



## **“Conditionality and its Effects on Ownership in Bolivia”**

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# Conditionality and its Effects on Ownership in Bolivia<sup>1</sup>

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## Lessons from the 1985-2005 period

The dependence on foreign finance deepened after the Bolivian debt crisis and hyperinflation of the early 80s, compounded with the longer term drop in its terms of trade. As a result and for the next two decades the government was able to generate revenues only to cover for its current expenditures but not enough for capital expenditures that would have some impact on development. To compensate the government had to adopt a highly liberal relationship with the international development architecture in order to ensure foreign finance from different sources available<sup>3</sup>. This became possible through debt negotiations with the Paris Club along with IMF approval of macroeconomic stability programs and under the World Bank leadership in development policy design through a consultative group mechanism, followed by the bilateral cooperation. As a consequence, over the years Bolivia implemented market liberalization policies, private sector development, privatization, regulation, decentralization and local development, health and education reforms, a poverty reduction strategy, all HIPC related initiatives<sup>4</sup>, reported on the MDGs and on alignment and harmonization for aid effectiveness. In order to better adapt some of those policies the government introduced some local variations, like capitalization<sup>5</sup>, popular participation<sup>6</sup> and national dialogues<sup>7</sup>. Bolivia certainly did it all and more, frequently expressing “we are the experiment” or that “Bolivia was the best student of the aid architecture.” Expressions that suggest Bolivia basically gave up ownership of its development policy agenda in exchange for foreign finance.

During this period there were three levels of ownership problems that resulted from donor-driven reform programs and their conditionality:

*Level one:* The donor-driven policy conditionality and its evolution affected ownership because it did not recognize the scope of Bolivian specificities and heterogeneities (economic, social, political, cultural, geographic and historical) that make up its fundamental structural constraint; that the majority of population could not participate of the market economy because of the degree of poverty and inequality, but also because of their heterogeneous visions of development; because market-led development reproduced a narrow natural resource based economy as opposed to a broad based economy; there was excessive attention to basic services provision and little on production and employment, which was a consequence of excessive reliance on private sector development; Other issues not considered were the magnitude and role of the Bolivian indigenous population and the “internal colonization” problem which resulted in the perception by many that policy conditionality included alignment with the local elite.

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<sup>3</sup> Loans and grants represented on average above 53% of total public investment and FDI represented 76% of total private investment, this last mostly concentrated in 1996-2003.

<sup>4</sup> HIPC I, HIPC II, Beyond HIPC and lately MDRI.

<sup>5</sup> A Bolivian version of privatization of state owned enterprises in infrastructure sectors.

<sup>6</sup> Automatic transfer of a percent of fiscal revenues to all municipal governments and public universities.

<sup>7</sup> A procedure to fulfill the requirement of social participation in the design of the PRSP.

However, not all problems came from policy conditionality; Bolivians know that government itself has been an important part of the development problem because of weak government and governance. The domestic dispersion of cultural and development visions generate a government with a profound internal political conflict, which helps explain its structural inefficiency and its permanent political interference and instability (which is different to lack of government commitment). Weak government and governance has been and continues to be the expression of the fundamental structural constraint, which together with the lack of a regulatory framework regarding aid flows<sup>8</sup>, had a significant impact on ownership and aid effectiveness. Donors have used this to find a comfortable niche for their aid operations (Bolivia became a donor darling), frequently bypassing government and following their own heterogeneous visions (some bilateral cooperation clashed with their own NGOs) and indirectly contributing to further weakening of government, governance and its sources.

The above arguments suggest that the donor-driven policy conditionality have affected ownership by not fully recognizing Bolivian specificities and heterogeneities and by leaving behind many other Bolivians with their different development views and daily reality. Government appropriation of new trends in development ideas was not enough if only a small portion of society is sharing those ideas. Rather it generated a disconnection between government and a large part of society, which immediately fed into governance problems. It is Bolivians who need to better understand their own reality and experiment with own development ideas, and this needs to be supported by the aid architecture.

*Level two:* The combination of weak government and governance plus the legitimate requirement of donor accountability to its tax payers<sup>9</sup>, created an incentive for further conditionality with the inevitable byproduct of weakening further domestic public organizations, institutions and systems. Once the donor decided on the degree of concessionality of its loan<sup>10</sup> or ultimately grant, conditionality continued toward different degrees of dominance over the hundreds of decisions during a project or program implementation, from beginning to end, project by project. The result was the introduction of significant distortions in the form of parallel government units or the management leadership of projects and programs within a government office or the co-administration of a project, plus labor market distortions. The appearance of hundreds of foreign and domestic NGOs<sup>11</sup> as well as strong bilateral agencies was an expression of this fact, despite that some financing innovations were being practiced in recent years like basket funds, sector wide approaches and direct budgetary support.

*Level three:* By 2005 there were 28 multilateral agencies, 26 bilateral agencies and above 500 NGOs registered operating in aid related activities. All of these agencies need to monitor the use of their resources and, as elsewhere, the problem of multiple agencies introduced significant transaction costs that affected aid effectiveness. This issue has received significant attention in recent years leading to harmonization efforts among agencies through VIPFE (a specific government office) and under the *New Framework for the Relationship with the International Cooperation*, sometimes with the believe that solving the multiple agency problem would solve

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<sup>8</sup> Currently the Paris Declaration is being used as that framework.

<sup>9</sup> This is the source of the donor right to decide about the destiny and use of a concessional loan or grant, while in the case of a commercial loan this right belongs fully to the recipient.

<sup>10</sup> The mix of interest rates, payback period and grace period.

<sup>11</sup> Most domestic NGOs have foreign finance and most foreign NGOs are supported by bilateral agencies.

the aid effectiveness problem (the above first and second level problems), when in fact it works in the opposite direction.

