Defining and Implementing Conditionality
The Case of Uganda

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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>DFID</td>
<td>Department for International Development (UK)</td>
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<td>EC</td>
<td>European Commission</td>
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<td>ESAF</td>
<td>Enhanced Structural Adjustment Facility</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>HIPC</td>
<td>Highly Indebted Poor Country</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>MTEF</td>
<td>Medium Term Expenditure Framework</td>
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<td>OECD DAC</td>
<td>Organisation for Economic Co-operation and Development, Development Assistance Committee</td>
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<tr>
<td>PAF</td>
<td>Poverty Action Fund</td>
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<td>PAPSCA</td>
<td>Programme for the Alleviation of Poverty and the Social Costs of Adjustment</td>
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<td>PEAP</td>
<td>Poverty Eradication Action Plan</td>
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<td>PFM</td>
<td>Public Financial Management</td>
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<td>PGBS</td>
<td>Partnership General Budget Support</td>
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<td>PMA</td>
<td>Plan for the Modernisation of Agriculture</td>
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<td>PRGF</td>
<td>Poverty Reduction Growth Facility</td>
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<td>PRSC</td>
<td>Poverty Reduction Strategy Credit</td>
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<td>PRS(P)</td>
<td>Poverty Reduction Strategy (Paper)</td>
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<td>PSI</td>
<td>Policy Support Instrument</td>
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<td>SAC</td>
<td>Structural Adjustment Credit</td>
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<td>SAF</td>
<td>Structural Adjustment Facility</td>
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<tr>
<td>SDR</td>
<td>Special Drawing Rights</td>
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<td>SWAp</td>
<td>Sector Wide Approach</td>
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<tr>
<td>UJAS</td>
<td>Uganda Joint Assistance Strategy</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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Abstract

The use of conditionality in development co-operation has varied in terms of content and enforcement, over time but also depending on the partners involved. This paper provides a description of conditionality mainly focusing on the years 1995-2005.

Initially, the two main theoretical approaches to conditionality, the principal agent model and the political economy approach, are outlined. An important difference in the approaches is how they treat ownership of conditions by the partner country. The principal-agent model can be said to be applicable in situations where the recipient does not own the policies favoured by the donor. The political economy perspective builds on ownership, but holds that, in order for conditionality not to be redundant, there has to be a conflict of interest somewhere. Conditionality then functions as a counterbalance.

Conditionality is then described as it has been defined and implemented by the Bretton Woods Institutions, the European Commission and a few bilateral donors. The overview shows a trend during the studied decade, towards linking conditions to poverty reduction strategies prepared by development partner countries. A shift from imposing conditions on partner countries towards increasing ownership, through negotiation, can also be observed.

Uganda was one of the first countries to bring out a poverty reduction strategy of its own. Donors have increasingly co-ordinated with the Ugandan government and harmonised amongst themselves, leading to a greater focus of development co-operation on the PRS. The main conditions that Uganda has been faced with were negotiated by the World Bank. A process has led to participation by a number of bilateral donors, as well as to conditions increasingly being drawn from Uganda’s Poverty Eradication Action Plan. A set of issues and conditions revolving around democracy, human rights, governance and internal conflict have however remained outside this process. As a consequence, Uganda has had two sets of conditions, one which to a high degree has been owned by the Ugandan government, and one which has been rejected by the same government. These two sets of conditions provide the case on which the theoretical approaches to conditionality can be tested.

The application of the models reveals that there are many dilemmas involved when conditionality is used in a development co-operation relationship. The ability to enforce conditions can be influenced by the Samaritan’s dilemma, incentives promoting disbursement by donor
organisations, or the simple desire to prove successful. The transparency and predictability of conditions and their consequences is an issue that further complicates the analysis of conditionality and its usefulness. Ownership proves to be a complex matter; how should it be defined, how broad and deep must it be in order for true ownership to be present?

The discussion leads to a conclusion that while the political economy approach results in many questions regarding the quality and character of ownership that would deserve closer examination, few alternative courses of action are offered if real ownership cannot be achieved. The principal-agent model provides the background for a discussion about the enforcement of conditions and factors that influence enforcement. But it also allows for a closer scrutinisation of donor behaviour when it comes to the transparency and predictability of conditions. Again, these are issues that leave room for further exploration.
1. Introduction

Over the years, conditionality in the relationship between developing countries and the donor community has been a much discussed and disputed phenomenon. In the 1980’s it was mainly linked with the Bretton Woods institutions and what were often perceived as harsh requirements vis-à-vis developing countries and their macroeconomic policies. Structural adjustment was the term used to describe a one-fits-all solution to the difficulties facing developing nations. Conditionality was the term used to describe the conditions and requirements that went along with structural adjustment programmes and that had to be fulfilled in order for the client countries to access loans from the IMF, the World Bank and the regional development banks.

After a number of years’ implementation of this kind of programmes, it became apparent that they sometimes did not have the desired effects, and criticism of IMF and World Bank policies grew stronger and stronger. Since then, conditionality has changed its face to become oriented more towards poverty eradication rather than macroeconomic stabilisation, privatisation programmes and trade policy liberalisation, even if those themes have not entirely disappeared from the agenda. The new catch-words are ownership, partnership and harmonisation. The emergence of poverty reduction strategies has provided development partners with a new instrument and with new strategies with which to pursue development and growth alongside the fight against poverty. It is also with poverty reduction strategies that conditionality is becoming increasingly linked.

New actors have entered the arena as more and more bilateral donors have started providing sector or programme support, as well as budget support. For those donors, the use of budget support has increased their interest, as well as their stakes, in poverty reduction policies being pursued by client governments and their effects and results. It has also made it all the more important for a larger group of donors to follow economic and financial policy, budget processes and budget execution and follow-up in the countries where they are engaged.

The aim of these constantly changing policies and strategies, as well as of conditionality, is to find ways and means of assisting nations with unacceptably high proportions of their populations below the poverty line. This aim is nowadays clearly stated by most development partners, and the UN millennium declaration is a clear expression of concern and determination, as well as an agreement on the goals that should be pursued by development partners, through development co-
operation. Policies and reforms have to be identified that will achieve the millennium development goals and move people and nations away from poverty and towards economic growth and increased welfare for all.

Also, efforts are being made to co-ordinate and harmonise development co-operation in order to make it more effective and manageable for beneficiary countries, while also increasing their ownership. These ambitions have been expressed in joint declarations, most important of which are the Rome declaration on harmonisation and the Paris declaration on aid effectiveness.

But there is also a need for safeguards, to make sure that necessary policies and reforms are carried out, that this is done in an effective and efficient way, and that the desired results in terms of poverty eradication are achieved. Safeguards are also needed to ensure that public resources, or taxpayers’ money, are used in an accountable way and for the purposes that they were intended. One such safeguard is called conditionality.

This paper will provide an overview of conditionality and examine how it has evolved over some 20-25 years. The use of conditionality in Uganda will be described as an illustrative case, and its’ usefulness in relation to Ugandan policies will be discussed. That section will focus mainly on the years 1995-2005. Finally, conclusions regarding conditionality will be drawn from these descriptions and discussions.

The paper will follow a simple structure, with chapter 2 covering the evolution and design of conditionality since the 1980’s Chapter 3 will describe conditionality and how it has developed in Uganda, and in chapter 4 conclusions will be drawn.
2. The Evolution and Design of Conditionality

2.1 What is Conditionality – Definitions, Concepts and Principles

As mentioned in the introduction, conditionality became more broadly used as a term, or a concept, in the process that led to the introduction of structural adjustment programmes in the 1980’s. The term has been defined and described in many ways and to suit varying uses. Initially the definition depended on World Bank and IMF perceptions of what the word entailed. It is important to note that different observers do not always use the word with the same meaning. While some consider it synonymous with the interpretations made by the Bretton Woods institutions, others include all kinds of requirements for lending, as well as for grants, being made available by different actors in the donor community to governments in developing countries.

The recent Review of World Bank Conditionality¹ does indeed state that the term conditionality has been interpreted in many ways and that “it has been associated by some with all the types of activities a country may need to undertake to gain access to or influence the level of financing” that the country in question is pursuing. Here one could include eligibility criteria used by the IMF, or so-called selectivity criteria, the general criteria that the Bank and others use and require the adherence to when at all considering lending or granting funds to a country. Examples of criteria are that a potential borrower/recipient of grants should have a favourable policy environment and commitment to a viable development strategy. Some observers may define conditionality very broadly and view any interaction between donor and country authorities on economic or other policies and outcomes as conditionality.

Conditionality has also been the subject of research for twenty years or more, and it has resulted in theoretical and empirical analyses and literature, both critical of (see a summary by Paul²) and positive to the phenomenon.

