




Policy Analysis FOR Effective Development

**STRENGTHENING
TRANSITION
ECONOMIES**



KRISTIN MORSE ■ RAYMOND J. STRUYK

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Strengthening
Transition Economies

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Policy Analysis for Effective Development

Preface

The responsibilities of governments in transition countries have been utterly transformed over the past decade. The delivery of public services has changed from a responsibility of the central government to one resting with localities. This dramatically alters the responsibilities of both local and federal officials. Government officials increasingly feel the pressure of budget constraints, accountability, and higher public expectations of and needs for public services; they must now develop, implement, and evaluate policies and programs addressing a range of pressing social and economic issues. This book provides professionals and students with the practical skills and information they need to meet today's urban challenges.

Our goal is for this book to be as practical and interactive as possible. Public policy and important current events lend themselves to lively discussion and debate. Although the book includes a certain amount of economic and governmental theory, key concepts are always applied to real world problems. Students, including those who are already accomplished policymakers, should find the topics covered here relevant and useful to careers in public policy or program administration.

The book is intended to equip students “with intellectual tools to aid practitioners in the identification and specification of policy problems and the development of sensible, useful, and politically viable solutions,”¹ all in the context of a basic market-oriented approach to the division of public and private functions. We introduce students to analytical decisionmaking methods and describe how to monitor and evaluate programs. Other topics include key concepts in policymaking, such as considering the distributional aspects of policies (who benefits/pays), developing explicit decisionmaking criteria, balancing political and technical factors, defining public goods and services, and introducing competition into the public sector.

The ultimate objective of the book is critical thinking. Many public officials—throughout the world—tend to operate at what might be termed “the descriptive

level.” In other words, when discussing a problem, they can describe a situation and outline a proposed policy, often relying heavily on the experience of how they solved similar problems in the past. This approach describes how many people solve problems. However, the demands on policymakers require that they reach a higher “analytic level,” where the problem and potential solutions are analyzed in terms of incentives that affect behavior. Hence the task of this book and instructors using it is to constantly challenge students to defend their statements in terms of rigorous analysis of incentives, behavioral relations, and consistency with general principles of good management.

Students of public policy include both traditional university students and professionals. It is our belief that students better integrate new information or skills when given an opportunity to apply them to concrete problems. Best practices in adult education generally emphasize an interactive approach. Those with professional experience are accustomed to expressing their views and can add considerably to a group discussion. Younger students are also more likely to master material in an active environment than when sitting passively in the classroom. Thus, this book is designed to emphasize interaction with students. In addition, the exercises are the most dynamic part of the book, providing students with an opportunity to apply new skills and concepts to practical problems. Many of the exercises offer students a chance to apply concepts to a problem of their own choosing.

The book is based on a public policy course developed by the Urban Institute (Washington, D.C.) and the Institute for Urban Economics (Moscow) to meet the needs of government officials and representatives from nongovernmental organizations (NGOs) in transition countries.² Hundreds of professionals and students in Russia, Bosnia, and Kyrgyzstan reported that the course was beneficial to their work, crediting it with helping to “systematize” their approach to public policy issues. Many students offered concrete examples of how our materials had assisted them in developing programs, designing monitoring systems, and facilitating competitive procurement for goods or services. Our purpose here is to make those tools available and useful to a wider audience.

We have prepared a comprehensive Instructor’s Manual, available online, that offers ideas for discussion, elaborates on key topics, and provides answers to the exercises. Instructors who would like to access the manual are encouraged to contact Raymond Struyk at rstruyk@ui.urban.org.

* * *

We want to acknowledge the generous support of the US Agency for International Development for the preparation of the original course and the chance to teach it in several countries. Rita Pinegina, Clare Romanik, and Marina Shapiro contributed importantly to the development of the course. Alexander Puzanov provided

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Contents

<i>List of Tables and Figures</i>	vii
<i>Preface</i>	xi
1 Why Policy Analysis?	1
Part 1 The Basic Tools	
2 The Policy Analysis Model	11
3 Stakeholder Analysis	37
4 Data Collection and Analysis	55
Part 2 Designing and Implementing Policies and Programs	
5 Allocating Government Resources	85
6 Assigning Government Responsibilities	121
7 Implementing Government Programs	153
8 Outsourcing Public Services	169
Part 3 Monitoring and Evaluating Programs	
9 Program Monitoring	191
10 Performance Management	235
11 Program Evaluation	265

12	Impact Evaluation	293
13	Benefit-Cost Evaluation	317
Part 4 Preparing Policy Recommendations		
14	Writing and Presenting Policy Recommendations	353
<i>Appendix: Policy Case Studies</i>		379
<i>Notes</i>		419
<i>Bibliography</i>		427
<i>Index</i>		433
<i>About the Book</i>		441

