Briefing

Budget support to Uganda 1998-2012

A review

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Cover photo: Marie and her child in their plastic shelter, Grace Cahill/Oxfam, Democratic Repulic of Congo.

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Policy recommendations

- Budget support works best when it follows a strong political commitment to reform, when the policy priorities of the Government and donors are closely aligned, and when there is enough fiscal space for increased budget allocations.
- Donors should react quickly if priorities diverge, targeting policy dialogue on issues where their priorities overlap with those of the Government and focusing on the local context.
- Donors should link budget support to other forms of development assistance, such as project financing and technical cooperation, to address institutional issues alongside policy objectives.
- Inclusive dialogue should be encouraged across all forms of aid and donors should be consistent in their responses when performance conditions are not met.
- In countries with low domestic revenues and relatively high foreign aid, measures should be taken to enhance fiscal space and sustainability through domestic revenue mobilisation from the outset.

Acknowledgements

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1 Introduction

Uganda was one of the first recipients of budget support from international donors in the late 1990s, in what was seen as a pro-development partnership between a reform-minded government and external funders. From 1998 to 2012, donors supported the Government of Uganda's development agenda by providing direct budget financing of $5.36 billion. But this positive story had unravelled by 2012, with the views of the Government and donors diverging over political governance and the use of public funds. So, what fuelled early success, and what changed? How should we judge the results of 15 years of partnership and financial support?

2 The evolution of budget support to Uganda

This paper reviews the experience of budget support in Uganda and draws lessons for future development practice, summarising in-depth ODI research (Williamson et al., 2015), and drawing on previous evaluations of budget support in Uganda (Lister et al., 2006; Steffensen, 2009; Hedger et al., 2010). It examines the expectations and performance of budget support provision – including both general and sector financing, as well as the complementary non-financial inputs – through four main themes.

- Politics, governance and partnership between the Government and donors
- Macroeconomic, fiscal and budgetary performance
- Strengthening core public-sector institutions and systems
- Sector performance and service delivery

The analysis distinguishes three phases of budget support: Sector Budget Support (SBS) from 1998 to 2001, General Budget Support (GBS) from 2001 to 2008, and a shift back to project support from 2008 to 2012. An understanding of this supply-side evolution is important for the assessment of its effectiveness.

When Uganda qualified for debt relief in 1998, donors started to provide earmarked financing to sectors through the budget. This SBS had two explicit purposes. The first was to provide direct finance to the Government's policy priorities such as Universal Primary Education, and the related education sector strategies. The second was to enable donor financing to provide *additional* resources for designated pro-poor government expenditures, through a ring-fenced mechanism in the budget known as the Poverty Action Fund (PAF). These funding arrangements were embedded rapidly through sector-planning processes – notably sector-wide approaches.

By the early 2000s, the Ministry of Finance and some donors decided that the rapid scale up in financing to earmarked budget areas under SBS and the PAF was distorting optimal budget allocations across and within sectors for implementation of Uganda's national development strategy (the Poverty Eradication Action Plan).

Box 1: Definition of budget support

Budget support is a method of financing a country's budget through a transfer of resources from an external financing agency to the partner government's national treasury. The funds transferred are managed in accordance with the recipient's budgetary procedures.

Typically, budget support is a package of financing, conditionality, policy dialogue and technical assistance. It may be provided either as General Budget Support (GBS) or as Sector Budget Support (SBS). GBS supports the implementation of a national development strategy, while SBS supports the implementation of a sector-development programme.

Source: OECD (2012, 2006)

The Ministry pushed for greater flexibility, and for greater control over the aggregate level of spending financed by donor inflows. The World Bank and the UK Department for International Development (DFID) responded by switching to non-earmarked GBS through a new instrument, the Poverty Reduction Support Credit (PRSC). Disbursement of these funds was tied to conditions set out in the PRSC performance matrix, but it no longer triggered an automatic increase in government expenditures.

The budget support relationship between the Government and donors changed more fundamentally in the mid-2000s as the Government's strategic priorities shifted towards infrastructure and the productive sectors. Donors, meanwhile, became increasingly concerned about democratic governance, the misuse of public funds and the inefficiency of wider public spending. Notably, they cut budget support in response to the (mis)management of the elections in 2006. This introduction of governance issues into decisions on whether to disburse budget support was a major departure from the primary role of budget support as a financing instrument.

