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Foreign Aid and the Weakening of Democratic Accountability in Uganda

by Andrew Mwenda

Executive Summary

Africa is the world's poorest continent. Between 1974 and 2003, the per capita income in sub-Saharan Africa declined by 11 percent. Africa continues to trail the rest of the world on human development indicators including life expectancy; infant mortality; undernourishment; school enrollment; and the incidence of HIV/AIDS, malaria, and tuberculosis. The international aid lobby advocates more foreign aid and greater debt relief for Africa as solutions.

Unfortunately, as the case of Uganda shows, foreign aid and debt relief can exacerbate Africa's problems by postponing economic reforms and the emergence of a transparent and accountable government.

Uganda implemented significant economic reforms in the 1990s because of domestic economic and political factors. That progress led many observers to label Uganda as an economic success story and brought the country debt relief and an increase in foreign aid. But foreign aid, which makes up 50 percent of the Ugandan government's budget, is providing the government with an independent source of "unearned" revenue. That allows the government to avoid accountability to Uganda's citizens. Moreover, foreign aid enables the government to pay its bills without having to undertake further necessary economic reforms.

Similarly, debt relief to Uganda has had some unintended consequences. It has enabled the government to borrow still more money and remain highly indebted by significantly increasing its level of absolute debt. The country's debt as a share of gross domestic product is still more than 50 percent. The government is wasting much of the new money on military equipment and political patronage. To promote democracy and accountability, the West should discontinue future aid flows.

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Most of Africa's problems are internal, not external, and concern domestic policies and institutions.

Introduction

Last year British prime minister Tony Blair brought Africa's misery to the center of world attention. Those efforts culminated in the G8 summit in Gleneagles, Scotland, and the accompanying Live 8 concerts organized by the Irish pop star Sir Bob Geldof. However, instead of providing a new approach to Africa's state of permanent crisis, Blair, his Commission for Africa (CFA), and the G8 summit restated the conventional and failed solutions to African poverty by endorsing increased foreign aid and the canceling of Africa's debts.

Those initiatives suggest that the solutions to Africa's internal crisis are external. It is true that the CFA mentioned some domestic policy and institutional problems in Africa and suggested remedies for them.[1] But those internal problems were treated as secondary causes of African poverty. However, most of Africa's problems are internal, not external, and concern domestic policies and institutions. Until those internal problems are addressed, no amount of Western assistance will bring Africa out of poverty. In fact, Western assistance could postpone much-needed reforms in the way that African countries are governed.

Africa is a large and diverse continent comprising 54 countries. Each of those countries faces unique challenges that may indeed require different policy and political interventions. However, the current obsession with increasing aid and debt cancellation ignores many of the difficulties that most African countries share.

Foreign Aid Is a Disincentive to Domestic Reform

First, let us examine the proposal to increase financial aid from the West to Africa as a way of fighting poverty on the continent. The underlying assumption of the aid lobby is that governments in Africa lack the necessary resources to generate sufficient revenue to meet their public expenditure needs in areas such as health care, education, and infrastructure. Although that argument sounds convincing, it ignores the distorted fiscal priorities of African governments.

Take the example of Uganda, a country hailed by international donors, especially the World Bank and the International Monetary Fund, as an African economic success story.[2] The country depends on foreign aid for nearly 50 percent of her budget. Foreign aid is important in Uganda because it finances free primary education, free basic health care, and infrastructure rehabilitation and maintenance. However, is it true that without foreign aid Uganda would lack revenue to meet those public expenditure needs?

Consider Uganda's taxation policy. Tax collection by the Uganda Revenue Authority amounts to about 12 percent of GDP, which is below the sub-Saharan African average of 18–20 percent and well below the government's target of 24 percent.[3] The Ministry of Finance claims that the failure to collect more taxes is due to administrative weaknesses, which is why the URA's commissioner general, Allen Kagina, believes that more government investment in the quality of human resources and computerization of tax information is needed. As the former commissioner general of the URA, Annebritt Aslund, stated, another reason for Uganda's tax shortfall is the fact that the rich and politically well connected don't pay taxes.[4] The top individual income tax bracket in Uganda is 30 percent. That rate may encourage some individuals to avoid payment—especially given the low quality of services that Ugandans expect to receive in return. Similarly, Uganda's corporate tax, which amounts to 42.9 percent of gross profit, is quite high and may encourage tax evasion as well as discourage investment in the formal economy. Fast-growing economies tend to have a lower tax burden. Hong Kong's corporate tax, for example, amounted to only 14.3 percent of gross profits in 2005.[5]

