Chapter 10

# The Relationship between Aid and Economic Growth: What Aid Strategy Should the Government of Uganda Promote?

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## 1. Introduction

Attempts to correlate increases in aid with economic growth have persisted in research and policy circles for over five decades to justify foreign assistance from rich to poor countries. While the vast majority of studies find no causal connection between them, some argue that there is a correlation between aid and growth for certain countries having strong policies and institutions. It is this argument that has the greatest significance for Uganda's aid infrastructure in today's socio-economic climate. Uganda has come a long way from the aid-dependent post-civil war economy of the late 1980s, where aid levels once reached 30 percent of GDP (Roberts & Fagernas, 2004). Pertinent questions have to be raised that take into account the improved level of economic development and institutional capacity of Uganda. Now that Uganda is on a sustained economic growth path with sound fiscal, monetary, and trade policies, will increasing aid flows have an important impact on growth? Or, is there a point of diminishing returns? Should different types of aid be mobilised to respond to the changing climate in Uganda? These are the kinds of questions that the government of Uganda should be considering in its aid negotiations with development partners.

* All the opinions expressed in this paper are the author's personal views and do not necessarily reflect those of the Ministry of Finance, Planning and Economic Development or the government of Uganda, for which the author serves.

This paper will not attempt to address the question on diminishing returns from aid, given the complexities in this debate,[1] nor will it examine the wider macroeconomic impact on growth with regard to money supply and exchange rate appreciation (Mugume, 2007). Instead, the main aim will be to assess the possible growth impact of two contrasting bilateral donors based on the composition of their aid, in the context of Uganda's Poverty Eradication Action Plan (PEAP).[2] Section 2 will revisit the evolution of the literature on aid and economic growth, highlighting the ongoing perceptions and misconceptions related to this debate in the context of Uganda. Section 3 will draw on the findings of the literature and test the applicability of the findings through case study analyses of the UK and Japan. The UK is characterised by a sustained approach to General Budget Support and institutional-based project support, whereas Japan is characterised by project support largely channelled through technical co-operation and tied aid (aid linked to the purchase of goods and consultants from the source country) in the areas of investment and productivity enhancement. The chapter ultimately concludes that despite the UK's adherence to the aid effectiveness agenda as outlined by the Paris Declaration (2005), Japanese support, which diverges from this agenda, is more targeted towards stimulating short-term economic growth based on the ethos of the East Asian model of development.

Regarding the methodology, case studies were conducted to highlight the magnitude of research in this field. For Uganda country statistics, specific primary and secondary sources are utilised from the Ministry of Finance, Planning and Economic Development (MFPED) and the Uganda Bureau of Statistics (UBOS). The aid data for the UK and Japan are based on official data that form part of the external resource envelope for the Medium Term Expenditure Framework

1. The debate has been multifaceted, but mainly centers on the issue of reverse causality or endogeniety, i.e., natural bias, given that aid is historically provided to failing or slow-growing economies. Aid in response to an economic crisis, for example, will always yield beneficial results in the short term, but how is it possible to determine what the impact would otherwise have been? This situation distorts not only the domestic efforts of the host economy, but also the ability to evaluate the performance of an increase in aid.
2. The PEAP is Uganda's Poverty Reduction Strategy Paper. The first PEAP was prepared in 1997 and revised in 2000 and 2004. The current PEAP was approved by Cabinet in November 2004 as the national framework for development, covering the period of 2005-2008.

(MTEF) process. In addition, primary evidence was obtained through direct missions by the respective development partners and through individual interviews.

A few caveats should be noted regarding the analysis in this chapter. First, given the multiplicity of the variables in question, simplifications have been unavoidable when assessing linkages between aid flows and growth effects. The complex arrangements of aid flows have been interpreted as one-dimensional, blurring distinctions between the macro and micro impacts that aid has on the economy, although the distinctions have been made where possible. Second, individual project interventions have not been scrutinised for their specific impact on economic growth through consumption, savings or export growth, but instead classified into growth- or non growth-enhancing areas based on donor investment. This is because the problem of assigning causality of economic growth in a specific geographical area to an individual aid intervention is increasingly complex due to the multiple interventions across Uganda, implying the existence of a macro bias in the analysis. Third, the issues of inequality and sustainability have not been addressed, largely because of the inconclusive debates surrounding predominantly growth-led strategies and the non-economic factors that can impact these issues.[3] Finally, it has to be stressed that while the focus of this chapter is economic growth as opposed to other areas of a comprehensive development framework, there is no intention to suggest that growth has priority over other areas such as human development or the promotion of democracy.

## 2. Literature review

For over five decades a continual game of “ping-pong” has taken place in forums for research and policy in an attempt to find a tangible link between

3. A recent study by the Asian Development Bank found that income inequality has risen in many East Asian economies, bringing into question the “growth with equity” claims that the tiger economies proclaimed during the 1990s. Similarly, a recent independent evaluation of the World Bank cited inequality as one of the three weakest areas in its economic growth-led programmes (*The Economist,* 2007, August).

increased levels of aid and economic growth. The below summarises the main contemporary debates, focusing on Uganda where possible. In sum, the link remains tenuous, although researchers have started to explore different angles that have important ramifications for Uganda's present economic and institutional climate.

