Economic Commission for Africa

Economic Report on Africa 2003

Uganda

A Tale of Two Economies?

Chapter 2

This is an advance copy of Chapter 2 of the Economic Report on Africa 2003. The entire report will be available in July 2003. Materials in this draft are not to be quoted or reprinted.

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Chapter 2

Overview

The Ugandan economy grew by 5.6% in 2001/02 (July-June), slightly below the 6.0% growth rate registered in 2000/01. The solid growth performance of the economy has been accompanied by substantial poverty reduction—lifting more than 4 million people out of poverty (22% of the population) over the past decade. However, there is no room for complacency as one in three Ugandans still lives below the poverty line. More disturbing however is the fact that the national poverty numbers mask vast regional disparities. The Central and Western areas of the country have grown more rapidly than the North and the East. In particular the high levels of poverty in the Northern region is of grave concern. This has raised concerns that Uganda's economic performance may be a "tale of two economies" with excellent national growth and poverty numbers masking huge swaths of the economy that have not enjoyed the benefits of recent progress.

"Rapid growth has lifted 4 million out of poverty over the past decade"

Pre-existing inequalities between the more affluent Central crescent area around Lake Victoria and the drier, more disadvantaged Northern part of the country have been exacerbated by the pattern of development in the last ten years. Fear of civil conflict along regional or ethnic lines are one genuine reason for concern over the spatial pattern of development in Uganda. If one region lags far behind another, this may engender bitterness and ultimately foster rebellion.

Despite increased spending on social services, most social indicators are still below the average for comparator countries like Kenya, Ghana, and Zambia. This reflects systemic problems in public service delivery at the district level as well as specific problems associated with the HIV/AIDS pandemic. Improving the quality of social services, especially in education and health remain crucial for making further gains.

"but increasing and high levels of poverty in North of critical concern."

Prudent macroeconomic management coupled with good weather has kept inflation at single digit levels in 2001/02. Savings and domestic investment rates remain low compared to other Sub-Saharan African countries, but have maintained an upward trend. The financial sector has undergone considerable reforms that have helped deliver financial stability.

The fiscal program has managed to deliver priority expenditures as outlined in the poverty reduction strategy while at the same time exercising restraint. However, the government still relies on donor funding for close to 60% of the development budget, showing the high aid dependency of the economy. The fiscal deficit, excluding grants, rose slightly from 11.2% of GDP in 2000/01 to 12.6% in 2001/02.

During 2001/02, monetary policy has been successful in its objective of achieving stable and low inflation rates. Moreover, sterilization actions by the Bank of Uganda successfully thwarted the pressure on the Ugandan shilling to appreciate. Overall, the movement in monetary aggregates has been in line with the monetary policy stance. Interest rates have also depicted a downward trend. Net Foreign Assets of the banking system grew by 28.2% in 2001/02 to a comfortable level of US$992 million.

The export sector remains highly concentrated in commodity exports. The share of coffee, which constituted 58.7% of total export earnings in 1997/98, however declined to 19.2% in 2001/02. The current account balance has persistently been in deficit, which has increased over the years to $476 million in 2001/02. The external position, however, showed some strengthening in 2001/02. The overall balance was a deficit of $2.8 million compared to the deficit of $55.6 million in 2000/01.

"Reducing regional disparities can boost growth beyond 6%"

The total debt stock continues to rise in spite of debt strategies aimed at reducing the debt burden. In 2001/02, the total debt stock stood at $3.8 billion and the debt stock to GDP ratio was 68.2%.

The potential for economic growth and poverty reduction through macroeconomic reforms have now been largely exploited. Further impetus to growth requires a deeper reform agenda to create an enabling environment for private sector to operate. Reducing regional disparities would help unleash the full potential of the population and boost growth. It is the private sector, farmers, traders, and the like, that can lift Uganda's growth one notch up from an average of 6% per annum to 7% that is required to achieve the country's goal (from its Poverty Eradication Action Plan and PRSP) of reducing poverty to 10% by 2017. Private sector concerns are many: they range from corruption, weak regulatory structures, inadequacy of infrastructure, to low access to financial services. These reforms have to deal with difficult governance issues and fundamental structural changes to the economy. Sustained growth and poverty reduction in Uganda will largely depend on deepening such reforms.

Recent economic performance

Uganda's economic performance has been solid even in the midst of a difficult international environment manifested in the deteriorating terms of trade, which affected the expansion of the productive sectors. During the financial year 2001/02, the economy is estimated to have grown by 5.6%, slightly below the 6.0% growth rate realised in 2000/01. The resilience of the economy to external shocks is a product of the pursuance of prudent macroeconomic policies that have resulted in macroeconomic stability. However, this growth rate is below the target growth rate of 7.0% that is required to reduce poverty by half by 2015. Per capita GDP grew by 3.3% in 2001/02 to about US$250.

Developments in the real sector

The fastest growing sector in 2001/02 was transport and communications, which grew by 10% compared to a growth rate of 8.2%

in the previous year. This was followed by mining and quarrying, manufacturing, construction, wholesale and retail trade, and electricity and water services. The agricultural sector grew by 4.8% in 2001/02, up from 4.6% in the previous year. Overall, Monetary GDP grew by 5.9% while non-monetary GDP grew by 4.3% compared to 6.2% and 5.4% respectively in 2000/01. Details of the sectoral performance of GDP are shown in Appendix 1.

The agricultural sector dominates the Ugandan economy. Its contribution to GDP in 2001/2002 is estimated at 41%, though the importance of the sector has declined over time from about 72% in the late-70s. The sector provides employment to about 80% of the labour force and generates almost all the country's exports. Ugandan agriculture is dominated by smallholder farmers (average holding of less than 2 hectares), of which a large proportion is engaged in subsistence agriculture. The performance of the sector is affected by commodity price fluctuations, droughts, and plant diseases. Given the importance of agriculture, economic growth prospects of the country to a large degree depend on modernising and diversifying this sector. In this respect, access to rural credit and improved public service delivery, in particular good infrastructure, are key constraints that need addressing.

"Accelerating growth depends on a modern agricultural sector"

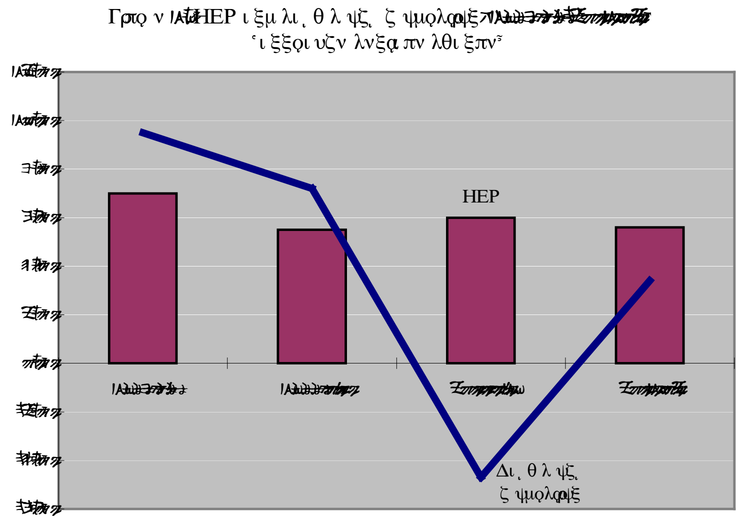
Current government policy on the agricultural sector is contained in the Plan for Modernisation of Agriculture (PMA) whose vision is poverty eradication through a profitable, competitive, sustainable and dynamic agricultural and agro-industrial sector. The PMA identifies six core areas for government action: research and technology; advisory services; access to rural finance; education in the sector; access to markets; and sustainable natural resource management.

"Tremendous foreign investor interest in agro-processing sector"

The mining sector represents only 1% of GDP and remains largely untapped. Recent efforts to attract foreign investment have resulted in some success in exploration activities in gold, phosphates, and petroleum.

The manufacturing sector, which accounts for about 10% of GDP, is largely based on further processing of agricultural products such as sugar, cotton, and food crops. A recent survey financed by the World Bank found tremendous foreign investor interest in the agro processing sector (EIU 2002). Government strategy for the manufacturing sector emphasises the development of agro-based and small and medium-scale industries. Capacity building in terms of managerial and technical skills, and increasing private sector participation through the privatisation process are given special attention in the strategy. Horticulture, food processing and packaging are the areas Uganda Investment Authority has been aggressively promoting in recent years.

Growth is robust but below potential



Source: Economic Commission for Africa from official sources.

Savings still low

"Private deposits have grown by 30.2%"

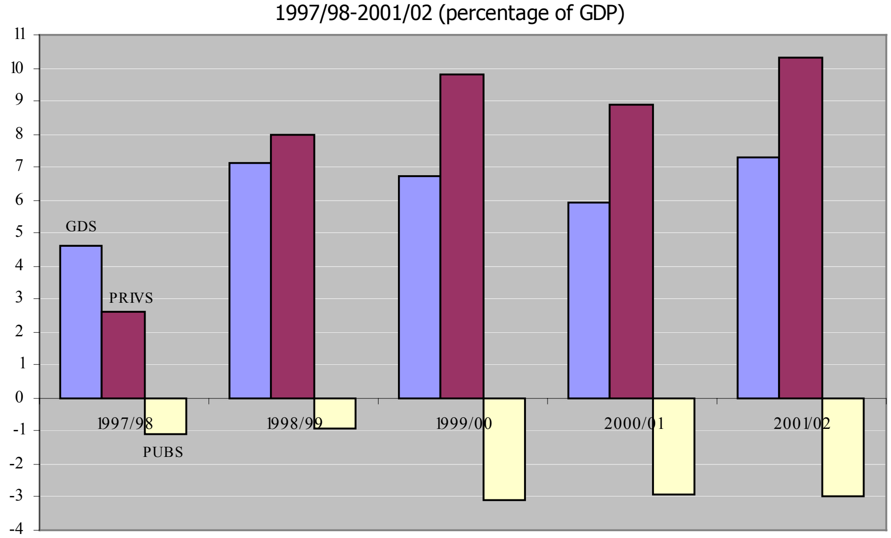
Savings remain low, but have maintained an upward trend over the last decade. Gross Domestic Savings rose from 4.6% of GDP in 1997/98 to 7.3% of GDP in 2001/02 and gross national savings, which include private transfers and grant financing of the government budget, rose from 10.4% of GDP to 13.6% of GDP over the same period. A decomposition of gross domestic savings into private and public savings shows that private savings have maintained an up-ward trend while public savings have been declining (see Figure 2 & Appendix 2).

The up-ward trend in private savings is in line with the recovery of the financial sector from the turbulence of bank failures in 1998. The signs of recovery are reflected in the increased levels of private sector shilling deposits at the banks, which have grown by 30.2% from an equivalent of $461.5 million in June 1999 to the equivalent of $601 million as of June 2002. However, other forms of unproductive savings such as those in the form of real estate, and the holding of foreign exchange for wealth and speculative motives still impede the growth of urban household financial savings. Moreover because of the limited access to financial services, the asset composition of the rural households is to a large extent determined by the economic activities of the area. Hence savings are in the form of commodity stocks, livestock and land. This in turn is reflected in the magnitude of the non-monetary economy, which constitutes an efficiency loss in the economy.

"Public deficit targeted to fall gradually"

With regard to the public sector, the recent decline in its savings is largely on account of increased expenditures to finance poverty reduction programs. In spite of this however, the government's medium-term fiscal program aims at reconciling the provision of adequate resources for the essential poverty reduction programs with fiscal sustainability. Accordingly, the overall deficit is targeted to fall gradually, leading to an improvement in public savings.