Uganda's public expenditures should also be fixed. Last year the government spent 11 percent of its annual budget, or US$200 million, on the military.[6] However, about 20 percent of that amount, or US$40 million, was lost to corruption.[7] The army payroll includes thousands of "ghost soldiers," whose salaries go straight into the pockets of the army officers. It is apparent that Uganda spends too much on the military. After all, the government had almost wiped out the rebels from the Lord's Resistance Army by 1992, when military spending was about one-fifth of the current amount. The government also spends 12.5 percent of its annual budget on public administration that is mostly political patronage.[8] Uganda has 68 cabinet ministers, 73 presidential advisers, a stadium-sized parliament, and numerous local governments, which in the last year alone increased from 56 to 80.[9]

Corruption in Uganda is endemic. For example, a 2004 study by Ritva Reinikka from the World Bank and Jakob Svensson from Stockholm University found that 20 percent of Uganda's total public expenditure went for education in the mid-1990s. However, only 13 percent of Uganda's sizable education budget ever reached the schools. The rest "was captured by local officials (and politicians)."[10] Not surprisingly, a study by Uganda's own Ministry of Finance concluded that expenditure on political patronage could be cut by 50 percent and the country would get better services at a cheaper price.[11]

Uganda does not need more foreign aid. Rather, it needs to improve its tax administration by investing in better staff and motivating them with better pay and better facilities. It needs to tackle the problem of tax evasion by the rich and well connected. Most important, the government needs to put into place incentives for people to pay taxes. Those include a substantial reduction of Uganda's tax rates, which currently punish hard work and entrepreneurship, and a dramatic improvement in the delivery of services. Taxpayers ought to receive the services they pay for, or they should be allowed to opt out and pay for service delivery by the private sector. The government also needs to replace its profligate military and public administration expenditures with prudent fiscal policy.

Why does the government of Uganda not implement these seemingly simple and beneficial reforms? A large part of the answer lies in the incentive structure that foreign aid creates. To start with, taxation is a politically contentious issue—people don't like to pay taxes. Why would any government antagonize key political and business allies in the name of tax collection when international donors are forever willing to pick up the bill?

Moreover, foreign aid acts as a subsidy for government corruption and incompetence. It creates disincentives to reform tax administration and to streamline public expenditure. If donors began to turn off the aid taps, the government of Uganda would likely be forced to reform its imprudent fiscal policies or stare regime collapse in the eye. When dictators in Africa have plundered their economies, they have often found themselves in fiscal crisis. Difficulties in meeting their public expenditure needs have often sparked political struggles for reform. Many of the regimes on the continent have been saved from political collapse by foreign aid. Politically, therefore, foreign aid undermines democracy and government accountability. A smart international response to Africa's problems would involve measures that induce African governments to be more fiscally responsible, not more fiscally dependent.

Many of the regimes on the continent have been saved from political collapse by foreign aid.

Between 1960 and 2003, some US$568 billion (in 2003 dollars) poured into Africa,[12] yet the continent has been growing poorer, not richer. Many promoters of foreign aid argue that the problem is not aid itself but how the aid is used. It is important to examine the logic behind aid, however. More money may not be the best solution to poverty for the simple reason that capital is a byproduct of the development process, not its prerequisite. True, even when African politicians and bureaucrats steal much of it, aid can occasionally help. Part of it is sometimes used to build a school here, feed a hungry village there, or deliver medicines to a village full of diseased peasants. It is important to note that such aid can achieve only short-term humanitarian objectives. In the long

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term, aid can stifle domestic reform and, consequently, undermine the basis for long-term economic growth and prosperity.

To hold and retain power, all governments need to deliver particular benefits to specific groups, who form the basis of their political survival. Narrowly, those benefits may include paying the military and intelligence services, the civil servants, and the political hangers-on of the regime. Broadly, they include providing social services, such as education and health, and the construction and maintenance of infrastructure. All those services require money. If the source of that money is the private sector, the government is more likely to govern in a more enlightened fashion out of self-interest. The need for resources will induce the government to negotiate with local and foreign investors about policies and institutions necessary for growth and increased productivity and thus more revenue.

