



**An analysis of the absorption capacity of Official Development Assistance in
Kenya from 1981 to 2010 and its relationship with Economic Development**

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ABSTRACT

One of the key components of development funds for Kenya is Official Development Assistance (ODA). However, given ODA's general underwhelming nature and overall ineffectiveness in fostering economic development, it would be useful to consider absorption capacity as the best measure of how well aid to Kenya is working, and not just the gross amount of ODA flows to Kenya. That is the basis of this research. The research utilized time series data obtained from the World Bank aggregator, using a time period of 30 years i.e. 1981 to 2010. The dependent variable in this research is GDP growth rate, which indexes economic development. The absorptive capacity was found to display a mean reverting trend, with an average of 87% over the past 30 years. Thereafter, an Autoregressive Distributed Lag model was used to determine the long run relationship between ODA absorption and economic development. The results of the model showed that the absorptive capacity of ODA negatively influences economic development in the current time period, but it has a positive and significant influence on economic development in the next time period. However, in the long run, the relationship between the two variables is statistically insignificant, meaning that the relationship between the two cannot be determined to be a result of anything but mere chance.

Contents

1	INTRODUCTION.....	- 1 -
1.1	Background	- 1 -
1.2	Statement Of The Problem	- 4 -
1.3	Research Objectives	- 5 -
1.4	Research Questions.....	- 5 -
1.5	Purpose Of The Study	- 5 -
2	LITERATURE REVIEW.....	- 7 -
2.1	Introduction.....	- 7 -
2.2	Empirical Literature Review	- 7 -
2.3	Theoretical Literature Review.....	- 12 -
3	RESEARCH METHODOLOGY.....	- 22 -
3.1	Research Design.....	- 22 -
	Table 2-Description of Variables	- 23 -
3.2	Model specification.....	- 23 -
3.3	Population sample and sampling techniques.....	- 24 -
3.4	Data collection methods	- 25 -
3.5	Data analysis and presentation.....	- 25 -
4	DATA ANALYSIS AND INTERPRETATION	- 27 -
4.1	Description of key variables	- 27 -
	Stationarity.....	- 29 -
4.2	Results.....	- 29 -
4.2.1	Objective 1: trend of ODA absorption overtime	- 29 -
4.2.2	Objective 2: impact of ODA absorption on economic development	- 30 -
4.2.3	Objective 3: Impact of net ODA flows on economic development.....	- 34 -
5	DISCUSSION, CONCLUSION AND RECOMMENDATIONS.....	- 39 -
5.1	Discussion and Conclusion	- 39 -

5.1.1	Objective 1: determine the average absorptive capacity of ODA and observe it's trend overtime	- 39 -
5.1.2	Objective 2: impact of ODA absorption on economic development	- 40 -
5.1.3	Objective 3: impact of official development assistance on economic development	- 40 -
5.2	Recommendations	- 41 -
5.3	Limitations To The Study	- 42 -
5.4	Areas For Further Study	- 42 -
6	REFERENCES	- 43 -
	Bibliography	- 43 -

1 INTRODUCTION

1.1 Background

According to the Organisation for Economic Co-operation and Development, Official Development Assistance (ODA) can be defined as those flows to countries and territories on the Development Assistance Committee List of ODA Recipients and to multilateral institutions which are provided by official agencies, including state and local governments, or by their executive agencies. Each transaction is administered with the promotion of the economic development and welfare of developing countries as its main objective. Additionally, each transaction is concessional in character and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent)."

There are two main characteristics of ODA, according to Sengupta (2002). First, ODA is provided directly to developing countries, or indirectly through multilateral agencies, by the official authorities of the industrial countries at their discretion, motivated by their own interests or objectives and not determined by market returns. Second, ODA is provided on highly concessional terms, almost 90 per cent as grants and at low interest for long periods if given as loan. Due to both these characteristics, ODA becomes particularly attractive to developing countries as a source of financing.

Sengupta adds that ODA remains one of the most effective ways through which development in low income countries can be promoted; this is due to their weak financial institutions, underdeveloped physical infrastructures and failing market prices.