Figure 2. Gross domestic savings, private savings and public savings, 1997/98-2001/02 (percentage of GDP)

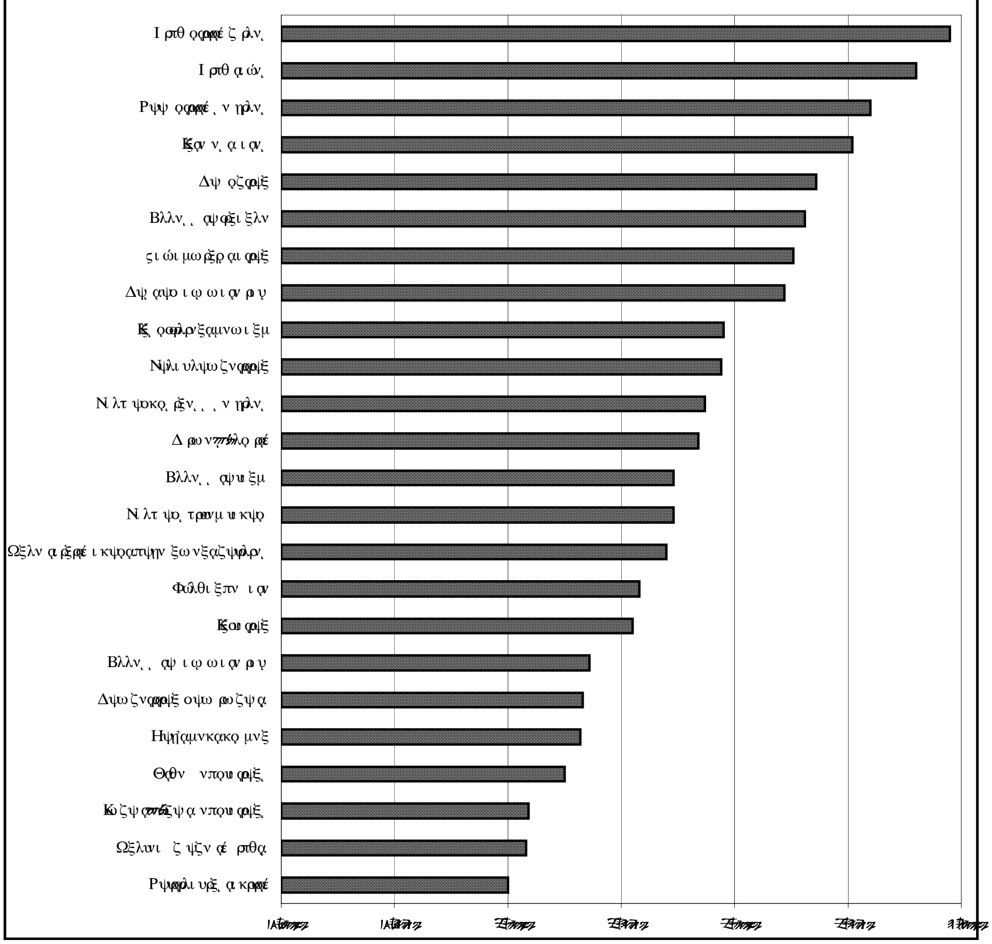


Note: GDS signifies gross domestic savings, PRIVS stands for private savings, and PUBS represents public savings.
Source: Ugandan Authorities and Fund estimates & projections

Private investment sluggish

Despite major improvements in the policy environment private investment remains low (10%) and close to sub-Saharan African (SSA) average (figure 3 and table 1). There are several reasons for the sluggish investment response to the improved policy environment. First, increased competition, due to economic liberalization has put pressure on firms to cut costs. However, many of these costs (related to utility services, transport and corruption) are not under the control of the firm. Apart from increasing the operating costs of firms, several of these factors (see Figure) —including erratic infrastructure services, arbitrary tax administration and crime—also affect firms perception of the risks of investing in partly irreversible capital, Reinikka and Svensson (2000). Second, firms, in particular small ones are liquidity constrained in the sense that they only invest when sufficient internal funds are available.

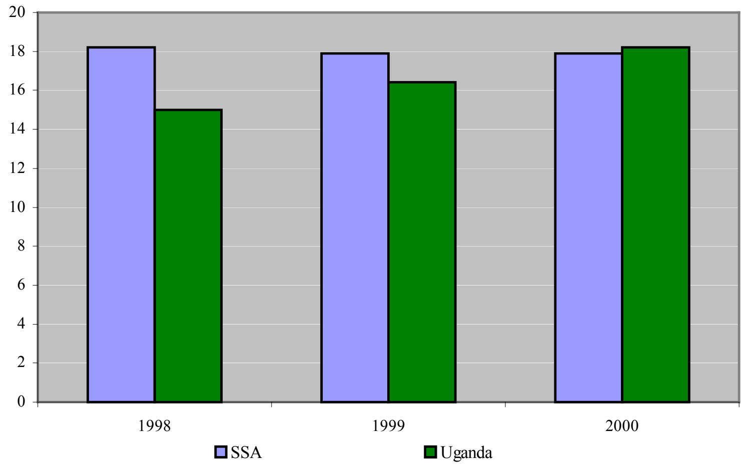
Figure 3: Ranking of constarints to investment



The Gross Domestic Savings (GDS) on average during the period 1997/98 to 2001/02 fell short of Gross Domestic Investment (GDI) by about 13 percentage points of GDP. However, the Gross National Savings (GNS) reduced this resource gap to an average of 6 percentage points over the same period. It is also worth noting that the gap between gross domestic savings and investment has been financed by highly concessional loans from financial institutions such as the African Development Bank (AfDB) and the International Development Association (IDA).

Investment close to SSA average

Figure 4: Gross domestic investment: Urganda vis a vis SSA, 1998-2000 (percentage of GDP)



Source: World Bank Africa Database 2002 CD-ROM

Table 1
Investment rates in Uganda vis-à-vis SSA (% of GDP)

	1995	1996	1997	1998	1999	2000
Uganda						
Gross domestic investment	**16.4**	**16.1**	**16.1**	**15**	**16.4**	**18.2**
Gross public investment	5.4	5.3	4.7	4.6	4.7	6.7
Gross private investment	10.2	11.3	11.6	10.5	11.7	11.5
Sub-Saharan Africa						
Gross domestic investment	**18.0**	**17.7**	**17.4**	**18.2**	**17.9**	**17.9**
Gross public investment	5.2	5.2	5.4	6.3	6.2	5.7
Gross private investment	11.8	11.9	11.8	12.1	11.8	12.0

Source: World Bank Africa Database 2002 CD-ROM

Monetary policy: Tight

The major objective of the monetary policy is to achieve price stability that is conducive to growth. In response to negative headline inflation[1] rates registered in 2001/2002, monetary policy has been accommodative. Overall, the monetary policy stance adopted during the year was cautious and implemented in a manner that exerted minimum disturbances on the domestic money and foreign exchange markets.

"Monetary policy was effective in minimizing disturbances on domestic and foreign exchange markets"

The conduct of monetary policy has gradually moved away from use of direct to indirect instruments. Initially, largely on account of the rudimentary nature of the financial system and the limited array of instruments, co-ordination between monetary and fiscal policy was an important part of conduct of monetary policy. This co-ordination is reflected in the surrendering of Treasury Bill issuance by the Ministry of Finance, Planning and Economic Development to the Bank of Uganda for monetary policy purposes. However, by June 2002, the array of instruments for managing liquidity and enhancing monetary policy effectiveness had been widened. Notwithstanding this development, co-ordination between the fiscal and monetary authorities still exists.

Developments in monetary aggregates[2]

The annual growth rate of M3[3] for the period ending June 2002 was 21.6%, up from 17.6% and 16% registered for the year ending June 2001 and June 2000 respectively. Developments in M3 have been largely a result of the accelerated growth in all components of M3. On the other hand, M2[4] grew by 25.2%, 10 percentage points above the growth rate realised in June 2001. On the supply side, Net Foreign Assets (NFA) of the banking system grew by 28.2% in 2001/02 compared to a growth rate of 33.6% in 2000/01, while Net Domestic Assets (NDA) remained unchanged compared to a decline of -15.5% realised in 2000/01 as shown in table 2.

Table 2
Trend of the determinants and components of broad money (M3) in millions of US Dollars*.

Aggregate	June 2000	June 2001	June 2002	Change June 2001 – June 2002	
				Absolute	Percentage
Net foreign Assets	578.7	773.3	991.5	218.2	28.2
Bank of Uganda	392.6	505.9	696.4	190.5	37.6
Commercial banks	186.1	267.3	295.1	27.8	10.4
Net Domestic Assets	281.5	238.0	238.0	0.0	0.0
Claims on Government	264.8	294.1	317.5	23.4	7.9
Claims on Private sector	370.6	405.4	412.8	7.3	1.8
Claims on other public entities[1]	11.1	7.2	4.9	(2.3)	(31.9)
Other Items Net (OIN)	-364.9	-468.8	-497.2	(28.4)	(6.1)
Broad Money (M3)	860.3	1011.3	1229.5	218.2	21.6
Foreign Exchange Deposits	198.5	249.2	277.7	28.5	11.4
Currency in Circulation	195.8	223.6	260.0	36.4	16.3
Demand Deposits	263.8	308.4	394.3	86.0	27.9
Savings and Time Deposits	202.2	230.1	297.5	67.4	29.3

* Converted to US$ using end period exchange rate for June 2000
1. Includes parastatals and local governments
Source: Economic Commission for Africa from official sources

"External assets rose by 21.6%"

Bank of Uganda's external assets rose by 21.6% while its liabilities declined by 3.4%. Foreign liabilities declined largely on account of repurchases made to the IMF while assets increased due to increased budgetary support by donors.

With regard to net domestic assets, what is noteworthy is the slow growth in private sector credit. Between June 2001 and June 2002, private sector credit grew by only 1.8% compared to a growth rate of 9.4% in 2000/01. The decline in the growth of outstanding private sector credit is partly a result of increased recoveries as reflected in the decline in the level of non-performing assets to about 5% of the total private sector credit (see also section 3.3).

Domestic price developments: Good weather turns inflation negative

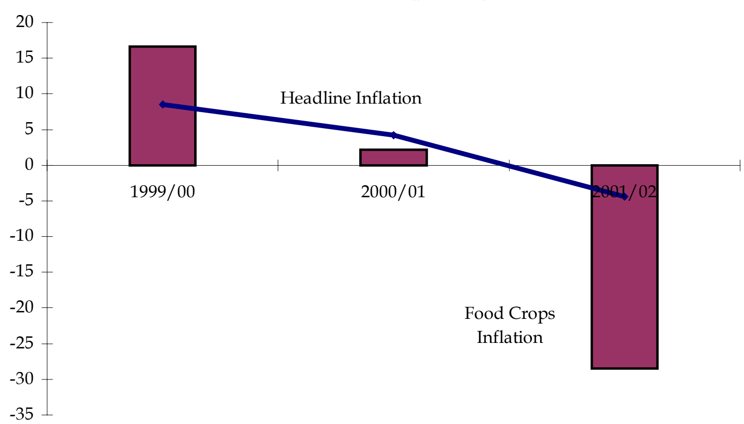
"Private sector credit growth of 1.8% down from 9.4% in 2000/01 of concern"

The inflation out-turn in the 1990's was impressive, being maintained on average at single digit levels. From the volatile trend in consumer prices during the 1980s, which led to a headline annual inflation rate of 250% in 1987, the rate has declined gradually to less than 10% per annum. The success in managing inflation is due to the simultaneous strengthening of liquidity and budget management especially since 1992 (Box 1).

During the period September, 2001 to June 2002, the economy registered negative annual headline inflation rate which is based on relative changes in prices of all goods and services (table 3). This is largely attributed to the sharp drop in food crop inflation as a result of good weather conditions. Annual food crop inflation has been negative since the beginning of the financial year 2001/02. It steadily declined from –3.7% in July 2001 to –28.5% in December 2001 before rising to -13.0% in June 2002. Over the same period, annual underlying inflation[5] rates that exclude food crop inflation have been positive but well below 5% since October 2001.

Inflation plummets

Figure 5: Inflation in December month: 1999/00-2001/02 (percent)



Source: Uganda Bureau of Statistics

Table 3
Annual inflation (1999/2000-2001/02)

	Food Crops Inflation			Underlying Inflation[1]			Headline Inflation[2]		
	1999/00	2000/01	2001/02	1999/00	2000/01	2001/02	1999/00	2000/01	2001/02
July	12.7	-1.1	-3.7	5.7	3.4	7.1	7.2	2.5	4.8
August	17.4	2.8	-13.5	6.4	2.9	6.4	8.7	2.9	2.0
September	19.9	1.9	-21.5	7.2	3.0	5.5	9.9	2.9	-0.8
October	19.4	2.2	-24.5	7.0	4.7	3.6	9.6	4.2	-3.1
November	20.5	6.5	-27.0	6.8	5.9	1.6	9.7	6.1	-5.4
December	16.6	2.2	-28.5	6.2	4.7	3.3	8.5	4.2	-4.4
January	8.9	2.8	-26.5	5.1	5.0	3.5	5.9	4.6	-3.5
February	-1.9	8.9	-22.8	3.4	5.4	2.7	2.1	6.2	-2.9
March	0.7	2.5	-23.6	4.0	5.0	3.6	3.1	4.5	-2.3
April	1.2	1.6	-22.9	2.8	5.7	2.6	2.4	4.9	-3.1
May	-0.7	1.8	-19.9	3.0	5.9	2.4	2.2	5.1	-2.4
June	-1.8	-2.0	-13.0	2.9	7.9	0.1	1.9	5.9	-2.5

1. Underlying inflation is based on the relative changes in prices for all goods and services excluding food crops. The exclusion of food crops minimises the effects of irregular long-term price fluctuations that are mainly induced by weather shocks.
2. Headline inflation is based on relative changes in prices of all goods and services.