Tables and Figures

Tables

1.1	Overall Transition Indicators for European Transition Countries	2
2.1	Unemployment Data for Selected Cities	13
2.2	Evaluation Criteria	16
2.3	Types of Policy Actions	17
2.4	Scenario Table for the Perm Jobs Program	19
3.1	Proposed Roles of Stakeholders for the Karnataka Watershed Development Project	45
3.2	Residents' Ranking of Problems	46
4.1	Distribution of Poverty by Household and Age	56
4.2	Placement and Adoption Services for Abused Children and Orphans, Annual Report 2003	58
4.3	Average Family Income for Selected Cities, 2002	66
4.4	Percentage Distribution	67
4.5	Frequency Distribution	68
4.6	Interquartile Range	69
5.1	Categorical Program Examples	90
5.2	Targeting Summary	100
5.3	Forms of Government Assistance	101
5.4	Targeting Approaches Applied to Various Forms of Assistance	102
5.5	Summary Evaluation of Forms of Assistance	105
5.6	Flat Benefit Example	107
5.7	Example of a Flat Subsidy of 300 Rubles with Income Limit of 500 Rubles	108
5.8	Tiered Benefit Example	110
5.9	Simple Gap Benefit Example	111

5.10	Benefit Structure Summary	114
6.1	Expenditure Assignment to Subnational Authorities	131
6.2	Allocation of Social Functions to Subnational Governments in Selected Countries	136
6.3	Types of Taxes and Intergovernmental Assistance	140
6.4	Different Types of Taxes and Their Attributes	142
7.1	Strengths and Weaknesses of Service Delivery Options	162
9.1	Outputs and Outcomes	194
9.2	Comprehensive Monitoring Program	198
9.3	HUD's Financial Assessment Subsystem (FASS)	199
9.4	Sample Report: Comparative Financial Data	200
9.5	Sample Occupancy Loss Details Report	201
9.6	Monitoring Categories	207
9.7	Logical Frame: Solid Waste Collection	211
9.8	Tuberculosis Unit Monthly Report, March 2003	212
9.9	Employment Center and Its Services	215
9.10	Municipal Jobs Program, Annual Report 2004	216
9.11	Defining "How Many?"	220
9.12	Client Activity by Quarter	220
9.13	Client Population by Referral Source	222
9.14	Services for Children: Social Rehabilitation	223
9.15	Service Definition	224
9.16	Police: Complaints of Minor Crimes Processed by Each District	225
9.17	Child Allowance Program Monthly Report, March 2004	228
10.1	Implementation Steps for Performance Management	242
10.2	Municipal Report Card, New York City	248
10.3	Uses for Performance Indicators	250
10.4	Advantages and Disadvantages of Trained Observer Ratings	253
10.5	Written Rating Scale: Street Sign Grades	255
10.6	Written Rating Scale: Road Conditions	256
11.1	Questions for Different Types of Evaluations	267
11.2	Participation Rates	278
11.3	Distribution of Participants by Income Quintile	279
11.4	Client Satisfaction: Timeliness	279
11.5	Client Satisfaction: Staff Performance	280
12.1	Model of Implementation and Results for Health Intervention Program	294
12.2	STAR Program: Basic Results	311
12.3	Summary of Strengths and Weaknesses of Design Strategies	312
13.1	Benefit-Cost Evaluation: Bus Fleet Replacement	320

13.2	Benefit-Cost Framework for Slum Clearance/Housing Relocation Project	322
13.3	Housing Price and Quality of Education	331
13.4	Estimated Net Present Values per Job Corps Member	333
13.5	Cost-Effectiveness Analysis for Drug Treatment Programs	337
13.6	Cost-Effectiveness Analysis of Residential Drug Treatment Compared to Doing Nothing	338
13.7	Costs and Effectiveness Summary: Latvia Welfare Reform Project	339
14.1	Key Differences Between Poor and Nonpoor Families	361

Figures

4.1	Normal Bell Curve	70
4.2	Example of a Normal Bell Curve	71
4.3	Sample Pie Chart	77
5.1	Nontargeted Benefit	107
5.2	Targeted Flat Benefit	109
5.3	Tiered Benefit	109
5.4	Simple Gap Benefit	111
5.5	Gap Benefit with Earnings Disregard	113
7.1	Options for Carrying Out Government Functions	155
9.1	Program Model	204
9.2	Program Model for the Municipal Jobs Program	205
12.1	Wage Rates and Years of School	303
14.1	Factors Influencing Poverty Rates	363

Why Policy Analysis?