The new Joint Budget Support Framework (JBSF) introduced in 2008 aimed to address the perceived shortcomings of the PRSC regime, including its omission of governance issues and its relatively selective sector focus. The JBSF incorporated a broader sector scope as well as underlying governance principles. However, it came at a time when the financial significance of budget support was dwindling and when trust between donors and the Government had been damaged by the misuse of funds allocated to the Commonwealth Heads of Government Meeting (CHOGM) in Uganda. This growing distrust was coupled with donor misgivings about the waning effectiveness of budget support.

The JBSF was overburdened by its wide variety of objectives, and the declining importance of budget support as a source of budgetary finance weakened its political traction and policy influence still further. All budget support to Uganda, including the JBSF, was suspended abruptly in 2012 following the discovery that $15 million of budget support funding to support recovery in Northern Uganda had been diverted to the Office of the Prime Minister. Although it was not the worst corruption scandal since 1998, donors responded forcefully because it involved the direct misuse of external funds. By early 2014, they had still not decided whether or how to restore any form of direct budget financing to the Government.

This 15-year backdrop of budget support provision and its withdrawal allows us to assess its performance against its explicit objectives and its implicit expectations.

3 Politics, governance and partnership between the Government and donors

The partnership between the Government of Uganda and donors was strongest in the early years of budget support, when their expectations were fully aligned, based on the concept of budget support as a financing instrument to support long-term development objectives. It proved effective in an auxiliary role – to help the Government reduce its fiscal gap and to finance priority sectors. On the institutional side, budget support conditions worked when they tried to strengthen the hand of reformers in the finance ministry, rather than trying to direct change. Any discussions of broader governance issues, such as corruption, democracy and human rights, were separated from dialogue on budget support.

In the mid-2000s, however, the prospect of multi-party politics changed the incentives for Uganda's political leadership, which became less attentive to the interests of external donors, just at the moment when donors, in contrast, aimed to increase their influence. The donors' introduction of governance issues into the dialogue on budget support after 2003 reflected their concerns, rather than those of the Government and this mismatch undermined the partnership over time. Increasingly, donors' expectations that they could use budget support to influence governance outcomes were pushing against the grain of Uganda's prevailing political context.

Donors started to withhold or reduce budget support in response to infractions by the Government, but the incremental cuts linked to specific governance issues, notably the 2006 elections and the CHOGM case, had little real leverage. Small cuts allowed the donors to express their dissatisfaction over government actions in the short term, while broadly maintaining their funding for longer-term poverty reduction programmes. However, the cuts were not financially significant to the Government and donor influence had already waned significantly.

Having introduced governance issues into the dialogue, donors weakened their credibility still further through a lack of coordinated or systematic action in the face of further breaches of expected governance standards. Inconsistent reactions made the behaviour of budget support donors less predictable to the Government and budget support itself less effective. Establishing a common position among a diverse group of partners was a particular challenge, and each of the donors retained their own independent basis for decision-making on disbursements.