Source: Economic Commission for Africa from official sources

Box 1
An impressive inflation out-turn

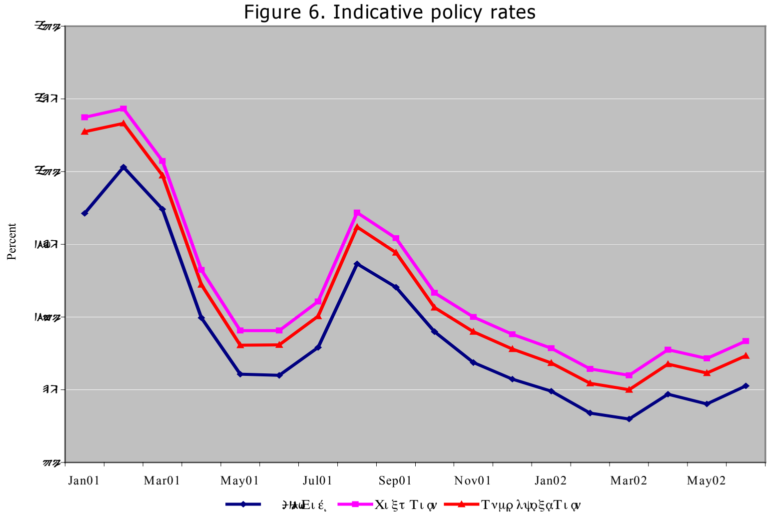
The impressive inflation out-turn is a result of the anti-inflation policies that have been designed to manage aggregate demand on the one hand, and the adjustment and reforms to address supply constraints on the other. Prudent monetary and fiscal policies, combined with close coordination between the monetary and fiscal authorities have assisted tremendously in bringing down inflationary expectations. The Government has consistently pursued financial discipline in its budgetary operations. The overall objective has been to contain the fiscal deficit to levels that can be financed on a sustainable basis while at the same time reducing government indebtedness to the banking sector. In situations where fiscal operations could inject liquidity that overwhelms the available monetary policy instruments, co-ordination between the institutions could lead to a cut down on expenditures in favour of macroeconomic stability.

However, in the recent past this has become difficult owing to poverty reducing expenditures which are of a priority nature. The bulk of the adjustment is now borne by monetary policy. Thus notwithstanding the huge weather-related shocks that brought prices down, monetary authorities have managed to reduce and eventually keep the underlying inflation, which excludes food price effects, stable at around 5% per annum.

Interest rates: On a downward trend

As a result of the accommodative monetary policy stance pursued by the Bank of Uganda, the annualized 91-day Treasury Bills rate declined from 12% in September 2001 to 3% in March 2002 before rising marginally to 5% in June 2002. The rediscount rate and the bank rate also followed a similar pattern to that portrayed by the 91-day Treasury Bills rate. Figure 5 traces the evolution of indicative policy rates.

Figure 6. Indicative policy rates



Source: Economic Commission for Africa from official sources

However, commercial banks' deposit and lending rates registered only a marginal decline. The weighted time deposit rate was recorded at 3.6% compared to 6.6% at the end of June 2001 for shilling denominated deposits. The weighted lending rate also declined from 21.7% recorded in June 2001 to 17.6% at the end of June 2002. As a result, the accommodative monetary policy did not achieve the expected rise in private credit. Another concern is the large spread between the lending and deposit rate that has not changed despite the impressive drop in non-performing loans in the banking sector. The cost to banks in meeting prudential requirements (see financial sector discussion), and high cost in doing banking business, particularly in terms of cost of utilities such as communication, electricity, rents, security services are some factors contributing to wide spreads (Kasekende and Atingi-Ego, 1996, and 1999).

"No change in large spread between lending and deposit rates"

Fiscal policies and developments: Pursuing prudent policies

Prudent fiscal management has had a very significant role in controlling and maintaining inflation at single digit levels. The infancy of the financial system meant that there were few monetary policy instruments available. Therefore, since there was limited potency for monetary policy, in-built flexibility in cash-budget management allowed fiscal policy to respond to volatile movements in the foreign exchange market, unrealized revenue performance and shortfalls in the external budgetary support. Notable examples of this flexibility was the surrendering of the treasury bill instrument to the monetary authorities, the imposition of a coffee stabilization tax during the 1994-95 coffee price boom and expenditure cuts whenever there were shortfalls in programmed revenues as was the case in 1998/99. The negative impact of these actions on the fiscal programs was compensated by the benefits of the resultant macroeconomic stability.

"MTEF links budget to PRSP in a rigorous fashion"

Fiscal policy geared to poverty reduction

The government's medium-term fiscal program has the dual aim of sustaining financial stability and supporting poverty reduction programs. The medium term expenditure framework is the main mechanism through which poverty strategy is linked to the budget (box 2).

Box 2
MTEF links poverty reduction strategy to the budget

Prior to 1992 Uganda only produced yearly budgets. Fiscal policy was not linked to development planning and often the changes in expenditure allocations were based on incremental adjustments to the previous year's budget.

Since 1997/98 the government has used the Medium Term Expenditure Framework (MTEF) to allocate resources and align expenditure priorities with poverty reduction strategies articulated in the PEAP/PRSP. Another objective of the MTEF is to allocate all public expenditures in a framework that ensures consistency with overall resource constraints. The MTEF does this by setting sector and district spending ceilings within a rolling 3-year framework, taking into consideration the macroeconomic development and prospects for resource mobilization, both domestic and external. District and sectoral working groups, compromising the Ministry of Finance and line ministries then help develop sectoral priorities within the expenditure limits, ensuring that these are in line with PEAP/PRSP priorities. The process culminates in working groups preparing sectoral and district Budget Framework Papers that get incorporated into the MTEF.

Within the MTEF, the government initially created a Poverty Action Plan (PAP) to earmark savings from HIPC debt relief for basic social services. Since then, the PAP has attracted additional donor funds.

Since the introduction of the MTEF the budget and planning process has improved significantly. The MTEF has also increased the harmonization of donor financing plans with PEAP/PRSP objectives. However, the success of the MTEF process very much depends on realizing the financing assumptions made by the government. This means that with regard to external funding, timeliness and predictability of aid flows are crucial. Equally important is the realization of domestic revenues as projected. More progress is needed on both fronts.

ECA (2001)

"Fiscal deficit rises due to poverty reduction programmes"

The fiscal deficit has been on the rise in the last 5 years largely on account of the increased government expenditure on poverty reduction programs. As a percentage of GDP, the fiscal deficit, on cash basis, rose from –1.4% in 1997/98 to –5.5% in 2001/02, while the deficit, excluding grants, rose from –6.5% to –12.6% during the same period. The 2001/02 deficit was largely financed by donor assistance which amounted to about 11.7% of GDP, mainly reflecting the budgetary support received from the World Bank in terms of a Poverty Reduction Support Credit (IMF 2002). The government budgetary operations for the period 1997/98 – 2001/02 are shown in Appendix 3.

Recurrent expenditure remained relatively constant throughout the period 1997/98 – 2000/01 and only rising significantly in 2001/02. The latter is due mainly to increases in expenditures under Poverty Action Fund (that channels part of the HIPC debt relief), remuneration to members of parliament, allocations for state house, missions abroad, local government elections and defence (Background to the Budget 2001/02). In the meantime, development expenditure has exhibited an upward trend throughout the period 1997/98 – 2001/02. Development expenditure is financed mainly from external sources, which accounted for about 71% of total development expenditure on average during the period 1997/98 – 2001/02. To reduce aid dependency, it is therefore important to bolster the domestic financing component of development expenditure.

Box 3
Fiscal decentralisation and fiscal transfers in Uganda

Uganda embarked on an extensive decentralisation process in 1993 with the objective of shifting the responsibility for development to local authorities so as to improve accountability, efficiency, equity, effectiveness and sustainability in the provision of social services across the country. Accordingly, the responsibility for the provision of a large number of services has been devolved to district and urban authorities in order to increase people's participation in the decision making process, and to make decisions more transparent and public officers more accountable.

The prioritisation of expenditures in the districts is largely set by the conditional grants determined by the central Government. Local government operations are mainly financed by taxes, fees, user charges and central government grants. Foreign donors also provide substantial resources to finance development programs. Local Governments are allowed to borrow from the banking system, within the constraints imposed by the Local Government Act of 1997, although there has been little borrowing to date. Local tax rates and fees are determined freely by Local Governments, with the advice of the Local Governments Finance Commission. The commission was set up to advise the president on the total amount of grants to be allocated and on the design of a formula for their distribution; recommend potential sources of revenue for Local Governments; and advise the Local Governments on the appropriate tax rates. Local Governments have graduated tax as their main source of revenue and accounts for about 80% of total revenue, excluding grants. The local authorities receive three types of transfers from the central government i.e. unconditional, conditional and equalisation grants.

Unconditional Grants

The unconditional grant is the minimum grants paid to local governments to run decentralised services. The Local Authorities have independence to determine expenditure priorities for this grant. However, the Local Authorities determine their priorities within the context of the National Priority Programme Areas (NPPAs). These grants are paid to Districts, Municipal Councils and Town Councils only and the amount is determined by a formula of population and area with weights of 85% and 15%, respectively.

Conditional Grants

The conditional grants consists of money given to local governments to finance programmes agreed upon between the government and the local governments and are expended for purposes for which it was made and in accordance with conditions agreed upon. The conditional grants are currently being paid to Districts only.

Equalisation Grant

The equalisation grant is a subsidy or special provision for the least developed districts and is based on the degree to which a local government unit is lagging behind the national average standard for a particular service.

Source: "Fiscal decentralisation and fiscal transfers in Uganda", Ministry of Local Government.

Revenue performance sluggish

"*Weak revenue performance a threat to MTEF*"

Despite efforts by the government towards revenue enhancement, the revenue performance has been sluggish. Deficiencies in tax administration, a narrow tax base, non-compliance and corruption have hampered revenue efforts. The weak revenue performance also puts the MTEF process in disarray. Several measures to improve the efficiency of tax administration as well as tax policy reforms have been undertaken. These reforms include the setting up of a quasi-independent revenue collecting body, Uganda Revenue Authority (URA) in 1991, and the introduction of Value Added Tax (VAT) in 1996 to replace the Sales Tax and Commercial Transaction Levy (CTL). This was followed by reforms in the Income Tax Act in 1997 and 1998, streamlining exemptions and introduction of accelerated depreciation allowances for investments in plant, machinery and equipment.

For the first time in three years, fiscal revenues increased relative to GDP to 12% in 2001/02 due mainly to higher revenues from income taxes and value added taxes. However, revenue performance is still low relative to other SSA countries that have tax revenue to GDP ratios of about 20%. In order to improve the revenue performance further, efforts are under way to expand the tax base, enhance tax compliance, and most importantly to improve tax administration. The major focus of the latter is to stamp out corruption in the Uganda Revenue Authority. Only a thorough anti-corruption program would significantly improve revenue collection in the medium-term.

Weak capacity hinders fiscal transparency and service delivery

"*Expenditure monitoring and control requires strengthening at district level*"

Measures for expenditure monitoring and control have been introduced at both the central and local government levels. In this regard, domestic development outlays have been brought under the Commitment Control System (CCS). The government has also transferred a large volume of budgetary resources to districts, in order to provide services effectively, and monitor their physical and financial operations. This is consistent with the objective of shifting the delivery of most public services to the districts.