The problem in many African countries is that governments look for revenue not in the domestic economy but in the pockets of international donors.[13] Rather than listen to investors and other constituencies regarding their policy and institutional needs, many governments find it easier to negotiate with international creditors for foreign aid. In that manner, foreign aid impedes the emergence of a mutually beneficial relationship between the government and the citizens. It also encourages a dependence mentality among politicians and bureaucrats, so that every time there is a fiscal shortage, they are inclined to look for aid, rather than for policies and institutions that favor economic growth. Aid thus undermines long-term growth.

Debt Cancellation Leads to More Government Borrowing

Debt cancellation causes similar problems. In theory, debt cancellation is supposed to ease the debt service burden and release badly needed revenue to finance basic health services, education, clean water, and infrastructure. That theory is based on the naïve assumption that when countries are forgiven their debts their governments employ the saved resources for the benefit of the poor. In 1996 the IMF and World Bank unveiled the Heavily Indebted Poor Countries debt relief initiative with much fanfare, and the world celebrated. However, the law of unintended consequences applies to debt forgiveness as well. Uganda may, again, serve as an example.

Uganda was the first country to benefit from the HIPC initiative. When it qualified for HIPC status, Uganda's total debt stock was about US$3.2 billion. Under both the "original" (1998) and the "enhanced" (2000) HIPC program, Uganda got debt relief to the tune of US$2 billion. That is, nearly two-thirds of the country's debt was written off. However, the justifications for Uganda's qualification for HIPC were seriously flawed and went against economic principles and basic common sense. The World Bank argued that Uganda "deserved" debt relief because government had created a "good policy environment" through macroeconomic policy reforms that led to impressive and sustained economic growth rates for over a decade. On the flip side, the World Bank argued that Uganda "needed" debt relief because its debt burden was unsustainable and not only was going to undermine future economic growth but also was going to put economic reforms in jeopardy.

If Uganda "deserved" debt relief, then it should not have "needed" it. When a government implements good reforms leading to high growth rates, those growth rates should then enable the government to meet its obligations to its creditors. Conversely, countries that need debt relief often don't deserve it because they have pursued wrong-headed economic policies. In such cases, debt relief could encourage them to continue down the wrong path.

More important, debt cancellation can lead to moral hazard. One government may borrow, work hard, and use the loan in a productive way that allows it to repay the loan. Another country may also borrow but allow the politicians and bureaucrats to steal and misuse the money. When it fails to repay the loan, international donors forgive it. Such an approach penalizes good performers and rewards corrupt and incompetent borrowers. It does not create the right incentives for better loan management. Debt cancellation induces governments to think that they can borrow and spend money in any way they like without paying the price for their actions. Throwing money at governments is certainly not the right way to make them fiscally prudent. Easy money can turn even potentially responsible governments into reckless spenders. Instead of using resources saved from debt cancellation to improve the welfare of poor citizens, governments may be tempted to squander them on ostentatious consumption.

In Uganda's case, debt relief served as a license for the government to borrow even more. As Table 1 shows, in the six years before HIPC, foreign aid to Uganda averaged US$593 million per year. In the six years after HIPC, it averaged US$783 million per year. That means that, after HIPC, foreign aid inflows to Uganda increased by 32 percent.

Following the HIPC initiative, donors increasingly moved away from loans and toward grants. In 2001, for example, 60 percent of total foreign aid inflows into Uganda were in the form of grants (i.e., free money). The rest came in the form of highly concessionary loans from multilateral donors like the World Bank. In spite of that generosity, Uganda's external absolute debt—all of which was public or publicly guaranteed—substantially increased (Table 2). Uganda's relative debt (debt/GDP) also increased and reached a peak in fiscal year 2002–03. Uganda's relative debt has fallen since then, but the IMF and the World Bank warned that Uganda's debt was unsustainable as recently as 2004.[14]

From independence in 1962 to 1998, Uganda's debt grew to US$3.2 billion. In the five years following the HIPC debt relief of US$2 billion, the debt rose to US$4.9 billion. Uganda did not accumulate that debt burden because of "mismanagement" under the brutal regime of Idi Amin. On the contrary, over 90 percent of Uganda's debt was incurred during the implementation of World Bank– and IMF-sponsored economic reform policies of stabilization and structural adjustment, beginning in 1981. If those policies had worked as their advocates argued, Uganda should have been able to pay its way out of debt.[15]