4 Macroeconomic, fiscal and budgetary performance

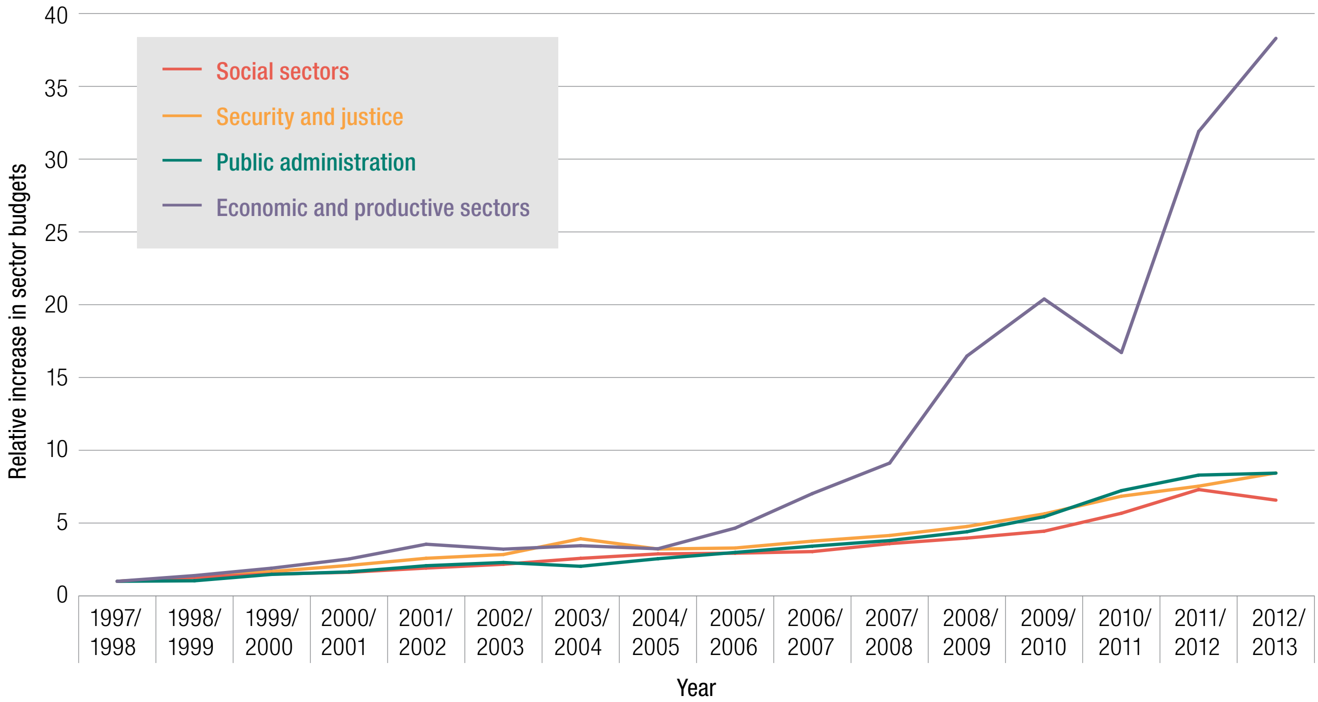
While budget support was effective in underpinning Uganda's macroeconomic stability, it did not drive it. In reality, stability was maintained as a result of the Government's political and institutional commitment. With hindsight, the emphasis on macroeconomic stability should have been combined with a stronger focus on increasing domestic revenue, as higher levels of domestic revenue were needed to sustain the fiscal expansion kick-started by budget support, once the Government began to reduce the deficit.

Instead, donors concentrated on the expenditure side of the budget and urged the Government to translate more budget support financing directly into increased public spending. But their arguments were ineffective, given the strength of the Government's commitment to reduce the deficit in order to maintain macroeconomic stability. At the same time, the donors missed an opportunity to shift the policy dialogue towards the mobilisation of domestic revenue to increase the fiscal space for spending.

While there was strong agreement between the Government and donors on budgetary priorities in the early years of budget support and rapid increases in expenditure on those priorities, that consensus reduced after 2002/03. In the absence of any significant improvement in the levels of domestic revenue, which remained stuck at around 12% of GDP, the Government's deficit reduction policy meant that relatively less money was available to fund new policy priorities. Marginal trade-offs around budget allocations became more acute, making it harder to maintain agreement between the Government and the budget-support donors.

From 2005, government expenditure priorities started to shift away from the pro-poor sectors that had underpinned the original consensus on budget support and towards economic infrastructure and growth-related sectors (Figure 1). At first, donors were reluctant to adapt the budget support framework to accommodate this shift, and by the time they did so, the chance of an agreement had already been weakened by a deterioration in budget credibility. Indeed, the level of supplementary appropriations to the budgets approved by the Government increased from the mid-2000s and analysis of budget execution revealed a stronger Government prioritisation of the public administration and security and justice sectors. With the notable exception of limits to defence spending up to 2001/02, budget support conditions did little to constrain public expenditure in areas that were less favoured by donors but more favoured by the Government.

Figure 1: Relative increase in sector budgets 1997/98 to 2012/13 (1997/98 = 1)



Source: Ministry of Finance, Planning and Economic Development.