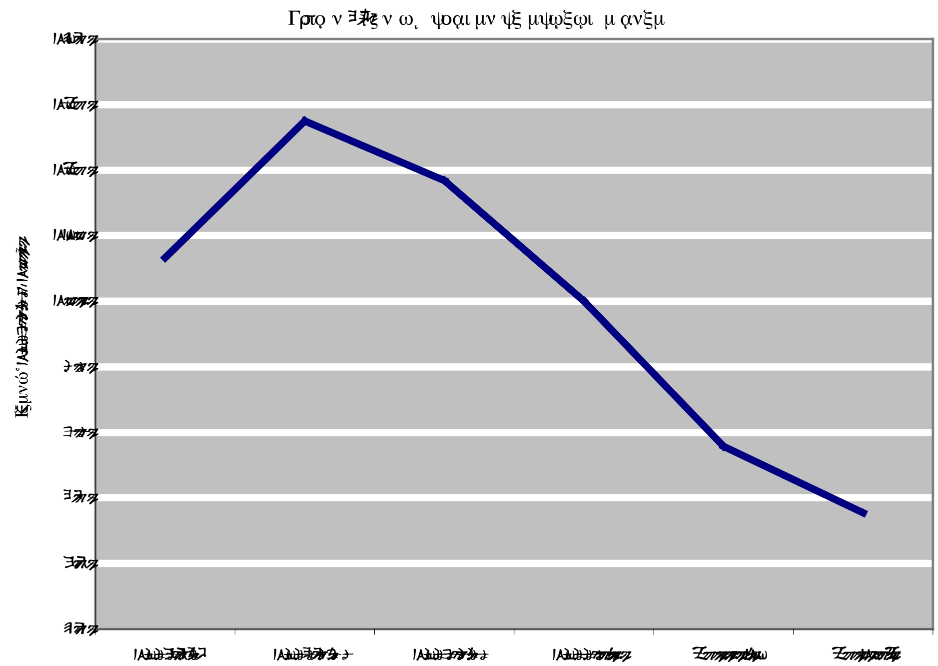
However, the enforcement of these rules and regulations has been poor, due to weak capacity at the line ministries and at local government level. It appears that local governments are not capable of coping with the increased decentralization of fiscal responsibilities (box 3). The burden is further exacerbated because the PEAP/PRSP requires that a large share of total government expenditures be undertaken at local government level. The tracking of local government activities and expenditures has been problematic as these accounts are not forthcoming on a timely basis. Furthermore, weak capacity hinders the main objective of the decentralization process—efficient service delivery.

External sector policies and developments

Exports predominately consist of agricultural products with coffee as the main export crop, while manufactured goods dominate imports. The share of coffee in total export revenues has fallen from 59% in 1997/98 to about 19% in 2001/02, reflecting fluctuations in international prices (table 4). Export revenues from non-traditional exports (other than coffee, tea, cotton, and tobacco) has grown steadily and significantly in recent years, showing progress in export diversification. In particular, revenues from fish, cut flowers, gold, and tobacco have grown.

"Commodity price collapse led by coffee"

The persistent fall in international commodity prices has led to a consistent downward trend in the terms of trade. Whereas import prices displayed general stability, realised export unit values declined almost across the board. Figure 6 below shows the evolution of the terms of trade over the last six years.



Source: Economic Commission for Africa from official sources

The trade and current account balances have persistently been in deficit. This trend has increased over the years. It is a symptom of the extent to which Uganda relies on donor assistance to finance its import bill.

The external position, however, showed some strengthening in 2001/02 (table 6). The overall balance was a deficit of $2.8 million compared to the deficit of $55.6 million in 2000/01. This was largely financed through exceptional financing consisting mainly of debt cancellations under the HIPC initiative and deferred debt payments to countries that have not accepted the HIPC terms. Exceptional financing in 2001/02 stood at $101.7 million, of which $72.2 million was debt cancellation under the HIPC initiative. The remaining amount accounts for repurchases made to the IMF for $32.9 million.

"Coffee's share in exports has fallen from 59% to 19%"

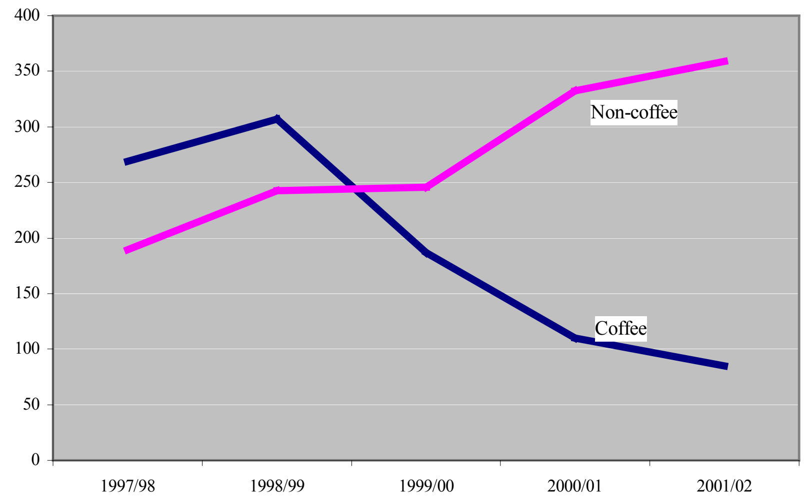
Merchandise exports rose marginally

Merchandise exports rose marginally from $441.8 million in 2000/2001 to $444.2 million in 2001/2002, representing an increase of only 0.5 per cent. This increase is largely on account of the improved performance of non-coffee exports as coffee export receipts declined from $109.68 million in year 2000/01 to $85.25 million in 2001/02. This was caused by the fall in the realized world market unit price from $0.64 per Kg to $0.45 per Kg.

Non-coffee export receipts on the other hand registered an increase of 8.1 per cent in 2001/2002, rising to $358.9 million from $332.08 million in the previous financial year. Fish exports in particular rose to $80.85 million in 2001/2002 compared to $50.11 million in 2000/2001. The increase was due to improvement in both volumes and world market prices. Details of the composition and performance of exports are shown in table 4.

Diversification of exports on the rise

Figure 8. Trends in coffee and non-coffee export earnings, 1997/98-2001/02 (millions of US$)



Source: Bank of Uganda

Table 4
Composition of exports (US $ million)

	1997/98	1998/99	1999/00	2000/01	2001/02*
Coffee	**268.90**	**306.74**	**186.87**	**109.68**	**85.25**
Total Non-coffee	**189.60**	**242.40**	**245.65**	**332.08**	**358.9**
Cotton	11.38	10.83	22.50	14.08	13.30
Tea	35.03	22.67	31.88	35.93	26.85
Fish	27.98	47.57	18.64	50.11	80.85
Beans	2.20	4.62	4.82	2.04	1.45
Maize	8.10	5.89	4.01	6.13	13.07
Flowers	6.82	7.20	8.29	13.22	15.91
Gold	25.45	27.95	39.39	58.49	56.67
Tobacco	10.81	22.86	22.43	27.67	32.27
Simsim	0.04	1.34	0.83	0.66	0.47
Electricity	11.96	12.27	13.76	16.67	13.94
Hides/Skins	7.83	6.61	6.15	22.70	19.65
Cobalt	0.0	0.0	7.34	12.78	10.95
Others	41.97	72.69	83.82	71.60	74.01
Grand Total	**458.50**	**549.24**	**453.75**	**441.80**	**444.15**

* Estimates
Source: Economic Commission for Africa from official sources

The main destinations of Uganda exports in 2001 has shifted to a more balanced position as opposed to the preceding period in which 80 – 90% of exports were destined for the developed countries. The European Union, COMESA[6] and Asia absorbed 28.5%, 20.3% and 19.1% of total exports respectively. If sustained, this shift would reflect some success in market diversification, thus reducing over-reliance on a few markets.

"Kenya biggest source of imports"

Merchandise imports

Total merchandise imports rose significantly from $973.2 million in 2000/2001 to $1221.1 million in 2001/2002 (see table 5 and table 6). This increase is partly on account of the increase in private sector non-oil imports, which rose by 10.8%. Government imports also rose from $121.9 million in 2000/01 to $136 million in 2001/02. Oil imports on the other hand dropped from $136.1 million in 2000/2001 to $124.7 million in 2001/2002 partly due to the fall in world oil prices (table 5).

The main source of imports has remained Kenya. About 29% of imports come from the COMESA of which Kenya accounts for about 17.8%. Asia, the European Union and the Middle East accounted for 26.6%, 23.5% and 9.8% respectively.

Table 5
Trend and composition of imports (US$ millions)

	1997/98	1998/99	1999/00	2000/01	2001/02*
Total Imports	966.2	1039.4	977.8	973.3	1221.1
Government Imports	193.4	217.1	190.0	121.9	136.0
Project	170.8	164.3	114.9	89.6	108.8
Non-Project	22.6	52.8	75.1	32.3	27.1
Private Sector Imports	572.3	558.4	568.9	737.7	791.3
Oil	70.3	90.0	119.4	136.1	124.7
Non-oil	502.0	468.4	449.6	601.6	666.6
Estimated Imports	200.4	263.9	218.8	113.7	293.8

* Estimates
Source: Economic Commission for Africa from official sources

Services and transfers

"Remittances increased by 71.8%"

Service exports rose marginally from $187.7 million realized in 2000/01 to $193.4 million in 2001/2002, an increase of 3.0 per cent. Tourism in particular accounted for 82% of total non-factor service exports showing some recovery in the aftermath of the Bwindi National Park murders of 1999. Payments for services abroad also increased marginally. Uganda therefore remained a net importer of non-factor services.

Private transfers continued to be a substantial component of foreign exchange inflows to the economy, increasing by 71.8% in 2001/02 to $683.1 million. Official transfers to Uganda on the other hand, declined to $375.2 million in 2001/2002 compared to $420.8 million realized in the previous financial year.

The capital and financial account

Uganda removed all restrictions on international capital transactions in 1997 (box 4). The capital and financial account has recorded surpluses for the last 5 years mainly due to donor funding. In 2001/2002 the surplus amounted to $478.4 million up from a surplus of $309.5 million recorded in 2000/2001. The level of both donor and private loan disbursements more than offset debt repayments. Foreign direct investment also grew though marginally from $143.8 million in 2000/2001 to $145.7 million in 2001/02.

Table 6
Balance of payments (US $ million)

	1997/98	1998/99	1999/00	2000/01	2001/02
CURRENT ACCOUNT BALANCE	**-251.7**	**-358.8**	**-401.75**	**-365.11**	**-476.03**
Exports (fob)	458.4	549.1	453.75	441.76	444.15
Imports (fob)	-966.2	-1,039.4	-977.78	-973.33	-1072.62
Service (net)	-202.0	-230.4	-235.2	-293.0	-447.2
Income (net)	-83.9	-108.2	-536.03	-127.85	-145.11
Current Transfers (net)	542.0	475.1	484.53	587.28	596.81
a) General Government	507.0	438.5	366.79	420.82	375.24
b) Private Transfers (net)	35.0	36.6	117.75	166.46	474.60
CAPITAL & FINANCIAL ACCOUNT	**351.9**	**355.5**	**274.94**	**309.53**	**473.20**
Capital Transfers	40.6	40.1	0.00	0.00	0.00
Financial Account	311.4	315.4	274.94	309.53	478.43
O/w Foreign Direct Investment	120.0	145.3	156.40	143.76	145.71
O/w Other Liabilities	191.4	170.1	118.54	165.76	332.72
Medium and Long-term Loans	212.0	181.5	93.94	181.69	362.39
O/w Debt Amortization	-68.5	-75.0	-79.79	-81.92	-80.91
Short term net	-20.6	-11.4	24.59	-15.92	-29.67
OVERALL BALANCE	**100.2**	**1.7**	**-126.4**	**-55.58**	**-2.83**
FINANCING ITEMS	**-100.2**	**-1.7**	**126.4**	**55.58**	**2.83**
Use of IMF Credit Net	-4.6	-34.2	-15.54	-20.86	-36.96
Change of Gross Reserves	-128.6	2.4	28.70	-19.30	-127.70
Exceptional Financing	14.9	42.3	77.86	109.74	101.08
Errors and Omissions	**18.1**	**-12.2**	**35.4**	**-14.00**	**62.40**

* Estimates
Source: Economic Commission for Africa from official sources

Box 4
The liberalization of the capital account: A lesson for other countries?

Uganda has a fully liberalized capital account. The liberalisation of the capital account in 1997 was preceded by the successful fiscal reform that reduced the fiscal deficit significantly and ensured financing of the remaining deficit in a non-inflationary manner; strengthening of the prudential supervision and regulation of financial institutions, especially in the area of foreign exchange risk exposure; successful liberalisation of the domestic financial sector; and debt restructuring.

However, the experience of Uganda with a liberal capital account cannot be compared to that of the South East Asian countries. This is largely because Uganda's financial markets are not well developed and as a result, the markets are not liquid enough to facilitate the development of financial instruments that could attract portfolio investment

Results so far are positive:
A relatively large inflow of foreign capital largely in form of trade flows, transfers, investment flows has been recorded.

- Uganda has recorded participation in the domestic capital market, for which initial response reveals some interest by foreign fund managers in shilling denominated assets. The recent issue of EADB bonds attracted foreign participation. Similarly, the promissory notes issued by government have attracted foreign interest.
- Increased levels of private sector investments.
- Shift from shilling denominated accounts to dollar denominated ones opened avenues for diversification of savings and borrowing for domestic agents.
- Ensured continued fiscal discipline and prudent conduct of monetary policy

But there may be challenges in the future:
Foreign exchange inflows under a liberal capital account have presented challenges to stability in the foreign exchange market and the management of liquidity.