### *Paradigm 1 : An aid-financed "big push"*

The "big push" argument holds that a large inflow of aggregate aid in social and productive sectors will result in growth across all sectors of society. This is originated from the Jeffrey Sachs school of thought and is based on the theory of a "poverty trap" and consistent low productivity, which prevent poor countries from growing. The big push argument has caught the interest of policy groups and governments and has taken shape through initiatives such as the United Nations (UN) Millennium Project, which advocates high concentrations of aid to specific geographical areas, and the International Finance Facility (IFF), which proposes the frontloading of aid from rich countries to meet the Millennium Development Goals (MDGs) and the Gleneagles G8 pledge to double aid to Africa by 2015. The rationale is quite simple, specifically that the poorest sections of society are too poor to save for the future and are therefore prone to becoming trapped into low or negative growth rates. Large increases in aid through multiple organisations (NGOs, government, the private sector) would finance a big push in public investment and increase Africa's underlying productivity through human, agricultural and industrial development to lift people out of this trap (Sachs, 2005). The big push approach is characterised by a holistic approach to improving the lives of the poor, utilising various forms of foreign aid and delivering a plethora of projects and programmes to enable the attainment of intended goals.

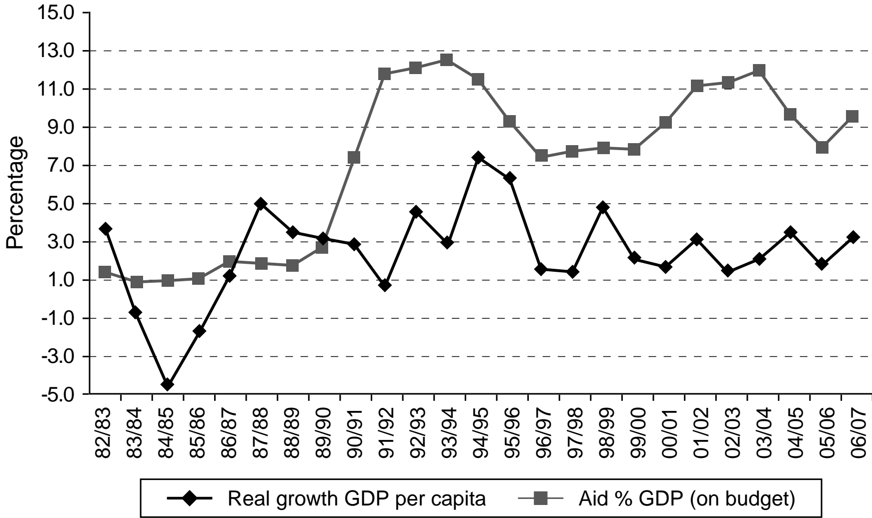
The big push argument is compelling, especially in countries where governments have failed to invest in needed public investment and private alternatives have not been ready to invest sufficiently. On a macro scale, historical aid trends to Sub-Saharan Africa have totalled US$2.3 trillion over the past five decades, and yet the growth outcomes expected with this "big push" have

failed to come about. Data for 22 African countries from 1970 to 1994 show that US$324 billion was spent on public investment, US$187 billion of which was provided by donors, yet growth rates during this period failed to take off as the big push theory predicted (Easterly, 2006). Of course, it is very difficult to single out whether ineffective government utilisation or indeed ineffective aid delivery is to blame for this dismal trend. Nevertheless, the sheer quantity of financial flows seriously brings into question the idea that a second influx of money would reverse this trend, not to mention whether the institutional capacity exists to absorb such increases.

In a revolutionary study Boone (1994) directly addressed the big push theory. His conclusions were that while large aid inflows create micro-level increases to the consumption patterns for poor households, this had no impact on financing investment and growth. This study therefore proved that the big push theory had serious flaws regarding its claims of society-wide transformation. Similarly, in a cross-country study of 137 of the world's poorest countries between 1950 and 2001, Easterly (2006) tested the per capita growth increase after dividing these countries into two groups, namely those that received above-average foreign aid and those that received below-average aid. No difference was found in the growth rates between the two sets of countries, a finding that again seriously brings the big push argument into question. That said, are these big push findings applicable to Uganda? Figure 10-1 shows that a weak to non-existent link exists when aid and growth figures are correlated.

The figure gives a snapshot of the correlation between aid and growth in Uganda for the significant inflow of aid received since 1986. It does not represent the impact of vast population growth, the government of Uganda's focus on stability before growth (outlined in Chapter 8 of the PEAP) or the trade-off between growth and equity, for example through the provision of public goods such as universal primary education. Nevertheless, it does raise some interesting questions given that there still exists a general consensus amongst development partners in Uganda that more aid will enhance growth. Jeffrey Sachs himself on a recent visit to Kampala stated that Uganda could only attain the MDGs targets through increasing donor support to finance initiatives such as

Figure 10-1: Aid and Growth in Uganda 1982-Present
(GDP growth at constant prices)




Source: UBOS (2007), BTTB various years and Draft Budget 2006/07.

Note: GDP per capita was used in this analysis to represent the distribution of growth in Uganda. This trend is partly dependent on the annual population growth of 3.4 percent over the period. When plotted with actual GDP growth, no trend was found either.

the Millennium Development Villages, which rely on per capita funding of US$110 (currently provided by United Nations Development Programme and private philanthropists).[4] This approach has become vastly popular in policy circles, despite coming under increased scrutiny for doing little to trigger individual initiative or the growth impact of small-scale entrepreneurial enterprises (Easterly, 2006). Moreover, the inflated unit costs to sustain a big push approach raises concerns of continued financial wastage that have been highlighted to date in Uganda (MFPED, 2004).[5]

4. The initiative of the Millennium Villages has been promoted by Jeffrey Sachs, who headed the independent advisory body to the United Nations Secretary-General to develop concrete action plans to achieve the MDGs. This is based on an idea that impoverished villages can transform themselves and meet the MDGs if they are empowered with proven, powerful, practical technologies, through investments in health, food production, education, access to clean water, and essential infrastructure.
5. A notable example of this is the health sector, where the shift from donor-funded project spending to spending through the government of Uganda budget brought a major improvement in the allocation of expenditures towards priorities identified in the Health Sector Strategic Plan.