Below, the theory of conditionality will be outlined first. A section will follow describing the approaches of different donors, multilateral and bilateral, to conditionality.

¹ The World Bank 2005, Review of World Bank Conditionality, p. 3
2.1.1. Theoretical Approaches to Conditionality

A paper included in the World Bank Review of Conditionality from 2005\(^3\) gives an overview of conditionality in theory and its links to practice. There are two main theoretical approaches to conditionality.

One is known as the so-called *principal-agent* model. In this model, there are two players with conflicting objectives. The principal, or the donor, offers a contract, and aid, to the agent, a recipient government, that provides it with appropriate incentives to align their objectives. The donor has altruistic preferences and e.g. cares about public spending aimed at poverty reduction. The recipient government, however, weighs poverty reduction against other factors that only benefit certain segments of the country’s population. In circumstances such as these, the donor, which is seen as more concerned with the poor than the government, will use conditionality to enforce compliance with poverty reduction policies, i.e. transfers are conditional on increased poverty reduction spending. Only the agent is aware, or has information, about its ability, opportunities and the cost of choosing the donor’s preferred policy. In the end, the principal may be able to observe the final amount of poverty reduction spending, but cannot observe the agent’s action, or the cost of the action. This is called a “moral hazard setting” and the scenario is frequently used to describe cases of ownership failure.

The effectiveness of conditionality will depend on the principal’s ability to enforce the contract. This ability is weakened the more altruistic the donor is, with a highly altruistic donor always releasing the funds, irrespective of what the agent does. This relationship, the so-called Samaritan’s dilemma, can be taken advantage of by the recipient. On the basis of this reasoning, there is widespread consensus that the inability of donors to commit to the enforcement of conditions makes aid ineffective as a means for policy reform.

The literature on conditionality offers three main methods to get around this dilemma. One is to arrange a kind of competition amongst recipients, in which the donor only rewards governments that implement poverty reducing reforms. This lies close to the principle of selectivity, according to which aid should only be offered to “good performers”. To a greater or lesser degree, this principle is applied by certain donors, e.g. the World Bank. The second method is about the donor building a long-term relationship with a recipient, in which the donor accepts the costs of high poverty rates for the number of periods necessary in order for it to build its reputation as a

contract enforcer. This would eventually “force” the recipient into compliance with conditions, with poverty reducing effects in the long term. The third method is to delegate the disbursement of aid to a third party that is supposedly less adverse to poverty, such as a multilateral institution.

The second approach is known as the political economy perspective. The principal-agent model is, in theory, applicable in situations where the recipient does not own the policies favoured by the donor. One of the main criticisms of conditionality is, however, that conditionality only works in situations where ownership by the recipient is strong. But would not conditionality be meaningless in a situation where there is ownership? What is the added value of ownership in such situations?

The political economy perspective holds that, in order for conditionality not to be redundant, there has to be a conflict of interest somewhere. Even if government ownership is strong, domestic conflicts of interest and pressure from special interest groups may give conditionality an important role to play, in order to counterbalance those special interests. At the same time, it is the presence of interest groups that delays reforms, such as the reduction/removal of tariffs, privatisation of state-owned firms and land redistribution. Empirical research has shown that the compliance with conditions is low in election and pre-election years; In order not to jeopardize their political future, governments will be more likely to go along with the demands of interest groups rather than implement prescribed policies.

The purpose of conditionality in the political economy setting is hence to support and strengthen a government to push policies and reforms that benefit a majority, against special interests.

Other research has shown that aid will be ineffective unless the government is liberal. Length of tenure and democratic elections also influence whether reform programmes are successful.

### 2.1.2. Donor Approaches to Conditionality

The World Bank makes its own, current “definition”, or description of content, of conditionality in the document referred to above. In the section on modalities of conditionality, it states that “Conditionality is involved whenever the flow of resources from the Bank can be halted in case the recipient country does not meet certain conditions”. Three broad conditions are included in World Bank loan agreements: 1. Maintenance of an adequate macroeconomic policy framework; 2. Implementation of the overall programme in a manner satisfactory to the Bank and 3.
Implementation of the policy and institutional actions that are deemed critical for the implementation and expected results of the supported programme. These broad and overarching conditions are, in their turn, subdivided into various conditions, preliminary conditions, and indicators, termed “triggers”, “prior actions”, “benchmarks” and so on. These are discussed at length by the World Bank paper (and are also described further in ch. 2.2, the section on the World Bank, p. 13).

The **IMF** describes/defines conditionality as “the commitments a government makes on economic and financial policies when it borrows from the IMF”. The Fund’s traditional use of conditionality relied on quantitative macroeconomic targets, with a focus on fiscal deficits, public debt, the expansion of domestic credit and the accumulation of international reserves. In addition, the IMF has developed the concept of structural conditionality, which involves conditions regarding changes in policy processes, legislation and institutional reform. This has lead to the inclusion of policy areas that are in need of structural reform in many of the IMF’s client countries, such as trade policy, price liberalisation and privatisation. These structural conditions have however led to some confusion regarding the division of labour between the IMF and the World Bank. Like the World Bank, the IMF has a number of tools for specifying conditionality, including performance criteria, structural benchmarks, programme reviews and prior actions.

The **European Commission** concept of conditionality bases disbursements on the achievement of results, or outcomes, agreed with the partner government, rather than basing them on actions to be carried out. Support is divided into tranches, with the release of each tranche depending on the fulfilment of different sets of conditions/achievement of results. The linking of disbursement tranches to different conditions is also known as the graduated response mechanism. According to the EC, this results-oriented approach, gives greater flexibility to the partner country to choose its own path towards reaching specified goals, and allows the donor to move away from intrusive micromanagement. This in turn implies greater partner country ownership, as well as predictability. It is however an approach that requires somewhat longer time frames compared with practise until now. Donors in general are beginning to seek a clearer orientation towards results. Methodological work still remains to be done, however, and few donors have brought out clear concepts in the way that the EC has done.

For the disbursement of aid, **bilateral donors** have traditionally relied mainly on the IMF, but also on the World Bank, to indicate if a country’s macro-economic policy and strategies where

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4 IMF 2005
satisfactory and “on-track”. Amongst bilateral donors, some have become more involved above all in World Bank processes and assessments. A few have begun defining how they wish to interpret and use conditionality, while many donors have no clear interpretation or policy of their own.

**DFID** (The UK Department for International Development) has brought out a policy paper,\(^5\) in which they “set out a significantly new approach, to building a successful partnership for poverty reduction, focussing on poverty outcomes rather than specific policy conditions”. DFID specifies three main areas upon which conditionality is built. If conditions in those areas are not adhered to, the UK will consider reducing or interrupting aid. Those areas are a) countries move away from agreed poverty reduction objectives or outcomes or the agreed objectives of a particular aid commitment; b) countries are in significant violation of human rights or other international obligations, or, c) there is a significant breakdown in partner government financial management and accountability, leading to the risk of funds being misused through weak administration or corruption.

In a paper mainly focussing on budget support,\(^6\) **Norad** discusses conditionality as one of the reasons for lack of predictability of donor aid inflows to developing countries. A graduated response, which entails tying parts, or tranches, of an agreed amount of budget support, to different conditions (also described under EC section above), is proposed to improve predictability while still applying conditionality. The graduated response or similar concepts are being put to use in certain countries e.g. by the World Bank and DFID, and other donors are showing increasing interest in this mechanism. Without specifying areas in which conditionality should be applied, Norad does identify a number of principles for conditionality: conditions should preferably be based on performance indicators taken from poverty reduction strategies; they should not be too numerous; they should be easy to monitor and evaluate; they must be reasonably under the control of the authorities of the partner country; conditions should be clearly defined and leave little margin for interpretation, rendering political conditionality a difficult area that is best handled in the context of political dialogue.

The above illustrates that the understanding of what conditionality is, varies from one observer to another, and from one organisation to another. The topic is controversial. Some observers or representatives of development partner governments argue for minimising conditionality and for

\(^5\) DFID, Foreign & Commonwealth Office and HM Treasury, 2005  
\(^6\) Norad 2005
making development assistance, loans and grants available with as few strings attached as possible. Their reasons are that conditionality makes access to donor funds less predictable, or that it lays additional burden on overwhelmed governments. Others wish to impose heavy and strict conditions, giving priority to accountability towards the donor government and tax payers in the donor country. What some call conditionality, others call predictability, arguing that a government that knows what it has to do to access certain funds, can predict what its actions (or failure to act) will lead to.

There is also a lot of disagreement as far as the effect, or impact, of conditionality is concerned. It is not clear if conditionality always does contribute to the delivery of results and attainment of objectives that it was designed for. Nor is it clear what the effects of conditionality are on the dialogue between donor and recipient governments, on ownership and partnership. Studies, evaluations and reviews have been carried out, and more are planned, mainly by the World Bank and the IMF. The conclusions so far, however, are not clear, and these issues continue to be the source of discussion and sometimes disagreement.

