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Uganda: Poverty Reduction Strategy Paper—Joint Staff Advisory Note

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UGANDA

National Development Plan 2010/11–2014/15
Joint Staff Advisory Note

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I. OVERVIEW AND ISSUES FOR DISCUSSION

1. **This Joint Staff Advisory Note reviews the National Development Plan (NDP) 2010/11 to 2014/15 prepared by the Government of Uganda**. The NDP was approved by cabinet on February 17, 2010 and was submitted to the International Development Association (IDA) and the International Monetary Fund (IMF) on March 9, 2010.

2. **The NDP is the first in a series of six plans intended to move the country towards the national vision of a transformed modern economy in the next 30 years.** The five-year NDP will guide policies and resource allocation over the period 2010/11 to 2014/15.[1] The NDP succeeds the third Poverty Eradication Action Plan (PEAP) which expires in June 2010. During the PEAP era, the authorities conducted periodic reviews of implementation and outcomes. The last of such reviews was the Annual PEAP Implementation Review (APIR) issued in November 2007. The JSAN of the APIR was submitted to the Executive Boards of the World Bank and IMF on December 15 and December 16, 2008, respectively.

3. **The NDP expands on the vision of the earlier PEAPs, and was developed through an extensive and broad-based country-driven consultative process over the period 2008–2009**. Although the process took longer than expected, it combined a bottom-up and top-down approach through active consultations with the grass-root stakeholders, including at the local government level. Cabinet discussions helped to build greater ownership within Government prior to presenting the final NDP to Uganda's Parliament. The NDP, therefore, reflects a broad national consensus on the country's strategy for growth, social progress, and governance.

4. **The NDP broadens the strategic focus of the authorities from 'poverty reduction' to 'structural transformation' in order to raise growth and living standards.** In recent years, the authorities' policies have increasingly targeted a rise in potential growth and reduction in income poverty. Building on the achievements under the PEAP, the NDP aims at fostering

[1] The fiscal year starts July 1.

skilled employment growth and a sectoral shift to higher value-added activities. It gives the government a strategic role in this process by eliminating remaining, persistent barriers to growth and promoting private sector involvement in selected priority areas. The NDP identifies four priority targets: human resources development through health, education and skills building; boosting up physical infrastructure, particularly in the energy and transportation areas; supporting science, technology and innovation; and facilitating private access to critical production inputs, particularly in agriculture. Sixteen national 'flagship' projects are proposed to spearhead achievement of these targets.

5. **The development goals of the Ugandan NDP are well focused and well adapted to Uganda's current needs**. Both the macroeconomic framework and the sector-specific plans are generally compatible with the Government's long-term vision of structurally transforming the economy. The drive to boost public infrastructure, together with more focused sectoral interventions, will support growth and expand opportunities for the poor.

6. **Weak governance and exogenous shocks could affect implementation adversely.** In spite of progress with reforms aimed at strengthening public financial management (PFM), under-developed institutions, limited technical capacity and weak control mechanisms continue to constrain policy effectiveness in Uganda, fueling inefficiencies and corruption. Going forward, stronger commitment to structural reforms, in particular for governance and capacity enhancement, including decisive actions to increase transparency and accountability, will be critical to support growth and poverty reduction. The economy is also vulnerable to exogenous shocks, including recurrent droughts and other natural hazards, adverse terms-of-trade developments, and regional insecurity. The prospect of oil revenues over the medium term raises substantial additional institutional and governance challenges.

7. **Staffs recommend some measures to strengthen the NDP and enhance its implementation**. First, the many programs envisaged could be better prioritized and timed, and complemented by actions explicitly aimed at better integrating the lagging regions with the leading ones, so as to make growth more inclusive. Second, the implementation of the ambitious public investment program should be mindful of preserving space for private sector initiative and development. In this respect, the legal and fiscal framework for public-private partnerships (PPPs) could be reviewed and strengthened as needed. Lastly, given the importance of improving PFM and governance, indicators of performances in these areas could be usefully included in the NDP monitoring and evaluation plan consistent with the Joint Performance Assessment Framework indicators already used by the Government in the Joint Budget Support Framework. The World Bank and the IMF stand ready to support the authorities in designing policies to overcome the challenges and risks identified, with the collaboration of other development partners.

