

**AID EFFECTIVENESS AND GOOD GOVERNANCE: THE  
CASE OF UGANDA**

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## **Introduction**

Ladies and gentlemen, it is my pleasure to address you this morning on such a topical issue and also share my experience of aid effectiveness and good governance in Uganda. I am pleased to be able to highlight the emerging issues arising from the reforms of the mobilisation and disbursement of external aid at global and national levels.

Aid strategies are undergoing fundamental reforms. In recent years, the strengthening of good governance in our developing countries has become both an objective of aid and a condition for development assistance. The debate on good governance continues to reflect concern over the effectiveness of aid in recipient countries. NGOs and advocates for anti-corruption strategies in developing countries have openly criticised donors, who play an important role in global governance and have considerable leverage over developing country governments through their aid regimes.

My submission is that foreign aid promotes good governance but does not sustain aid effectiveness and better public expenditure management. Part 1 will look at the initiatives undertaken by the Government of Uganda with the support of its development partners in an effort to build a good governance structure for better public expenditure management. Part 2 identifies the challenges that hinder aid effectiveness, as evident from emerging fiscal and fiduciary issues as well as the whole question of donor compliance with the agreed Partnership Principles. The conclusion makes an attempt to bring on board the underlying question of public ethics and moral conduct and in particular the role of donors in promoting integrity and ethical conduct.

## **Part 1: Better Governance for Foreign Aid in Uganda**

In the last decade or so, the Government of Uganda has emphasised the importance of democracy and good governance in an effort to improve service delivery. A key component of this commitment is the road map that provides short and medium term interventions to improve Public Expenditure Management. The government's focus has been to promote the effective mobilisation and utilisation of all resources (including external aid) towards sustaining broad based economic growth and poverty reduction.

The Government has, since the early 1990s, enjoyed substantial amounts of foreign aid as part of its national budget. External donor support has constituted an annual average of 40% of the Ugandan national budget since 1998.

It is Government policy that foreign development assistance to Uganda, including loans, grants and technical assistance (TA) should be made within the framework of its development agenda - clearly articulated in the Poverty Eradication Action

Plan (PEAP). The Government is committed to taking the leading role in the nation's development process. Within this context, Government has worked closely with all stakeholders including the development partners and institutionalised a framework that should enhance the effectiveness of foreign aid. The main thrust has been to build budget credibility so as to promote good governance in the management of public funds.

A credible Budget should be consistent with agreed expenditure priorities and deliver projected targets, outputs and eventually outcomes. The Government of Uganda has succeeded in institutionalising a framework that promotes synergy between policies, legislation, and processes to sustain a credible budget through:

- Consensus orientation around priorities and responsiveness (ownership);
- Linking the Budget with agreed priorities (assurance);
- Predictability of resources (trust); and
- Delivery of budget with minimum deviation (confidence).

### **Responsiveness and Consensus Orientation**

In 1996, the Government resolved to prioritise poverty eradication as the major focus of its overall sustained growth and development strategy, and as a guide to the mobilisation and strategic allocation of resources. The rapid development in governance structures within a decentralised framework have necessitated that the planning and budgeting processes are undertaken in a highly participatory manner.

For instance, revision of the PEAP/PRSP has been institutionalised every three years as an essential element of the planning and monitoring process and is carried out in a highly participatory manner for maximum ownership of the policy and strategies. The revisions conducted so far (in 2000 and 2003) took account of the findings from the 'voice of the poor' captured under the Uganda Participatory Poverty Assessment Programmes (PPAP) conducted in 9 districts in (1999/2000) and 12 districts (2001/2) of Uganda. Findings from the PPAP formed a basis for the policy review process and have influenced major policy options that resulted in shifts in resource allocations towards the water sector, governance issues, HIV/AIDS, justice, etc which are major concerns of the poor.

Extensive consultation with all stakeholders and the country's donor partners is a central component of Uganda's policy formulation, planning, implementation and monitoring processes. The aim is to ensure that the policies, which underlie the expenditure priorities and resource allocations, are fully owned by the stakeholders. Such reforms have included the participation of civil society organisations in both the formulation and monitoring of policies and programmes and in particular the budget process. The process also offers a platform for those who are pushing for serious economic reforms to put across arguments for reform before the public and politicians.

Consultations have been promoted through various institutional frameworks operating at the central and local government levels, as well as through working groups for donors, sectors and civil society. These frameworks provide a coordinated approach to discuss and build consensus on the emerging issues or differences in policy issues, priorities and resource allocation. In addition, the consultative meetings provide an opportunity to sort out the tensions that normally exist between the policy and political considerations. It is important to note that some of the policies that are critical for the long-term success of poverty eradication strategies do not always have widespread support among all stakeholders.