There have been varying attitudes towards aid for a significant amount of time; as Easterly (2003) puts it, the discussion on the effectiveness of aid is like a 'hot football'. Pedersen (1996) argues that it is not possible to conclude that the foreign aid has a positive impact on growth. Morrissey (2001) claimed that aid works well conditional on

other variables in the growth regression. Mosley (1987), and Boone (1996), and Jensen & Paldam (2006) found evidence to suggest that aid has no impact on growth. Burnside & Dollar (2000) conditioned the effectiveness of aid on good policies being adopted by the parent country; they indicate that aid which is managed multilaterally in developing countries only works in the presence of good policies.

However, Majority of scholars are focusing on relationship between Aid and growth and but fail to account for absorption

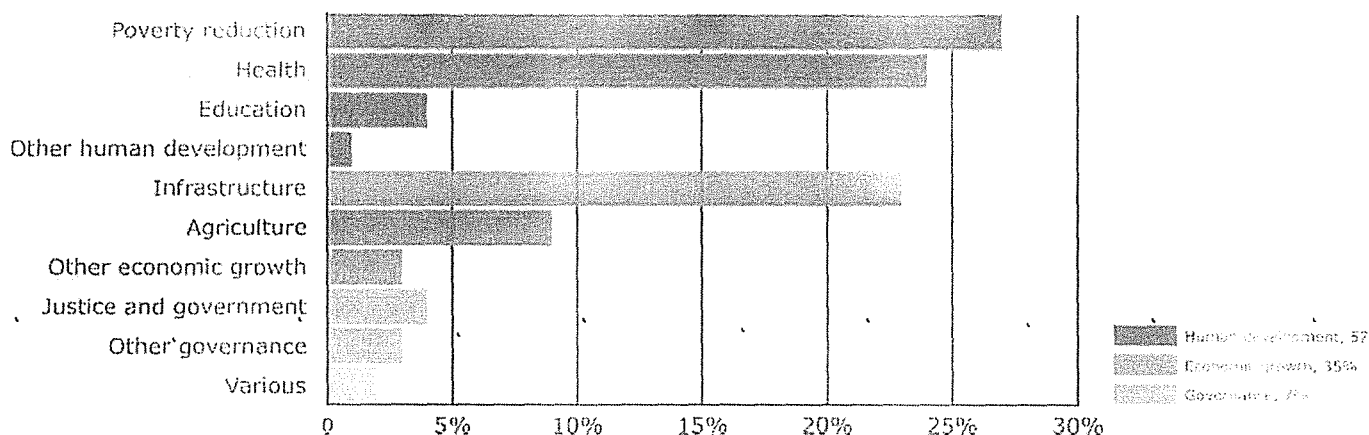
Donors have multiple objectives in providing foreign assistance to poor countries. Aid is motivated in part by donors' foreign policy objectives; for example, much U.S. aid goes to Egypt and Israel to maintain peace in the region. Aid is also motivated by commercial concerns and is often granted conditional on the funds being used to purchase goods or services from firms in the donor country Moreira (2005).

Kenya falls under Moreira's classification of poor countries, owing to the fact that 20% of its 39.8 million population lived under the 1.25 dollar a day income poverty line in 2005 (World Development Indicators, 2011). This factor, coupled with the stunted economic development and political instability that resulted from the 2008 elections-related violence, has increased the need for ODA over the past 10 years.

It has been the Kenyan Government's intention to engage its bilateral and multilateral development partners/agencies to extend concessional loans and grants for financing development projects; a feat in which it has achieved some level of success, because Official Development Assistance has accounted for some level of growth of in Kenya; Net official development assistance (ODA) to Kenya totaled USD 1778 million. Since 2005, net ODA has averaged 5% of gross national income (GNI) and 23% of central government expense (WDI, 2011). In 2010, the top five donors contributed to 62% of Kenya's core ODA. (Kenya aid effectiveness, 2012)

The following is a graphical description of the main sector beneficiaries of EU ODA funds, retrieved from a report on European Union Aid in Kenya:

Figure 1-EU sectorial funds



Absorption capacity is an indicator which corresponds to the competence of a country to spend efficiently and effectively financial resources allocated by development partners (Litra, Gaibu, Lozovanu, & Girbu, 2011). The cycle of funds utilization involves several phases of financial flows, each of them having their own absorption capacity. Furthermore, Litra qualifies that absorption capacity is determined by three main factors: **Macroeconomic absorption capacity, financial absorption capacity, and administrative absorption capacity.**

Litra carried out a case study on absorption capacity in Moldova between 2006 and 2010; Litra chose the year 2006 because it is the year in which Moldova joined the 2005 Paris Declaration on Aid Efficiency, and also because development partners committed to provide USD 1.2 billion in the framework of Advisory Group Meeting of donors for Moldova. Litra found that the Government of Moldova was able to contract projects of EUR 1.2 billion out of the EUR 1.8 billion earmarked by the donors, which translates to 66%. According to a study carried out by the Romanian National Bank in 2008, only 0.42 billion of the 1.28 billion allocated by the EU was drawn from the budget, putting the absorption capacity of EU funds by Romania at 32.7 %. Georgescu (Georgescu, 2013) did a study on the determinants of EU funds absorption rate in the same country and found that the determinants are related to are related to the availability of internal resources for projects cofinancing, adequate administrative capacity at central and local

levels, appropriate interinstitutional coordination and public-private partnerships, high skills and motivation of human resources working in operational programs Management Authorities and intermediary bodies.

According to a report by the Kenya Aid Effectiveness Group, there are a number of issues affecting the absorption of ODA in Kenya. They include procurement related challenges; specifically lengthy procurement processes and lack of expertise in donor procurement processes, inadequate planning and poor coordination among Development Agencies, weak linkages between the Treasury and the implementing agencies, weak and delayed reporting on budgeting and expenditure returns, and stringent conditionalities associated with development partners. Additionally, there are issues which affect ODA disbursement. One of the issues is lengthy disbursement procedures; for example, The World Bank requires 15 steps to be involved in the process. Additionally, the Aid Effectiveness Group found that the ministries were not rationalizing the budget for donor financed projects, and neither were they adhering to work plans when budgeting for donor financed projects. These are some of the key challenges that affect the effectiveness of ODA in Kenya.

1.2 Statement Of The Problem

As a developing country, Kenya is in dire need of investment and development funds to be channeled towards development initiatives that would likely empower Kenyans towards the achievement of Vision 2030 and the Millennium Development Goals. One of the key components of development funds for Kenya is Official Development Assistance (ODA). However, ODA has been underwhelming at best; some level of foreign aid has been left unaccounted for, and it has posed the argument of whether amount of aid flows is the best indication for effectiveness of aid. Given the continued evident ineffectiveness of aid, it would be useful to consider absorption capacity as the

best measure of how well aid to Kenya is working, and not just the gross amount of ODA flows to Kenya.

It has been the intention of the Kenyan Government to absorb at least 80% of Official Development Assistance (ODA) funds budgeted in a Financial Year, and this has been made necessary in order to achieve the Government's commitments in terms of sustained economic growth and improved standards of living for all Kenyans.

The aim of this research is to analyse the absorption rates of ODA by Kenya over the past 10 years. The absorption capacity is going to serve as a measure of how effective foreign aid to Kenya is; specifically, the competence of the Kenyan government to disburse and utilize resources is going to be tested under this framework.

1.3 Research Objectives

The following objectives will guide the study:

1. To determine the absorptive capacity of foreign aid.
2. To analyse the relationship between GDP growth and the long term ODA absorption capacity.
3. To analyse the relationship between economic development in Kenya and foreign aid and its sign, measured against the millennium development goals.

1.4 Research Questions

1. What is the absorptive capacity of ODA?
2. What is the sign of the relationship between GDP growth and Kenya's absorptive capacity?
3. What is the sign of the relationship between GDP growth in Kenya and foreign aid?

1.5 Purpose Of The Study

Given that ODA is in line with the medium term plans and overall goals of the Vision 2030, it targets Government implementing agencies and donors as its industry of focus.