8. **Issues for Discussion:** In considering the NDP and this JSAN, do Directors concur with staff's identification of risks to the Plan? Do Directors agree with the staff's conclusions on areas in which the NDP could be strengthened during its implementation?

II. BACKGROUND

9. **Uganda has achieved an impressive record of prudent macroeconomic management and structural reform over the last two decades**. Per capita income grew at about 4 percent per annum over the past decade, and inflation has generally remained in single-digit territory, notwithstanding a number of shocks, including drought-related power shortages, surges in international food and fuel prices, and the recent global economic crisis. Fiscal deficits have been modest and public debt is low, due to debt relief and a cautious borrowing policy. Many of the best practices in development economics were first piloted in Uganda, including poverty reduction strategy papers (PRSPs), medium-term expenditure frameworks (MTEFs), and sector-wide approaches (SWAps). In addition, the authorities took the lead in requesting development partners to provide untied budget support as a way of strengthening national public finance management systems.

10. **The impact of the global economic crisis on the Ugandan economy has been less severe than originally expected**. Growth has remained impressive (around 6 percent) even in the face of the global downturn, thanks to buoyant regional demand, particularly for food in light of the regional drought; and supportive macroeconomic policies, including a flexible exchange rate regime. The financial system proved resilient as well, owing partly to Uganda's sound banking system and to its limited exposure to assets whose prices fell during the crisis.

11. **Employment growth in the non-agricultural sectors has helped reduce poverty.** The service sector has driven growth in Uganda over the past two decades, increasing its contribution to GDP from 35 percent to over 50 percent. Agriculture's share in GDP, in contrast, declined from 56 percent to 25 percent, while that of the industrial sector doubled to 26 percent over the same period. However, Uganda needs to spur productivity improvements in all sectors to bridge the income gap between rural and urban areas.

12. **Uganda will implement this NDP against the backdrop of significant political and social challenges.** President Museveni, who assumed power in 1986 after years of economic and political decay, is expected to seek a fourth term of office in 2011. The civil conflict in Northern Uganda seems to be coming to an end, fostering a revival of economic activity in that region. But regional and ethnic tensions could flare up if inequalities persist or widen. Uganda's population is young and growing rapidly, putting pressure on the government's ability to deliver the services needed for a healthy and educated labor force. Despite years of reform, PFM systems remain weak and recurrent governance problems risk eroding confidence. The recent discovery of oil is raising development opportunities together with significant macroeconomic, political and governance challenges. Full-scale production of oil is not expected to materialize until well beyond the NDP period.

III. POVERTY DIAGNOSTICS

13. **The NDP provides an adequate picture of Uganda's poverty profile, both spatially and across time.** The NDP draws on in-depth household surveys undertaken between 1992/93 and 2005/06, poverty maps detailing spatial trends of poverty over this period and complementary analyses on poverty and inequality carried out by the World Bank to provide a

comprehensive picture of poverty and its determinants in Uganda. The poverty head count declined from 56 percent in 1992/93 to 31 percent by 2005/06. The main drivers were the improvements in crop prices, particularly coffee, in 1993–94, and 2003-06, and the economic diversification both within agriculture and away from agriculture.

14. **The NDP highlights persistent spatial inequality in living standards.** Income inequality persists within and between regions, and there is growing urban-rural inequality. The Gini coefficient is 0.41, with mean consumption of the richest areas (Kampala) 2.5 times that of the Northern region. Largely due to prolonged civil strife and insecurity, income poverty in Northern Uganda was still above 60 percent in 2005/06.