### *Paradigm 2 : Aid works in a good policy environment*

Realising the shortfalls of the big push approach, a second paradigm emerged which argues that aid works in countries where institutional and macroeconomic frameworks are conducive, namely with good fiscal, monetary and trade policies (Burnside & Dollar, 2000). The authors implicitly addressed the issue of good governance in their study, outlining how aid can either be invested for productive means or consumed (by recipient governments) in an unproductive way. These findings were well received within policy circles, most notably by the World Bank and the US government. The latter subsequently announced a US$5 billion increase in foreign assistance to be administered by the Millennium Challenge Corporation (MCC). As a result, Uganda received US$10 million for being a "good policy" country, as the government of Uganda scored highly in the index of institutional quality established by the MCC.

According to follow-up studies, increased aid has had the growth-enhancing and poverty-reducing impact for the government of Uganda's fiscal framework through the expansion of the development budget (Roberts & Fagernas, 2004). The findings demonstrate that a combination of increased aid coupled with specific progressive domestic reforms, namely tax administration reform, consistent cash budgeting through the Poverty Action Fund (PAF) and a medium-term consultative budget process, produced beneficial results for growth and poverty reduction.

This "aid works in a good policy environment" argument certainly seems convincing and to a large extent fairly logical as it portrays aid as an investment, which impacts domestic output (in either a positive or a negative way). The argument does, however, seem to contain a number of oversimplified areas that need to be investigated further. For example, the assumption that all aid to the development budget has had a productive impact is contrary to the recent analyses that break down the composition of expenditures between consumption (workshops, consultants' wages, technical assistance) and real investment in social or economic reform programmes. This composition has been referred to as unproductive and productive spending (World Bank, 2007b). MFPED (2007) has provisional estimates that the consumption element of the develop-

ment budget for 2006/07 could be as high as 45-50 percent, suggesting that not all of the aid received was reaching the intended growth-enhancing target. Instead, much of it was used on recurrent costs, which are now being scrutinised with respect to their effectiveness. This raises questions about what factors actually contributed to Uganda's growth over the period in question.

In addition to the above criticisms, there remain serious questions regarding endogeneity, in that governments with sound macroeconomic policies are conducive to growth enhancement independently of aid flows. Historical case studies certainly add weight to this argument. The most known cases of development transition from low- to high-income countries with steady progress in poverty reduction and growth have been the Asian tigers of Hong Kong, Korea, Singapore and Taiwan, each of which developed using an effective combination of home-grown industrial and trade policies, coupled with targeted loans from neighbouring Japan to develop basic industries and export facilities. This subsequently shifted their comparative advantage in the global economy. During their growth trajectory these countries were in the bottom quartile for Least Developed Countries (LDCs) in terms of aid receipts as a proportion of their income. They did not qualify under the category of "good institutions" outlined by Burnside and Dollar, especially with regard to an open trade policy and good governance (Khan & Jomo, 2000).[6] Despite sceptics claiming the same is not possible in Africa, Botswana has followed a similar approach and has registered the world's highest per capita growth rate from 1960 to the present with little to no dependence on foreign aid.

### *Paradigm 3 : The type of aid matters*

Given the continual failures to establish a feasible link between aggregate aid and growth,[7] the debate has recently been re-ignited in research forums from the

6. The ratios of aid to GDP from 1980-2002 for the Asian tigers were: Hong Kong 0.02, Korea 0.03, Singapore 0.07 and Taiwan 0.00. Taiwan and Korea had received a high level of US assistance in the 1950s and 1960s, strongly in line with policies of local technocrats through land reform and export-led growth (Haggard, 1990).
7. Easterly, Levine & Roodman (2004) discarded the Burnside & Dollar study, using the same statistical techniques but with an extended sample. They found no evidence that aid raised growth among countries with good policies.

perspective of aid effectiveness prescribed in the Paris Declaration (OECD, 2005). Clemens, Radelet & Bhavani (2004) found that different types of aid modality and the composition of aid could have distinct growth impacts. More specifically, budget support or balance of payments support, and project aid given for infrastructure and productive investments (including transport, communications, energy, agriculture, and industry) are likely to have "short-term growth impact," while technical cooperation and most social sector investments (including education, health, population control, environment, and aid to support democracy) would have "long-term growth impact."[8] Stating that because of this heterogeneity in aid flows, previous studies failed to find a causal relationship, they claim that if this methodology is used, the growth impact of aid is found to be at least two to three times larger than that found in previous studies that used aggregate aid. Moreover, they found that higher than average short-impact aid to Sub-Saharan Africa raised per capita growth rates there by about one percentage point over the growth that would have been achieved by average aid flows. Institutions and domestic policy do play a positive role; however, short-impact aid will lead to economic growth even in countries with weak institutions.

Not surprisingly, given the ambiguity of the categorisations, the study was subject to criticism in research circles. Despite the criticism, it did shift the aid and growth debate into the realm of aid effectiveness. This study was closely followed by similar work by Rajan & Subramanian (2005), who, while criticising the findings of the study by Clemens et al. (2004), shed light on reasons why foreign aid does not cause growth, through their analysis of tied aid and aid for political reasons, which also may limit the effectiveness of aid. Hence, the authors concluded that although historic data fail to provide a strong link, this does not imply that aid cannot be improved in the future in terms of how it is delivered, to whom, in what form, and under what conditions. Their findings therefore strongly support efforts underway to improve aid effectiveness.