- On many occasions, the authorities are constrained in their efforts to deal with inflows known to be of a temporary nature due to program requirements of achieving a floor on Net International Reserves.
- The capital account was liberalised before a system to collect data on capital account transactions was put in place. The system for holding regular surveys and reporting requirements has just been developed. To date, perfecting the foreign exchange transactions are yet to be passed.
- Liberalization of the capital account created new forms of risks for the domestic banks, which they had little experience in managing.
- The vulnerability to speculative attacks and the possibility of contagion effects could cause massive outflows of capital from the country.
- There is need to develop instruments to deal with the exposure risks and uncertainty faced by the private sector in a situation where markets and instruments to hedge against these is lacking.

Exchange rate policy and trends

In the pre-liberalisation period, Uganda operated a fixed exchange rate regime, where the exchange rate was used as an anchor for domestic prices. Today, the country operates a flexible exchange rate regime, which allows the value of the shilling vis-à-vis all other currencies to flexibly change in line with the market conditions and the underlying fundamentals. Bank of Uganda's intervention is aimed at reducing wide fluctuations in the exchange without targeting any predetermined level or

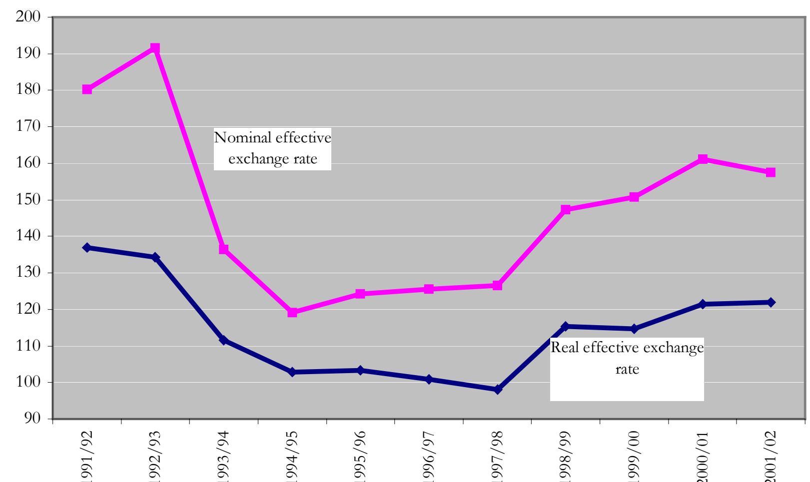
"*Shilling depreciates in real terms*"

trend of the exchange rate. Currently, the exchange rate policy is geared at creating a viable and sustainable external sector.

The Uganda Shilling remained relatively stable against the US dollar during most of 2001/2002. The inter-bank weighted period average mid rate appreciated by 0.5 per cent compared to a depreciation of 16.5 per cent recorded in 2000/2001. The appreciation of the Uganda shilling was largely on account of increased donor inflows and the improved performance of the non-coffee exports, which increased from $310.9 million in 2000/01 to $346.2 million in 2001/02. On a few occasion during the year, the Bank of Uganda increased net sales of dollars in the foreign exchange market in order to mop up excess liquidity. Although it was earlier on feared that lumpy and significant poverty reducing donor resources would appreciate the nominal and real exchange rate, and hence hurt the export sector, the prudent sterilisation of these resources by the Bank of Uganda ensured that the exchange rate remained competitive.

The average nominal effective exchange rate (NEER) appreciated by 2.3% while the real effective exchange rate (REER) depreciated by 0.4% during 2001/02. However, on an end-period basis, the NEER and the REER depreciated by 6.9% and 9.8% respectively. These movements in the exchange rate are depicted in figure 8 and table 7.

Figure 9. Exchange rates: nominal effective and real effective, period average, 1991/92-2001/02 (1990=100)



Downward movement is appreciation while an upward movement exhibits depreciation.
Source: Bank of Uganda

Table 7
Developments in exchange rate (1991/92 – 2001/02)

Period	Period Averages (1990=100)			Percentage Change Period Averages		Percentage Change End Period	
	Nominal Exchange Rate	Nominal Effective Exchange Rate	Real Effective Exchange Rate	Nominal Effective Exchange Rate	Real Effective Exchange Rate	Nominal Effective Exchange Rate	Real Effective Exchange Rate
1991/1992	960.8	180.2	137.0	48.9	20.1	57.2	14.9
1992/1993	1,201.8	191.6	134.3	6.3	-2.0	-22.5	-5.1
1993/1994	1,102.7	136.5	111.5	-28.7	-17.0	-28.9	-24.2
1994/1995	932.5	119.2	102.9	-12.7	-7.7	6.9	6.9
1995/1996	1,012.8	124.2	103.3	4.2	0.4	0.9	-0.7
1996/1997	1,058.1	125.5	100.8	1.1	-2.4	-0.9	-6.9
1997/1998	1,149.7	126.5	98.2	0.8	-2.6	8.4	11.8
1998/1999	1,362.0	147.3	115.3	16.4	17.5	9.3	4.1
1999/2000	1,512.8	150.8	114.7	2.4	-0.6	2.9	3.9
2000/2001	1,762.9	161.2	121.4	6.8	5.9	5.9	1.6
2001/2002*	1754.6	157.5	122.0	-2.3	0.4	6.9	9.8

* Estimates
Source: Economic Commission for Africa from official sources

External debt management strategies and trends

"External debt remains a drag on economy despite HIPC status."

Uganda has implemented several strategies to reduce its debt burden. These debt strategies have included among others, borrowing on concessional terms, rescheduling and debt cancellation arrangements, as well as debt buyback operations. However, in spite of these strategies the external debt indicators continued to deteriorate as the country continued to accumulate debt to finance development programmes in the 1990s. Uganda therefore remained heavily indebted with the external debt stock amounting to $3.5 billion and arrears totalling to $250 million by the close of 1995/96. The external debt-to GDP ratio also remained high, averaging about 70% between 1992/93 and 1997/98. The ratio of debt-to-export of goods also remained high although it declined from 1526.6% in 1992/93 to 535.5% in 1996/97, with multilateral creditors accounting for 76% of the Disbursed and Outstanding Debt.

Uganda's consistency in pursuing sound macroeconomic policies and its commitment to structural reforms enabled it to become the first country to qualify for debt relief under the HIPC initiative. The usual three year interval between the decision and completion points was reduced to one year with a decision point set in April 1997 and the completion point reached in April 1998, when Uganda received US$347 million in debt relief. Uganda also became the first country to benefit from the enhanced HIPC initiative in April 2000 under which it secured $656 million of debt relief.

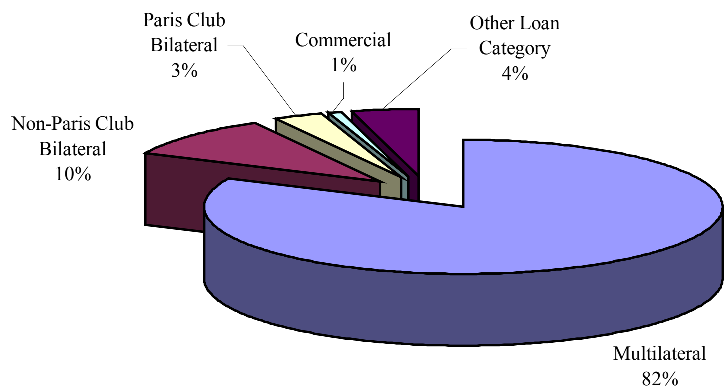
External debt profile—debt sustainability deteriorating

Even after receiving debt relief under HIPC, Uganda's debt sustainability has not significantly improved. Uganda's stock of outstanding and disbursed external debt at the end of June 2002 was estimated at $3.8

billion, an increase of 11.5% over the June 2001 level. The total debt stock as a ratio of GDP also rose to 68% at the end of June 2002 compared to 65% at the end of June 2001. In line with Uganda's debt strategy, which requires new borrowing to be on highly concessional terms, about 82% of external debt is owed to multilateral institutions.

The ratio of debt service (including IMF maturities) to total exports of goods and non-factor services was recorded at 24.1% at end June 2002, down from 26.6% at end June 2001. This is largely a result of the improved export performance during 2001/2002 compared to the previous fiscal year and the decline in total debt service from $167.17 million to $153.82 million during the same period. The developments for the period 1998 – 2002 (for the year ending June) are summarised in table 8.

Figure 10. Uganda Public Outstanding Debt by Creditor, 2002



Source: Bank of Uganda and Ministry of Finance, Planning and Economic Development

Table 8
Uganda: Outstanding public debt by creditor 1998 – 2002 (US$ million, end period)

CREDITOR CATEGORY	1998	1999	2000	2001	2002*
Total Debt Stock	3631.0	3495.6	3588.9	3395.2	3782.9
Multilateral	2826.8	2782.6	2930.60	2892.9	3102.7
Non-Paris Club Bilateral	423.6	361.7	345.30	341.3	371.7
Paris Club Bilateral	324.4	288.2	259.10	122.9	115.0
Commercial	33.4	40.7	27.70	18.0	34.6
Other Loan Category	22.6	26.3	26.20	20.1	158.9
Debt Service	173.7	176.4	176.8	167.2	153.8
Debt Service/Export of Goods and Non-factor Services (%)	27.4	24.2	27.2	26.6	24.1
Debt Service/GDP (%)	1.4	1.1	1.2	0.7	0.6
Debt Stock/GDP (%)	58.8	60.4	64.3	64.7	68.2

Note: The figures are for the end June position
* Estimates
Source: Economic Commission for Africa from official sources

Social sector developments

With the help of prudent macroeconomic management that generated sustained higher growth in the last decade, Uganda has managed to improve the living standards of her population significantly. The proportion of people living below poverty level has declined from 56% in 1992 to 35% in 2000. Also, thanks to increased public spending on basic services, most key education and health indicators have improved.

"Despite tremendous progress in poverty reduction, one in three Ugandans still lives below the poverty line."

These impressive gains aside, still, one in three Ugandans lives below the poverty line. The overall poverty numbers also hide the vast regional and urban-rural disparities. Also, notwithstanding the substantial increases in public spending on basic services, most social indicators are still below the average for comparator countries like Kenya, Ghana, and Zimbabwe. The HIV/AIDS epidemic, though now under control, has also taken a toll on social indicators.

Table 9
Social indicators

	Infant mortality rate per 1000 live births 2000	Under 5 mortality rate per 1000 live births 2000	Life expectancy at birth 2000	Combined gross enrolment Rate in Primary , Secondary and Tertiary (%) 1999 (a)	Adult literacy Rate (% age 15 and above) 2000
Ghana	58	102	56.8	42	71.5
Kenya	77	120	50.8	51	82.4
Nigeria	110	184	51.7	45	63.9
Tanzania	104	165	51.1	32	75.1
Uganda	81	127	44.0	45	67.1
Zambia	112	202	41.4	49	78.1
Zimbabwe	73	117	42.9	65	88.7
Sub-Saharan Africa	107	174	48.7	42	61.5

(a) Preliminary UNESCO estimates subject to further revision
Source: UNDP 2002

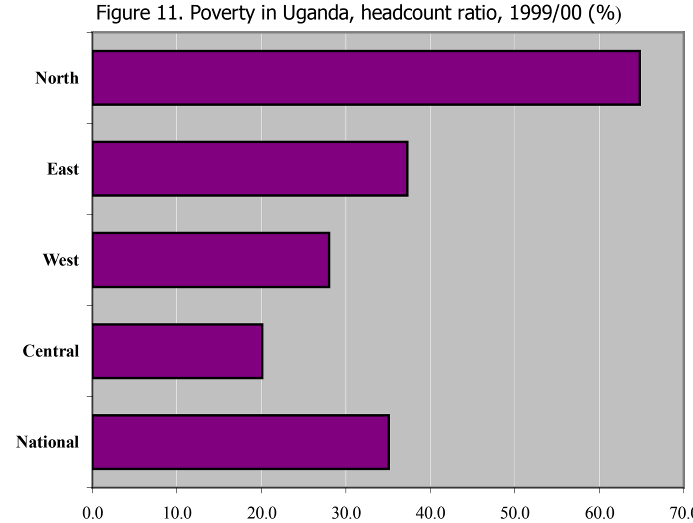
Poverty reduction is at the heart of the development strategy of the country. The PEAP/PRSP sets out its overall strategy to reduce income poverty by 10% by 2017 by taking measures to create an enabling environment for economic agents to participate in economic activities, and directly increase the living standards of the population.