15. **The NDP recognizes that progress in other areas of welfare has been mixed**. Ranked at 157 out of 182 countries in the UN's 2009 Human Development Index (HDI), Uganda moved from a low to medium human development category. The introduction of Universal Primary Education (UPE) in 1997 broadened access to education, and enrolment rates increased to over 90 percent. The Universal Post Primary education and training (UPPET) program, for which phased implementation commenced in 2007, is expected to increase absorption of primary leavers. Nonetheless, primary completion rates are still low at 52 percent and secondary enrolment is only 27 percent. Progress in the health sector has not been sufficient to improve health outcomes significantly. Child, infant and maternal mortality were 137, 76, and 435 per 100,000, respectively, by 2005/06. It is highly unlikely that Uganda will meet the health-related MDG targets.

16. **A more equitable distribution of income growth will support poverty reduction.** World Bank studies suggest that inequality among households and between regions is driven by differences in income-earning opportunities, which in turn are driven by unequal access to markets and public services, including education and basic infrastructure. To increase equity, decisive steps must be taken to reduce disparities in access to basic public services, including education, health, water and sanitation—although it must also be acknowledged that spatial income disparities will persist for some time to come.

IV. THE POVERTY REDUCTION STRATEGY

A. Macroeconomic Framework and Fiscal Strategy

17. **The National Development Plan is predicated on prudent macroeconomic assumptions.** It envisages GDP growth to gradually accelerate from around 6 percent in 2009/10 to 7.5 percent by 2014/15. Public expenditures are expected to rise from 17 percent of GDP in 2008/09 to just below 20 percent of GDP by the end of the plan period, reflecting the drive to boost public infrastructure. On the heels of tax mobilization efforts, revenues (excluding grants) are projected to rise by about 0.5 percent of GDP per year, reaching 15 percent of GDP by end of the plan and compensating for the expected decline in concessional support. Thus, the fiscal deficit will remain sustainable and readily-financed by a mix of aid and borrowing. Public debt ratios will increase to close to 20 per cent of GDP by the end of the period, but will remain well below the sustainable threshold. A preliminary debt sustainability analysis suggests that even under the least favorable financing assumptions, the debt distress rating would remain low.

Monetary policy will continue to focus on maintaining low inflation and a level of reserves sufficient to serve as a buffer from potential shocks, while financial sector policy reforms will support an increase in intermediation to support growth.

18. **Staffs consider the targeted growth rates achievable, and the underlying medium-term macroeconomic framework sensible and internally consistent.** The global financial crisis has had a limited impact on Uganda and growth should rebound as the global economy recovers. It should also benefit from buoyant regional trade and improved security conditions in Northern Uganda. Uganda is still subject to downside risks from weather-related shocks, uncertainties of post-election developments, and regional and global uncertainties, but has a strong track record of cautious fiscal and monetary management, even in the face of unexpected shocks.

19. **Staffs welcome the increase in infrastructure investment to address binding constraints to growth**. Sustaining per capita income growth in the medium and long term will depend on bridging the infrastructure gap. Accordingly, the NDP includes a large increase in total investment—from about 23 percent of GDP in 2009/10 to 28 percent by the end of the Plan period. However, most of this growth is on account of the increase in public investment, itself concentrated on large 'flagship' projects in agriculture, oil refining and mining, education, transport, energy and water. The expanded provision of public services, particularly in infrastructure, should pave the way for increased private sector investment. Nevertheless, staffs encourage the authorities to be mindful of the risks of crowding out the private sector, and more broadly to ensure that adequate space is left for private initiative in key and other sectors. To limit the risk of unproductive spending and adverse macroeconomic spillovers, it would also be advisable to align the pace of project execution to increases in absorptive capacity and the development of a supportive institutional framework.

20. **Raising efficiency in public spending is one of the key objectives of the Plan**. The NDP strongly advocates improvements in both allocative and operational efficiency in public spending. However, it falls short of concrete measures to improve governance, accountability, and transparency, particularly with regard to the large inefficiencies and waste it identifies in key sectors like education, health, and roads. Limited absorptive capacity within government and for the economy as a whole could raise further challenges. Staffs advise the Government to give priority to development of a system for project appraisal, implementation, monitoring and evaluation. As some observers have noted, Uganda needs to "invest in its ability to invest."