The purpose of this research is to establish the effectiveness of implementing agencies and donors alike in the process of ODA allocation and implementation; as a result, my aim would be to see my work contribute to research on how the process of ODA allocation and improvement can be improved. It is my wish that my paper would help to serve as a point of assistance to any of these two parties that want to improve their efficiency.

2 LITERATURE REVIEW

2.1 Introduction

This section provides a review of previous studies done on Official Development Assistance and its absorptive capacity, focusing on its effectiveness and the country's competence to utilize the aid.

Additionally, the literature review is going to be discussed under both an empirical framework and a theoretical framework.

2.2 Empirical Literature Review

This section of the literature review is going to discuss empirical studies conducted on the effectiveness of ODA as well as the concept of ODA absorption.

Burnside and Dollar (2000) set out to analyse the relationships among foreign aid, economic policies and growth per capita of GDP. They adopted a neoclassical growth model, and used a foreign aid database that had just been developed by the World Bank. Their empirical model set out to determine the effect of aid on economic policies and whether donor governments and agencies allocated more aid to countries with good policies; they set out to answer that question by looking at variants of the following equations:

$$g_{it} = \gamma_{it} + a_{it}\beta_a + p_{it}\beta_p + z_{it}\beta_z + g_t + \varepsilon_{it}^g$$

$$a_{it} = \gamma_y + p_{it}\gamma_p + z_{it}\gamma_z + a_t\varepsilon_{it}^a$$

Where i indexes countries, t indexes time, g_{it} is per capita real GDP growth, γ_{it} is the logarithm of initial real per capita GDP, a_{it} is aid receipts relative to GDP, p_{it} is a $P \times 1$ vector of policies that affect growth, z_{it} is a $K \times 1$ vector of other exogenous variables that might affect growth and the allocation of aid, g_t and a_t are fixed time effects and ε_{it}^g and ε_{it}^a are mean zero scalars.

Burnside and Dollar found that aid would be more effective if it were more systematically conditioned on good policy.

Moreira (2005) carried out a cross country evaluation of the impact of foreign aid on economic growth, focusing on the aid-growth relationship only at the macro level. Moreira's underlying theory was that a host of other factors apart from physical accumulation were known to affect economic growth, therefore the Harrod-Domar model and the Chenery and Strout two-gap model were seen to be effective.

The empirical model estimated by Moreira was given by the following form:

$$PCG_{it} = \beta_1(S_{it}) + \beta_2(ODA_{it}) + \beta_3(\Delta ODA_{it}) + \beta_4(ODA_{it}^2) + \beta_5(\Delta ODA_{it}^2) + \beta_6(PF_{it}) + \beta_7(OOF_{it}) + \delta(PG_{it}) + \rho(PCG_{i,t-1}) + \tau_t + X_{it} + w_{it}$$

Where $w_{it} = \mu_i + \varepsilon_{it}$, i indexes countries, t indexes time, PCG_{it} is per capita GDP growth rate, S_{it} are domestic savings relative to GDP, PF_{it} are private flows relative to GDP, OOF_{it} are other official flows relative to GDP, PG_{it} is the population growth rate, τ_t represents time period effects, X_{it} represents other growth determinants, w_{it} represents both country effects, and ε_{it} represents the remainder error term.

Moreira's results suggested that foreign aid contributes positively to economic growth as long as the aid to GDP ratio is not excessively high.

Ekanayanake & Chartna (2008) conducted a study to analyse the effects of foreign aid on the economic growth of developing countries, focusing on 85 countries. The effects were analyzed using panel data series for foreign aid, focusing on four different time periods (1980-1989, 1990-1999, 2000-2007 and the entire time period of 1980-2007) and accounting for regional differences in Asian, African, Latin American, and the Caribbean countries as well as the differences in income levels. When the model was estimated for different time periods, foreign aid variable has a negative sign in three out of four cases, indicating that foreign aid appears to have an adverse effect on economic growth in developing countries. When the model was estimated for different regions,

foreign aid variable has a negative sign in three out of four cases, indicating that foreign aid appears to have an adverse effect on economic growth in developing countries. However, this variable is positive for African region indicating that foreign aid has a positive effect on economic growth in African countries. Ekanayake and Chartna attribute this exception to Africa being the largest recipient of foreign aid as compared to the rest of these regions. These results show a mixed impact of foreign aid on economic growth of developing countries.