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8. According to Clemens et al. (2004), "short-term growth impact" aid can stimulate economic growth within a four-year period. A US$1 increase in short-term aid raises output and income by US$8 in a typical developing country. This has diminishing returns once short-term aid reaches 8 percent of GDP. "Long-term growth impact" aid is likely to have no relationship to growth within a four-year period.

## *Summary and lessons learned from the literature*

To summarise this section, the aid and growth debate has experienced three paradigm shifts, all of which have failed to find a causal link between more aid and increased economic growth. The first paradigm shift was based on growth rates increasing through a "big push" in aid flows to supplement public investment and stimulate rural and urban productivity. The second was along the same lines, but assumed that growth would increase only when aid was channelled to countries with sound fiscal, monetary, trade and governance policies. Serious concerns were raised in adopting these approaches, based on historic aid inflows to Sub-Saharan Africa that have failed to meet the objectives of raising economic growth or substantially reducing poverty levels. Despite the attempts of skilled econometricians, it is impossible to determine whether growth rates would have been any different without the aid that has been received. Both paradigms were criticised through statistical research and, more importantly, in the Ugandan context. The final paradigm shift directly addressed the issues of aid composition and, more specifically, how the effectiveness of aid can impact the subsequent growth effect. Cross-country research has produced contrasting findings in this new area, which is still to a large extent not covered in the literature.

Is there anything that Uganda can learn from the extensive research in this area? The general answer is yes. This is mainly because debates appearing in the literature are still strongly reflected in the actions of the donor community today. Development partners have contrasting viewpoints as to how aid is best spent and administered in Uganda. Some believe that a "big push" in all areas is necessary to achieve sustainable development through a diverse mix of NGO, government and private sector-based programmes (UN agencies and United States Agency for International Development (USAID), for example). Others argue that institutional strengthening is of primary importance to administer budget support for sustainable impacts (Uganda Joint Assistance Strategy donors), whereas a final group believes that investment in key growth-enhancing areas such as roads, energy and agricultural transformation is essential (World Bank, Japan, Norway, Germany and China).

The existing aid and growth debates predominantly use aggregated total aid and rely on cross-country growth regressions, which have well-known shortcomings in identifying causal linkages between aid and growth. As a result, they fail to capture the complexity and heterogeneity of aid flows (Rodrik, 2005). Because the time period of their analyses spans from the 1950s to the present, they also fail to account for changes in foreign aid flows over the past two decades resulting from the end of the Cold War, the shift from Structural Adjustment to Poverty Reduction Strategy Papers (PRSPs) and, most importantly in the context of this chapter, developments in the aid effectiveness agenda. In light of this, a more detailed microanalysis of aid strategies performed by specific donors can help the government of Uganda determine how these approaches should interplay with domestic growth strategies during aid negotiations. The case study section that follows will attempt to do this by analysing two frameworks that build upon the third paradigm of the literature, specifically: a) the aid effectiveness agenda and b) the composition of specific aid flows to determine the possible growth impact.

## 3. Case Study Analysis

### *Objectives and methodology of case studies*

This section will compare the aid strategies of two bilateral donors in Uganda, namely, the UK and Japan, building upon the third paradigm presented in the literature review. First, several indicators from the Paris Declaration on Aid Effectiveness (OECD, 2005) will be used to rank the performance of the two donors in terms of possible linkages towards economic growth. Second, a comparative analysis will be made on the composition of their assistance based on the PEAP pillars and priority sectors of MTEF. The current PEAP is built on five pillars: (1) economic management; (2) enhancing production, competitiveness and incomes; (3) security, conflict resolution and disaster management; (4) good governance; (5) human development. In addition, the project portfolios of respective donors will be analysed in light of their consumption- or investment-orientation and the time-scope of their growth effects (i.e., short-term or long-term growth effects).

In doing this, several assumptions have been made including:

(a) Transaction costs for government distort efforts to manage the economy efficiently.

(b) Nationally owned strategies have more effective outputs than other strategies.

(c) Aid is more growth-enhancing when it is targeted at pillar 2 of the PEAP through productivity-enhancing measures. It will be assumed that this has a greater short/medium impact on aid as compared to other PEAP pillars, which are more indirectly associated with growth, and therefore has a longer-term impact.

(d) Investment is assumed as a physical tangible investment and takes precedence over intangible investments such as human development and capacity building.

## *Comparing the UK and Japan using aid effectiveness indicators*[9]

This section develops the findings of Rajan & Subramanian (2005) as mentioned in the third paradigm. They argued that efforts underway through the aid effectiveness agenda can have a benign effect on the impact on growth, primarily depending on the way it is delivered. Table 10-1 below sets out a series of possible linkages between aid effectiveness targets and economic growth, built on the notion that high transaction costs distort the effectiveness of government in creating a necessary framework to foster private sector-led growth. Table 10-2 then measures each of these indicators for the UK and Japan based on their current and medium-term aid portfolios (2000-2010) and their respective aid mandates in Uganda.

As Table 10-3 shows, adherence to the Paris Declaration is of higher importance to the UK than it is for Japan. The UK has taken the lead in the donor

9. The UK aid flows are those provided by the Department for International Development (DFID) and Japan's aid flows are those provided by the Ministry of Foreign Affairs (MOFA) and Japan International Cooperation Agency (JICA).