Spatial dimensions of poverty

There is considerable spatial variation in the levels of consumption in the start year of 1992/93. On average, consumption per adult equivalent was twice as high in urban areas as in rural areas. Within rural areas, Central region had the highest income followed by Western and then Eastern region. Rural areas of Northern region averaged the lowest income, with incomes in rural areas in Central region being a third higher. The spatial pattern of growth has tended to exacerbate pre-existing income inequalities between locations.

Mean consumption per adult equivalent rose by an annualised rate of 4.6% between 1992 and 2000 in the country as a whole. However, the corresponding growth rates were much higher (at 6.2%) in urban areas than in rural areas (where they were 3.9%). Within rural areas, those regions with higher initial incomes grew more rapidly. Incomes in rural areas of Central region grew by 5.2% per annum, Western rural by 4.5% and Eastern rural by 3.9%. In Northern rural, there was virtual stagnation – incomes grew by only 0.5% per annum.

Figure 11. Poverty in Uganda, headcount ratio, 1999/00 (%)



A similar disparity can be observed in poverty dynamics: whereas 61% of the urban households that were poor in 1992 moved out of poverty by 1996, only 39% of rural households managed in the same period (Okidi and Mugambe 2002).

The North is significantly poorer: Poverty reduction was confined to Central, Western, and Eastern regions (table 10). The largest reduction in the number of people living in poverty was reported in the Central regions (from 46% in 1992 to 20% in 1999) where the initial incidence of poverty was the lowest in 1992. Though to a lesser extent, both the Eastern and Western regions saw a decline in poverty. In contrast, the Northern region where poverty incidence is the highest, has seen it increasing to 65% in 1999 from 59% two years earlier A similar picture emerges when comparing poverty dynamics across regions. In Northern regions, only 27% of the households that were poor in 1992 moved out of poverty by 1996, while the figures are much higher in Eastern (37%), Western (60%) and Central (63%) regions (Okidi and Mugambe 2002). Uganda's north has many disadvantages: continued civil conflict, remoteness, unfavourable agro-climatic conditions, low population density, and prevalence of internally displaced people are some of the contributory factors to poverty (box 5).

A number of factors may explain these spatial variations in growth and poverty reduction. First Uganda's growth in the 1990s can be viewed as recovery from disaster, rather growth *per se.* By 2000, the economy was only just returning to levels of income per capita that had enjoyed in the early 1970s. In the intervening period, disastrous economic policies, invasion and civil war had undermined the formal economy and caused "a retreat to subsistence". This hit urban areas more than rural areas. Hence, when a stable economic policy framework and security were restored, there was more scope for the formal economy to "bounce-back" and hence economic opportunities improved more in urban than rural areas. This may also help explain the better performance of Central rural areas, which are likely to have benefited from proximity to Uganda's major urban centres. A related, second factor, is that the restoration of security has been uneven. The slow growth of Northern – and to some extent, Eastern – rural areas not only reflects its distance from the cities but also the fact that security there improved much less than elsewhere in the country. Indeed, it is possible that security did not improve in certain parts of the country – it is notable that four districts were excluded from the 1999/2000 survey due to insecurity compared to two in 1992/93 and none in 1993/94. A third factor is the localised impact of the coffee boom in 1994/95 when unit valued for Ugandan coffee exports rose to $2.55 per kilo compared to $0.82 in 1992/93. Coffee growing only accounts for a sizeable share of income in Western and Central regions – it is not grown at all in the North. Although the trade shock was only temporary, it is likely that much of the windfall income was saved and thus resulted in a permanent rise in income (Collier and Gunning, 1999).

Poverty persists in the food crop sector: There are wide disparities in the ability of various socio-economic groups to benefit from economic opportunities created by stable macroeconomic environment in the country. The food crop sector which predominantly consists of subsistence farming activities was the poorest in 1992. Poverty declined from 64% in 1992 to 58% in 1996 ((Okidi and Mugambe 2002). Whereas cash-crop farming, which was the second poorest in 1992 with 60% poverty level, saw the highest drop in poverty to 41% in 1996. This reduction is due to two factors: removal of market controls from coffee sector that benefited small holder coffee farmers enabling them to get better farm gate prices, and the hike in international coffee prices in the mid-90s that remained high for several years. Significant declines in poverty was also observed in manufacturing and trading activities.

The evolution of the Gini coefficient shows that national welfare inequality has not significantly changed over the years (table 10). Therefore, the downward trend in poverty in Uganda largely emanated from improved economic growth rather than redistribution of wealth. This means that in Uganda the poor are those who have not had access to the economic opportunities created in the 90s through higher growth. They do not operate in the formal economy—as they are subsistence farmers; they may not have human and technical skills to benefit from economic opportunities; they may belong to vulnerable groups—women, children, refugees etc.; and they may be subjected to disruption in livelihoods due to wars and natural disasters.

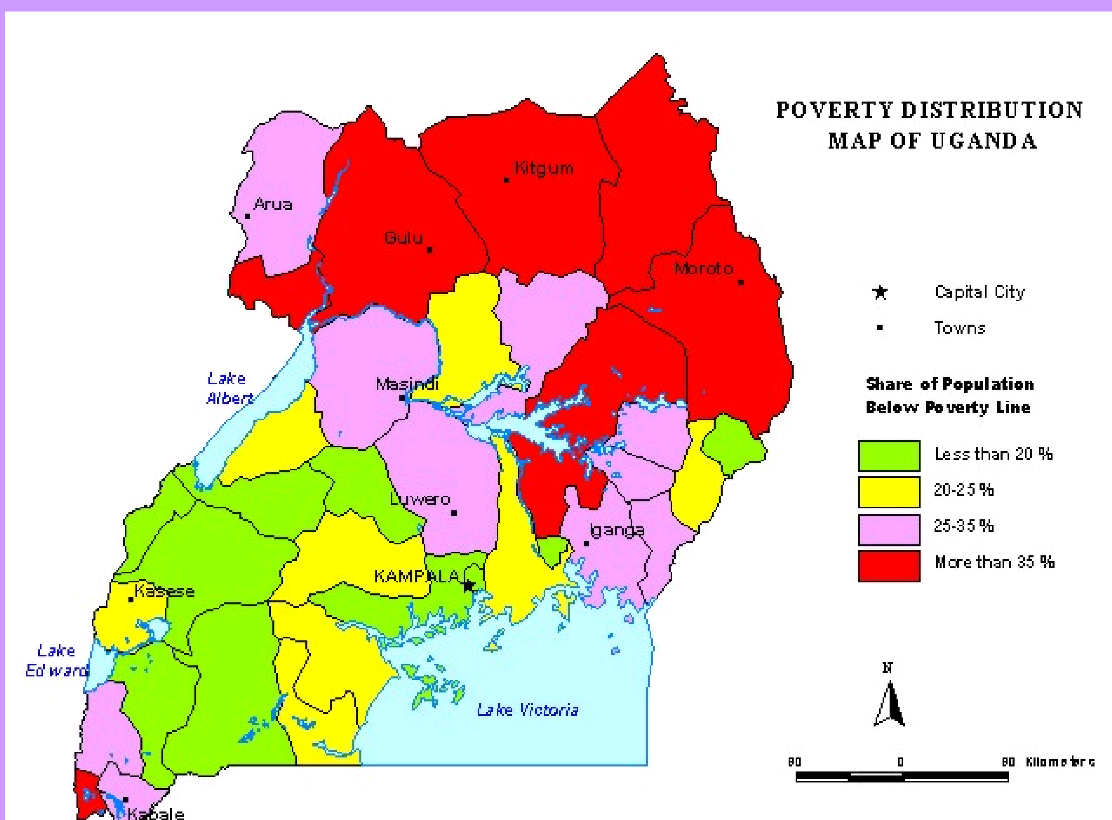
Box 5
The untold side of the success story

The benefits of Uganda's high growth have not been evenly distributed across the whole country. There are still great inequalities between the more affluent Central Crescent area around Lake Victoria and the drier, more disadvantaged Northern part of the Country. The North lags far behind the rest of the country with regard to social indicators such as food-security, health and education.

This state of underdevelopment can be considered as one of the main factors, which fuel bitterness and the perennial conflict in the northern region. It has greatly shattered the social and cultural arrangements that existed before, and have generally retarded economic development. Ugandan governments, past and present, have failed to create an environment conducive to the participation of all groups, irrespective of their ethnical backgrounds, in the governance process. And it is unfortunately amidst these groups that conflicts have emerged and persisted.

The northern districts have suffered a lot in terms of deaths, torture, abduction of children, disruption of livelihoods, and displacement of the populations. Over 800,000 people have been displaced by the ongoing civil war and live in squalid camps. Another 150,000 refugees in 66 settlements in eight districts are also in need of food. According to the World Food Program 108,000 tons of food are needed for the first 6 months in 2003 to avoid famine in the war-torn north

Development is not about economic growth only; it is about human based development, embracing equity, social justice and an institutional framework for realizing these standards. Uganda's economic performance has obviously failed to distribute its gains to all her citizens.



Source: Economic Commission for Africa from official sources

Addressing deep pockets of poverty across the country should be a priority. In particular the regression observed in the North is a grave concern. While efforts by the government in terms of fiscal decentralization, equalization grants, increased social spending, targeted intervention programs, and agricultural development programs are commendable, more commitment is necessary to address the priorities identified by the poor themselves: improving security, curbing corruption, and access to basic social services, infrastructure and markets (Uganda Participatory Poverty Assessment Project). In this context, establishing political stability and ending economic alienation of Uganda's North should be a key priority of the government.

Table 10
Poverty headcount: 1992-2000 (Headcount Ratios – percent)

	1992/93	1992/93	1994/95	1995/96	1997/98	1999/00
National	55.5	52.2	50.1	48.5	44.0	35.1
Central	45.5	35.6	30.5	30.1	27.7	20.1
East	59.2	58.0	64.9	57.5	54.3	37.3
West	52.8	56.0	50.4	46.7	42.0	28.0
North	71.3	69.2	63.5	68.0	58.8	64.8
Urban	28.2	20.6	22.3	19.5	16.3	10.1
Rural	59.4	56.7	54.0	53.0	48.2	39.0
Gini Coefficient (National)[1]	0.391	0.395	0.400	0.416	0.384	--

Source: Appleton et al., 1999, Appleton (2001a).
1. Okidi et al., (2000)

Poverty-sensitive distribution of resources

On the basis of the trends in economic growth and regional inequality, the Ministry of Finance, Planning and Economic Development (MFPED) has analyzed the geographical pattern of government expenditure under the MTEF

Three factors seem to be of importance in the comparisons between the different regions:

(a) Population size: District with a higher population should be allocated relatively more resources because they carry a higher burden of service delivery
(b) Geographical area: It is relatively more costly to provide services to a geographically disbursed, and sometimes, isolated population;
(c) Poverty level: Poor districts have a lower tax base than rich districts because the economic activity is limited.

For illustrative purposes, the MFPED gives the following weights to the three factors: population (60%), area (20%) and poverty (20%). Under these weights, a poverty sensitive distribution was developed (as reported in the Table below).

Table 11
Example of a Poverty Sensitive Distribution of Local Government Transfers

	Weight	Central	West	East	North
1. Population	(60%)	28%	28%	25%	19%
2. Geographical Area	(20%)	19%	25%	14%	42%
3. Poverty (Consumption)	(20%)	13%	19%	22%	46%
Poverty Sensitive Distribution		23%	26%	22%	29%

The Table shows that the Central and Western regions have a bigger population (28%), the East (25%) and the North (19%). The Northern region is the biggest in terms of area (42%), followed by Western, Central and Eastern regions. Poverty is measured by the total household consumption in the region. The Central region has the biggest share of total household expenditure (39%), followed by the Western region (27%), the Eastern region (23%) and the Northern Region (11%). If the poverty criterion is calculated as the inverse consumption share, the North should receive 46%, the East 22%, the West 19% and the Central region 13%.

"Primary education receives 70% of education budget"

Given the weights in the example, the table also shows that a poverty sensitive distribution would allocate 29% to the Northern region, 26% to the Western region, 23% to the Central region and 22% to the Eastern region. Based on this example it can be concluded that the current distribution of resources could become more poverty sensitive if the allocation to the Northern districts were to be increased. This could be done only when the displaced people will be resettled in their home villages and provided decent homes.

Education – Primary education for all

Government policy on education has focused on increasing access to primary education (see Box on policies for higher education). In 1997, the government launched the Universal primary Education (UPE) programme. Under the UPE policy, every four children per family are entitled to free primary education (the President recently announced that UPE will be extended to every child). Accordingly, the public expenditure on education has shifted towards primary education relative to secondary and tertiary institutions. Primary education now receives approximately 70% of the education budget.

