextual analysis in order to understand the potential for and blockers to change (i.e. understanding the rules of the game). It can be about trying to solve a particular problem (i.e. how to navigate the rules to construct a pathway for change). It can be about developing a reform strategy to shift the rules of the game.

PEA on development projects is commonly done using a combination of two modes: (1) in-depth analysis; and (2) regular and ongoing analysis ('everyday political analysis')<sup>4</sup>. Experience suggests that engaging the full delivery team in PEA is vital: it increases the likelihood of fostering a mindset and approach that is open to thinking and working politically and GESI sensitive.

## 3. Integrating a GESI lens into Political Economy Analysis

GESI analysis must be fully embedded throughout political economy work. GESI seeks to understand how social identities – such as gender, race, disability, age, caste and ethnicity – intersect with structural systems of power, including patriarchy, racism, ableism and colonial legacies. These systems shape differential access to resources, influence, and opportunities, leading to varied experiences of privilege, exclusion and oppression. Embedding this perspective ensures that political economy analysis moves beyond narrow or siloed views of marginalisation and instead captures the full complexity of power relations in any context.

<sup>3</sup> See 'Political Economy of Public Financial Management Reforms Experiences and Implications for Dialogue and Operational Engagement', World Bank, 2017

<sup>4</sup> See 'Everyday Political Analysis', Hudson, Marquette & Waldock, DLP, 2016

## Introducing GESI and intersectional analysis in PEA:

- Illuminates how inequality is structured and maintained in fiscal policy and practice
- Reveals hidden barriers to inclusion and reform
- Highlights how stakeholders may simultaneously hold power and experience exclusion in different domains.<sup>5</sup>

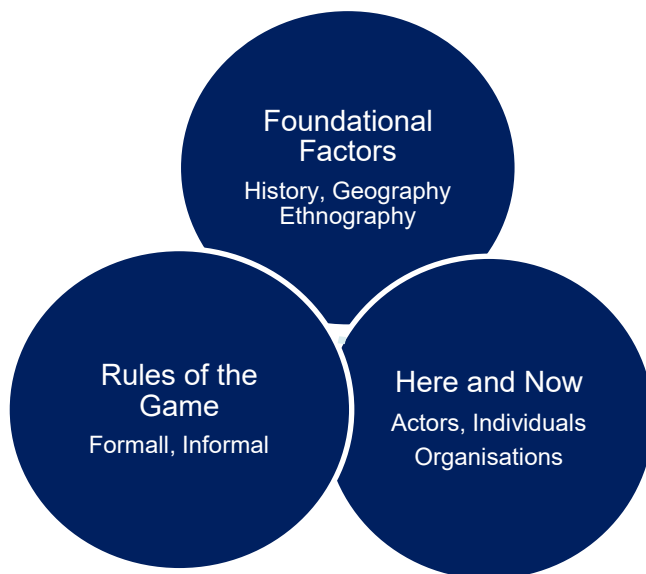
Incorporating GESI enables more accurate and inclusive analysis of how PFM systems operate, understanding the full spectrum of power dynamics influencing fiscal decisions impact resource distribution, and public service delivery<sup>6</sup>.

## 4. In-Depth PEA

A commissioned in-depth PEA should be built around the three building blocks of a PEA<sup>7</sup>:

- An understanding of context (the '**foundational factors**') – including history, geography, demography, ethnography, conflict and politics
- An appreciation of the political, economic and social '**rules of the game**' both formal and informal. This is generally called institutional analysis
- An account of the nature and incentives of the prevailing networks of interest and power. We call this **stakeholder analysis**, or the 'here and now'.

These analytical building blocks are interlinked, and PEA seeks to understand the dynamic interaction between these three domains.



**Foundational Factors.** Foundational factors are long-term contextual factors that are not readily influenced but have a pervasive impact on political economy and development. They include the extent to which an economy is dominated by resource extraction or depends on agriculture or manufacturing and services. Historical legacies, including conflict, are generally of major influence. Ethno-linguistic fragmentation can bring with it increased potential for conflict. Demography is important: a youth bubble creates particular demands, challenges and opportunities. Applying the GESI lens is essential, as analyses of historical

<sup>5</sup> GADN. 2018. Putting gender in political economy analysis: why it matters and how to do it.

<sup>6</sup> 'Gender, Inclusion, Power and Politics' (GIPP), Christian Aid and Social Development Direct, 2021.