This book aims to improve the quality of public decisionmaking and service delivery. Governments everywhere are under pressure to do better with fewer resources. In transition countries these pressures are even more acute, as they are accompanied by the need to develop the legal and regulatory framework for a market economy, design more efficient ways to conduct the remaining government tasks, and reinvent a social safety net to protect vulnerable citizens from poverty. Added to these overarching tasks is an organizational shift from central planning and management to local government responsibility for the delivery of many public services. Amid these challenges, governments do what they can to maintain current programs, address pressing problems, and implement new initiatives and reforms. Some accomplish this better than others.

This transition is occurring on an uneven playing field. The countries in the region are vastly different in terms of the pace of reform and other attributes. These differences have, in part, affected the countries' reform policies. Table 1.1 groups European transition countries according to their overall transition progress, as assessed by the European Bank for Reconstruction and Development (EBRD).¹ The EBRD defines the main tasks of transition as the following:

- Macroeconomic stabilization.
- Price and trade liberalization.
- Privatization of state assets.
- Institutional reforms to support the development of market finance, to commercialize public infrastructure, and to strengthen public administration.

The literature is divided on whether initial conditions or policy decisions have played a larger role in the shifting economic status of these nations. Influential initial conditions include income, proximity to other markets, natural resources,

Table 1.1 Overall Transition Indicators for European Transition Countries

High Level of Reform	Medium Level of Reform	Low Level of Reform
Croatia	Albania	Azerbaijan
Czech Republic	Armenia	Belarus
Hungary	Bulgaria	Bosnia and Herzegovina
Estonia	FYR Macedonia	Tajikistan
Lithuania	Georgia	Turkmenistan
Latvia	Kazakhstan	Uzbekistan
Poland	Kyrgyzstan	
Slovak Republic	Moldova	
Slovenia	Romania	
	Russia	
	Ukraine	

Source: European Bank for Reconstruction and Development (EBRD), *Transition Impact Retrospective* (London: EBRD, 2001).

industrial concentration, and war. For example, central and southeastern European and Baltic countries benefited from proximity to European markets, market memory, and relatively high incomes (compared to other transition states). Russia benefited from its natural resources, yet struggled with cities concentrated on failing industries and limited public support for reform. Several of the central Asian countries began the transition with weak infrastructure and rampant industrial failure. Bloody conflicts in Armenia, Azerbaijan, Bosnia, Georgia, and Tajikistan absorbed resources, thwarted transition, and blocked economic growth.

A recent World Bank report found that initial conditions explained considerably more of the variation in performance than did policy decisions in the early transition period. These conditions, however, had less of an impact when looked at over the entire decade of transition. Others have found that differences in the pursued policies had a larger impact on outcomes than initial conditions.²

East Germany, for example, started the transition with several significant advantages, yet today its feeble growth and rampant unemployment put it in a class with some of the most disadvantaged and least reformed nations in the region.³ It quickly solved the challenge of developing a legal framework by adopting the laws and government structures of West Germany. It had ample resources to fund private sector investment, generous social protection programs, and other public expenditures through transfers from West Germany. From 1991 to 1997, these

transfers amounted to 40 to 60 percent of East Germany's gross domestic product (GDP) and dwarfed Western governments' aid to the entire region. Finally, with German unification, East Germany became an instant member of the European Union (EU), gaining favorable access to European markets years before the central European and Baltic states.

East Germany made a bad turn at the outset, however. Two economic policy choices set a course for disaster. First, in response to political pressures, East German marks were grossly overvalued in the conversion to a single currency, making East Germans quickly—but temporarily—flush. Second, because of a policy to create wage parity between the East and West, East German wages grew unrelated to workers' productivity. This rendered many East German firms unable to compete and workers were knocked out of jobs that might otherwise have been retained as the economy restructured. These policies resulted in high unemployment and obstructed new enterprise growth. This dismal economic scene is somewhat mitigated by massive social protection spending supported by West Germany, which itself suffers from low growth and a rising deficit.

It is easy to imagine the political pressures that contributed to these policy decisions. German policymakers may have also miscalculated that the advantages enjoyed by East Germany at the start of the process would offset some of the economic and political compromises made along the way. After the fact, it is easy to identify poor decisions. But the complexity of these issues makes formulating effective public policy a challenge even for those with the best intentions and training.

Public policy has the potential to dramatically improve people's lives and to achieve multiple social, economic, and political objectives. For example, in fall 1992, Russia needed to quickly relocate and retire about 5,000 military officers stationed in the Baltics. These countries had just won their independence and were less than welcoming toward Russia's continued military presence. At the same time, the officers had served with merit and deserved appropriate housing in Russia. However, Russia suffered from its own housing shortage and hard budget constraints. Waiting lists for newly constructed housing were already many years long—and even a new program to build necessary units for the officers would take years to complete.