21. **Financing will rely increasingly on non-grant revenues but aid will remain important**. Notwithstanding the intended increase in tax revenue, Uganda's tax-to-GDP ratio, at 15 percent by the end of the period, would remain well below the current average for sub-Saharan Africa. The continued need for development assistance will require that the authorities make a concerted effort to retain access to concessional funding at a time when aid budgets will likely be under stress. Staffs see scope for a more ambitious effort to mobilize domestic revenue.

22. **The NDP also calls for a sharp increase in the use of PPPs to reduce the pressure on government funding.** Staff notes that there are important advantages to bringing private sector expertise into public sector projects. But PPPs also pose significant fiscal risks that must be mitigated; and their associated contingent liabilities have to be built into the budget process at

the inception stage to avoid a nontransparent assumption by government of downstream obligations. Staffs encourage the authorities to review and strengthen as needed the legal and fiscal framework for PPPs before markedly expanding their use, particularly for large projects.

23. **The NDP could have better related the public investment drive to the various sectoral integration processes under consideration in the EAC.** These include, in particular, the ongoing promotion of EAC region as a single tourist destination and the need for coordinated efforts to facilitate trade with neighboring countries.

24. **The policy environment is expected to change in the medium term as petroleum revenues materialize**. Exploration results to date indicate that Uganda could have up to two billion barrels of recoverable oil, and reserves of more than 800 million barrels have been confirmed. Although the full impact of petroleum resources will materialize only after the current NDP period, staffs recommend mapping out its potential macroeconomic effects early on. In particular, macroeconomic policy design will have to take into account the likely appreciation of the exchange rate and more volatile fiscal revenues, among others. In the fiscal area, a more transparent public expenditure management process, and rule-based evaluations of (new) public expenditure programs could go a long way in mitigating the inefficiencies and waste too often associated with large oil windfalls.

B. Structural and Social Sector Reforms

25. **The NDP presents a conceptual framework for harnessing inter-sectoral linkages, functional relationships and synergies among economic actors.** The sectors have been organized into four clusters: primary growth drivers, complementary sectors, social sectors and enabling sectors. However, the NDP does not clearly prioritize public sector actions needed to accelerate growth and structural transformation. This section of the JSAN reviews the NDP vision for some key sectors: infrastructure, agriculture, social services, and financial services.

26. **The NDP rightly stresses the importance of increasing the stock and quality of infrastructure.** The emphasis on infrastructure is in line with the World Bank's Country Economic Memorandum of 2007, which identified infrastructure as the main binding constraint to growth. The NDP identifies the key infrastructure gaps: in the transport sector, which is currently almost fully dependent on road transport, only 4 percent of roads are paved; in the energy sector, only 11 percent of the population has access to grid electricity, consumption stands at 60 kWh per capita per year, and cost is double that in Kenya and Tanzania; in information and communication technology (ICT), coverage is still low and cost too high for businesses; and in the water for production sector, consumption stands at 21 cubic meters per capita, compared to the world average of 599, partly reflecting low access to irrigation in Uganda. Staffs commend the strategic actions identified to address these gaps and the increased resources planned for infrastructure development over the plan period. However, staffs encourage more prioritization in the public investment budget. Particular attention would need to be given to coordinated investments in support of regional trade. At the same time, interconnectivity between large market hubs (or dense economic centers) and intra-urban connectivity within Kampala is also critical.

27. **The NDP identifies acceleration of agricultural growth as a priority given the sector's contribution to industrial growth, export growth, employment, and food security.** The Plan envisages boosting production and productivity in a sustainable way, increasing value addition, building markets, and strengthening agricultural institutions. However, the mixed performance of the sector in recent years, increasing pressures on the environment and on natural resources from population growth and climate change, and the lack of clarity on the role of government in agriculture raise questions as to whether the Plan's recommendations will generate the desired outcomes.[2] In contrast to the overall thrust of the plan to remove the binding constraints that hinder private sector development, the strategy for the agricultural sector relies on direct public interventions that risk crowding out the private sector. In addition, the Plan does not discuss the role of different factors of production (in particular land and water). High population growth rates will increase pressure on land and intensify land-tenure related conflicts. Against this background, the promotion of efficient land market institutions, conflict resolution mechanisms, and ease of transfers of land use rights would seem a worthy priority.