The UPE has the potential to be one of the most important poverty reduction strategies in Uganda. The estimates of direct impact of education shows that universal primary education would increase agricultural production by about 15% whereas agricultural productivity gains from access to roads, and extension services are less than that of UPE (Deininger and Okidi, 2001). As shown in table 11, there has been a substantial improvement in primary education indicators.

Going beyond the tremendous achievements made in terms of quantity, increased efforts are now needed in improving quality indicators such as qualified teachers, pupil-teacher and pupil-classroom ratios. The government is also moving in the right direction in reforming the tertiary education sector and the results are already apparent in terms of increased enrolment.

Table 12
Primary education indicators

	1994/95	2001/02
Public expenditure on Education as a percentage of government expenditure	15	24.4
Enrolment Rate in Primary schools (%)	55	98
Ratio of girls to total pupils	45:55	45:55
Primary school dropout rate (%)	70	6.6

Source: Economic Commission for Africa from official sources

Health Sector – Fighting ill health on all fronts

The Participatory Poverty Assessment of Uganda identified ill health as the most frequently quoted cause and consequence of poverty by the poor. The government has responded by allocating more resources, increasing the number of health facilities across the country, and by moving health services from curative orientation to preventive, with particular attention being accorded to health education and information, and public health programmes; thus reorienting the health system to primary health care (PHC).

"HIV/AIDS prevalence drops from 15% in 1993 to 7% in 2002"

The government takes a multi-sectoral approach to addressing ill health. For example, health education on maternal and child health, family planning, and the prevention and control of HIV/AIDS is undertaken to increase awareness in the population. Similarly, Uganda's aggressive response to the HIV/AIDS epidemic shows the commitment of the government to fighting ill-health on all fronts. The government's first policy action was to open up public debate on HIV/AIDS, which was a taboo at the time, and call for international assistance. The government then took steps to increase civil society participation in HIV/AIDS work from program planning and design to awareness building across the country. And most importantly, the government prepared a multi-sectoral approach to AIDS by involving 12 line ministries. The strategy paid off. Once the number one in the world for HIV infection, Uganda managed to be one of the first countries in Africa to reverse the HIV prevalence rate in the adult population from 15% in 1993 to about 7% in 2002. The largest decline was observed among adolescents (age 15-19) with a prevalence rate dropping from 32% in 1992 to 10% by 1998.

"Infant mortality has declined"

The other performance indicators of the health sector have shown significant improvements as shown in table 12. Infant mortality has declined from 88 per 1000 births in 1995 to 81 per 1000 births in 2000 and the percentage of one-year-old children that are fully immunized rose from 66% in 1995 to 83% in 2000 and more than 90% in June 2002. Moreover, health accessibility improved from 49% in 1995 to 70% in 1999 and about 80% in 2001 (table 13). As in the education sector, the challenge for the government now is to ensure improvements in the quality of medical care.

Table 13
Performance indicators of the health sector

Indicators	1995	2000
Public Expenditure on health as a % of GDP	1.6	7
Infant mortality rate per 1000 live births	88	**81**
Under 5 mortality rate per 1000	141	127
Health accessibility	49	80
Maternal mortality rate per 1000 live births	12	5
Live expectancy at birth	40.5	44
Percentage of people with access to:		
Safe water	46	50
Health services	41	80
Sanitation	57	80
Percentage of 1 year olds fully immunized	66	83

Source: UNDP 2002, and Economic Commission for Africa from official sources

Policy challenges

"Domestic private sector still hobbled by energy concerns

The potential for growth and poverty reduction through macroeconomic reforms have now been largely exploited, further impetus to economic growth in Uganda requires a deeper reform agenda to create an enabling environment for private sector to operate. These reforms are to do with difficult governance and structural changes.

In this context, it should also be noted that average real GDP growth rate of 6% over the last decade, though impressive, is still below the target 7% per annum that is required to achieve the government's goal of reducing income poverty to 10% by 2017. Lifting growth up by one notch therefore falls squarely on the private sector actors in the economy. Given that Uganda is a predominantly rural agrarian economy, as the PEAP/PRSP identifies, private sector led growth hinges on modernization and diversification of the agriculture sector. This is where the majority of Uganda's poor live and make a living. Any benefit to them therefore is not only growth inducing but also directly related to reducing poverty. In addition, attracting FDI is also crucial for driving further economic growth.

Throughout the last decade, the government has undertaken a series of reforms to address private sector development issues. Removing controls on agricultural products, particularly for coffee, liberalising the trading regime and international capital flows, privatizing state owned enterprises are some of these reforms to create an investor friendly environment.

So far, however, domestic private sector investment has not responded as strongly (table 1) as expected to these reforms. Even though FDI inflows have steadily increased from about $54 million in 1993 to about $145 million in 2002, it is not an adequate response to Uganda's impressive track record on sound economic management.

Private sector identifies many constraints to doing business

- Lack of confidence in and access to the financial sector;
- Poor public service provision including utilities and basic infrastructure; and
- Weak governance, that includes concerns over corruption, red tape, and security;

The discussion below will take stock of government reform efforts in addressing above concerns and identify what more needs to be done.

Financial sector developments: Building confidence but lagging in access

"Central bank carries out more effective supervision and enforcement of prudential regulation"

Uganda's financial sector has undergone considerable reforms over the last decade. These reforms were aimed at strengthening, deepening and broadening the financial system, and encouraging a competitive environment within the financial system. The full liberalization of interest rates and relaxation of entry requirements witnessed the entry of new banking and other financial institutions. Bank of Uganda has also instituted a framework for a more effective supervision and enforcement of prudential regulations of the banking system. New prudential regulations have been introduced, including the increase in the minimum capital requirements for financial institutions. As evidence of strict surveillance of the financial sector and intolerance for the use of unethical standards, Bank of Uganda has since 1998/99 closed four banks that were insolvent due to fraud and mismanagement (box 6).

A new Financial Institutions Bill (FIB 2002) aimed at further strengthening the financial sector has been presented to parliament for enactment. This statute strengthens licensing and specifies corporate governance requirements, strengthens restrictions on insider lending and large loan exposures and introduces a requirement for mandatory prompt corrective action to be imposed on distressed banks.

Box 6
Cleaning up the banking sector

The biggest shock in the history of Uganda's banking sector occurred in FY1998/99, when the Bank of Uganda (BOU) closed three banks. The reasons ranged from inefficient management to capital inadequacy that ultimately resulted in illiquidity and insolvency. Since then one more bank (1999/00) and one credit institution (2001/02) were closed. The closure of the mismanaged banks was intended to clean up the banking system and ensure that the banking industry promotes flexibility and growth of the economy through facilitating financial intermediation.

The initial closures prompted a run on the banks as the general public rushed into withdraw their savings with the banking system. Banks were however able to contain this by rediscounting their investments in liquid assets. During the 1998/99 budget, the government committed itself to compensate all non-insured depositors at a cost to the tax payer about 5% of GDP. The depositors of the other bank and the credit institution that were closed latter were paid their insured deposits which amounts to about US$ 1700 per customer, from the Deposits Protection Fund.

In order to avoid of the repeat of the 1998/99 scenario and its effects on the financial sector, the Bank of Uganda has taken several measures to:

- Improve supervisory capacity and management;
- Raise the minimum unimpaired capital requirements for commercial banks to US$2 million effective January 2000 and US$4 million effective January 2003. Credit institutions are required to have a minimum unimpaired capital equivalent to US$ 650,000;
- Announce commitment of the government not to bail out failed banks; and
- Strengthen the legal framework.

Attempts are also underway to establish a credit reference bureau.

Source: Bank of Uganda Press Releases 1998, 1999,2000,2001, 2002

Several instruments have been introduced to reduce the cost of doing business. An electronic clearing system has been inaugurated and as of May 2002, cheques have been cleared electronically. The new system is expected to reduce the amount of time it takes to clear a cheque from three working days to only two. Most commercial banks have also introduced new products such as debit cards, cash cards, Automatic teller machines (ATM) and specially packaged accounts to attract savers. In an attempt to further deepen the financial sector, enhance competition and ensure a wider financial product range, Bank of Uganda has allowed entry of foreign banks.

The government has finally divested itself of banking business by privatising the state owned Uganda Commercial Bank (Box 7). The creation of credit rating bureaus, strengthening bankruptcy laws, and quick resolution of non-performing assets would also help improving confidence in the banking sector.

Table 14 shows that the reforms have resulted in significant improvements in financial sector indicators. Nonetheless, it is too early to gauge how much confidence these reforms have generated among investors, both domestic and foreign.

Banking system is considerably stronger

Table 14
Financial Sector Indicators

	June 1992	June 2002
Financial depth (M2/GDP)	8.2%	15%
Private sector deposits (as a ratio of GDP)	5%	11%
Total assets of the banking system (as a ratio of GDP)	12.1%	26.7%
Non-performing assets (as a ratio of total outstanding loans)	50%	5%

Source: Economic Commission for Africa from official sources

Significant weaknesses still exist in access to credit by micro and small enterprises. Most of them access credit from micro-finance institutions (MFIs) who at the moment operate in a regulatory vacuum. Some of the MFIs take deposits for purposes of intermediating them and are also clients of the banking system (Kasekende 2002). Hence, the risk exposure to the banking sector and the public has further increased. Given that the majority of poor people live in the rural areas and are engaged in the agricultural sector, which is a crucial driver of economic diversification efforts, the provision of rural finance through strengthening MFIs should be a priority. There are many benefits to strengthening of this segment: it will effectively address the problem of outreach; minimize the risk of exposure for the clients; and could offer a reliable institutional set up for savings mobilization of rural areas (Kasekende 2002). Strengthening MFIs will improve the overall health of the financial sector.

"Weaknesses exist in access to credit by micro enterprises"

Box 7
Successful resolution of the Uganda Commercial Bank Limited (UCBL) Sale

An initial attempt at privatization of UCBL to a Malaysian firm, Westmont, failed due to the poor handling of the divestiture process coupled with serious concerns raised by parliament on the divestiture process. This prompted Bank of Uganda's intervention.

The process of resolving UCBL commenced in February 2001, when the Bank of Uganda approached 11 major international banks to ascertain their interest in purchasing UCBL. Four banks were subsequently invited to conduct due diligence on the bank, two of which submitted bids to purchase the bank. Bank of Uganda decided that the sale of UCBL to Stanbic would best meet its objectives for the resolution of UCBL. Stanbic will own 80% of the shares while the government retained 20% of the shares, which will be made available to the general public through the Uganda Securities Exchange.

There were various allegations of irregularities of the deal with Stanbic, in particular that the sale price was lower than the value of assets (*New Vision*). The UK auditors that undertook an investigation later on, however, gave the all clear sign to the deal.

The resolution of UCBL has achieved the Government's long standing policy of divesting itself from the ownership and management of commercial banks. More importantly, the Bank of Uganda has attracted a major international bank, with operations in 17 African countries, assets of US$ 38 billion and capital of US$2,316 million to purchase UCBL and to assume responsibility for its branch network and country-wide retail banking operations.

Source: Bank of Uganda Press Releases 20 February 2001, 30 May 2001, 8 August 2001, 15 October 2001, 12 July 2002

Efficient delivery of services

The privatization program that was undertaken in earnest in the early 1990s intended to get the public sector out of doing business, for the most part inefficiently, that is essentially private in nature. Building basic infrastructure is another area where there is a lot of emphasis.

Getting out of private business

Prior to the privatisation and divestiture of public enterprises in 1992, the parastatal sector was carrying out a wide range of activities ranging from trade and commerce, agro-production and processing, manufacturing, insurance, etc. Over 85% of these activities were commercial in nature and were already facing competition from the private sector. The enterprises had a debt stock of nearly $1.0 billion compared to the national debt stock of $3.5 billion. The sector was operating at less than optimal capacity and capacity utilisation was estimated to be between 25% and 30%, with its contribution to GDP estimated at 5%.

"Govt. subsidies to parastatals amounted to 5% of GDP in 94/95"

Inefficiency in these enterprises meant that they could not generate enough resources to finance their operations or save for re-investment. Consequently, government subsidisation of these enterprises amounted to 5% of GDP in 1994/95, which was equivalent to five and a half times government recurrent expenditure on health and about double that on education. It is against this background that the government instituted reforms and divestiture of public enterprises motivated by the objective of redefining the role of the state in the economy; reducing the financial and administrative burden imposed on government by the public enterprises; improving efficiency; and encouraging private investment.

At the beginning of the program, there were over 150 parastatals involved in virtually all sectors, most of which were majority-owned by the State. To date, the government has completed the divestiture of 110 enterprises using various methods including sale of assets, outright sale of government share through Management Buy Out, Joint Venture, Competitive bidding, Concessions, Repossession, Pre-emptive Rights, Debt/Equity Swap, Management Contract and sale through listing on the Security Exchange.