Mwega (2009) carried out a case study on aid effectiveness in Kenya, focusing on aid volatility and fragmentation in the Kenyan health sector. He found that foreign aid to Kenya is very volatile. Based on OECD-DAC data and measuring volatility by dividing the root mean squared error by the mean of the relevant aid flows during the corresponding period, volatility of aid (at current prices) was 24.1 percent compared to 17.2 percent for Africa and 13.9 percent for all developing countries during 1980-2006. He also found that fragmentation in Kenya, measured by the Hirschmann-Herfindahl Index, stood at 0.1 compared to 0.3 for all developing countries and 0.22 for Sub-Saharan Africa in 2006. Hence aid fragmentation is much higher in Kenya than is the case for Africa and developing countries in General.

Fasanya & Onakoya (2012) analyzed the impact of foreign aid on economic growth in Nigeria during the period of 1970-2012. Their model for aid-growth relationship follows the specification of the neoclassical growth model, which took the form:

$$Y(t) = F(K(t), A(t)L(t))$$

Additionally, they used the ADF to check the stationarity of the variables under study before proceeding with the OLS method, and subsequently found all variables to be stationary. These employed models provided enough evidence to show that foreign aid positively impacts economic growth in Nigeria.

Litra, (2011), in his analysis of absorption capacity of external assistance in Moldova, defined absorption capacity as an indicator which corresponds to the competence of a

country to spend efficiently and effectively financial funds allocated by development partners. In his analysis, he found that the absorption capacity of Moldova between the years 2006 and 2010 stood at 66, which is understood to be an improvement by Litra. Litra added that one can determine the real absorption capacity on concrete projects by looking at allocations on the Economic Survey that were direct budget support, and that the absorption rate was balancing between 40% and 50% (+/- 10%). Litra also identified inadequate administrative capacities as a major constraint to absorption, thus adding weight to the belief that administrative absorption capacity is where most developing countries fail.

Wild & Domingo (2012) conducted research on aid effectiveness and accountability in Uganda and Zambia. They subsequently found evidence of lack of attention paid (in both countries) to how the Sector Working approach frameworks and its accompanying mechanisms interacted with existing domestic accountability dynamics e.g. in terms of the capacity and strengths of parliamentarians or of civil society. Additionally, the study found that some of the mechanisms supported by the aid effectiveness agenda are not yet leading to meaningful shifts in the dynamics of domestic accountability. This highlighted the challenges facing accountability in absorption of aid in the two countries.

Another key finding that the same study found in relation to effectiveness of aid is that moments of crisis can provide both challenges and opportunities for strengthening accountability, including around aid. The corruption scandal in Zambia in 2009 posed challenges in that donors responded by freezing funds and reverting back to their own self-interest, but it also led to recognition of the capabilities of some domestic actors, including the Anti-Corruption Commission and the Auditor General, which were able to identify a problem and ensure steps were taken to address it.

Wild and Domingo believe that to date, the aid effectiveness agenda, derived from the Paris Declaration on Aid Effectiveness and the Accra Agenda for action, has been

premised on the assumption that accountability for aid combined with country ownership over development agendas will, in part, lead to better development results. However, they believe that there remains limited understanding of the types of accountability relations that should be prioritized, and the directions of accountability.

Juselius, Framroze & Tarp (2014) carried out an analysis of the long run impact of foreign aid in 36 African countries, drawing insights from multivariate time series analysis. The model they used was the Cointegrated VAR (CVAR) model. The main conclusion drawn from that study is that there is little evidence to support the thesis that 'aid is harmful' as some earlier researchers such as Lancaster (1999) had suggested.

2.3 Theoretical Literature Review

Absorption capacity can be defined as the extent to which a state is able to fully spend the allocated resources from the EU funds in an effective and efficient way. This capacity is necessary for making a contribution to economic and social cohesion (Vitek, 1999). Vitek was speaking from a point of the European Union, not taking into account other existing donors. Vitek further qualifies that based on past experiences; the commission had come to a conclusion that countries have a limited capacity to absorb external investment support effectively and efficiently.