5 Strengthening core public-sector institutions and systems

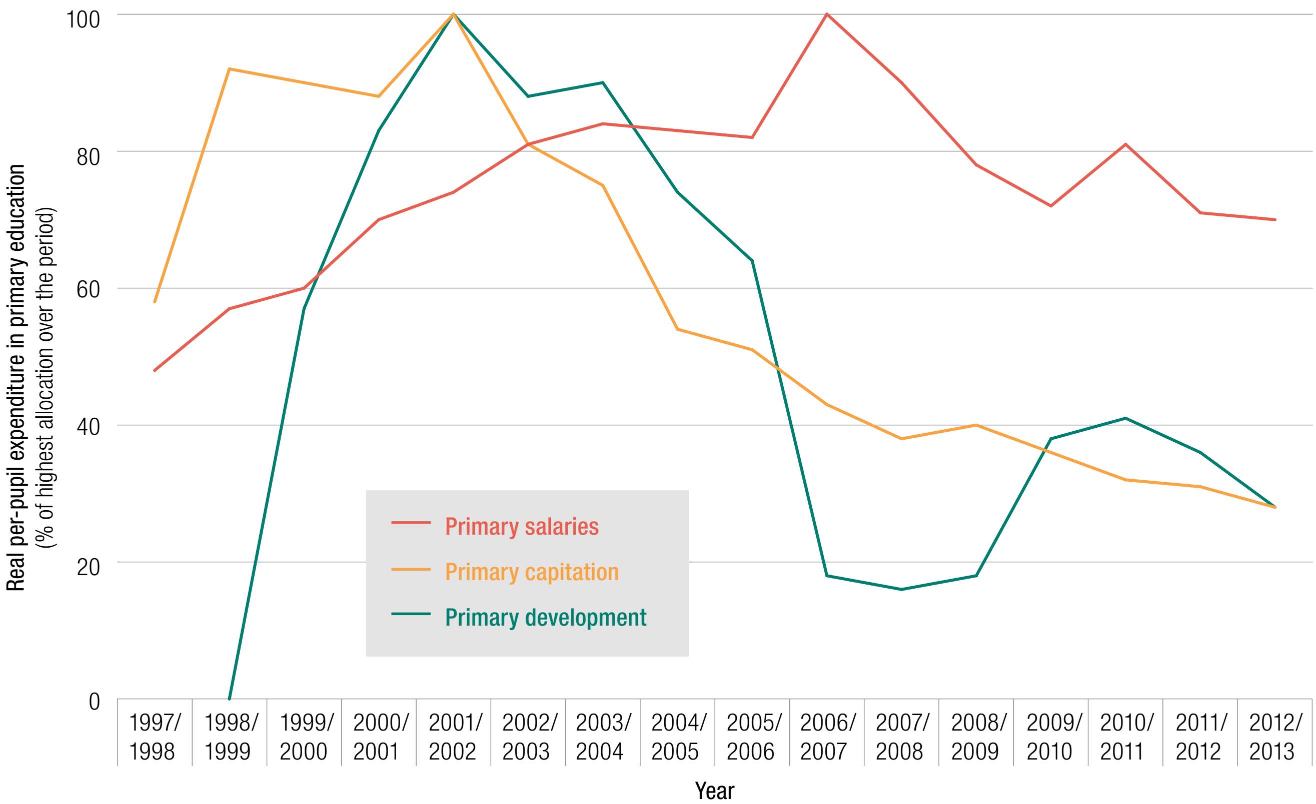
The existing strength of Uganda's public financial management (PFM) system, coupled with a commitment by the Government to further reform, provided the initial justification donors needed to switch to budget support in the early days. In addition to budget support financing and dialogue, there was extensive technical assistance and project support for PFM. The reform of core public sector institutions and systems only became a major feature of budget support dialogue and conditions with the introduction of GBS in the 2000s.

The results have been mixed. PFM systems were far stronger by 2012 than they were in 1998, and the underlying technical capacity of finance officials was much improved, with a highly capable Ministry of Finance at the centre of the reform process. However, at both the national and local-government levels, these system reforms did not necessarily result in better PFM outcomes. The Ministry of Finance, by its own admission, had become complacent. While the aggregate fiscal management was sound, the credibility of the budget deteriorated over time and increasing corruption undermined the gains made in the operational efficiency of spending.

There was also a mismatch between the increased funding for service delivery by *local* government that was financed initially by budget support and the predominant focus of both the dialogue and conditions on *central* government PFM processes and systems. Although there were early efforts to improve the accountability for grants to local governments, the approach to strengthening sub-national PFM systems was incoherent and capacity building was not systematic. The Local Government Development Programme (LGDP) stood out as a positive exception that built incentives for improved institutional performance. For the most part, however, the gains in expenditure efficiency achieved by channelling funds through local-government systems were undermined by the relative lack of focus on strengthening local institutions.