Table 10-1: Selected Paris Declaration Indicators Localised for Uganda

| Paris Declaration Commitment | Implications for Donors and Government of Uganda | Benefits for Government of Uganda | How These Benefits Could Be Linked to Economic Growth |
|---|---|---|---|
| Ownership (Indicator 1) | Recipient ownership of national poverty reduction strategy linked to the MTEF. | Single national policy and expenditure programme to promote government leadership. | Ownership ensures a greater desire to achieve objectives and results so aid money is spent efficiently. |
| Alignment to National Policies (Indicator 2) | Aid flows are aligned to national priorities. | Focused goals and objectives targeted towards priority areas that support service delivery by government. | Alignment can reduce duplication and wastage of projects, therefore encouraging efficiency. |
| Predictability of Aid (Indicator 7) | Disbursements are released in accordance with agreed schedules to meet MTEF planning requirements. | Enhanced budgeting mechanisms for better and more predictable future planning. | Investment and spending plans can be utilised in productive areas without disbursement delays. |
| Aid is Untied (Indicator 8) | Contracts for the purchase of goods and hiring of consultants are not linked to the host country. | Allowing goods and services to be procured competitively in the recipient country. | Local resources can be used to generate employment and wealth creation. |
| Harmonisation (Indicator 9) | Aid flows and activities are harmonised in accordance with Sector Investment Plans (SIPs) and PEAP priorities. | Reduced transaction costs through coordination of aid delivery with government programmes to avoid duplication. | Harmonised donor activities reduce the transaction costs for government (reporting, missions, etc.). This extra capacity can be used in productive areas. |

community with respect to strengthening ownership of the national budgeting process through proportionally large General Budget Support commitments. Similarly, strong political will in providing budget support aid, basket funding and untied aid makes the UK a prominent figure in Uganda's aid effectiveness agenda. Japan on the other hand only adopted its Official Development Assistance (ODA) charter in 1992 and since then has made continuous efforts to establish its own aid philosophy, which differs from the commitments to the Paris Declaration (Ishikawa, 2005).

## Table 10-2: Performance of UK and Japan on Aid Effectiveness

| Paris Declaration Commitment | Aid Effectiveness Indicator | UK | Japan |
|---|---|---|---|
| ***Ownership*** (Extent to which aid is provided according to PEAP priorities) | Percentage of total aid allocated through budget support. | Around 50% of total aid from 2000 is through budget support. This level is to be maintained in the medium term. | All project aid (technical assistance and grant aid) is derived through sector priority areas. Currently, no budget support is provided. |
| ***Alignment*** to National Policies | Percentage of total aid that is recorded on budget. | 70% on average (2002/3-2008/9). | 35% on average (2002/3-2008/9). |
| ***Predictability*** of Aid | Percentage of aid released according to agreed schedules. | Predictability of budget support was 100% from 2000/1-2004/5, but reduced for the first time following the 2006 elections. Project performance has been consistently high in 2004/5 and 2005/6, at 86% and 74%, respectively. | Recent disbursements are significantly higher than what is allocated in the MTEF. In 2006/7, for example, disbursements were 137% of the commitment. Two significant projects in 2007/8 are expected to triple the MTEF allocation for this year. |
| | Flexibility in MTEF planning (level of decentralisation). | UK operates on a fully decentralised system and negotiations are underway for the implementation of ten-year horizons for development assistance. Such horizons are currently in use for several other countries in which UK operates. | The Ministry of Foreign Affairs plays a central role for aid allocations, limited to a one-year forecast horizon. The primary reason for Japan's unpredictable aid flows is that its project approval is bound by the annual budget cycle, making it difficult to accommodate the MTEF cycle. |
| Aid is ***Untied*** | Percentage of aid that is tied. | All aid is untied, as mandated in the 1997 and 2000 DFID White Papers. | Grant aid and technical assistance are fully tied although the proposed Japan Bank for International Cooperation (JBIC) loan (1st in Uganda) is untied. |
| ***Harmonisation*** to Sector Investment Plans and PEAP Priorities | Percentage of aid received through Programme-based approaches[1] and/or basket funding. | The share of Programme-based approaches for 2005/6 is 73%.[2] All on-budget project assistance is channelled through basket funding with other donors to limit transaction costs for the government of Uganda. | The share of Programme-based approaches for 2005/6 is 51%.[3] Requests for grant aid and technical assistance are derived from sector ministries. Apart from off-budget humanitarian assistance (channelled predominantly through UN agencies), no basket funding is provided for central government aid flows.[4] |

Notes :
1. These are defined as co-ordinated support for a locally owned programme such as a national development strategy or a sector programme. Programme-based approaches share features of: a) leadership by the host country, b) a single comprehensive programme and budget framework, c) a formalised process for donor co-ordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement and d) efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation (OECD, 2005).
2. OECD. (2007) "2006 Survey on Monitoring The Paris Declaration-Country Chapters for Uganda."
3. See Note 2 above.
4. This excludes Japanese assistance to the Financial Management Accountability Programme (FINMAP), which remains unsigned at the time of writing.

Table 10-3: Summary of Aid Effectiveness Performance

| Paris Declaration Commitment | UK | Japan |
|---|---|---|
| Ownership | Good progress being made | Some progress being made |
| Alignment | Good progress being made | Some progress being made |
| Predictability | Good progress being made | Some progress being made |
| Aid Untying | Good progress being made | Little or no progress made |
| Harmonisation | Good progress being made | Some progress being made |

Source: Assembled by the author, based on Tables 10-1 and 10-2.

### *Comparing the UK and Japan by aid composition*

The aim of this analysis is to highlight the proportion of aid that is targeted towards growth-enhancing activities. This is conducted in three ways. Firstly, it is done by decomposing the current project portfolio of both donors in accordance with PEAP objectives. Secondly, projects are divided into consumption and investment categories, as in Clemens et al. (2004).[10] Thirdly, projects are sub-divided based on the time scope of growth impacts: short-term, long-term or no growth impact, also using the methodology of Clemens et al. (2004). The full list of projects and categories can be found in the Appendix. The analysis excludes the effect of General Budget Support because of the difficulty in separating it from the effect of the Ugandan government's domestic policy. This is further complicated by the fact that Uganda's strong macroeconomic performance had begun before General Budget Support was considered (OECD, 2006).