The OECD/DAC has for a number of years provided a forum for work to improve harmonisation and co-ordination of development co-operation efforts amongst donors and partner countries. This work has led to agreements amongst a large number of donor and partner countries, as well as with multilateral organisations. The two most important arrangements are the Rome Declaration on Harmonisation (February 2003) and the subsequent Paris Declaration on Aid Effectiveness (March 2005)\(^7\). In the section on donors’ alignment with partner country strategies, the Paris declaration includes commitments to principles as regards conditionality. Those donor commitments include the following two principles:

1. Donors commit to draw conditions whenever possible, from a partner’s national development strategy or its annual review of progress in implementing this strategy. Other conditions would be included only when a sound justification exists and would be undertaken transparently and in close consultation with other donors and stakeholders.
2. Donors commit to link funding to a single framework of conditions and/or a manageable set of indicators derived from the national development strategy. This does not mean that all donors have identical conditions, but that each donor’s conditions should be derived from a common streamlined framework aimed at achieving lasting results.

\(^7\) OECD/DAC High Level Forum 2005
2.2 A Brief History of Conditionality and Instruments Used to Apply Conditionality

The IMF

Although the IMF has worked with macroeconomic policy conditions since the 1950’s, it was mainly in the 1980’s that conditionality became a more broadly used expression amongst development economists and members of the donor community. The term has always been closely associated with the IMF, and in the 80’s it was also mainly used to describe the conditions applied by the Fund in its dealings, negotiations and agreements with client, or member governments. These conditions revolved around quantitative, macro-economic targets that were considered crucial for a country’s external credibility and viability. The targets that the IMF and its clients focussed on included the size of a country’s fiscal deficit, its public debt, the expansion of domestic credit and the accumulation of domestic reserves.

Having initially been set up to assist countries dealing with the effects of the Second World War (Belgium was the first country to access a credit in 1952), the IMF has become increasingly involved with low-income and transition countries, suffering balance of payments problems due to structural weaknesses. In the 1980’s, the complexity and scope of structural conditions increased and led to the emergence of new concessional lending facilities for low-income countries. The Structural Adjustment Facility (SAF) was established in 1986, followed by the Enhanced Structural Adjustment Facility (ESAF) in 1987. With these facilities, the use of structural conditionality grew alongside the macro-economic, quantitative variables that had traditionally been used. Structural conditionality became an IMF concept in its own right, covering changes in policy processes, legislation and institutional reforms.

As argued in an issues paper by the IMF\textsuperscript{8}, the Fund attached more and more importance to “structural reforms for achieving more sustainable results in the areas of macro-economic stability and better equipping economies to cope with the effects of adverse external shocks”. Areas such as trade reform, price liberalisation and privatisation gained prominence. Central banks, government agencies, state-owned enterprises and the financial sector were the targets of reform. The aim and intention was to increase efficiency and promote investment and growth. At the same time, the number of structural conditions steadily rose.

\textsuperscript{8} IMF 2005
In the 1990’s, this resulted in the IMF being criticised for applying conditions that were too intrusive, that undermined national ownership and also had negative effects on other programmes that the IMF and other development partners were supporting. The number of conditions overburdened governments that already had enormous challenges to tackle, and that lacked the capacity and competence to deal with so many requirements in a sustainable fashion. Another important criticism was the lack of orientation towards poverty reduction, and in some countries, the IMF’s conditions were even said to have negative effects on efforts to fight poverty. Yet another disputed topic was that with the increase in IMF structural conditionality, the Fund was overstepping its mandate and rendering the division of labour between the IMF and the World Bank unclear. Finally, the IMF was seen to make use of its financial leverage to promote certain policy agendas that could short-circuit or dictate the outcome of national decision-making processes (e.g. requiring that a reform decision be pushed through parliament before a certain deadline).

In response to the heavy criticism, the IMF started work to bring out new guidelines on how it applies conditionality. Interim guidance on the streamlining of conditionality was issued in 2000, followed in 2002 by new conditionality guidelines. According to the above-mentioned IMF paper, structural conditionality is now viewed as a complement to traditional, quantitative conditionality with the two objectives of 1.correcting problems of a non-macroeconomic nature that are critical to growth and poverty reduction in low-income countries, and 2.seeking a lasting solution to macroeconomic problems through more fundamental policy and institutional changes. The streamlining of conditionality has eventually also contributed to a clearer division of labour between the IMF and the World Bank. Fund conditionality has become more limited, to measures that have a direct and critical impact on a programme’s macro-economic objectives.  

In an IMF staff paper included in a World Bank document entitled “Conditionality Revisited”, the author outlines five principles that now serve as “key to programme effectiveness and implementation, which, in turn, are key to safeguarding IMF resources”: 1. national ownership of programmes 2.parsimony (or restrictiveness) in the application of conditionality 3.tailoring of programmes to countries’ circumstances 4.effective co-ordination with other multilateral institutions and 5.clarity in the specification of conditions. If implemented, these principles should

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address many of the concerns that critics have put forward, and reviews are currently being carried out to evaluate how effective the new IMF guidelines have been in improving IMF operations and co-operation with their borrowing members. According to the IMF paper, there is already evidence that conditions have become more focussed, that they have become more heavily weighted towards the fiscal sector and towards conditions emphasising the need for improved allocation of expenditures to address poverty concerns.

These changes were also reflected in the concessional loan facilities offered to low-income countries by the IMF. Alongside the emergence of Poverty Reduction Strategy Papers, or PRSPs, the IMF established the Poverty reduction Growth Facility, or PRGF\(^\text{11}\). The PRGF replaced the ESAF in November 1999, with the aim of making the objectives of poverty reduction and growth more central to IMF lending operations in its poorest member countries. PRGF programmes are framed around the PRSP, a strategy prepared by the government with broad public participation, of civil society and others. The PRSP increases the likelihood of country ownership and allows PRGF programmes to better reflect the poverty reduction and growth priorities of a low-income member country. The arrival of the PRGF also came with an ambition to pay more attention to the poverty and social impacts of key macroeconomic policy measures, as required by the IMF. The conditions of eligibility to access the PRGF are the same as for the previous ESAF programme: assessment of a country’s per capita income, and eligibility to World Bank concessional lending.

*The World Bank*

Like the IMF, the World Bank and its policies have evolved and changed over time. In the 1980s and early 1990s, the Bank’s operations consisted of traditional structural adjustment programmes addressing short-term macroeconomic imbalances and economic distortions. Their focus was on macroeconomic and fiscal stabilisation and liberalisation of the state sector. A number of events and occurrences did however necessitate a change in policies. As outlined in the World Bank Review of Conditionality, those events included the collapse of planned economies in Central and Eastern Europe, the fiscal crises of welfare states around the globe, and, finally, the collapse of the state and humanitarian crises in many developing countries. The World Bank too was subjected to criticism for pushing through policies that were insufficiently owned by the borrowing country. They were often considered to do more harm than good; particularly in low-income countries where the poor majority of populations had to deal with negative effects of certain policies. As in the IMF case, the number of conditions grew without the desired results being achieved.

\(^{11}\) IMF website 2004 and 2005.
The above mentioned Review (and its chapter “Experience with World Bank Conditionality”) describes how these events have contributed to a significant change in the content and composition of World Bank conditions and benchmarks since 1980. In summary, those changes are that 1. the relative importance of public sector governance (public expenditure, financial management and procurement) issues has increased; 2. the emphasis on privatisation has declined; 3. the application of user fee conditions is extremely limited and 4. trade conditions and benchmarks have declined significantly. Simultaneously, the number of conditions applied in World Bank programmes have decreased, from more than 35 in the 1980s to an average of 12 in 2005. Lending has become more selective, in favour of better-performing countries. Also, the focus of conditionality has changed from short-term reforms to longer-term and more complex issues, according to the review. This has resulted in higher quality adjustment operations, with an increase over the last decade of World Bank operations with satisfactory ratings.

These experiences and lessons have lead to revisions in the application of the World Bank’s operational policy for development policy lending. The Review of World Bank Conditionality (referred to above) proposes the introduction of five good practice principles, which should further streamline and improve the current approach to conditionality.

1. Reinforce country ownership
2. Harmonisation: Agree up-front with the government and other financial partners on a co-ordinated accountability framework
3. Customise the accountability framework and modalities of Bank support to country circumstances
4. Choose only actions critical for achieving results as conditions for disbursement
5. Conduct transparent progress reviews conducive to predictable and performance-based financial support

These good practice principles make an interesting comparison with the five IMF key principles outlined above.