Public sector reform efforts linked to budget support did not, in general, respond adequately to the domestic political and institutional context. Technical reforms, for example, did not translate into improved outcomes because they often failed to navigate influential interests. Both government officials and donor staff focused excessively on a technocratic agenda that emphasised formal improvements to systems. There were some positive examples such as the PAF, which protected pro-poor expenditures in the budget, and the support given to the Public Accounts Committee in the mid-2000s following the introduction of multi-party politics. By contrast, however, budget support conditions had far less influence – and were less effective – in relation to the introduction of codes of conduct for public officials and the donor opposition to the creation of new districts in 2005.

Figure 2: Real per-pupil expenditure in primary education 1997/98 to 2012/13 (% of highest allocation over the period)



Source: Ministry of Finance, Planning and Economic Development.

6 Sector performance and service delivery

The near-complete shift by sector donors from projects to budget support, coupled with the year-on-year increases in sector-budget allocations by the Government, provided strong incentives for sector reforms. Primary education was a major focus for budget support at sector level and early initiatives, led by the Ministry of Education, succeeded in targeting the way in which education sector funds were allocated and channelled to local governments. Expenditure tracking studies were used to check that these funds were reaching the intended beneficiaries and there were significant early efforts to develop both systems and capacity at the district and school levels.

The switch by the World Bank and DFID from targeted sector financing to GBS in the early 2000s pulled the focus of the policy dialogue away from the education sector. On the Government side, the decision by the Ministry of Finance to reduce the fiscal deficit from 2003 ended the translation of additional SBS funds into commensurate increases in sector expenditure ceilings – reducing the incentives for sector reform. The early focus on local-capacity development was not sustained and non-salary transfers for local primary education spending declined in real terms (Figure 2).

The second half of the 2000s saw growing frustrations about the failure to address education quality. The JBSF identified a lack of funding at the service-delivery level and set targets for non-salary district expenditure. It also focused more on downstream systems for delivery, with teacher absenteeism, school inspection and school management all highlighted for the first time in 2009. These were positive measures, which contrasted with the relative neglect of sector outcomes during the middle phase of budget support. However, donors continued to neglect the complementary role of project support to address institutional reform issues.

The water and sanitation sector had more success in designing complementary approaches for the expansion of service delivery through budget support and project assistance to address institutional constraints. From the early 2000s, the sector used local government grants to fund the district water offices and, in parallel, invested in technical assistance and capacity development via regional technical-support units – an approach that continued for a decade.

Across all of these basic service sectors, budget support was most effective in the early period of the late 1990s and early 2000s when it funded major increases in the budget lines for service delivery and underpinned an expansion in the quantity of services. However, continued donor financing did not prevent an erosion of the real value of operational and investment funding after the early 2000s. Overall public expenditure was constrained by the lack of improvement in domestic revenues, and the Government shifted its focus to infrastructure and production. What's more, with the notable exception of the water sector, budget support did not contribute to improvements in the quality or sustainability of service delivery.

7 Conclusion

The political and economic context in Uganda in 1998 provided a highly conducive environment for budget support. Three positive factors stand out:

- the country's political leadership had a strong and progressive reform orientation, with the President already an established reformer and a well-developed track record of partnership with donors;
- there was consensus between the Government and donors on policy priorities and the Government was committed to scaling up spending in pro-poor areas of the budget;
- there was enough fiscal space to accommodate increased financing, which meant that additional funds for budget support could translate into additional budgetary allocations in the priority sectors.

These positive conditions were underpinned by a strong and well-established technical dialogue between the Government and donors on economic issues, supported by an open and highly-capable Ministry of Finance. Given this positive context, budget support achieved a number of early successes. First, it enabled the Government to scale up financing for service delivery in the budget, which led, in turn, to a rapid increase in service-delivery outputs. Second, it was effective (until 2003) in influencing the pro-poor orientation of budget allocations overall. Third, it strengthened institutional frameworks for planning, budgeting and decentralised fiscal transfers –helping, in particular, to increase and maintain the pace of central PFM reforms. Finally, budget support also played a role in holding defence spending between 1997/98 and 2002/03 to the levels agreed between Government and the donors.

By 2003, however, the three positive factors of leadership, consensus and fiscal space had started to shift, making it increasingly difficult for budget support to deliver results on the same scale. As the era of multi-party politics beckoned, the priorities of the political leadership shifted towards winning the election and retaining power, eroding the earlier scope for external influence over public policy.