The results in Tables 10-4 and 10-5 demonstrate how Japanese project aid is more growth-oriented than that of the UK. The largest share of its current project portfolio (40 percent) is geared towards enhancing production, competi-

10. Consumption includes the consumption of goods such as drugs for a health project, personnel financed through technical assistance, or materials for information, education and communication (IEC) projects. Investment captures physical infrastructure and technical assistance that leads to enhancing competitiveness in rural and urban settings, which in turn contributes to human capital development.

Table 10-4: Composition of UK and Japanese Project Aid: Classification by PEAP Priorities

| PEAP Pillars | UK | Japan |
|---|---|---|
| Pillar 1: Economic Management | 17% | – |
| Pillar 2: Enhancing Production, Competitiveness and Incomes | 17% | 40% |
| Pillar 3: Security, Conflict Resolution and Disaster Management | 7% | 25% |
| Pillar 4: Good Governance | 25% | – |
| Pillar 5: Human Development | 24% | 35% |
| Multiple | 10% | – |

Notes: 1. Based on the information on project aid (on- and off-budget) for 2000-2010 for UK and for 2003-2009 for Japan.
2. Japanese aid for pillar 3 is delivered through the UN system.

Table 10-5: Predicted Impact of Aid on Economic Growth: UK and Japan

| | UK | Japan |
|---|---|---|
| Growth impact of project aid | | |
| No impact | 7% | 5% |
| Short term | 12% | 45% |
| Long term | 81% | 50% |
| Consumption/investment ratio | | |
| Investment | 19% | 25% |
| Consumption | 81% | 75% |

Source: Estimated by the author, based on the tables in Appendix.
Notes: 1. The percentages reflect the number of projects in a given category as a proportion of the total projects in the respective portfolios shown in the tables in Appendix.
2. The growth impact for each project is estimated using the methodology from the study by Clemens et al. (2004) and utilising Development Assistance Committee (DAC) classifications of aid categories.

tiveness and incomes (PEAP pillar 2). Almost half of its project assistance has a short-term impact on economic growth based on the definitions by the study of Clemens et al. (2004) and a quarter is investment-oriented. This is equally represented in the share of aid disbursements, with agriculture, roads, and Economic Functions and Social Services (EFSS) obtaining the greatest shares, in addition to the heavily supported hospital rehabilitation programme, which

skews the figures for the health component. For example, in 2006/07 Japanese disbursements to agriculture, roads and health sectors accounted for more than ninety percent of its total disbursements. From 2007/08 the share of EFSS has been increasing.

The UK perspective is completely the opposite. The major share of support has been seen and will continue to be in the area of good governance with accountability, public administration and public sector management featuring prominently. Specifically, the share of UK disbursements to the accountability sector has increased since 2004/05. It is projected that from 2007/08 the accountability sector will account for almost half of the total disbursements. This is hardly surprising given that institutional strengthening is supposed to be a by-product of General Budget Support and not a productivity-enhancing measure. Eighty percent of project assistance could have possible long-term growth effects and the same amount is consumption-based, due to a high level of capacity building projects.

## 4. Discussion and analysis

Results indicate that the UK performs better when judged on the Paris Declaration Indicators, whereas the composition of Japanese aid is more focused towards increasing productivity, investment and subsequently, economic growth. The principal findings show that the composition-based results offer a more robust insight into a possible growth impact categorised by the PEAP pillars, disbursements into MTEF sectors and consumption/investment ratios.

### *Aid effectiveness and growth*

The main point of analysis is concerned with the extent to which the aid effectiveness agenda can assist economic growth vis-à-vis reduced transaction costs, increased country ownership and policy alignment. The results showed that the UK is leading the way in the aid effectiveness agenda. However, it is

increasingly difficult to judge the extent to which support to productivity increase will progressively follow. The linkage therefore remains weak, and although ownership is imperative to ensure money is better spent, too many interplaying variables remain, making it impossible to conclude that the aid effectiveness agenda will lead to economic growth. It is yet to be seen, for example, that basket funding leads to reduced transaction costs, given that the process is in its infancy. The results are therefore inconclusive as to how much reduction in transaction costs will free up greater resources within the government of Uganda to steer the economy along a more efficient growth path.

Furthermore, the Paris Indicators only give a small representation of a donor's in-country activity, as understandably all results-oriented systems have short-falls. For example, although the majority of Japan's project aid is in the form of technical assistance, it is proportionally outstripped by Japan's assistance to humanitarian relief, therefore giving an unbalanced picture of on- and off-budget aid. More importantly, the indicators used fail to capture Japan's "request-based" approach that strongly supports country ownership. This is demonstrated by the joint pre-discussions regarding technical assistance and grant aid to identify need, which subsequently strengthened policy dialogue with the government of Uganda in determining the allocation of aid. Japan's assistance has minimal to no conditionalities.[11] This approach was built on lessons learned from aid relationships with East Asian neighbours, in which mutual trust was established when Japan provided aid without attaching conditionalities (Ishikawa, 2005).

## *Composition of aid flows*

Whilst not free from criticism, the results in this area provide more robust findings. Certainly, the omission of General Budget Support from the analysis makes a comprehensive cross-country comparison incomplete. Similarly, sub-

11. Generally, the only condition is that an exit strategy is adopted, with domestic funds ensuring project maintenance and continuation to promote sustainability.

jective outcomes were at times employed in order to predict a short- or long-term growth impact. Nevertheless, the project portfolios of respective donors, i.e., their composition and disbursement data offered strong evidence of their underlying thinking, while UK clearly follows institutional strengthening in areas of good governance, and Japan adheres to a more growth-led development strategy based on historical commitments to East Asian neighbours.