28. **The NDP makes a strong case for increasing the quantity and strengthening the quality of human resources, particularly in view of Uganda's challenging demographic dynamics**. Investing in human resources, including health, education, and skills development is the first priority identified in the plan. Such public investments must be congruent with a fast-growing, young and highly dependent population. The NDP advocates for integrating population issues in sector development plans, policies and programs; improving access to health services and in particular, family planning; and promoting education and skills development. Staffs note that while the NDP envisages that public resources will be used more efficiently, it provides for disjointed interventions for ensuring good governance within the social service delivery sectors. A multi-sectoral approach is needed to raise access to health, education and skill development. This in turn calls for effective coordination structures which the NDP is silent about. There is also a need to decisively build up on recent efforts to improve budgeting in the education and health sectors, raise value for money, and reduce waste and inefficiencies. In view of the magnitude of continued governance problems in these sectors, staffs strongly encourage the government to strengthen enforcement of existing accountability mechanisms, to achieve the targeted increase in efficiency.

29. **Staffs welcome the strong focus on gender issues in the NDP.** Attaining gender balance in all sectors and programs is an overriding commitment of the NDP. The NDP proposes specific strategies to redress the gender gaps in access to education, access to and control of productive assets such as credit and land. It also aims at correcting under-representation of women in decision-making processes through affirmative action policy measures, and to combat gender-based violence and widespread retrogressive cultural practices such as female genital mutilation. Gender-sensitive strategies are less evident for the agricultural sector and access to modern sector wage employment, where the share of women was only 29 percent by 2006, or in policies to improve land access (women owned only 20 percent of registered land in 2009). The

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[2] Whereas the strategy of promoting value addition in agriculture through agro-processing is sensible, the suggested public actions risk wasting public resources without results. The special incentive program to attract private investment in rural areas and the revitalization of the Uganda Development Corporation to establish factories are strategies that have failed in many countries due to mismanagement and inefficiency of the public sector in running business.

NDP acknowledges that addressing inequality in education and formal sector employment would increase GDP growth by over a percentage point.

30. **The NDP identifies the low level of penetration of financial services, underdeveloped capital markets, and the high cost of credit as potential constraints for growth.** It lays down strategic actions aimed at stimulating savings and deepening financial intermediation over the plan period, including through the development of novel financial market instruments, liberalization of the pension sector, expansion of the financial infrastructure, and enhancing the microfinance industry. As a result, the savings rate is expected to rise from just below 13 percent of GDP to about 17½ percent by the end of the plan period. Staffs agree with the authorities that financial services are key to economic development. However, for these measures to have the desired effect, difficult steps will have to be taken to address intermediation constraints, rural access to financial services, and access to long-term finance. Sustaining reforms in the pension sector is a priority, including tackling the role and governance of the National Social Security Fund (NSSF).

C. Governance, Public Sector Management, and Public Sector Reforms

31. **Governance and public-sector management continue to be key challenges in Uganda**. The NDP acknowledges that weak public-sector management and administration systems and pervasive corruption constitute cross-cutting, binding constraints to growth. It articulates well the challenges of sustaining good governance, particularly given its multi-dimensional nature, and identifies strategic areas of action.

32. **Staffs commend the progress made in various areas of public financial management to improve transparency and accountability.** Building on a strong policy, legal, and regulatory framework, the Government has already initiated PFM reforms to improve efficiency, transparency, and accountability. Staffs endorse plans to promote results-based management within the public service through performance contracting and improved public access to information and data; introducing civilian oversight around the key legal, justice, and security institutions; and strengthening Parliament's oversight capacity. The NDP notes that even where initial efforts have been made, further interventions would be needed to enhance value for money in government operations, strengthen the demand side of accountability and foster compliance with accountability policies, service delivery standards and regulations for better governance. Jointly, these actions should strengthen public administration, deepen accountability and strengthen macroeconomic management.