To ensure that the decision making processes continues to be highly participatory, popular versions of a good number of Government plans and policies, as well as the Annual Budget (including the Budget-making process) have been produced in English and selected local languages. This move enabled easy engagement with the various sections of society that should contribute to the policy/poverty debate and demand accountability from government. It is important to note that summarized versions of the documents have also proved to be more effective in engaging parliamentarians, policy makers and implementers at central and local government level.

### **Linking Budgets with Priorities**

Through the Medium Term Expenditure Framework (MTEF), the overall strategic priorities as articulated in the PEAP, and the more detailed sector priorities as specified in the various sector wide plans, can be translated into resource allocations over the medium term. At the same time however, the MTEF ensures that the overall expenditure ceiling is maintained consistent with macroeconomic stability and the achievements of other government commitments, including agreements with donors.

Emphasis has been put on the development of Sector Wide Investment Plans that aim to spell out the goals, objectives and targets that have a direct impact on poverty eradication, and identify cost effective strategies and interventions by the respective stakeholders. The plans, with emphasis on outputs and outcomes, have guided the allocation of both recurrent and development resources within the identified priorities, sequenced over the medium term to ultimately improve efficiency and effectiveness in service delivery. Sector Wide Investment Plans have been developed in all key sectors, including Education, Health, Roads, Justice/Law and Order, and Agricultural Modernisation.

A Poverty Action Fund (PAF) was set up as a virtual fund in 1997/8 in order to channel the additional resources received under the Highly Indebted Poor Countries (HIPC) initiative to poverty reduction. The PAF consists of a sub-set of expenditures within the MTEF which are seen as directly contributing to poverty reduction. Since that time, the PAF has been expanded as donors are providing

additional funds for the PAF through budget support and, in addition, the year-on-year Government of Uganda contribution has been increasing steadily. The Fund has demonstrated commitment to budgeting for poverty reduction, and has also acted as catalyst for shifting from the traditional project support modalities on the part of donors to budget support. PAF-earmarked budget support has increased by 5 times since 1998; and overall budget support in Uganda has increased by 3 times over the same period.

The present planning system demonstrates an effective linkage between the Sector Policies and Budgets and the MTEF, better realignment of sector outputs and PEAP outcomes within the available resources: all of which is remarkable progress towards the attainment of the desired trust.

### **Predictability of Resources**

It is not enough to articulate priorities without the assurance that the resources will be mobilised to support the agreed-upon expenditures. It is important to note that the Ugandan economy is rain-fed and a large proportion of the national budget is donor-supported. Expanding domestic revenue and improving tax administration is acknowledged by most stakeholders to be the biggest challenge in improving the country's fiscal position. Predictability of resources therefore is a big challenge. Notwithstanding this, Government, supported by the donors, has invested substantially in improving domestic revenue collection; strengthening macroeconomic analysis, forecasting domestic revenue as well improved projections of donor disbursement over the medium term. All these efforts are geared towards enhanced predictability of resources from both domestic taxes and the donors.

The MTEF is used to distribute projected resources into sectoral and institutional allocations which give indicative ceilings for planning and execution purposes. Predictability increases public confidence in Government's commitment to its poverty eradication programmes.

### **Delivery of budget with minimum deviation**

Equally important is the need to guarantee that the appropriated funds will be released during the execution of the budget. A cash budgeting system has been implemented over several years to manage expenditures within realized resources. The system involves projecting the domestic revenue collection and donor disbursements over a specified period as well as planning the expenditures, in an effort to avoid over-commitments. The overall intention is to promote transparency and predictability of releases and also to ensure fiscal discipline and maintain macroeconomic stability. The policy, legislative and regulatory framework has been revised to promote the following:

- Adjustment in expenditures to respond to any underperformance of domestic revenues or to allow for emergency programmes.
- Adjusting foreign reserves to match under-disbursements of donor funds.
- Parliamentary approval of supplementary expenditures.

- Ring-fencing of priority expenditures to protect the critical programmes from cuts in case of low revenue collections or late disbursement from donors.

In order to enhance financial management, monitoring and accountability, the Government of Uganda has reformed the procurement system (through law, procedures, capacity building and the creation of a new cadre of profession in the service) where major cases of corruption have been found at central and local government levels in the past.