The three factors which determine absorption capacity are as follows:

The first factor is **macro-economic absorption capacity**, measured in terms of GDP. Aid flows have an essential impact related to the balance of payments, exchange rates and the behavior of the macro economy in general (Litra, Gaibu, Lozovanu, & Girbu, 2011). Gaibu then qualifies that the macroeconomic framework of the Development Assistance Committee addresses issues such as Long-term debt sustainability, Cautious level of aid dependence and possible appreciation of the exchange rate.

The second factor is **financial absorption capacity**: which he defined as the ability to co-finance EU-supported programmes and projects, to plan and guarantee these national contributions in multi-annual budgets, and to collect these contributions from several partners interested in a programme (state, regional and local authorities, private bodies) or project. (Litra, Gaibu, Lozovanu, & Girbu, 2011) explain the factors that influence financial absorption capacity as: *Co-finance requirements of the donors, co-finance ability of central and local authorities, multiannual contributions capacity required to repay finances, and co-finance ability of the private sector that can be attracted in public private partnership.*

Administrative capacity is the third mentioned factor, which he defined as the ability and skill of central, regional and local authorities to prepare suitable plans, programmes and projects in due time, to decide on programmes and projects, to arrange the coordination among principal partners, to cope with the administrative and reporting

requirements, and to finance and supervise implementation properly, avoiding irregularities as far as possible. The capacity is determined by design of the whole implementation system and also by its functioning (operationalization of rules) . According to Lozovanu and Girbu (2011), the analysis of administrative absorption capacity can be carried out in two dimensions; the first dimension is concerned with the institutional framework of the management of foreign assistance, and the second dimension is focused on aspects related to the implementation of the foreign assistance projects, including: 1) Preparation, elaboration and implementation of the projects, and 2) Performance in public service, financial management and public procurement.

According to Sumpikova, Pavel & Klazar (2004) Council of the EU has expressed its concern regarding the administrative capacity of the Candidate Countries in 2001 and defined many problems remaining to be solved in several CC in relation to the preparations for Structural/cohesion funding. One of the problems consists in the lack of a definition of responsibilities in terms of programming and managing EU funds, which would clearly reflect the requirements of Council Regulation (EC) 1260/99. In a summary of a research they carried out on aid effectiveness and absorption capacity in the Czech Republic, they concluded that in spite of the huge amount of money was spent for the improvement of absorption capacity of the candidate countries, the capacity of regional and local implementation structures in the Czech Republic to work in programme bases environment is still insufficient in comparison with the indicatively planned EU financial sources.

According to Oprescu (2005), there was a methodology created by the European Commission at the beginning of 2002, which was afterwards used for the assessment of the absorption capacity of the accession countries. To begin with, three stages must be taken into account when managing structural funds:

1. Programming (Design): this can be defined as an input variable.

2. **Functioning:** this is the extent to which structural funds are effectively and efficiently managed.
3. **Performance:** this is an output variable, and can only be measured at the end of the programming period. It can also be defined as the extent to which structural funds *were* efficiently and effectively managed.

The above considerations indicate that all that can be assessed more than one year before the likely date of accession is the planning, the design system of the institutional system which will be dedicated for the implementation of priorities and financial measures from Structural Funds.

Oprescu adds that the measuring of the administrative capacity involves the assessment of three elements, **structure, human resources, systems and tools**. **Structure** relates to the clear assignment of responsibilities and tasks to institutions or better at the level of departments or units within these institutions. This assignment refers to a range of structural funds tasks, including *management, programming, implementation, evaluation & monitoring*, and *financial management & control*. **Human resources** relate to the ability to detail tasks and responsibilities at the level of job descriptions to estimate the number and qualifications of staff, and to fulfill the requirement needs. This is due to the fact that securing the timely availability of experienced, skilled and motivated staff is a key success factor in the management of the structural funds, which conditions success of structural funds management. **System and tools** relate to the availability of instruments, manuals, systems, procedures, forms etc. In other words, these are all the job aids that can enhance the effectiveness of the functioning of the system.