### A new period starting 2006

The international aid architecture operating in Bolivia became one more player in the strategic game of Bolivian development, influencing other Bolivian players and being influenced by them, with unequal negotiating power. When including FDI, particularly in natural resource sectors, the perception was of excessive foreign influence to the point (expressed by the current government) that it was necessary to recover a sense of sovereignty. The social movements against government liberal policies that began in 2000 with the “water war” and continued with the “gas war”, the forced resignation of the President in 2003 and the agreement for a call to a Constitutional Assembly, are events that showed that government ownership was not enough, moreover the social movements felt they did not have ownership of Bolivia’s development.

After several years of social unrest and political instability since 2000, a new situation began in 2006 with the democratic arrival to government of the indigenous leader Evo Morales and his political party MAS, who contributed to the break of the fiscal structural problem<sup>12</sup>, began the return to government-led development and benefited from significant foreign debt reduction (MDRI) and a favorable term terms of trade shock. Morales and MAS came to power with a very strong agenda of regaining Bolivian sovereignty (and therefore ownership) and of controlling Bolivia’s development, which was a reaction against two decades of governments that had a very close relationship with the development architecture. In fact the Morales government was the first in two decades to develop a National Development Plan (NDP) without consultations with the international aid architecture. By July 2006 the government presented its NDP to the country and to the international community represented in Bolivia, in the hope of interesting their commitment to support it “without conditionality”. Their initial reaction was of support, but also suggested that the plan had to be improved and become more specific and operational. Throughout 2006 the government continued presenting its NDP expecting support and alignment without opening it up for discussion and negotiation, “because that would mean opening the door to conditionality”, which the aid architecture did not accept. Over time the government was able to develop agreements with multilateral agencies like the World Bank and IADB (concessional loans) and CAF (commercial loans) and bilateral cooperation like the Venezuelan<sup>13</sup> and Cuban governments (newcomers), the US government and European governments, the Chinese government and initial agreements with the Japanese cooperation, although in all of these cases with different degrees of alignment and less harmonization. A recent large contract with Indian private investors was also something new.

Today the economy has been experiencing excess liquidity in the external sector<sup>14</sup>, fiscal sector<sup>15</sup> and the financial sector which may have diminish somewhat the need and dependence on foreign finance<sup>16</sup>, at least in the short run. However, the economy in general was not prepared to

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<sup>12</sup> The policy of changing the contracts of the foreign petroleum companies has substantially increased the participation of government in the oil and gas rents, at the same time as the international oil price increased.

<sup>13</sup> Support from this government is very strong in many areas as well as domestic questions of it.

<sup>14</sup> The value of exports almost doubled from \$2.2 billion to \$4.2 billion from 2004 to 2006.

<sup>15</sup> After several decades the government experienced a positive balance of \$512 million or 4.6% of GDP.

<sup>16</sup> It is difficult to predict how long will the boom last. A drop in the international price of oil would be dramatic for the Bolivian economy, shifting it back to its dependency position.

administer and take advantage of the bonanza<sup>17</sup>. Nevertheless, the country will still need aid given the magnitude of the long term challenges of poverty<sup>18</sup> and inequality eradication and productivity increase. Those who live under the poverty line require significant support to ensure minimum goals in education, health, nutrition, security and access to energy, communications and legal services. Those who live above the poverty line require significant support in risk and uncertainty management. However this time, given the important political changes since 2006, a new initiative may be needed to connect the international aid architecture with Bolivia. Ideally the Bolivian state should promote a national agreement (expressed in a national law) in favor of reaching a set of long term Minimum Goals<sup>19</sup> for those who live under the poverty line. These goals would be pursued by any government regardless of its political views, development vision and interest group it represents. The international aid architecture would align and support them on a long term basis (even if it is not perfect under donor standards) regardless of the government in place and of the degree of uncertainty in the national and international political and economic environment. The political neutrality proposed here responds to the fact that the poverty, inequality and productivity issues regarding those who live under the poverty line can not wait for the solution of all internal political problems.

The mechanism of interaction with the aid architecture should be through a new type of “coordination mechanism” or maybe by creation of a “Development Agency” with own regulatory norms<sup>20</sup>, under the leadership of the Bolivian government and own development strategy, driven under the framework of the Paris Declaration and the Human Rights Declaration rather than debt management and reform requirements, with functions to attract concessional loans, grants and government allocations to be transferred through Bolivian institutions and systems (capacity building<sup>21</sup>), consistent with current domestic trends toward further decentralization, to the end-beneficiaries in the form of specific programs and projects planned according to annual operational minimum goals.

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<sup>17</sup> Government entities at the central, departmental and municipal levels have low operational capacities and can not scale up public investment, the small domestic private sector does not invest due to uncertainty since 2003 and the large amount of microenterprises operate mostly on a family survival mode. There are inflationary pressures because the productive sector can not cope with the excess demand, there are fears of “Dutch Disease” and the socio-political environment is highly unstable characterized by strong and polarized demands for change.

<sup>18</sup> By 2005 the poverty headcount ratio was at 60.5% in urban areas and in 79.5% in rural areas, with a national Gini coefficient of 0.65 expressing the highest degree of inequality of the region.

<sup>19</sup> Relative to poverty and inequality eradication but also relative to production and employment.

<sup>20</sup> Article 16 of the Paris Declaration could have the following sentence: Donors commit to base their overall support on partners’ own regulatory framework regarding aid flows, which would be based on international agreements and partner’s development strategies, institutions and systems.

<sup>21</sup> In the end capacity building may be the most important objective to achieve, at least for Bolivia under current circumstances.