The analysis of the composition of aid flows offers a clearer indication on growth orientation of a specific donor as compared to the aid effectiveness study. This gives credit to the methodology of the study by Clemens et al. (2004) and to a lesser extent supports the conclusions of Rajan & Subramanian (2005). This is not to render the aid effectiveness agenda ineffective—far from it. This is because the primary aim of the aid effectiveness agenda is to reduce wastage and burdensome bureaucracy for the recipient, and to a lesser extent to result in direct productivity gains. The findings are simply from a growth perspective, whereas the aid effectiveness agenda is multifaceted and aims primarily to evaluate donor performance in aid delivery. If anything, the findings simply tell us that different donors have different perspectives. The government of Uganda should be fully aware of these perspectives at the negotiating table.

## *Implications*

These findings raise a number of questions that centre on the extent to which poverty reduction is achieved through economic growth. Both the UK and Japan hold that "economic growth is the single most powerful way of pulling people out of poverty" (DFID, 2006, p.57). Nevertheless, the results of the case study analysis show a divergence in the approaches donor countries take to accomplish this goal. The UK believes that effective states, which are accountable to their citizens, create more stable investment climates to foster long-term growth. Hence, developing systems of accountability (audit institutions and parliamentary committees, amongst others) will promote this environment. Japan, on the other hand, is a strong believer in aid for trade, whereby concessional loan-based support is injected into public funds to promote

economic infrastructure development[12] that is initiated by external private sector development, as experienced with China, Korea, Thailand, and more recently with Vietnam. Poverty reduction through growth has been achieved by targeting rural areas to lower unit costs of inputs such as fuel, electricity and phone bills. This subsequently improves access to markets and competitiveness of existing and potential firms to stimulate employment generation. This is a critical first step in increasing FDI, leading to greater exports and subsequent economic growth.

So what do these contrasting aid strategies mean from the perspective of the government of Uganda? The findings have several implications, and in many ways raise more questions than answers. Firstly, should the government of Uganda be promoting an agenda based on Japanese assistance, which is predominantly based on "growth first" empirical results from East Asia and Botswana? To what extent does institutional development matter in the context of aid policy? What additional priority areas should be targeted beyond infrastructure development? Of course there is no clear-cut answer to these questions and aid policy must be balanced to address all of these areas, especially given that institutional development is based on the notions of self-help and sustainability, which are the underlying principles held by the government of Uganda. In addition, initiatives are needed to ensure that investment leads to employment generation. This is dependent upon sufficient regulation and accountability.

In light of a recent budget speech by the Minister of Finance, Planning and Economic Development on 14th June 2007 (MFPED, 2007), which prioritised rural development, increasing competitiveness, productivity and access to rural finance, it appears that the Japanese model is more attuned to the Ugandan government's way of thinking: to stimulate home-grown development based on the dynamism of individuals, firms and free markets, as opposed to relying on foreign aid. Moreover, despite having experienced poverty reduction and economic growth over the past 20 years, the economy remains largely

12. DAC defines this as energy generation and supply, transport and storage and communications.

infrastructure constrained, with economic growth outstripping road and energy infrastructure, a situation which is clearly highlighted by the congestion around Kampala and power shortages (World Bank, 2007a).[13] Japan's strategy directly aims to overcome this infrastructure constraint, so as to remove these barriers to growth. Given that aid flows have historically been linked to a plethora of areas advocated in the PEAP, the government of Uganda is now faced with re-considering future allocation and modalities of aid flows so as to reflect these pressing priorities. This does not imply that social sectors and institutional strengthening are to be ignored, but the current congestion from off-budget aid flows in these areas (ODI, 2008) could signal a shift towards a growth-led model. Currently, the World Bank and the African Development Bank dominate this area of support through concessional loans, with the EU and to a lesser extent Denmark and Norway providing support through grant aid. With greater consensus and support amongst other donors, a concerted drive could produce results like those experienced in Southeast Asian countries such as Vietnam.

As the big push theory appears to be coming to the fore, the government of Uganda must first fully comprehend the aid composition of its leading development partners. The government must be in a position to dictate where and how aid is spent so as to promote the intentions laid out in the recent budget speech. This position should come hand-in-hand with the government pushing for the aid effectiveness agenda. Without such leadership aid is at risk of being used inefficiently; much has been squandered in the past, and such handling of aid will only fuel aid dependency and a culture of handouts as opposed to one of investment-led growth. With the PEAP revision less than a year away, recommendations could be to prioritise among the PEAP pillars so as to give more weighting to growth-enhancing areas or to incorporate a harmonised investment productivity and savings strategy to draw specific donor support. Such an adjustment is especially important because the social and governance areas have had an overabundance of donor aid inflows in the recent past.

13. Other characteristics that suggest this are the underemployment of secondary school graduates and the high return to capital in formal businesses that restrict the entry of new firms to compete.