Let us now look at the unintended consequences of debt relief. Immediately after Uganda's debts were forgiven under the HIPC initiative, the government indulged the political elite and the military. It bought a private jet for the president at a cost of US$35 million.[16] The government also

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Table 1
Gross Inflows of Foreign Aid before and after HIPC (adjusted for inflation)

Inflows of Aid before HIPC		Inflows of Aid after HIPC	
1991–92	US$509m	1997–98	US$842m
1992–93	US$696m	1998–99	US$795m
1993–94	US$508m	1999–00	US$700m
1994–95	US$651m	2000–01	US$666m
1995–96	US$668m	2001–02	US$849m
1996–97	US$525m	2002–03	US$847m

Source: Uganda, Ministry of Finance, Planning and Economic Development, "Background to the Budget," 1999–92 through 2002–03.

Table 2
Key Indicators of Uganda's External Debt in Millions of U.S. Dollars (adjusted for inflation)

	2000–01	2001–02	2002–03	2003–04	2004–05
Total debt stock	3,574.8	3,785.8	4,284.2	4,510.0	4,874.9
Total debt service	164.7	133.6	172.0	179.7	192.1
Debt service after HIPC	90.3	53.2	78.8	97.0	96.6
Savings from HIPC	74.4	80.4	93.2	82.7	95.5
Ratio of debt stock to GDP	63.2%	64.8%	68.5%	63.2%	56.2%

Source: Uganda, Ministry of Finance, Planning and Economic Development, "Background to the Budget," 2005–06.

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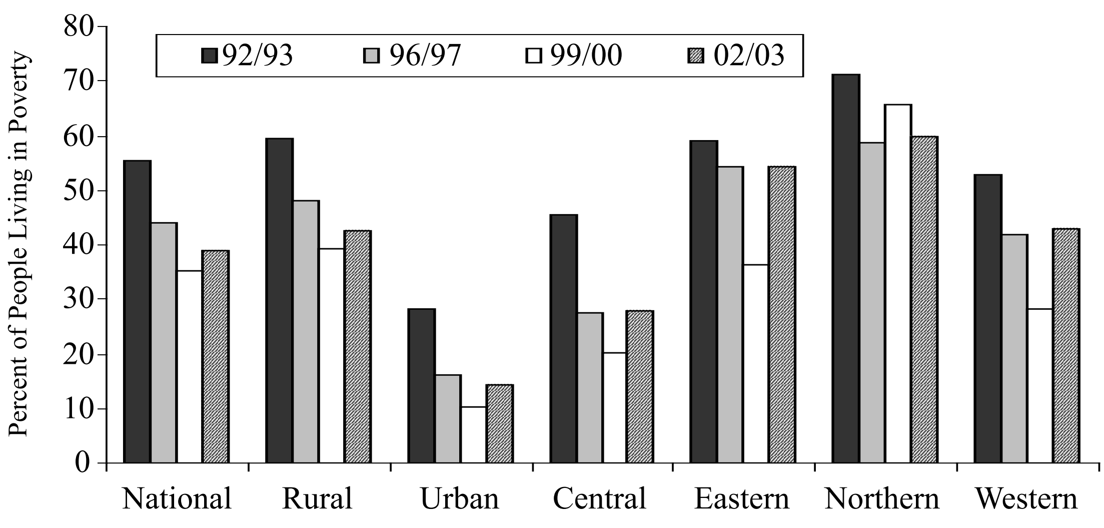
launched military adventures in Sudan and Congo. Consequently, Ugandan military spending almost doubled from US$110 million in 2000 to US$200 million in 2005.[17] Military corruption skyrocketed while the civil war in northern Uganda worsened. The government also increased expenditures on public administration (i.e., political patronage). The Ministry of Finance "Public Expenditure Review" of 2002 showed that the costs of political patronage increased by 16 percent per annum from 1998 on.[18]

Uganda's experience is important because it demonstrates the weakness of the arguments for more aid and debt forgiveness. The World Bank and the IMF argue that Uganda has one of the best policy environments in sub-Saharan Africa. Both institutions also maintain that Uganda has the highest return on each dollar of foreign aid spent. If Uganda's behavior is the best, it is discouraging to think about the rest of Africa.