33. **Nonetheless, the PFM agenda faces some challenges**. These include control of government arrears and improving cash-flow planning and budget preparation. Local government levels also face an array of problems related to operational efficiency and funding (including the increasing number of districts, reduced local revenues, and increased administration costs). Staffs recommend that performance measures for the achievement of these objectives be more explicitly stated in the implementation plan, with more precise performance indicators and milestones. The major challenge, however, is enforcement of existing legislation, and this needs to be addressed upfront.

34. **Progress in PFM and accountability notwithstanding, Staffs caution against creating special incentives for favored sectors**. All projects, whether donor- or domestically-financed, should be subject to similar budget scrutiny and selected through the regular budget process (and embedded in the MTEF) without special budgeting, ring-fencing, or fast-tracked decisions. Earmarking revenues for certain 'flagship' projects and placing them outside the regular budget must be avoided, as it would create distortions in the budget prioritization process. As during the PEAPs, budget priorities may evolve over the planning period. Furthermore, it is important that all flagship projects be subject to the appropriate public procurement policies, in line with recent reforms to improve transparency in public procurement.

V. Implementation Framework, Monitoring and Evaluation

35. **Staffs note the proposed framework for monitoring and evaluation, which aims to fully integrate, harmonize and coordinate the implementation of the NDP**. The policy and results framework tracks key performance targets, outputs, and outcomes over the NDP period and visualizes how these will impact intermediate results over the longer term. The framework provides for progress reports on an annual basis, and identifies the agencies responsible for reporting. The National Planning Forum chaired by the President to regularly assess NDP performance and the feedback mechanism envisaged for the Ministry of Finance, Planning and Economic Development (MoFPED) to report on budget execution and performance will be particularly useful. Staffs note that the challenge will be to ensure that the proposed government-wide M&E system is implemented, building on existing systems. For effective tracking and reporting on NDP implementation and results, a coherent results framework needs to be developed which defines measurable indicators with baseline and targets for each intended sector objective with clear linkage to suggested interventions.

36. **Staffs welcome the frequency of planned progress reports and the inclusion of specific annual milestones over the life span of the NDP.** Charging specific agencies with reporting performance on outcome indicators would help them demonstrate their effectiveness in meeting their mandate while showing the efficiency with which resources are deployed. However, it is not clear how different periodic reports (Performance Reports coordinated by OPM, MoFPED and NPA) are going to be integrated and used to assess agency performance and accountability to produce specific results. Staffs note that the bigger challenge will be to ensure that the monitoring and evaluation framework gets resources, clear institutional mandates and support from all levels of Government.

37. **Staffs note that most of the monitoring and evaluation data would be generated under the umbrella of the National Statistical System, which is headed by the Uganda Bureau of Statistics.** This calls for adequate funding of UBOS to allow it to produce the data and analysis required for a full evaluation of the NDP.

VI. Conclusions and Recommendations

38. **Staffs endorse the focus of the NDP on structural transformation to achieve faster growth and poverty reduction.** Building on the achievements under the PEAP, efforts to boost

public infrastructure, foster skilled employment growth and facilitate the expansion of higher value-added activities will raise growth and expand opportunities for the poor. However, exogenous shocks, weak governance, limited administrative capacity and delays in structural reforms could impede or constrain implementation, with adverse consequences for growth and for poverty reduction.

39. Staffs recommend that as the authorities implement the NDP, particular attention be focused on the following issues:

(i) Maintain a cautious macro stance in view of the uncertain path of global and regional growth, unpredictable weather-related and other shocks, and lingering weaknesses in implementation capacity;

(ii) Decisively strengthen governance, accountability and transparency, through stronger commitment and enforcement, to raise public spending efficiency;

(iii) Build capacity to manage risks associated with oil resource development over the medium-term;

(iv) Clarify the appropriate role of the public and private sectors in the ‘flagship’ projects and agricultural strategy;

(v) Improve project selection and prioritization in the public investment budget; and

(vi) Address the risks associated with a fast-growing, young population.