# Appendix

## Detailed Breakdown of DFID's Current Project Portfolio (2000-2010)

| MTEF Sector | Project Name | PEAP Pillar | Investment/ Consumption | Growth Impact |
|---|---|---|---|---|
| **Agriculture** | Aquaculture in Uganda / Fish Farming | 2 | Investment | Short Term |
| | Support to Plan for Modernisation of Agriculture Secretariat | 2 | Investment | Short Term |
| | Improving Rural Livelihood (NARO) (TA) | 2 | Consumption | Long Term |
| **Education** | Education Sector Programme (ESIP) | 5 | Investment | Long Term |
| **Health** | Health Planning Unit Project (TA) | 5 | Consumption | Long Term |
| | Support to Water & Sanitation Programme / Environment Health Division | 5 | Consumption | Long Term |
| | Support to Malaria Control and Prevention | 5 | Consumption | Long Term |
| | Uganda Aids Commission | 5 | Consumption | Long Term |
| | Partnership Fund Project | 5 | Consumption | Long Term |
| **Accountability** | Financial Accountability Programme (Financial Aid) | 4 | Consumption | Long Term |
| | MFPED Economic Advice | 1 | Consumption | Long Term |
| | Support to Ministry of Finance | 1 | Consumption | Long Term |
| | Public Financial Management (FINMAP) | 4 | Consumption | Long Term |
| | Evidence Based Decision Making (MFPED) | 1 | Consumption | Long Term |
| | Support to Uganda Bureau of Statistics | 1 | Consumption | Long Term |
| | Evidence Based Decision Making (UBOS) | Multiple | Consumption | Long Term |
| | Population Census | Multiple | Consumption | Long Term |
| | Support to Privatisation Utility Reform | 1 | Consumption | Long Term |
| | Deregulation | 1 | Consumption | Long Term |
| | Poverty Monitoring & Policy Analysis | Multiple | Consumption | Long Term |
| | Anti Corruption Support | 4 | Consumption | Long Term |
| | Democratic Deepening Project | 4 | Consumption | Long Term |
| **Economic Functions and Social Services (EFSS)** | Evidence Based Decision Making | Multiple | Consumption | Long Term |
| | Uganda Revenue Authority | 1 | Investment | Short Term |
| | Decentralisation Support Programme | 4 | Consumption | Long Term |
| | Support to National Forestry Authority | 2 | Consumption | Long Term |
| | Pilot Cash Transfer | N/A | Consumption | Long Term |
| **Justice, Law and Order Sector (JLOS)** | Commercial Justice System Reform | 4 | Consumption | Long Term |
| | Law Revision/Printing | 4 | Consumption | Long Term |
| **Public Sector Management** | Public Service Reform Program | 4 | Consumption | Long Term |
| **Public Administration** | Support to Parliament (through Strategic Fund) | 4 | Consumption | Long Term |
| | Support to EU-GoU Capacity Building Programme | 4 | Consumption | Long Term |
| **Water and Environment** | Integrated Lake Management | 2 | Investment | Long Term |
| | National Water and Sanitation Programme | 5 | Investment | Long Term |
| **Security** | Support to Defence Review Unit | 3 | Consumption | No Impact |
| | **Off Budget Projects** | | | |
| **Accountability** | Civil Society Programme | 4 | Consumption | Long Term |
| **Security** | Humanitarian Aid | 3 | Consumption | No Impact |
| | Conflict Reduction/NGOs and Amnesty Commission | 3 | Consumption | Long Term |
| **Health** | Support to Measles and Polio | 5 | Consumption | Long Term |
| | HIV Umbrella Programme | 5 | Consumption | Long Term |
| | Response to Meningitis | 5 | Consumption | No Impact |
| **Agriculture** | Enhancing Competiveness of Commercial Agriculture | 2 | Investment | Short Term |
| **EFSS** | Support to Private Sector | 2 | Investment | Short Term |

Source: MTEF, Ministry of Finance, Planning and Economic Development

Detailed Breakdown of Japan's Current Project Portfolio (2003-2009)

| MTEF Sector | Project Name | PEAP Pillar | Investment/ Consumption | Growth Impact |
|---|---|---|---|---|
| **Roads and Works** | Improvement of Traffic in Kampala City Council | 2 | Investment | Short Term |
| | Study on Greater Kampala Road Network | 2 | Consumption | Short Term |
| **Agriculture** | Study on Post Harvesting and Marketing | 2 | Consumption | Short Term |
| | Study on Sustainable Irrigation | 2 | Consumption | Short Term |
| | Technical Capacity of Animal Disease Control | 2 | Consumption | Short Term |
| **Education** | Nakawa Vocational Training Institute | 5 | Consumption | Long Term |
| | Secondary Science and Mathematics | 5 | Consumption | Long Term |
| **Health** | Rehabilitation Health Facilities Eastern Region | 5 | Investment | Short Term |
| | Improvement of Health Infrastructure Development & Management | 5 | Consumption | Long Term |
| **EFSS** | Project for Rural Electrification Phase II | 2 | Investment | Short Term |
| | Bujagali Interconnection Project | 2 | Investment | Short Term |
| | Medium Wave Radio Broadcasting Network | 2 | Investment | Short Term |
| | **Off Budget Projects** | | | |
| **Security** | Emergency Assistance to Conflict-Affected Areas | 3 | Consumption | No Impact |
| | Northern Uganda Youth Rehabilitation Fund | 3 | Consumption | Long Term |
| **Agriculture** | Cassava-Agricultural Support in West Uganda | 3 | Consumption | Long Term |
| | Emergency Food Supply in Northern Uganda | 3 | Consumption | Long Term |
| **Health** | Provision of Long-lasting Insecticide Net | 3 | Consumption | Long Term |
| | Expanded Programme on Immunisation Revitalization & Polio Eradication | 5 | Consumption | Long Term |
| | Protection and Promotion of Rights of Children in Acholi Area | 5 | Consumption | Long Term |
| **Mutliple** | Support to Grassroots Projects | 5 | Consumption | Long Term |

Source: MTEF, Ministry of Finance, Planning and Economic Development

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