Indeed, there is no evidence of a positive relationship between increasing aid and debt forgiveness on the one hand and poverty reduction on the other. Poverty in Uganda

Figure 1
Uganda's Poverty Indicators since the Early 1990s



Source: World Bank, *From Conflict to Sustained Growth and Deep Reductions in Poverty* (Washington: World Bank, 2004).

had been declining steadily between 1992 and 1999.[19] However, since the debt relief in 1998 and the increase in foreign aid, poverty has begun to increase again (Figure 1).

Economic Reform, Not Aid, Will Reduce Poverty

In the years prior to the debt relief and foreign aid increase, Uganda experienced high rates of economic growth and poverty reduction. That growth was partly due to the price of coffee on the international market, which increased from US$0.87 per kilogram in 1992 to US$2.58 in 1995. But it was also a result of the economic liberalization of coffee marketing in 1992, which allowed farmers to receive a higher percentage of the international price of coffee. Additional reforms included the removal of import bans and export taxes, the abolition of many licensing requirements, the reduction of import tariffs, and the flotation of the Ugandan shilling.[20]

Why did those reforms take place? According to the World Bank, the Museveni government "initially embraced liberal reforms out of economic desperation."[21] Indeed, after nine years of civil war and conflict with Tanzania, Uganda's economy was in ruins. For example, Uganda's GDP per capita in constant 2000 dollars fell from US$177 in 1982 (the first year for which data are available) to US$158 in 1986. Because reforms were gradual, the positive consequences of initial economic reforms strengthened the position of the reformers and enabled them to continue down the reformist path. Although the World Bank points out the "important" role of the international donors as "external catalysts" of economic reforms, it acknowledges that "the main commitment to reform came from the [Ugandan] bureaucracy."[22]

The rapid economic expansion that Uganda experienced during the mid-1990s came to an end for a number of reasons. The fall in the price of coffee to US$0.89 per kilogram in 2005 undoubtedly contributed to Uganda's economic slowdown and increase in poverty. However, a 2005 World Bank study of Uganda's poverty eradication programs points to additional reasons. Persistent insecurity in the north of the country that is ravaged by civil war and high mortality due to the spread of HIV/AIDS have been blamed for making poverty worse. The World Bank also found that public expenditure tended to benefit public administration and defense officials.[23] Moreover, the government's liberalization drive, which was partly responsible for the rapid economic growth in the 1990s, has waned. According to the *Economic Freedom of the World: 2005 Annual Report,* published by the Fraser Institute in Canada, though economic freedom in Uganda increased from 2.9 in 1990 to 6.5 in 2000,[24] it has not moved up since then.[25]

Uganda's experience shows that debt cancellation, like its sister policy of increased aid, does not necessarily help the poor. Instead, such unearned income leads to an expansion in unnecessary government spending and bureaucracy, and a reduction in government accountability. Ultimately, that bodes ill for economic growth, even in a country like Uganda that has so far experienced decent growth rates. What Uganda needs is to continue down the path of economic reforms. The government should adopt policies that contribute to economic growth. Those policies should include tax reduction, increased protection of private property rights, further trade liberalization, and deregulation.[26] Further reforms will contribute to making the Ugandan economy more vibrant and resilient to the changes in the price of commodities such as coffee.

Of course, for further reforms to happen, the government must become more responsive to the needs of private citizens and producers. Unfortunately, much of the aid community is ignorant of the obstacles facing Uganda's private sector. Thus, on June 12, 2005, the G8 agreed to cut Africa's debt and to double aid to the continent. Under the deal, 80 percent of Uganda's total debt of US$ 4.9 billion will be canceled. Upon hearing the news, the govern-

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ment increased the number of administrative districts in the country, which serve as the main instrument of political patronage, from 56 to 80. That move increased public administration expenditures by US$120 million.

Conclusion

Democracy forces governments to be more accountable and pursue policies that improve the welfare of the citizens. When looking for the money needed to pay for those policies, governments can listen to domestic constituencies that include the private sector and put into place policies that expand output. Increased output, combined with trade liberalization, then allows producers to sell their goods abroad and become more prosperous in the process. Moreover, when governments negotiate with domestic constituencies, they become more democratic. Alternatively, governments can rely on debt forgiveness and increased aid to provide cheap resources needed to sustain corrupt and incompetent regimes in power. When that happens, both economic development and freedom take a beating. Foreign aid and debt cancellation undermine Africa's democratization and economic recovery. They should be discontinued.