In its lending operations, the World Bank has made use of a range of different instruments, which have been part of the Bank’s Adjustment Lending Policy. The instruments have included adjustment loans, structural adjustment loans and, later on, Poverty Reduction Support Credits, or PRSCs. In 2004, the Adjustment Lending framework was replaced by Development Policy
Lending. The change was made to mark the transformation towards greater country ownership, harmonisation and the need in low-income countries for longer-term structural change.

In the late 90s, another important development was the introduction of the Heavily Indebted Poor Country Initiative, HIPC. It was launched by the World Bank and the IMF in 1996 to provide comprehensive debt relief to the poorest and most heavily indebted countries. Two years later the HIPC was expanded as the Enhanced HIPC Initiative. These initiatives became important ingredients in the strategies applied to support low-income countries.

The PRSC was introduced by the World Bank in May 2001, with the objective of helping countries implement their PRSPs and to facilitate a move away from project-centred approaches. More emphasis was given to country ownership and it helped induce a change in conditionality, from a traditional role of leveraging reforms to a means for reaching mutual understandings with governments on reform priorities. The PRSC is the Bank’s version of budget support, i.e. non-project financing that is usually annual, with a medium-term timeframe and based on progress in achieving the objectives of the government’s PRSP. At the beginning of 2005, the World Bank Board had approved 33 PRSCs in 20 countries, and it has become an important instrument in development policy lending, representing some 50% of operations and commitments.

These different instruments have all come with different sets of conditions. Many of them are applied in order for a country at all to be considered for support. Under the HIPC, the Bank and the Fund assess a country’s eligibility for debt relief. Once it has been approved (the so-called decision point), it has to implement policies that have been determined (so-called triggers) in order to reach a completion point.

The PRSC approach is offered to countries that are “good performers”, i.e. show solid country performance, commitment to an effective reform programme and readiness to improve fiduciary and public financial management arrangements. The World Bank often speaks of a “good track record” as an essential deciding factor. The Bank and the country then agree on a limited number of high-priority actions that are reflected in the country’s strategy (the PRSP where available) and priorities. These prior actions are monitored and assessed by World Bank teams, and it is progress of these actions that determines the size, and sometimes the timing, of the PRSC disbursement.

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14 World Bank 2005
Whereas the prior actions are conditions for disbursement of a credit, and of late also of grants, up to a specified amount, there are also other indicators, such as benchmarks and triggers (the next PRSC’s preliminary prior actions). These are however not used to influence disbursements, but rather as a monitoring and follow-up mechanism.

*The European Commission*

In the 1980s and 1990s, the EC provided structural adjustment support which was usually linked to the conditionality set by the IMF and the World Bank. The critique of those programmes and of the conditions that were attached to them also led the EC to revise its approach, which is described in a paper on budget support and conditionality.\(^{15}\)

The main elements of the approach are 1. That budget support programmes should be pluriannual; 2. That budget support should be untargeted/unearmarked; 3. That it should be provided for the implementation of a poverty reduction strategy, when and where possible; 4. That it should consist of fixed and variable tranche disbursements within the framework of a country’s PRS; 5. That performance should be measured annually, preferably making use of a government-led PRS review; 6. That improved Public Financial Management should be an explicit goal and a condition for eligibility and finally 7. That donor coordination should be pursued.

The fixed and variable tranche mechanism for disbursement of support revolves around two separate sets of conditions. The release, usually annually, of the fixed tranche will normally be linked to general conditions of macro-economic stability and improvements in PFM. This tranche would be released in full or, if the general conditions are not met, not at all (the “all-or-nothing” principle). The disbursement of variable tranches will often be based on PFM indicators and on results in the reduction of dimensions of poverty, directly linked to service delivery. These indicators must be possible to measure on an annual basis and should be capable of reasonable annual variation, in order for them to be visible and true indicators of progress towards poverty reduction, usually in response to government action. This implies that the results that should be studied cannot be of a medium or long-term character (e.g. life expectancy or literacy rates, which would require long time frames in order to be measurable). The EC paper suggests that the Millennium Development Goals or similar indicators can be suitable. In principle they should be drawn from the PRS or its equivalent, and targets for each indicator for each year, should be

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\(^{15}\) European Commission 2005.
agreed with government. Actual outturns can then be compared with the targets, and the variable tranches would then be disbursed depending on the degree to which targets are met.

According to the EC, this system would allow for room to manoeuvre for the country concerned. It would have the freedom to decide in which manner results should be achieved, rather than having the course of action spelt out in advance, and often by donors. This should result in clearer country ownership. The EC also argues that the system provides predictability; government is informed well in advance of results to be achieved in order for certain amounts of support to be made available.

The fixed and variable tranche mechanism, which is sometimes also known as graduated response, also has the advantage of responding to partial performance with partial disbursement. In theory, conditionality has been designed to operate according to the “all-or-nothing” principle mentioned above. In other words, when conditions have been fully met, funds have been released in full, while if conditions are not met, all the funding is withheld. In practice, few countries have been able to meet all conditions according to plan, and have been granted waivers, or have been able to argue for less demanding interpretations of conditions, and thus still access the funds in full. This has reduced the credibility of conditionality.

The graduated response mechanism makes it possible to remain credible where the adherence to conditions is concerned, and also avoids situations in which sudden suspension of large amounts of support leads to drastic negative fiscal consequences for a country.

*Bilateral Donors*

Until the mid to late 1990s, many bilateral donors followed the assessments made by the Bretton Woods institutions, and some made their aid disbursements largely dependent on those assessments. During the second half of the 90s, a shift from project aid towards programmes, sector-wide support and budget support began. It is with the emergence of PRSPs (Poverty Reduction Strategy Papers, see section 2.2 above) and the subsequent increase in budget support as a development co-operation instrument, that a few bilateral donors as well as the EC have considered and eventually brought out their own concepts or policies in relation to conditionality.

With the introduction of budget support, development co-operation has become increasingly politicised. Concerns may arise about how political developments and government actions in a
country affect the use of the state budget, a budget to which some donors contribute grant aid in the form of budget support. In some countries and politically uncertain situations, this has meant that bilateral donors may view the assessments of the Bank and the Fund as insufficient. The ongoing debate on political conditionality is an expression of the need perceived by some donors, to go further than the IMF and the World Bank may be willing and/or able to.

The mandates of the Bank and the Fund do not allow them to work with political conditions. Democracy and good governance issues are not part of the policies or the assessments made by them. When the World Bank does speak of governance, it usually refers to accountability, transparency, rule of law and anti-corruption. In its recent policy paper on conditionality\textsuperscript{16}, DFID includes, as one of three areas, “significant violation of human rights or other international obligations” as a reason for withholding or cancelling disbursements of aid. This is an illustration of the need perceived by some donors to go further than the Bretton Woods institutions. In countries with problematic environments and controversial issues as far as democracy and human rights are concerned, bilateral donors have reduced aid not only as a result of IMF/World Bank assessments. Aid is also withheld or cut due to dissatisfaction with the direction that political and democratic development has taken, even if conditions to that effect have not been clearly spelt out in co-operation agreements between the donor and the recipient. This occurs at the same time as many observers argue that budget support is not the correct instrument for resolving these issues, and that the course of political dialogue is a preferable and more effective avenue. In any case, this type of conditionality is a reality, and it may become more important in the future.

\textsuperscript{16} DFID, Foreign & Commonwealth Office and HM Treasury, 2005
3. Conditionality in Uganda

In this chapter, conditionality will be described and studied in the specific country context of Uganda. The country has been chosen partly because it has been subject to many and different types of conditions, but also because the relationship between Uganda and its development partners has gone through a transition, which has put that relationship, and the conditions that have gone with it, to a test. Uganda was for many years considered a “model country”, which was pursuing the “right” policies and to a large extent was following the recommendations of the Bretton Woods institutions. The international community was generally satisfied, also with how democracy and good governance were handled. This in turn led to a large number of donors taking interest in and embarking on development co-operation programmes with the country.

It is during the past few years that concerns have emerged and dissatisfaction has been expressed, mainly by development partners, over the slow pace at which planned political transition has taken place. Security issues and the resulting increases in military spending have also caused growing concern. Government’s failure to tackle what is described by Transparency International as “widespread complacency about corruption”\(^\text{17}\) is another source of disappointment.

The fact that Uganda’s “good performer” status has eroded in the last few years makes it particularly interesting from a conditionality point of view. The lack of progress in the areas of security, democracy and good governance have resulted in new conditions being developed and imposed by donors. These developments, and the implementation of different conditions over time, will serve as an illustration of the general background that has been provided in the previous chapter.

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\(^{17}\) Transparency International, Global Corruption Report 2004, Uganda, p.263
3.1 The Evolution of Aid Instruments and Mechanisms in the Ugandan Context

In order to understand how conditionality has evolved over the last ten years, it is also necessary to be aware of how aid instruments have evolved in Uganda. This process is described below.