The Government has also commenced a number of substantive reforms that are geared towards mainstreaming performance orientation and monitoring progress with respect to desired targets and outcomes. Some of the actions include:

- (i) Mainstreaming Results Oriented Management (ROM) across the public sector to improve the efficiency, effectiveness and transparency of service delivery;
- (ii) Promotion of access to information, so that citizens demand accountability from government and their leaders. The Government considers provision of public information as a critical component of improving transparency and accountability;
- (iii) Ensuring that mandatory notices of monthly cash releases to various sectors, are pinned up in public places such as schools and health facilities and published in local media; and
- (iv) Institutionalising periodic monitoring of (a) the PEAP (Poverty Assessments, Household Integrated Surveys, Health Demographic Surveys, Integrity Surveys, National Service Delivery Survey etc) as well as (b) national and local government budgets (Annual and Quarterly Budget Performance Reports; District and Sector Reports).

## **Part 2: Emerging Issues and Role of External Stakeholders**

The building of budget credibility has been a long-term initiative and not always a smooth path. Nonetheless, the country has reaped immense benefits, particularly arising from better public expenditure management - ultimately resulting in the expansion of service delivery to the poor. The proportion of people below the poverty line fell from 44% in 1997 to 35% in 2000. Part of the success is also attributable to the strong and committed political leadership supported by a competent and committed executive arm of Government. However, all is not as rosy as it seems. Poverty levels, although reduced, are still unacceptably high and there are signs of inequalities between rural and urban areas, between different geographical areas and between socio-economic groups. The issue of effective use of resources remain a big challenge in the poverty reduction initiatives. I will dwell on some of the key challenges to the meaningful use of external aid.

## **Fiscal Risks**

Many challenges have unfolded along the way of mobilising additional resources. Total donor disbursements to Uganda constitute around 45% of total budget with multilateral financial institutions accounting for over 35%. The total budget deficit excluding grants for the last five years exceeded 10%. It is important to acknowledge that official assistance will continue to play a bridging role for some foreseeable future, before the domestic economy is large enough to provide all Government's resource requirements through taxation. However, it should not be forgotten that this is not a sustainable means of financing development in real terms.

Too great a dependency on donor aid to finance the budget makes Government expenditure vulnerable to shocks in aid flows. Any sudden cut-back in aid flows has serious implications for the funding of key poverty-eradication programmes and potentially leads to severe budget cuts. It also gives rise to political concern that Government sovereignty is being undermined, particularly in terms of constraints to its economic and budgetary choices.

Increasing donor flows does create a need to mop out excess liquidity from the economy through a combination of Treasury Bills sales and foreign exchange sales - which has the adverse effect of driving up the interest rates and causing exchange rate appreciation. This has posed a number of macroeconomic challenges:

- High cost of private sector borrowing: sales of Treasury Bonds have pushed up interest rates - with the stock of government securities increasing fivefold in five years. The proportion of commercial Bank lending going to the private sector has fallen from 55% in 1999 to 40% in 2003.
- High domestic interest payments: Interest payments have risen to 8% of budget in 2004/04. The payment has reduced the availability of resources for other programmes and also exceeded the budget for some key sectors.
- Overvalued exchange rates: Sales for foreign exchange executed for sterilisation purposes have risen ten fold in the last five years, causing an overvaluation of the currency.
- Rising external debt burden: the government has continued to borrow from multilateral donors since HIPC and, combined with lower export growth projections and lower world interests rates, this has seen the debt to export ratio more than double to 325 per cent.

Clearly, this is not a sustainable situation. Higher export volumes and stable prices are critical elements of the development path but capital inflows and private investment also must increase significantly in the short to medium term. Uganda is therefore committed to reducing its fiscal deficit, to boosting private investment, assisting the depreciation of the real exchange rate and maintaining private sector-led economic growth. It is also committed to improving revenue

efficiency, and to raising the tax base through new tax measures where appropriate.

There is consensus among all stakeholders that the deficit should be reduced. But the biggest challenge is that a strategy that is excessively focussed on deficit reduction could deter the offer and use of more funds. It is feared that this in turn would undermine productive investment growth as well as constrain the attainment Millennium Development Goals.

### **Diminishing Aid Returns**

Another emerging concern is the extent to which aid is being used effectively and impacting on the desired targets and outcomes, as aid levels rise. The subject, according to McGillivray (2003), has been examined closely by most recent aid-growth studies, and almost all studies show negative returns setting in when the aid inflow reaches anywhere between 15- 45% of GDP. In Uganda, this concern is more glaring in selected aid programmes, for instance control of HIV/AIDS where numerous donors are channelling funds or assistance - using many different modalities. This has overwhelmed the nation with funds and challenged the capacity of government to coordinate the much-needed support. On the other hand, it also reveals failures on the part of donors to comply with the Partnership Principles.