<sup>7</sup> Each of these three must incorporate intersectional GESI considerations.

exclusions and identity-based structural disadvantages will point to the nuanced ways these factors affect different groups based on gender, location, ethnicity, ability, age and class.

**Rules of the Game.** There is often a significant gap between formal institutions (how things are supposed to work) and informal practices (how things actually work). And there are often deeply embedded social norms, for example, discrimination against particular groups. In some countries the budget process can be seen as ‘theatre’ or ritual that masks the actual distribution of resources and spending patterns: there can be a large deviation between budget estimates and actual spending, with strong systematic biases and large leakages between the centre and the frontline. If this is the case, simply building capacity of the stakeholders to implement the budget calendar will not be sufficient to deliver change.

The analysis of rules of the game should encompass how formal and informal processes sit together and how people operate within their systems and political and organisational cultures. It will generally require an account of the political or elite settlement. It will be interested in the extent to which patrimonialism, clientelism and patronage drive politics and public sector decision making. This analysis should be taken into account when designing Interventions and identifying pathways to change.

**Stakeholder analysis (Here and Now).** Identifying the range of stakeholders and their interests can be challenging, especially since ‘rent-seeking behaviour’, corruption, and ‘deal making’ are often informal and purposefully hidden from the public gaze<sup>8</sup>. Stakeholder motivation, interests and ideology need to be considered if the intended reform is to have a chance of being implemented. Applying a GESI lens can uncover how factors like gender, geographical location, ethnicity and class combine to shape the power and influence of various stakeholders. Understanding and demonstrating how financial management reforms will impact on expenditure chains and eventually impact on government delivery is critical for building the demand side for reform, and improving tax morale.

**Pathways of change.** The analysis of these three PEA building-blocks should be used to map out potential pathways of change, and how reform champions – with development partners working alongside them – can navigate a policy or programmatic change process that is technically sound and politically feasible (eg by building supportive coalitions). Insights from intersectional analysis can further refine these pathways by clarifying the root causes of challenges, exploring alternative responses, and identifying both change agents and resisters. This approach helps design intervention options that foster transformative processes while potentially engaging previously excluded actors in driving social, political and economic processes. The intervention’s theory of change and logical framework will build on this analysis.

## 5. Intervention specific PEA – analysis of interest, capabilities and power

Each potential workstream in a change strategy must initially identify actors who, in their own interest, will pursue a specific objective<sup>9</sup>. To be effective, these actors must have the capabilities to engage in the required activity, and sufficient power (formally and informally, that is, de jure and de facto). This has been described as a ‘power, capabilities and interests-driven’ (PCI) approach<sup>10</sup>. Generally, incentivising a coalition with sufficient power, capabilities and interests is at the heart of making any policy or reform programme implementable, particularly in countries where the rule of law is weak.

<sup>8</sup> Mapping stakeholders requires attention not only to their formal roles and interests, but also to how identity factors—such as gender, class, ethnicity, and location—shape their influence and vulnerability. Individuals and groups may simultaneously hold power and face marginalisation (for example, an elite woman operating within a male-dominated political network).

<sup>9</sup> When an intersectional perspective is applied, it can reveal that even though some groups strongly desire reform, systemic barriers may limit their participation.

<sup>10</sup> See for example, ‘Making anti-corruption real: using a ‘Power Capabilities and Interest Approach’ to stop wasting money and start making progress’, Mushtaq Khan and Pallavi Roy, ACE, 2022.

Alternative and slightly differing formulations of this framework have been proposed, including the ‘Acceptance, Authority, and Ability (AAA)’ model of change space analysis<sup>11</sup>. Most recently, FCDO has advocated a ‘Want, Can, Must’ framework<sup>12</sup>. Whatever specific framework is used, it is critical to demonstrate that proposed reforms are viable in terms of PCI, and during implementation to assess periodically the validity of assumptions made in these terms.

*‘The original interest in political economy analysis arose from the realisation that highly technical (usually input-based) development programmes often did not work very well. In particular donors would rally around a reform process, providing technical advisers and funds, only to see the planned changes stall and disappear. This would usually be written off as a lack of ‘genuine political will’. ... PEA helps us to unpack all the issues previously lumped into the political will box, so that we can consider the factors to which we must adapt and those that we can try to influence and change.’*

*‘The Beginner’s Guide to Political Economy Analysis’, Alan Whaites, National School of Government International, 2017*

The analysis of ‘interest, power, capabilities’ (or similar) should be included in the Approach Paper for each workstream proposed during the inception phase. This analysis will inform the level of ambition for the intervention, the change space for reform and potential entry points. It gives practical manifestation to the principle of ‘thinking and working politically’ (TWP). The analysis should articulate how the political economy dynamics – including those shaped by GESI – inform the level of ambition, change strategy, and potential risks associated with the intervention.