Mid 1990s-2000

In the years preceding the first Poverty Eradication Action Plan (or PEAP, Uganda’s PRSP), development assistance mainly consisted of World Bank and IMF structural adjustment programmes, balance of payments support and project aid from various donors. The IMF provided support through the ESAF, the Extended Structural Adjustment Facility (described above in section 2.2). The World Bank provided support through targeted investment credits which together constituted an investment portfolio, and through structural adjustment credits (SACs) and sector credits. In the early nineties, the structural adjustment interventions had had some negative social effects for Uganda, which also led to tension between the Government on one hand and the Bank and the Fund on the other. Amidst the criticism that was being aimed at the IMF and World Bank, concerns were becoming more clearly formulated about the need to address poverty issues in a more comprehensive way. In the early 1990s targeted interventions were carried out under the Programme for the Alleviation of Poverty and Social Costs of Adjustment (PAPSCA). The debate eventually also led to the creation of a task force which put together Uganda’s first PEAP.

Uganda was a forerunner where PRSPs are concerned. The country’s first Poverty Reduction Strategy, the PEAP, was presented in 1997. It was, to a large extent, developed on the initiative of the Ugandan government and authorities, and not so much as a result of pressure from the World Bank.

In connection with the arrival of PEAP I, which covered the years 1997-2000, a three-year rolling medium-term expenditure framework, MTEF, was introduced (1997/98). In countries where it is used, the MTEF seeks to link policy, planning and budgeting over the medium-term. It allows for medium-term projections of budget management through its two main objectives: the setting of

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fiscal targets and allocation of resources to strategic priorities within these targets. During the first PEAP, the first sector–wide approaches, or SWAPs were introduced. The MTEF was an important pre-requisite for donors wishing to work with SWAPs. The SWAPs in principle consisted of grants and loans to a chosen sector that were channelled directly through the Ugandan budget. The fact that funds flowed into the government budget made it impossible for donors to follow exactly where or how their particular contributions were put to use through that budget (a phenomenon known as fungibility). The MTEF, however, provided some assurance. It functioned, and still functions, as a monitoring instrument, with its break-down of the budget into sectors and regular follow-up of how moneys are channelled to different government sectors, against the fiscal targets that have been set. Another important element was the creation of sector working groups, made up of government line ministry/sector agency and donor representatives. They were given the responsibility for providing advice and working out medium term sector strategies within medium term sector ceilings.

It was also during the first PEAP, more precisely in April 1998 that Uganda as the first country was declared eligible for HIPC (Heavily Indebted Poor Countries, see above section 2.2) support. The PEAP was in fact a crucial criterion for Uganda to gain access to HIPC debt relief, alongside the commitment of the authorities to maintain macroeconomic stability. HIPC support became an important part of the World Bank Strategy\(^{20}\) for Uganda. The country reached its completion point; i.e. had implemented policies agreed upon with the World Bank, in May 2000. The policies agreed upon included\(^ {21}\) a presentation of a PRSP, to be endorsed by the Bank and the Fund, and efforts to clear arrears to bilateral creditors. Also on the basis of the PEAP, the IMF decided in 1999 to approve access for Uganda to its new instrument, the PRGF (see ch. 2.2, section on the IMF, p.9).

During the first PEAP yet another instrument was introduced, \textit{the Poverty Action Fund}, or \textit{PAF}. The PAF is a virtual fund originally created in 1998 to channel HIPC Initiative and other (mainly Nordic Multilateral Debt Fund) debt-relief funds, into parts of the budget supporting the PEAP.\(^ {22}\) The PAF consisted of those budget sectors that were considered critical to poverty reduction, such as health, education and water and sanitation. All PAF expenditures must support poverty reduction directly, and are subject to stringent accountability requirements. Donors that chose, and choose, to channel their funds through the PAF, are in other words provided with a kind of guarantee that those funds, or rather the equivalent amount, will only be used for such purposes

\(^{21}\) IMF/IDA 2000.
that were covered by the PAF. The PAF also provided a response, at least partially, to donor concerns that increases in military spending were crowding out essential development expenditures. The initiative paved the way for PAF budget support, i.e. support that was not earmarked for a particular sector or SWAP, but for all sectors contained in the PAF. Allocations to the PAF increased from 17% of the budget in the financial year 1997/98, to 37% in 2003/04. The kinds of conditions that were attached to PAF support and sector-wide support were that money should be channelled through the intended sectors and areas, and the MTEF was used to make sure that this was the case. Harmonisation and co-ordination groups, both at sector-level and at the ministry of finance/donor economist level, started to take shape in order for the necessary exchange of information and follow-up to take place in a structured manner. The conditions that were set by the World Bank and other donors included percentage rates of moneys that had to be channelled to PAF areas.

In 1999 the IMF approved the use of its new instrument, the PRGF, for Uganda (see ch. 2.2, section on the IMF, p.9).

2000-2004

The PEAP was revised and a second PEAP presented in 2000. The processes surrounding Uganda’s PRS were now firmly established, encouraging confidence amongst donors as well as increasing the number of SWAPs. A few donors decided to provide general, or full, budget support, i.e. budget support without any limitations in terms of sectors or the PAF. The World Bank approved Uganda’s first PRSC (see ch. 2.2, section on the World Bank, p.12) in 2001.

The need for improved public financial management had, however, become more apparent. With the World Bank and DFID taking the lead, donor demands on accountability and transparency were growing, particularly from those who were contributing with budget support or sector-wide programme support. A process of public financial management reform was embarked upon, and has become a core issue for many donors.

During this period, further efforts were made to harmonise and co-ordinate development co-operation, with government and its ministries, and amongst donor organisations. The so-called

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partnership principles\textsuperscript{24}, a document that outlines basic principles and rules for the Ugandan government and its development partners, was signed by all parties involved, in tune with the harmonisation agenda.

In 2003, three donors (Ireland, the Netherlands and the UK/DFID) however decided to withhold part of their budget support to Uganda. These cuts were largely due to dissatisfaction with the way government had handled the budget in 2002/03. They were mainly provoked by an increase of 18\% beyond the budget and the MTEF in defence expenditures\textsuperscript{25}, which resulted in cuts in planned and budgeted non-PAF expenditures by 23\%, with dire consequences for those sectors that were hit.

2004 and onwards

The process of revising the PEAP a second time was embarked upon in 2003, and PEAP III was presented late in 2004. This took place amongst increasing concerns regarding governance and democracy issues in Uganda, as the government presented a proposal for a revision of the country’s constitution. The changes would e.g. entail the removal of presidential term limits and increase the powers of the president. There was also dissatisfaction with slow progress of the political transition process, which would open up Ugandan politics to multi-partyism.

These issues were on top of several donor agendas, at the same time as a discussion took place about the PEAP and the PEAP matrix, containing indicators and benchmarks against which development and poverty eradication in Uganda would be measured. All were in agreement that the PEAP should be the guiding instrument and the tool that ought to be used to measure progress in terms of development, growth and poverty reduction. Donors, multilateral and bilateral, declared that the PEAP should be the common strategy in the efforts being made within the framework of development co-operation. A number of donors, led by the World Bank and DFID, also worked together to bring forward a common framework, the Uganda Joint Assistance Strategy or UJAS. The UJAS was intended as a co-ordinated donor response to and support of the PEAP.

In practice, however, three different policy and indicator matrices were being used to follow and monitor developments. One was the Government PEAP matrix, which was not considered

\textsuperscript{24} Ministry of Finance, Planning and Economic Development, Uganda, 2003  
sufficient by some donors. Another was the World Bank Poverty Reduction Strategy Credit (PRSC) matrix, a World Bank document used by the Bank in its assessment of progress against selected indicators. The third was the so called Governance matrix, created by a group including next to all bilateral donors present in Uganda, the EC and the UNDP. This matrix covered and measured developments in governance related areas: political transition towards improved democracy, human rights, transparency and accountability (i.e. anti-corruption) as well as the conflict in northern Uganda, which has devastated that part of the country since 1986.

In 2005, the World Bank took the decision to accept a merger of its PRSC matrix with the PEAP matrix, and to not pursue any indicators outside the common matrix. Several bilateral donors pursued a similar arrangement for the governance matrix, but the Ugandan government showed no interest in incorporating governance indicators into its matrix. The discussions reached a stalemate in connection with the proposals to change the Ugandan constitution. During the first half of 2005 a few bilateral donors (The UK, Ireland and Norway) decided to reduce or withhold parts of their budget support because of what were considered setbacks to the political transition process, a failure to halt corruption and stagnation in poverty alleviation. The World Bank delayed by six months (until the end of 2005) its decision regarding a fifth PRSC, not due to political transition issues, but because two of its prior actions, or conditions, had not been met. Later in 2005, the Netherlands and Sweden also announced that they would cut and/or withhold budget support, and the UK announced a further reduction of their budget support. The reasons for these decisions were continued concerns over obstacles to the democratic development of the country and continued delays in the government’s road map for political transition, as well as discontent with the poor management of the budget and increasing public administration expenditure.