The reduced influence of donors coincided with a divergence of views between the Government and donors over policy and budgetary priorities. The donors were reluctant to adapt the budget-support dialogue to reflect the Government's increasing focus on economic and productive sectors, and efforts to use budget-support conditions to limit spending on defence and public administration lost traction.

The fiscal space for budget support narrowed considerably. As the Government took steps to limit its donor-financed deficit, new priorities could no longer be financed by an increase in budget support. That also made it harder to achieve consensus between Government and the donors on budgetary allocations. Without the prospect of increased sector expenditure through the budget, sectors also had less incentive to engage in dialogue with budget-support donors.

Some clear conclusions emerge from this analysis about the effectiveness and appropriateness of budget support in Uganda. Over time, there was a narrowing of the domestic policy space in which donors could achieve results through budget support. In general, the donor response was to broaden the focus of the results framework in order to influence more variables as the individual results diminished – a strategy that proved ineffective. Donor policy responses often lagged behind the shifts in context or did not occur at all. Continuing to pursue policies that were no longer high priorities for the Government – notably the 'additionality' of financial aid, the relative emphasis on basic social sectors, and certain public administration reforms – caused friction in the partnership with the Government, without yielding results.

There were missed opportunities to invest in the sustainability of budget-support results. A greater focus on strengthening domestic revenue administration, for example, might have helped the Government to increase fiscal space, making the budgetary trade-offs between priorities less acute. Equally, an earlier and stronger sector focus on measures to improve quality might have protected and sustained the initial gains made through scaling-up the delivery of services.

Two critiques emerge from these conclusions on the way in which budget support donors responded to the changing context in Uganda between 1998 and 2012.

First, donors neglected the alternatives to budget support and project support was not used effectively as a complementary instrument. The shift to budget support was based on a view held by the Government and many budget support donors believed that it was superior to project support. As a result, there was little attempt to improve the quality of project design and implementation or to link project financing into the budget support dialogue. When budget support donors started to scale back their direct funding, the efficacy of the project-based alternatives had not improved.

Second, a lack of consistency among budget-support donors undermined the credibility of their responses. Donor agencies had different views on the implications of the shift in budget support context, and how best to respond. Some continued to treat budget support as a long-term financing instrument to support development objectives, while others saw it as an instrument to secure leverage for shorter-term governance outcomes. This lack of consensus among donors translated into a lack of consistency in their engagement with the Government, which undermined overall donor credibility.

8 Policy recommendations

The provision of budget support implies a high degree of understanding and trust between the parties involved. This requires, on the donor side, a considerable investment in understanding the actors and incentives, political interests and pressures in the partner country as the basis for the building and maintenance of realistic and effective relationships.

Donors should also scrutinise the policy and budget priorities of the government closely and continually, as well as the fiscal space for aid-financed increases in public expenditure, when considering the appropriateness of budget support. A robust analytical approach can help to identify the areas where there may be common ground for the provision of budget support. It could be built on a unified, broad-based partnership or respond to a number of smaller and separate partnerships where interests are aligned either at the sector level or around specific agendas.

Where there are concerns about governance, budget support exposes donors to greater reputational risk with their own domestic constituents. Donors need to be clear, therefore, with their counterparts about the conditions under which budget support is provided and the basis upon which it will be released or withheld. They must then be consistent in their responses if these conditions are not met.

Both flexibility and innovation matter for the provision of budget support to address political and fiduciary risks. For example, providing earmarked budget support (or even project funding) on a reimbursement basis reduces exposure to the direct misuse of funds. Forms of sector budget support, such as that provided directly to local government, may insulate budget support from political and governance risks.

Creating separate dialogue structures based on specific aid instruments can undermine the potential for important complementarity. Dialogue should, therefore, be inclusive across all forms of aid provision. It should focus on how governments, donors and other actors can address delivery issues collectively through financing, policy and institutional change, and different instruments should be used to achieve these objectives.

Finally, budget-support donors and governments should focus explicitly on fiscal sustainability, with the enhancement of domestic revenue high on the list of priorities in the aid relationship. Without this focus, the danger is that donors will continue to support and governments will continue to implement the unsustainable expansion of public services, which will become vulnerable as – inevitably – political priorities change.

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