For new workstreams proposed during implementation, this analysis will be included in the Concept Note.

## 6. Ongoing PEA analysis

A shift to thinking and working politically (TWP) has accompanied the move in development practice towards problem driven iterative adaptation (PDIA)<sup>13</sup>. The underlying analysis that led to PDIA drew attention to the problem of ‘isomorphic mimicry’, where prevailing practice attempted to mimic donor’s domestic institutions. Reforms did not focus on underlying problems, incentives and interests: as a consequence of this they focused on changes in organisational structure or rules (including legal and regulatory frameworks), while failing to change the way that organisations functioned (ie day-to-day practice). As a result, countries appeared on paper to have reformed their PFM systems, but the impact on day-to-day operations or the delivery of services was negligible.

The need for an adaptive approach is buttressed by an understanding that the political context is fluid: that economic or conflict-driven shifts can rapidly alter power dynamics and social norms. There is a need to be able to change course, sometimes frequently and sometimes quickly, in response to new information or a changing context.

Thus, it will be required to conduct a periodic PEA update and to re-examine their workstream-level assessments of ‘power, interest, capability’ (or similar). For multi-year Interventions, this should normally be

<sup>11</sup> See ‘Development as Leadership-led Change’, Matt Andrews et al, World Bank, 2010

<sup>12</sup> ‘Understanding Change as Politics not Political Will’, David Pedley, FCDO, 2024

<sup>13</sup> ‘Escaping Capability Traps Through Problem Driven Iterative Adaptation (PDIA)’, Matt Andrews et al, UNU Wider, 2012



every 6 months and for all Interventions, when there are significant changes in context. All delivery partners should practice ongoing 'everyday political analysis' as a matter of course.

This analysis will inform PFRC reflection sessions, to be organised by PFRC, and revisions to logical frameworks, guiding adjustments to interventions. This analysis must remain grounded in a GESI-informed understanding of power and agency, ensuring that evolving patterns of advantage and disadvantage are captured as part of the political economy, and that any adjustments uphold the principle of “do no harm.”

## ANNEX 1: The Three Objectives of PFM

In considering an appropriate organisational form it is important to focus on PFM's three key objectives: (i) maintaining a sustainable fiscal position, (ii) achieving the effective allocation of resources, and (iii) efficient delivery of public goods and services.

### (i) Maintaining a sustainable fiscal position

Maintaining a sustainable fiscal position has proven challenging for many countries. Recurrent debt crises have occurred, often requiring IMF programmes. Fiscal sustainability requires a balance between revenues, expenditure and debt. Aggregate levels of these variables - limits - should be determined by policy and should drive budget decisions. A medium-term framework is required. Developing robust fiscal rules or frameworks is a straightforward matter but maintaining them has been more problematic. Independent fiscal projections and assessments can play an important role in supporting fiscal discipline. But political pressures frequently trump fiscal prudence.

#### Corruption and Debt

In a recent report, Transparency International points out that debt ratios among low-income and developing economies are quickly reaching levels not seen since the 1990s. More than half of low income countries are in or at high risk of debt distress due in large part to failures in debt treatment programs since the early 2000s. Experts estimate at least 25 percent of middle-income countries are now considered to be at risk of debt distress.

A myriad of factors contributed to the failure over the past two decades of restructured and new financing to build sustainable economies, but none more central nor widespread than corruption. The lack of any meaningful governance reforms and enforceable accountability measures in loan agreements dating back to 2000 gave license to the theft and misuse of financing. Loans diverted from their intended purpose add billions in unsustainable debt for generations to come.

Countries in or at risk of debt distress perform significantly worse in governance-related indices than those able to manage their debt. Countries in or at risk of debt distress scored an average of 37/100 in Transparency International's latest Corruption Perceptions Index ("CPI"). In comparison, the average global score is 43/100. Similarly, the same countries scored an average of 38.2/100 using the World Bank's Control of Corruption indicator, compared to the global average of 50/100

Despite austerity and deregulation measures deemed "macro critical" for loan success by the IMF, more loan programs and sovereign debt restructurings have failed than have been successful. Of 75 countries that have restructured debt since 1975, 59 percent of those countries have undergone multiple debt restructurings. Reinforcing the above correlation between governance and debt sustainability, these countries also experienced relatively lower governance scores compared to those with one or no restructurings.