3.2 The Evolution of Conditionality in Uganda

General introduction:
Reforms in the early 1990s emphasised macroeconomic stabilisation and the need to reduce the fiscal deficit through mobilising revenues and reducing the size of the public sector.26 A number of development partners provided programme aid in the form of balance of payments support. The World Bank and the IMF provided structural adjustment lending, which came with ex-ante conditions. These mainly required liberalisation of the economy, including the abolition of foreign exchange controls, liberalisation of commodity markets and the reduction of trade barriers.

Another condition was the privatisation of state-owned enterprises. These programmes led to a recovery of export earnings and were thus considered successful. Their success was mainly due to the Government of Uganda and political support of the reforms. As a result, the need for programme aid in the form of balance of payments support declined. For Nordic donors, relief through the Multilateral Debt Fund was initiated in the mid-90s and meant a recovery of programme aid into the late 90s. Parallel with programme aid, project support continued in an uncoordinated and fragmented manner. The launch of the PEAP opened the possibility for better co-ordination with the government of Uganda and harmonisation amongst donors.

During the second half of the 1990s, most development partners, as mentioned above, were making their support conditional on the assessments being made by the IMF and the World Bank. The World Bank was, and remains, Uganda’s largest donor in financial terms, as well as the most influential donor. Although not as powerful in financial terms, the IMF too is heavily influential through its assessments of Uganda’s ability to maintain macroeconomic stability, as well as fiscal discipline. In Uganda as in many other low-income countries, the importance of obtaining the IMF’s “on-track” credibility cannot be underestimated.

From 1999/2000, bilateral donors have followed the IMF PRGF and World Bank PRSC assessments closely. As a consequence, most donors will adhere to the judgments made by the two Bretton Woods institutions. The sections below will mainly focus on how the two institutions have handled conditionality in the Ugandan context.

The IMF

Uganda has received support under the IMF ESAF programme since 1989. It included exchange rate liberalisation, the removal of import licensing, rehabilitation of infrastructure, improved fiscal controls and public enterprise reform. A fiscal crisis in 1992 led to loss of credibility, but successful stabilisation measures by government, did however lead to an agreement on a further ESAF programme (1994-97). In 1997 and ESAF support amounted to 1998: SDR 33,5 million annually, or approx. USD 45 million.

1994-1999: ESAF

The conditions under ESAF are well documented and included fiscal as well as structural reforms. Letters of Intent from the Government of Uganda to the IMF from the period show the criteria and benchmarks and the dates by which they had to be met. They include trade issues, fiscal issues, public service reform, financial sector reform, privatisation and railway issues. In a Memorandum of Economic and Financial Policies from October 1998, the Ugandan government describes performance during the 1997/98 ESAF programme. Examples of conditions are targets for the fiscal deficit (5.8 % of GDP, to be compared with the actual deficit of 6.4 % of GDP), targets for the government’s public enterprise divestiture and reform programme (85 enterprises divested compared to a benchmark of 95), and targets for staff retrenchment at the Uganda Electricity Board (benchmarks on staff reduction were met). Reserves were to be accumulated to five months of imports. It was on the basis of the fulfilment of such conditions that the IMF based its releases under ESAF. Deviations of the kind that appear in the Ugandan memorandum were considered minor and did not constitute obstacles to the IMF approving the planned support.

In response to the criticism of IMF structural adjustment programmes that has been discussed above, ESAF-supported programmes eventually began integrating social spending needs into programme design. Many ESAF countries were required to commit budgetary resources for social safety nets, with the aim of countering possible adverse short-term effects of reform measures on the poor and vulnerable. The IMF also created some room to absorb larger amounts of foreign aid for what they called “post-stabilisation countries” (countries that had achieved macro-economic stability and were well-advanced in structural reforms), and Uganda was included in that group. This meant that the IMF modified fiscal targets to make space for development and social expenditure, or to accelerate structural reform. This flexibility was closely linked to the availability or prospect of higher external budget financing. In Uganda this lead to the acceptance under ESAF programmes of higher fiscal deficits when additional external budget support was made available. The fact that this also lead to greater aid dependency for the concerned countries was not accorded much importance.

At the same time, the IMF increasingly recognised that still more could, and should, be done to ensure better integration of economic policies with social objectives, which would lead to a more direct focus on poverty reduction and poverty reduction strategies. This realisation led to the development and launch of the PRGF.

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1999-present: PRGF

Uganda was deemed eligible for support through the PRGF when it was introduced in 1999, and the then ongoing ESAF arrangement was converted into a PRGF arrangement. The first three-year PRGF arrangement for Uganda amounted to approx. USD 120 million (SDR 91.5 million). A second three-year PRGF arrangement was approved in September 2002 and amounted to approx. USD 20 million (SDR 13.5 million). While the lending involved declined sharply during the period, the importance of the IMF’s assessments of Uganda’s adherence to macro-economic stability and continued structural reforms could not be underestimated. Those assessments were used by many donors as the basis upon which decisions were made to provide Uganda with budget support. Parallel with the decline in Fund assistance, support from other donors rose gradually.

In the request for the second PRGF arrangement, the IMF listed a number of issues and areas that required continued action and reform. These included large current account and fiscal deficits; the need for further efforts to implement, on a sustained basis, consistent policy reforms in the fiscal, monetary and exchange rate areas; further efforts in the areas of tax policy and administration to raise revenue from a low level; improvements in the areas of expenditure management and local government finances in order to minimise deviations between budget and outcomes, and improve service delivery. Finally a number of measures to foster an environment favourable to private investment were mentioned.

These issues were in their turn translated into a number of quantitative targets, performance criteria and benchmarks that would serve as conditions for IMF approval of lending. Conditions included actions to be taken in the fiscal area (e.g., “the Uganda Revenue Authority will produce a business plan spelling out its strategy for improving tax collection”), on local government issues, in the financial sector, in the privatisation area and as regards transparency and corruption. In addition to this, the IMF benchmarks and criteria were complemented by structural measures under the World Bank PRSC, which would benefit the poor in the areas of health, education, productive services and governance. This shows that a clear division of labour by now had been established between the IMF and the World Bank. IMF/GoU semi-annual reviews were planned to follow up the programme and adherence to conditions.

A final review of the second arrangement under the PRGF was completed around the end of 2005. A number of waivers for the non-observance of performance criteria were approved throughout

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30 IMF 2002.
the PRGF process. This kept the programme as well as planned lending on track, despite
deviations from the conditions set. In 2006, the PRGF arrangement will be replaced by a new
instrument, the Policy Support Instrument (PSI), which is designed for low-income countries
which may not need, or want, IMF financial assistance, but still seek IMF advice, monitoring and
endorsement of their policies. This once again demonstrates the weight that IMF assessments and
endorsements carry for low income countries.

The World Bank

PRE-PRSC, mid 90s-2000: Structural Adjustment Credits

The World Bank has provided Structural Adjustment Credits to Uganda since the early 90s. A
second SAC amounting to approx. USD 57.8 million was approved in 1994, and it was used to
finance general imports. Its objective was “to reduce poverty through accelerated economic
growth and rapid human resource development”\(^{31}\). It included support of continued deregulation
of the economy, removal of trade and investment barriers, assistance to step up domestic revenue
generation (then only 8% of GDP), prioritisation of recurrent and development expenditure and a
downsizing of the civil service, as well as improvement of its efficiency. Conditions were drawn
up in line with these objectives.

A third SAC\(^{32}\) amounting to USD 100 million was approved in 1997. This time, it was provided
in the form of balance-of payments as well as budgetary support. Its focus was on long term fiscal
sustainability, including a more efficient tax system and better management of public expenditure.
It included measures to expand the tax base, to improve the efficiency in the management of
public expenditure, improvement of the budgetary process and, finally, different fiscal measures.
In 2000 a supplemental to SAC III (USD 25 million) was approved due to a sharp deterioration of
Uganda’s external terms of trade, caused by increasing oil prices and, more importantly, a decline
in world coffee prices. Coffee was, and is, one of Uganda’s main export items. No additional
conditions were attached to the supplemental, the purpose of which was to enable government to
keep its macroeconomic programme and the PEAP on track.