Oprescu finalizes that all these factors are to be combined into forming a management capability grid, (MCG), which is as follows:

Table 1-Management Capability Grid

	Design (Programming)			Functioning	Performance
	Structure	Human Resources	Tools		
Management					
Programming					
Implementation					
Monitoring and assessment					
Financial Management and Control					

Oprescu believes that indicators for the optimal level of Financial Absorption capacity can be seen as early as the preparation stage, whereby there are a series of key factors related to the level of co-financing which can already be identified and analysed, as part of an early warning that may help increase the financial absorption capacity.

The idea of ODA was developed with particular objectives in mind, which are all unique to different projects and countries being supported by the program. Sengupta (2002) believes that these objectives point to a general consensus that they should be related to the overall development of poor countries. This serves as a major factor that can be used to measure the effectiveness of ODA.

The effectiveness of aid is measured by the OECD through 5 key principles of the Paris declaration, (Paris Declaration an Accra agenda for action, 2005). The first principle,

Ownership, stipulates that partner countries exercise effective leadership over their development policies and strategies, and coordinate development actors. **Alignment**, as a principle states that donors base their overall support on partner countries' national development strategies, institutions and procedures. The **Harmonization** principle requires that donors' actions be more harmonized, transparent and collectively effective. **Managing for results** is a principle that aims at managing resources and improving decision-making for results. **Mutual accountability** requires that donors and partners are accountable for development results

The Paris Declaration emphasizes the need to strengthen both donors' and recipient country governments' accountability to their citizens and parliaments, as well as the importance of timely and transparent information on aid flows. While the Paris Declaration emphasized the need for both donor and recipient country governments' accountability, the follow-up forum in Accra placed greater emphasis on domestic accountability and on the roles of specific actors, such as parliamentarians and civil society, which were seen as left out from the original discussions. (Wild & Domingo, 2012)

One of the prevalent theories underpinning effectiveness of ODA is that aid effectiveness is positively related to accountability of government and foreign aid agencies alike. For example, Svensson (2006) believes that foreign aid agencies, like most agencies in the public sector, face various incentive constraints that influence how they behave and how and why they prioritize the things they do. Three important constraints discussed are **multiple objectives, difficulties in measuring output and performance, and weak incentives**. Although these institutional features are common in the public sector, they are often more pronounced in donor agencies. This highlights a key constraint to aid effectiveness.

On a note on the effectiveness of foreign aid, Svensson added that geographical and political separation between the beneficiaries and the donors severely constrains

mechanisms of ODA absorption. Citizens in the donor country have no direct knowledge or experience of the programmes financed by the aid agency. Moreover, it's very costly for taxpayers in the donor country to obtain reliable information on the outcomes of aid programmes that they finance. Svensson adds that focus on volume rather than impact also influences the way aid agencies work. When aid officials are not held accountable for performance, their incentives to spend time and effort seeking out information about the success and sustainability of ongoing projects will be adversely affected.

Svensson also introduces a foreign aid dilemma, whereby good aid programmes are typically associated with high risk. The very reason why the recipient needs foreign aid is that its own institutions are weak, and this will affect the expected return to aid. Thus, to allocate aid only to recipients with well-functioning institutions and good policies will typically not be optimal if poverty alleviation is the dominant criterion for foreign aid.

Dehn, Reinnika & Svensson (2003) carried out two case studies on educational spending in Uganda and Tanzania and found out that in all governments, information on public spending at the front lines is seldom available. To remedy this problem, the public expenditure tracking survey (PETS) was designed; it was designed to follow the flow of resources through various government strata to determine how much of the originally allocated resources reach each level. This serves to increase accountability of aid flows within the two countries.

Sengupta (2002) believes that concessionality (as a characteristic of ODA) makes ODA more effective and valuable to low-income countries, as it allows them to use it for activities whose benefits are widely dispersed and cannot be captured to pay for its costs. Conversely, Sengupta argues that the effectiveness of ODA is hindered by the inability of developing countries to attract sufficient private capital from the international market. Sengupta believes that if the public sector of developing countries

5 DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Discussion and Conclusion

This section is going to discuss the findings that were communicated and interpreted in the previous chapter of the research.