The balance between public investment and public 'consumption' is critical and if debt is used in effect to finance consumption, or if returns to investment are low or negative, a crisis can occur in the face of stagnant revenue growth (and low returns to investment can themselves lead to poor growth performance). Emerging problems can be hidden if governments have significant revenues from economic rents (e.g. from natural resources), especially if these rents allow governments ready access to international financial markets.

### (ii) The effective allocation of resources

The effective allocation of resources can be politically challenging. Budget incrementalism is entrenched in many countries and redirecting resources away from traditional uses to higher priority demands means confronting vested interests. Commonly, the budget is an instrument in building and maintaining a 'political

settlement' and in serving clientelist constituencies. Programme-based budget has not been notably successful. The IMF has suggested that reallocation may be most difficult PFM task<sup>14</sup>.

### (iii) Public services

Public services are critical points of contact between citizens and government, alongside the payment of taxes. They are part of the double-sided accountability of the social contract (see below). The agenda for improving public services extends way beyond PFM and generally embraces the concepts and approaches of 'New Public Management' (NPM). However, performance-related initiatives can play a role, including performance-based budgets, performance contracts, performance-related pay, and the use of output and outcome targets and indicators. Ultimately, a successful social contract requires a large degree of responsiveness by government to citizens in terms of service delivery: in the absence of that responsiveness, and in the absence of trust and confidence, it may be hard to build tax morale.

Strengthening financial accountability is a critical ingredient in building the social contract, and increased transparency is critical to that. However, transparency by itself will achieve little in terms of improved accountability and attention needs to be paid to the role of legislators and the public at large. Substantive public engagement can be hard to achieve, and the role of civil society organisations, think tanks, academia and the media deserves consideration.

### Taxation is not only about raising revenue

Tax is especially important in development: building tax capacity is closely linked to the process of economic development, growth and democracy. There is a long intellectual history behind this conception of the role of taxes and the state. Joseph Schumpeter emphasized that taxes are not only associated with the historical origin of the state, but they are also active in shaping it<sup>15</sup>. This can be explained as double-sided accountability in the social contract. As tax administration improves, social norms of behaviour change, this builds voluntary compliance on the part of taxpayers and a more responsive state. Tax revenues allowing government revenues to become more stable. Public governance improves as citizens demand (and the administration delivers) accountability. As the process deepens, public administration increasingly focuses on the public good - public goods and services - and acquires the capacity to deliver on it. This then delivers a significant acceleration in the process of growth and development.

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<sup>14</sup> IMF, 2013

<sup>15</sup> 'The Crisis of the Tax State' Joseph Schumpeter, 1918, quoted in 'Political Institutions, State Building, and Tax Capacity: Crossing the Tipping Point' Vitor Gaspar, Laura Jaramillo, and Philippe Wingender, IMF Working Paper WP/16/233, 2016



## **ANNEX 2: PEA Glossary**

**Patrimonialism:** a governance system in which a political strongman rules by personally distributing material resources and perks (many of which are ‘rents’) to followers. It becomes neo patrimonialism when combined with some formal, impersonal elements of governance (eg the legal system, or an administrative code for hiring staff).

**Patronage:** use of state resources to reward individuals for their electoral support.

**Clientelism:** exchange systems where voters trade political support for various outputs of the public decision-making process. Can have ethnic elements, religious or regional dimensions, family boundaries.

**Rent seeking:** an economic rent is the difference between what a factor of production is paid and how much it would need to be paid to remain in current use. Rents are often generated by access to natural resources, from control of regulation, or from illicit activities. The distribution of rents can be an important pillar of economic stability – part of the elite bargain.

**Elite bargain:** a discrete agreement, or a series of agreements, that explicitly re-negotiate the distribution of power and allocation of resources between elites

**Political settlement:** ‘an ongoing agreement among a society’s most powerful groups over a set of political and economic institutions expected to generate for them a minimally acceptable level of benefits, which thereby ends or prevents generalized civil war and/or political and economic disorder’.<sup>16</sup>

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<sup>16</sup> ‘Political Settlements and Development: Theory, Evidence, Implications’, Tim Kelsall et al, OUP, 2022