\(^{32}\) World Bank 1997.
The World Bank Group’s Assistance Strategy in Uganda from 1997 spoke of refocusing the Bank assistance programme with a consistent emphasis on poverty reduction (s 22). It also spoke of “rewarding good performance and policies in its assistance”. Against the background of Uganda having been approved for HIPC debt relief, the Bank in its strategy proposed to try to achieve the objective of a higher growth scenario, which assumed, on the part of the government: 1. Timely implementation of the SAC III programme 2. Meeting the HIPC Debt Initiative targets and 3. Demonstrated capacity of timely implementation of the existing investment portfolio. The achievement by Uganda of these objectives would result in a high scenario disbursement of funds. If the criteria were not met, a base case scenario would be applied, with fewer projects being prepared annually and lower disbursements. According to the 1997 strategy, lending would also decline “in the unlikely event that the macroeconomic and reform programme falters”.

The 1997 strategy and the World Bank’s new focus on Poverty reduction Strategies would eventually lead to the linking of support with the PEAP. It would however take a number of years for the Bank to take the concept of ownership so seriously as to start drawing its conditions directly from the PEAP. Until 2005, the Bank has maintained its own policy matrix and selected prior actions, albeit in dialogue with the Government of Uganda.

PRSC, 2001-present

Uganda began receiving PRSC funding (The World Bank Poverty Reduction Strategy Credit) in 2001. The PRSC became instrumental for organising and co-ordinating dialogue as well as for the setting of conditions for budget support donors. A PRSC steering committee was formed, with the participation of government as well as of donor representatives. The dialogue was guided by the PRSC policy matrix. Budget support conditionality became focussed on annual agreements with the Government of Uganda, for the World Bank as well as for bilateral partners. The agreements centred on the PRSC matrix, and within the matrix on a number of selected prior actions, or conditions that had to be fulfilled before PRSC funds could be released. The matrix and the prior actions were however not drawn directly from the PEAP. As mentioned above (section 3.1), work has however begun on a convergence of the PRSC and PEAP matrices.

Uganda’s first PRSC of USD 150 million was approved by the World Bank board in May 2001. It was designed to channel programmatic lending to support policy and institutional reforms in

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support of a country’s PRS\textsuperscript{35}. For Uganda, a series of annual credits was proposed, supporting a three-year rolling programme of reforms. They were open to co-financing by other donors in the form of grant budget support. The PRSC policy matrix was designed to set out the objectives to be reached in each area, actions to be taken and markers that would serve as indicators of success. Amongst these, a number of so called prior actions were, and are, selected. These actions have to be fulfilled in order for the next PRSC to be approved. They also fill the purpose of conditions to be met by the Government of Uganda, in order for the committed funds in a particular PRSC to be disbursed. Failure to fulfil prior actions can affect the disbursement of resources the next fiscal year.

The prior actions have usually been 10-12 in number. A few of the themes of these actions have remained the same from PRSC 1 up to what is currently a proposal for PRSC VI. Other prior actions have been fulfilled and thus removed from the list, while a few have remained but evolved over time. The actions are discussed and agreed upon with the Ugandan government during the World Bank appraisal and pre-appraisal PRSC missions to the country. As harmonisation amongst donors has intensified, bilateral donors have been able to participate in missions and also have some influence over the choice of prior actions.

By 2005, the World Bank was reviewing implementation of a fifth PRSC for Uganda, and plans were being made for PRSC 6. The disbursement of PRSC 5 was made contingent upon eleven prior actions\textsuperscript{36}, which had also been agreed upon with the Ugandan government:

1. In the Public Expenditure Review, Government has agreed with donors on the MTEF for 2004/05-2006/07, and has executed the 2004/05 budget consistent with budget allocations;
2. Expenditures for Public Administration in 2004/05 should be within the agreed allocations for budget 2004/05;
3. Ministries of Public Service and of Finance, Planning and Economic Development jointly commit to an updated pay reform strategy and target salary adjustment for the medium term;
4. Implementation of the National Anti-Corruption Plan commences;
5. The Inspector general of Government verifies asset declarations of Ministers and appropriate action is taken by relevant authorities in accordance with the law;

6. Ministry of Finance, Planning and Economic Development drafts a revised Audit Bill to ensure adequate operational independence of the Auditor General;

7. Local Government Amendment Bill (Procurement) is tabled in Parliament;

8. Increased alignment of budget allocations of a number of ministries to PMA (Plan of Modernisation of Agriculture) review undertakings;

9. Satisfactory implementation of the undertakings agreed in the education sector review in November 2003 and confirmed by the 2004 review;

10. Satisfactory implementation of the undertakings agreed in the health sector review in November 2003 and confirmed by the 2004 review; and

11. Satisfactory implementation of the undertakings agreed in the water and sanitation sector review in September 2003 and confirmed by the 2004 review.

Two of the above prior actions, nos 1 and 5, were experiencing difficulties in 2005 and led to the World Bank delaying its presentation to the Board of PRSC 5. At the end of the year, the World Bank considered one of the prior actions (no 1) to be only “partially met”, resulting in the World Bank withholding 10% (USD 15 million) of the PRSC. Whereas PRSC 4 had consisted entirely of grant financing, the World Bank now decided to provide USD 112.5 million as grant money, and the remaining USD 22.5 million as a credit. It is interesting to note that other donors than the World Bank, e.g. DFID, expressed strong dissatisfaction with the fulfilment of prior action no 5 during parts of the process, as with the World Bank’s interpretation of the prior action.

3.3 The Implementation and Theory of Conditionality in Uganda

During the last decade, Uganda can be said to have been subjected to conditions of two different kinds, each at one extreme of the ownership scale. The two extremes, or sets of conditions, will be studied in this section. There are however examples of a less clear-cut ownership scenario and those examples will also be looked into.

One set of conditions was agreed with government, such as IMF conditions and World Bank prior actions. These conditions have been fairly clearly spelt out, and they have often been linked to, if not derived from, Uganda’s own Poverty Eradication Action Plan (the PEAP). They have also been backed by political will and Ugandan ownership has been considered substantial. Other donors have been in broad agreement with these conditions and they have often been used as the basis for release of support also from bilateral donors.
Another set of conditions has emerged on the initiative of donors. These are conditions linked to progress as far as democracy and good governance is concerned. These conditions have been rejected by government, and the World Bank and the IMF have not wished to include them in their negotiations with the Ugandan government, since such issues lie outside their mandate. The issues included in the democracy and governance matrix have however been followed and monitored by a number of donors. The issues are clearly described in the matrix, but it has not been very clear what the consequences of the Ugandan government’s lack of action or the absence of progress would be. A few donors have had more or less clear paragraphs in their bilateral agreements with Uganda, about adherence to democratic principles and human rights. But the consequences of breaches of those principles have not always been spelt out.

Applying theory to conditionality with ownership

When studying the effects of these two separate sets of conditions, it would seem that for the first set of conditions, where the Ugandan government has demonstrated political will and ownership, conditions have more or less been met. This can be interpreted as a case for conditionality, that it can be effective when conditions are selected on the basis of ownership and political will.

This brings us back to one of the two theoretical models described in chapter 2.1.1. According to the political economy model, it is in this kind of situation that conditionality works. Ownership of reforms has been strong, and conditions have been geared towards areas in which reform was considered necessary. But the rationale of the political economy model is that conditionality has a role to play, as a counterbalance, if there are domestic conflicts of interest and pressure from special interest groups. The need for such a counterbalancing force is perhaps not so obvious in the Ugandan context, as far as the first set of conditions, the strongly owned ones, is concerned. Government, and particularly the President, have a very strong position, while civil society and the political opposition are considered weak. All forces have rallied around the Poverty Eradication Action Plan, which has progressively become more and more inclusive and participatory, and around which donors have increasingly built their support. Any interests in conflict with those owned by government, if and when they have presented themselves, have usually been accorded little importance, or attention, in Uganda.

There have in recent years been interesting examples of reforms that were agreed with and initially considered owned, by the Ugandan government, but that failed later on. In a paper by
Robinson, three governance reforms (civil service reform, the creation of a semi-autonomous revenue authority, and anti-corruption agencies) are studied. According to the paper, initial success in achieving a number of objectives was gradually undermined. An important reason was that political motivations were not anticipated, and that political priorities changed: “The personal commitment of a political leader like President Museveni cannot be assured over an extended time period, and governance reforms require a broader political constituency to ensure their sustainability”. What this illustrates, is that apparent ownership is not always a guarantee that conditions will be met. Risks can be high and ownership vulnerable when it is much centralised. In the case of Uganda, it mainly revolves around the President and a small circle close to him.