The US government stepped in to fund housing for these officers and relieve the tense situation. While the first impulse was to construct new units, a team of US and Russian policymakers developed a different scheme that granted eligible officers and their families vouchers to purchase housing in several Russian cities. Vouchers were set at local market prices and users could contribute their own funds if they wanted larger accommodations or particular amenities. Officers could use the vouchers to purchase new units from the government or private builders or units in the secondary market (existing housing). In addition to relocating the offi-

cers in a timely manner to housing that met their needs, the vouchers also served a secondary objective of helping to stimulate private construction and the market for existing housing.

When the program was implemented, Russia's housing market was still in its infancy and it was unclear whether the officers would find enough public or private owners to accept their vouchers. The program proved a success, with 2,700 officers relocated in 1993–1994 using vouchers (the others waited longer, some much longer, for newly constructed units to be completed).⁴

The voucher program is a good example of the creativity involved in policy-making. Because speed was such an important criterion in this case, policymakers were willing to risk a new approach that, if successful, would lead to quicker relocations.

There is a desperate need for creative and effective policymakers. Decentralization from central planning has dramatically expanded the number of policy players in regional and local government. These players, along with NGOs, contribute to defining public problems and pursuing more efficient solutions. Effective policymakers and analysts are those who approach each new problem with critical thinking—that is, they are able to conduct rigorous analyses, generate creative solutions, and bring experience as well as good judgment to decisionmaking. This book encourages critical thinking, teaches effective analytical techniques, and offers practical examples to help readers apply new ideas and skills to real world problems.

Organization of the Book

This book is written for policymakers and students interested in transition countries and development issues. We selected topics based on their immediacy to the policy challenges and political context of transition countries. These topics arise frequently in actual policy development and are those where officials and analysts often lack a solid grounding. The book is in keeping with the basic discipline of policy training as taught in North American universities (see Box 1.1), with a heavy emphasis on international best practices and case studies from the region.⁵

We focus on key policy skills, including analytical decisionmaking and how to monitor and evaluate programs. The book also covers major concepts in policy-making such as the following:

- Considering the distributional aspects of policies (who benefits/pays).
- Developing explicit decisionmaking criteria.
- Balancing political and technical factors.
- Defining public goods and services.
- Improving public services by fostering competition and utilizing the private sector.

Box 1.1 The Study of Public Policy

The field of public policy includes the ideas and actions of government and other players in response to societal problems. A wide variety of actors put problems on the agenda and undertake actions both within and outside government. Furthermore, policy studies address not only laws and regulations, but also how they are implemented and what effect their results have on the population and on the perception of the problem.

The formal study of public policy emerged over the past century as an outgrowth of US political science and an evolution of public management programs. Early in the twentieth century, political science was a discipline focused on how the state and formal government institutions were organized. As early as the 1920s, critics advocated that the discipline expand its study to include the dynamic processes of government actions. It was not until the 1950s, however, that several movements in political science advanced the study of policy. The first such movement to emerge was behavioralism, which sought to establish scientific methods of quantifying the

development of laws and predicting or describing political behavior. Another significant movement called for a more multidisciplinary approach to policy studies that would draw from legal studies, economics, sociology, and problem solving, with an emphasis on rational decisionmaking. By the 1960s and 1970s the field further expanded to include more analysis on how groups of citizens and other external factors influence policymaking.^a

Public administration programs trained public servants to implement and administer government programs. These programs eventually expanded their scope to include public policy, and many universities began to offer public affairs programs. By the 1960s and 1970s, economists and others had developed techniques for analyzing public problems, which prompted more formal policy programs to become popular. Today, public policy is taught in countless universities throughout the world and programs vary from those with a heavy emphasis on public administration to those with a more analytical approach.^b

Notes: a. The description of the evolution of policy studies from political science is drawn largely from Jessica R. Adolino and Charles H. Blake, *Comparing Public Policies: Issues and Choices in Six Industrialized Countries* (Washington, D.C.: Congressional Quarterly Press, 2002), pp. 10–11.

b. Association of Public Policy Analysis and Management website, <http://www.appam.org>.

The book draws on examples of policies, social and economic problems, and current practice to make the material practical and engaging.

In each chapter, students have the opportunity to use exercises or assignments to apply the concepts and skills from the text to practical policy problems. For example, after a description of how to conduct policy analysis, there is an exercise on how a city might reduce its traffic congestion problems. Similarly, following the text on using the private sector to improve the delivery of public services, there is an exercise on how to contract out social services on a competitive basis. These and other exercises are based on contemporary economic and social problems and make the study of public policy a lively and relevant process. The exercises are