Notes

1. Commission for Africa, *Our Common Interest: Report of the Commission for Africa* (London: Commission for Africa, March 2005), pp. 143–45, 151, 260–61, 265–66.

2. World Bank, *From Conflict to Sustained Growth and Deep Reductions in Poverty* (Washington: World Bank, 2004), p. 5.

3. See Uganda Revenue Authority, *Corporate Plan,* September 25, 2003, p. 9, www.ugrevenue.com/pdfs/corpplan2-3.pdf. See also "Uganda Roots Out Tax Corruption," *British Broadcasting Corporation Online,* March 15, 2002, http://news.bbc.co.uk/2/hi/business/1873529.stm.

4. Quoted in Andrew Mwenda, "Africa: Foreign Aid Sabotages Reform," *International Herald Tribune,* March 8, 2005.

5. World Bank, *Doing Business in 2006* (Washington: World Bank, 2005), pp. 128, 157.

6. Uganda, Ministry of Finance, Planning and Economic Development, *The Uganda Budget 2004/2005: A Citizen's Guide* (Kampala: Ministry of Finance, Plan-ning and Economic Development, 2005), p. 7, www.finance.go.ug/citizensGuide/citzens%20guide.pdf.

7. See Mwenda, "Africa."

8. See Uganda, Ministry of Finance, Planning and Economic Development, *The Uganda Budget 2004/2005: A Citizen's Guide.*

9. See Mwenda, "Africa."

10. Ritva Reinikka and Jakob Svensson, "Local Capture: Evidence from a Central Government Transfer Program in Uganda," *Quarterly Journal of Economics* 119, no. 2 (May 2004): 679.

11. Uganda, Ministry of Finance, Planning and Economic Development, *Public Expenditure Review: Confidential Report to the Minister* (Kampala: Ministry of Finance, Planning and Economic Development, May 2004).

12. William Easterly, "The Utopian Nightmare," *Foreign Policy,* September–October 2005, p. 61.

13. Some African governments rely on the extraction of natural resources for revenue. This natural resource "curse" has proved to be an important obstacle to economic development in resource-rich African countries. But it is not impossible for a determined government to escape the natural resource curse. Botswana, for example, was able to combine revenues from resource extraction with high rates of economic growth and respect for human rights and the private property of its citizens. See Scott A. Beaulier, "Explaining Botswana's Success: The Critical Role of Post-Colonial Policy," *Cato Journal* 23, no. 2 (Fall 2003): 227–40.

14. World Bank and International Monetary Fund, *Debt Sustainability Analysis,* Confidential report for the government of Uganda, 2004.

15. For information on how conditional lending generally fails to achieve its goals, see Paul Collier, "The Failure of Conditionality," in *Perspectives on Aid and Development,* ed. Catherine Gwin and Joan M. Nelson (Washington: Overseas Development Council, 1997), pp. 51–77.

16. "IMF Settles Uganda Plane Row," *British Broadcasting Corporation Online,* May 2, 2000, http://news.bbc.co.uk/2/hi/africa/732971.stm.

17. Andrew Mwenda, "Uganda Debt Trap: Between Donors and Government, Foreign Aid Is Lost

along the Way," *Daily Monitor* (Kampala, Uganda), July 19, 2005.

18. Chris Kassami, "Budgetary Aspects of Public Administration," Paper presented at a Public Expenditure Review meeting in Kampala, Uganda, May 21, 2002.

19. The levels of poverty in Figure 1 are measured in terms of "per capita cost of purchasing of specific basket of food items" and "essential non-food" items. For a more thorough discussion of the methodology, see World Bank, "How Should We Assess Poverty Using Data from Different Surveys?" September 1996; and Simon Appleton, "Regional or National Poverty Lines? The Case of Uganda in the 1990s," World Institute for Development Economics Research, Helsinki, December 2003, p. 14.

20. World Bank, *From Conflict to Sustained Growth and Deep Reductions in Poverty,* p. 12.

21. Ibid., p. 8.

22. Ibid., p. 7.

23. World Bank, "International Development Association Program Document," report no. 34382-UG, December 13, 2005, p. 12.

24. Economic freedom is measured on a scale from 0 to 10, where 10 represents the highest measured level of freedom and 0 represents the lowest measured level of freedom.

25. James Gwartney and Robert Lawson, *Economic Freedom of the World: 2005 Annual Report* (Vancouver: Fraser Institute, 2005), p. 163.

26. Ibid.

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