The discussion is done according to the research objectives, which are:

1. To determine the absorptive capacity of foreign aid.
2. To analyse the relationship between GDP growth and the long term ODA absorption capacity.
3. To analyse the relationship between economic development in Kenya and foreign aid and its sign, measured against the millennium development goals.

5.1.1 Objective 1: determine the average absorptive capacity of ODA and observe it's trend overtime

The average absorptive capacity of ODA flows, denoted in US dollars, is 87.8%. This signifies a relatively good performance of duties by the ministries and implementing agencies in charge of disbursing funds to various projects, because it achieves the 80% absorption target set by the National Treasury of Kenya and the aid effectiveness group.

Additionally, the trend shows that the absorption capacity of ODA by Kenya reverts around the mean of 80%, signifying that Kenya's relatively good ability to disburse funds into projects has been constant since 1981.

These findings are inconsistent with the expectations of the aid effectiveness group, who have previously estimated the absorption rate to be an average of 50% since Kenya started receiving foreign aid from the DAC, as stated in various reports.

5.1.2 Objective 2: impact of ODA absorption on economic development

In the short run, there is a negative and significant relationship between economic development and current absorption capacity. The results of the model show that a one unit change in the ODA absorption/GDP ratio results in a 212,446.4 unit change in economic development. However, if you look at the lagged value of ODA, it can be determined there is a positive and significant relationship between ODA in the last period and economic development today; a one unit change in yesterday's absorption capacity results in a positive 212,979.5 unit change in economic development today. This shows that the rate at which absorption is absorbed today will reflect positively in economic development tomorrow, but reflects negatively in economic development today.

However, in the long run, the relationship between economic development and absorptive capacity is found to be statistically insignificant. This implies that in the long run economic development cannot be determined to be a result of the absorption capacity of foreign aid, but rather it could be a result of mere chance, which was inconsistent with my expectations that economic development would be influenced by the rate at which foreign aid is absorbed into the economy.

5.1.3 Objective 3: impact of official development assistance on economic development

In the short run, ODA has a negative and significant relationship with economic development, such that a one unit change in ODA results in a -123 unit change in economic development. However, the model also reveals that a one unit change in the lagged value of ODA [ODA (-1)] results in a 74 unit positive change in economic growth, signifying a positive relationship between economic growth and the last period's net ODA flows. Therefore, similar to the previous objective, it can be seen that foreign aid flows today will have a negative impact on today's economic development but will have a positive impact on tomorrow's economic development.

In the long run, the relationship between foreign aid and economic development is found to be statistically insignificant. This implies that in the long run economic

development cannot be determined to be a result of foreign aid flows, but rather it could be a result of mere chance, which was inconsistent with my expectations that economic development would be influenced by the net foreign aid flows in the long run.

5.2 Recommendations

The following are ways through which ministries and implementing agencies can improve aid disbursement in Kenya:

1. Adherence to procurement plans and work plans; this can be done by making project work plans and procurement plans as budgeting tools.
2. The Treasury can provide adequate counterparty funds upon receipt of cash in order to avoid a case of projects not having counterpart funds.
3. The ministries could rationalize the budget for donor financed projects in order to avoid overprovision of the budget for donor financed projects.
4. Standardization of community driven development programmes- The treasury will have to standardize the Fiduciary Arrangement Manuals for such programmes.
5. The Treasury ought to engage development partners to resolve the issue of delays in the issuance of no objections, which results in failure in achieving procurement plans. They can request the Development Partners to develop an 18 month procurement plan as stipulated in financial agreements.
6. The Treasury should ensure that tax exemptions for donor-financed projects are finalized within twenty-one (21) days.
7. The Government should issue a policy framework on the use of electronic means to process withdrawal applications to speed up the utilization of the project loan and grant resources.

5.3 Limitations To The Study

The nature of the variables did not allow me to use more than one lag in my Autoregressive Distributed Lag model, due to occurrence of a singular matrix.

5.4 Areas For Further Study

A panel data analysis on the absorption rate volatility of foreign aid flows across African countries would prove a useful study.

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