Similar difficulties arose in 2005, when the trend of Uganda more or less complying with conditions and gaining approval from the Bretton Woods institutions was clearly broken. That year, the World Bank announced that two prior actions were off-track. Towards the end of the year and 10% of the PRSC was withheld because one prior action in particular had not been met. For the two prior actions concerned, political will seems to have weakened despite initial agreement with the World Bank. They revolved around the issues of budget execution in consistency with budget allocations, and governance/anti-corruption issues (the so-called “Leadership Code”, according to which all ministers should declare their assets). There were clearly interest groups, within government itself, who were against compliance with the conditions. This again shows that ownership is a sensitive and vulnerable thing that can change for different reasons. It is also necessary to ask what the concept of ownership entails. Whose ownership do we have in mind in this kind of context? How profound and wide-spread, or perhaps inclusive, does it have to be?

If the political economy model is applied to these cases, at least two different interpretations can be made. Despite initial ownership, conditionality (which in these cases could perhaps have been seen as a counterbalance of special interests) failed. The political economy model does not hold. On the other hand, ownership apparently was not strong enough, or perhaps not genuine? The political economy model is, perhaps, on the right track.

While studying the effectiveness of conditionality when ownership has been strong, it is important to note that waivers have been granted Uganda on a number of occasions when conditions were not fully met. Softer interpretations of conditions have also been allowed, when failure has been

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imminent. The watering-down of conditionality has also been described in the EC paper on conditionality: “Few countries meet fully the letter and the spirit of all conditions on time, and hence waivers or less formal relaxations of the interpretation of conditionalities have become common. This has reduced the credibility of conditionality, but has not sufficed to avoid the volatility created by “on-off” support”. In short, a reduction of the credibility of conditionality has been observed in Uganda, and conditionality has not been quite as effective as it may seem at first glance.

This scenario can also be analysed using the second model described in chapter 2.1.1, the principal-agent model. According to the model, the effectiveness of conditionality will depend on the principal’s (i.e. the donors) ability to enforce the contract between donor and partner. The above described erosion of the credibility of conditionality, and with it of the donors, corresponds to what in the model is described as the “Samaritan’s dilemma”. The good-will and the altruism of donors in Uganda seem to have landed donors in a situation corresponding to that described in the model. Some like to argue that there are further factors or incentives, in addition to those explained by the Samaritan’s dilemma, that influence donors and weaken their ability to enforce contracts. Those factors and incentives will be discussed later in this section.

**Applying theory to conditionality without ownership**

Moving on to the second set of conditions, the attempts at political conditionality in Uganda have not been successful at all. The government has rejected conditions linked to democratic development and issues of good governance, although some lip-service can be said to have been paid to issues of anti-corruption and accountability. Compared to the set of conditions where political will was apparent, donors have often failed to be clear about their intentions, and the reactions to the failings of the democratic processes in Uganda were with few exceptions (such as the UK/DFID) based on weak foundations.

In this case, the political economy model seems to provide a clear and simple explanation of the failure of conditions: There was no ownership, and as a consequence, no compliance with conditions. It is, however, also interesting to return to the principal-agent model. Some donors have reacted, but seem to have hesitated, perhaps because of the Samaritan’s dilemma, perhaps for other reasons, such as the lack of clarity as regards conditions. Finally, a few donors acted, but probably too late and too little. Again, questions need to be asked: Would more clarity vis-à-vis

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38 EC 2005, p.14
the Ugandan government about consequences have made any difference? Would more insistence, at an earlier stage, have influenced the course of events?

Mention has been made of other factors or incentives influencing the donors in their decisions as regards releasing or withholding funds. In a paper by Svensson\(^{39}\), the so-called budget pressure problem is studied. In the paper, the problem is captured in a few words by Edgren\(^{40}\): “In many administrations, both bilateral and multilateral, the emphasis is on disbursement and country allocations. Non-disbursed amounts will be noted by executive boards or parliamentary committees and may result in reduced allocations for the next fiscal year…..Results are measured against volume figures, with no regards for the quality”. While being somewhat drastic, this does provide one explanation as to why conditionality is less effective or clear than it could be. It is difficult to say, or to measure, to which degree the “budget pressure” incentive may have influenced donor reactions in Uganda, but realistically it did lead to hesitation amongst donors. Other influences would also have been present: political considerations vis-à-vis the donor country electorate and the media are examples.

The Joint Evaluation of Budget Support from May 2006 brings up the issue of political conditionality and says that “While donor concerns over political governance may be legitimate, it is clear that they are unable to influence the political process through dialogue and conditionality. This is widely acknowledged, even by those writing governance conditions into their PGBS (Partnership General Budget Support)\(^{41}\). At the same time, donors like to speak of the signalling effects of reducing or withholding support as important, and even as achievements in themselves. It would seem then that, when conditionality and dialogue have both failed, all that remains is the withholding/reduction of support, in order to send a signal, to the partner government, but also to the public and the media “at home”.

Finally, it is important to note that predictability, or rather the lack of predictability of aid flows has further reduced, or watered down, the effectiveness of conditionality. Most donors have expressed a commitment to maintaining aid levels and striving towards predictability of aid flows, given that political or military developments do not take place that could alienate donor support. Disbursements, and in particular budget support disbursements, have however tended to fall short of commitments in Uganda.

\(^{39}\) Jakob Svensson 2002.
\(^{40}\) Gösta Edgren, 1996, p. 11.
The governments’ reaction to this shortfall was for the Ministry of Finance to discount donor programme aid commitments by 10% in 2002/03. This discount factor was increased to 30% in 2003/04 and 2004/05, possibly as a reaction to three donors withholding budget support in 2003 after defence expenditure had been increased beyond its budget. In addition to the other problems associated with the effectiveness of conditionality, this method of handling reduced aid flows on the part of the partner country makes conditionality all the less effective.
4. Conclusions: Conditionality in Uganda

So does conditionality have any effect at all? If there is political will and ownership to pursue progress in certain areas, does donor conditionality make any difference? Or would progress be achievable also without conditions attached? And if there is no ownership, can compliance with conditions be forced through by donors demonstrating the ability to enforce clear contracts to the letter?

Some argue that conditionality can play an important role where objectives, targets and outcomes are a donor demand, rather than guided by government preferences. They can help put critical reforms or actions on the agenda in situations where they are politically difficult and have small chances of advancing without an outside push (see WB PRSC Stocktake). They can also provide a ministry of finance with leverage vis-à-vis sector or line ministries, where it would otherwise be difficult to gain agreement on necessary reforms. This is in line with the political economy perspective. In Uganda, conditions revolving around macro-economic and fiscal stability have had strong government/presidential ownership, but have perhaps not been as popular with other, weaker segments of government and society. Possibly, the support of donors, especially from the World Bank and the IMF, has played a role of counterbalancing other interests. During the second half of the 90s, the greater importance attached to the development of social sectors and the emergence of the PEAP would have made the need for such a counterbalance less important.

But there are also examples of conditionality, that has been agreed and where there was thought to be ownership; where conditionality has not worked, despite what would seem to be a need for a counterbalance.

The analysis becomes even more complicated when recent developments are studied. In the eyes of many donors, Uganda has moved away from its “good performer” status. Donors, while trying to apply pressure concerning democracy, security and governance, have found it difficult to enforce conditions, and Ugandan ownership was nowhere to be found. The recent enforcement of conditions has not led to any clear results. Perhaps it is too soon to ask, but it is difficult to say why. Was it because enforcement was too weak, given that the important donors such as the World Bank and the EC did not participate? Was it due to the lack of government ownership? Was it due to the lack of clarity amongst donors as regards the conditions and consequences of

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non-fulfilment? Did it have to do with the Ugandan governments’ practice of discounting budget support, rending a reduction of support impotent?

If the political economy model is applied, the outcome was to be expected, without ownership no achievements would be made. The principal-agent model would, however, explain the failure of conditions with poor donor enforcement.

In recent years, the political economy model has been the favoured one, amongst donors and partners alike. Ownership is considered the key, and the core argument has been that it is not possible to buy reform with aid money. The model does not, however, provide any guidance in situations where there is no ownership, and ownership, even when it seems to be there, cannot always be counted upon. The options that the political economy model leaves a donor with are not very encouraging. Either the donor stays with and continues supporting a country that demonstrates no will to improve its standing on crucial issues, such as democratic rule, or the donor must abandon the country altogether. According to the model, as long as there is no ownership, the donor must accept that it has little or no influence.

The principal-agent model does however provide other explanations, which, if examined more closely, could help in understanding the donor community’s role in a chain of events such as those in Uganda. Greater predictability, in terms of clarity in contracts between donors and partners, but also in terms of enforcement of those contracts, may need to be further explored. Other incentives influencing donor behaviour provide yet another area worthy of exploration.

In Uganda, a signal was sent by a few donors to show dissatisfaction with the lack of democratisation in the country. The next steps of those donors will be of great importance, certainly to the relationship between Uganda and its partners, but above all to the future of the Ugandan people. Will the events of the past few years soon be forgotten, or will the signal continue to ring out?
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