Donor compliance with partnership principles could be better. Recent studies on the alignment of budget support with national processes and donor compliance with the agreed upon principles have indicated overall satisfaction with the practises of the donors, with the rating being fair or acceptable on most fronts. Nonetheless, some areas of unsatisfactory performance still exist and have undermined the intention of enhancing the effective coordination of aid. The identified shortcomings include:

- Stand-alone programmes are a big setback in the alignment of aid in the national expenditure priorities - a situation worsened by the inadequate coordination mechanism on behalf of Government
- The donor-funded programmes are not subject to strict fiscal constraints and hence act as a disincentive to prioritisation. It is argued that donor projects do not carry any opportunity costs, which undermines budget efficiency and management; puts upward pressure on the aggregate fiscal deficit and creates constraints in macroeconomic management.
- Multilateral development institutions are known for failing to provide adequate information on projections and disbursements on a timely basis, which is a significant challenge to predictability of funding. They also have a track record of late disbursements as well as misalignment of disbursements with the budget cycle.
- Although some donors have shifted a large share of their aid into general budget support, projects are still the preferred modality of many donors.

Donors still want to push their own projects outside of the normal budgetary process, even where these are not government priorities. It must be recognized that the opportunity cost to the government of these projects is not zero. Donors recognize this, but some of their initiatives to strengthen capacity are proving counterproductive. For example, the supporting of new and or parallel bodies, which are not sustainable.

- Even where donors have shifted their aid into budget support, there is still a desire among some donors to “earmark” this support for particular sectors as a way of channelling their aid in the form of budget support while at the same time maintaining some control over how it is spent – this is a case of trying to have your cake and eat it. When earmarking actually influences budgetary decisions, the results will be harmful to rational budgetary management. Having said all this, the fungibility of funds sometimes means that tensions between policy and political objectives become apparent.

Conditionality is normally cited as a major setback to the promotion of aid effectiveness. It is argued that conditionality or benchmarks are not the most appropriate way to strengthen governance in our developing countries. I do agree, but hasten to elaborate that agreed-upon conditions are necessary to promote donor confidence and to some extent effectiveness. However, conditions are not sufficient to sustain the trust and effectiveness. The main thrust of the conditions has been to put in place the requisite policy, legal and institutional framework. Notwithstanding this, it is becoming clear that good governance is achieved only by the ability, capacity and willingness of political authorities and technocrats to enforce the law, implement policies, and ensure independence of key agencies so as to govern effectively in the common interest. The million-dollar question is what then is the role of development partners in case of lack of enforcement or implementation? Can the donors involve themselves in addressing issues of power, politics and democracy? The need for donors to be tough in this area has sometimes been trumped by their policy/wish to disburse or be generous.

Fiduciary concerns remain a serious challenge as cited by the recent World Bank Report (2004): ‘Corruption is a severe problem. To improve efficiency of resource allocation and obtain more value for money, corruption needs to be tackled from all angles.’ The challenges faced by the Government in this area are as follows:

- Uphold public interest in, and understanding of, the national plans and the Budget;
- Ensure that the authority and capacity of anti-corruption agencies to pursue their mandate is not compromised;
- Improve credibility of government watchdogs and ensure that the rules and laws are enforced;
- Reduce acceptability of bribes and develop a culture that will not tolerate poor service, non-transparent practices and lack of information; and

- Most importantly, understand the global circumstances and role of donors which can promote bad governance tendencies, and design strategies to handle the problem.

It is obvious that the Government has to strengthen its coordination machinery and commitment to partnerships principles. The status quo undermines the Government's ability to plan the budget based on a comprehensive understanding of the resources available, jeopardising the efficacy of public expenditures. The recent reform of mainstreaming project aid, though still debated, will go a long way to improve the coordination and management of aid and the rationalisation of expenditure priorities to secure accurate projections - which are essential for programming and budgeting purposes. This, however, calls for the full cooperation of politicians and donors.

### **Conclusion**

I strongly believe that aid programmes are more likely to be successful when the recipient government takes the lead in driving its development programmes and management of emergencies. Equally important is that the government must have the capacity to identify and articulate its own priorities and programmes; to guide the appropriate resource allocation, and the ability to implement, monitor and evaluate the resulting programmes in the context of its own planning and budgeting. Within this context, the politicians and technocrats must adhere to the Partnership Principles to ensure the equal participation of the development partners, and equity in development assistance. Efforts must be made to restore or sustain donor confidence, as well as the credibility of the budget and its associated institutional framework.

What then is the role of Donors? The partners must appreciate the need to enhance aid effectiveness and thus support measures and interventions that promote the pooling of resources and common arrangements for dialogue and monitoring - working more through the exchequer system and strengthening the coordination and management of aid.