Improving infrastructure

"Privatization of 110 of 150 parastatals completed to date"

The government has now embarked on infrastructure to reduce the cost of infrastructure services, improve the quality, increase accessibility, and reduce the costs incurred by government in the provision of infrastructure services. To achieve these objectives, the government has taken steps to increase private sector participation in the operation, financing and ownership of infrastructure services, with government providing only the regulatory role. Already, there are signs of increased competition and efficiency in the delivery of these services.

The government has undertaken a comprehensive overhaul of key utility sectors, including postal, telecommunications, energy, water and transport. Inefficient utility services have long been a major constraint to private sector activities. In particular, inadequate and unreliable electricity is ranked as the most binding infrastructure constraint to doing business by most domestic and foreign firms (World Bank 2000). Though the benefits are already being felt as a result of liberalising the telecom sector (box 8), benefits of other utility privatisation efforts are yet to be seen. Unless there are adequate regulatory structures to govern utility services, intended benefits, particularly in terms of higher quality of services and improved accessibility may not be realised.

"Inadequate and unreliable electricity is most binding constraint to doing business"

In addition to power, private sector surveys reveal that the state of the transport network, including roads and railways, poses considerable burden on private sector activities (World Bank 2000). Realising that this is a major impediment, the government has earmarked the road network for priority spending. With significant budget increases over the last 4 years, the main road program is funded at 90% of the PEAP/PRSP requirement. However the rural road program, which is also crucial, is still under funded (UN 2001).

Box 8
Telecoms sector is dynamic

The Government has undertaken sweeping reforms in the telecommunications sector. The monopoly of Uganda Posts and Telecommunications Corporation has been abolished and the Uganda Communications Commission established to regulate the communications sector. The Uganda Posts and Telecommunications Corporation has been split into three companies i.e. Uganda Telecommunications Limited (UTL), Uganda Postal limited (UPL) and Uganda Post Bank. The postal services were separated from communications services and a postal savings bank formed to cater mainly for the financial intermediation needs of the rural areas.

The second national operator, a cellular phone company MTN was licenced in 1998 to build, own and operate telecommunications facilities and services throughout the country, in direct competition with UTL.

Already there are positive changes in the communications sector as reflected in improved quality of services, increased coverage including rural areas, and a reduction in costs that has made communications services affordable to even the low income groups.

The use of information technology such as Internet Services is quickly developing. This is a positive development, which will contribute significantly to reducing communications cost further. They will also increase competition in the sector, thus contributing positively to improving the quality of services and efficiency in service delivery.

Addressing governance concerns—Some way to go

Concerns over governance, particularly related to corruption and insecurity, are high on the list of constraints to private sector participation in economic activities. These are also issues highlighted by the poor as key impediments to their livelihoods and access to public sector service delivery.

Corruption—strong commitment needed

Corruption in Uganda significantly increases the cost of doing business. Corruption is prevalent from the highest level (box 9). Firms and households identify police and the judiciary as the most corrupt. The

Uganda National Integrity Survey in 1998 reveals that 63% of respondents paid bribes to police officers and 50% had bribed court officials. The corruption in the police forces is well documented in the Sebutinde report that investigated police corruption in 2001 (box 9).

"Several steps have been taken to root out corruption"

On the positive side, corruption issues are discussed openly, particularly in the media, and government inquiries are launched on several cases and the population is becoming increasingly intolerant to corruption in high places. The government, partly pressed by the donors over the misuse of donor funds, has taken several steps to enhance the integrity and accountability of its institutions. The key measures taken recently on the anti-corruption front are:

(i) Strengthening existing anticorruption institutions (the Inspector General of Government, Auditor General, and Department of Public Prosecution) through capacity building and the provision of additional budgetary resources.
(ii) Establishing a Ministry of Ethics and Integrity to set standards and inquire into matters related to corruption.
(iii) Initiating inquiries into corruption in the public services: they include investigations on police forces and employees of Uganda Revenue Authority
(iv) Introducing a Leadership Code for declaring assets and incomes of government officials and parliamentarians.

"Political will is key to fight against corruption"

As voiced by the Minister of Ethics and Integrity, the government strategy has failed so far to address corruption effectively because of the lack of political will to implement various laws and regulations in effect (EIU 2002). The challenge is to muster commitment and political will at the highest levels to implement the anti corruption strategy. It would not only stamp out corruption effectively but also reassure investors, both domestic and foreign, about the prevailing business climate in the country.

Insecurity persists in many parts of the country

"Armed conflict over 16 years has hampered development in the North"

The poor security situation in many parts of the country remains a serious constraint to private sector activities and to overall development. Armed conflicts have severely hampered the livelihoods of the North, and some parts of the West and East. The North, where a bush war has been waging for the last 10 years, has suffered the most. In the West, the involvement of Uganda in the Democratic Republic of Congo was a major concern. A UN panel recently reported (UN 2002) looting of the wealth of the DRC by Ugandan armed forces.

Persistent conflicts may not bode well for maintaining political stability, attracting external funding from both donors and foreign investors, and maintaining fiscal stability as military expenses may continue to creep up. The people of these conflict-ridden regions are the biggest losers. The poor in Uganda identify insecurity (in terms of ongoing wars, rebel activity, cattle raiding and theft) as their biggest concern (Uganda Participatory Poverty Assessment Project). This is indeed telling.

Box 9
Poor governance widespread in the public sector

According to the Transparency International Corruption perceptions index of 2002, Uganda is ranked 92 out of 102 countries. Moreover, a national survey on corruption - particularly bribery - in the public sector, which was conducted in 1998, partly explains how and why Uganda still has such a bad ranking. About 70% of households interviewed reported their perception of corruption in public services as very high. The survey showed that the police and judiciary represented by far the highest level of corruption. The worst of it all is that the users who pay bribes do not even get better services. The districts were also ranked in order of the most corrupt to the least corrupt based on percentage of service users who paid a bribe and Mbale District was found to be the most corrupt with an amazing 73% while Kisoro District was found to be the least corrupt with only 11%.

The factors that have contributed to the spread of corruption in Uganda are deep-seated and date back to independence and Idi Amin's years into power.

By the time Museveni came to power, Uganda had experienced virtually every kind of corrupt practice one can imagine. The new administration made it clear that it viewed corruption as one of the evils inherited from the past and a key obstacle to progress in Uganda. It has been focusing on strategies of curbing corruption for 17 years through, inter alia, the appointment of an Inspector General of Government and the adoption of reform measures for increasing the transparency of public sector spending, and inquiring into various government level allegations.

However the current situation indicates that the fight against corruption is still a very difficult one. For instance, the Sebutinde report on corruption in the Uganda Revenue Authority shows how staff acquired wealth by helping importers evading tax. The corruption indicator of the International Country risk guide (ICRG) also shows that perceived corruption has become worse in the five past years.

Nevertheless one has to give credit to Uganda for being one of the few countries in Africa to have carried out a great deal of reforms. Moreover, the role of the press has been of great importance in curbing corruption and in providing the general public with information relating to the reforms. The Government of Uganda has recognized the value of a free press and the state-controlled media has also been fairly free to report on abuses of public office and has put great emphasis on the fight against corruption.

Sources: The East African, The Monitor, Transparency International, Uganda National Integrity Survey 1998

Medium-term outlook is promising

In line with developments on both the domestic and international scene, the medium-term outlook is promising. GDP is projected to grow at an average rate of 6.0% over the next three years and both annual underlying and annual headline inflation rates are expected to remain below the 5% level. Gross domestic investment is expected to rise to more than 22% of GDP, while domestic and national savings will remain within the current range. Revenue performance is also projected to rise to about 13% of GDP while gross reserves are projected to remain at a level of about 6 months of future imports. Export receipts are projected to increase by about 10% per annum while the terms of trade are expected to improve as the drive to diversification gains momentum.

Although the medium-term outlook is promising, significant challenges still lie ahead. Sustaining high economic growth rates and macroeconomic stability should be the key objectives of economic policy in the medium-term. Any policy slippage will be detrimental to the national development objective of reducing poverty.

Notwithstanding the commendable gains made in poverty reduction, still, one in three Ugandans live below the poverty line and most social indicators are still below the average for comparator countries. Improving poverty and social sector indicators would require higher growth. In fact, Uganda has to lift its growth from the current average of 6% per annum to 7% in order to achieve the country's goal of reducing poverty to 10% by 2017. Having now largely exploited the potential for economic growth through sound macroeconomic policies, the medium term challenge would be to find a new source of growth. It is the private sector that is capable of driving higher growth.

The challenge is to create an enabling environment for the private sector to operate. This would require undertaking deeper structural and governance reforms. Specifically, the government has to deepen financial sector reforms, improve the provision of public services, and address widespread corruption and insecurity in many parts of the country. In particular, addressing economic alienation and political instability of the Northern regions of Uganda needs to be high on the agenda. Uganda has a challenging task ahead before taking-off.

Notes

[1] Headline inflation is based on relative changes in prices of all goods and services.
[2] All conversions from Uganda shillings to US$ are based on the end period exchange rate for June 2000.
[3] M3 includes currency in circulation and private sector deposits including foreign currency deposits
[4] M2 includes currency in circulation and private sector deposits excluding foreign currency deposits.

[5] Underlying inflation is based on the relative changes in the prices of all goods and services excluding food crops.
[6] COMESA is the Common Market for Eastern and Southern Africa. The COMESA member countries include: Angola, Malawi, Burundi, Mauritius, Comoros, Namibia, Democratic Republic of Congo, Rwanda, Djibouti, Seychelles, Egypt, Sudan, Eritrea, Swaziland, Ethiopia, Uganda, Kenya, Zambia, Madagascar, and Zimbabwe.

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Appendix 1: GDP Performance by Sector (Percentage Growth Rates)

SECTOR	1998/99	1999/00	2000/01	2001/02*
MONETARY	**7.5**	**5.2**	**6.2**	**5.9**
Agriculture	6.6	5.3	4.3	5.5
Cash Crops	9.5	7.2	-4.7	3.4
Food Crops	7.5	5.9	7.7	6.2
Livestock	4.1	3.3	3.8	5.1
Forestry	6.4	8.7	8.5	6.3
Fishing	0.9	-0.1	4.0	6.2
Mining and Quarrying	5.9	4.8	5.9	7.8
Manufacturing	13.7	3.5	8.9	7.4
Formal	18.2	3.5	10.7	8.9
Informal	4.5	3.5	4.7	3.9
Electricity and Water	6.0	8.7	9.3	6.4
Construction	9.4	1.4	2.9	6.6
Wholesale and Retail Trade	9.2	1.9	6.3	6.4
Hotels and Restaurants	7.3	5.3	6.1	5.4
Transport and Communication	7.0	7.4	8.2	10.0
Community Services	4.5	8.6	7.5	5.9
NON-MONETARY	**5.3**	**6.2**	**5.4**	**4.3**
Agriculture	4.9	6.0	5.0	3.8
Food Crops	5.0	6.3	5.0	3.4
Livestock	4.5	5.1	5.6	6.8
Forestry	4.6	5.7	4.2	4.9
Fishing	0.9	-0.1	4.0	6.2
Construction	2.6	2.5	2.4	2.2
Owner-occupied Dwellings	8.5	8.0	8.0	7.0
TOTAL GDP	**7.0**	**5.5**	**6.0**	**5.6**
PERCAPITA GDP	**4.3**	**2.9**	**3.5**	**3.3**

* Estimates

Source: Economic Commission for Africa from official sources

Appendix 2: Savings and Investment (% of GDP)

Period	1997/98	1998/99	1999/00	2000/01	2001/02*
Gross Domestic Savings	4.6	7.1	6.7	5.9	7.3
Public	-1.1	-0.9	-3.1	-2.9	-3.0
Private	2.6	8.0	9.8	8.9	10.3
Gross National Savings	10.4	11.8	12.0	13.1	13.6
Gross Domestic Investment	17.1	20.3	19.9	20.4	19.9
Public	4.7	5.5	6.5	6.4	6.7
Private	12.4	14.8	13.5	14.0	13.2

* Estimates

Source: Economic Commission for Africa from official sources

Appendix 3. Budgetary operations (allocations, US$ millions[1])

	1997/98	1998/99	1999/00	2000/01	2001/02
Revenue and Grants	1,042.8	996.8	1042.2	1067.7	1167.4
Revenues	697.0	698.0	667.7	614.6	712.8
Grants	344.3	298.8	374.5	453.2	454.5
Total Expenditure	1,083.6	1,067.6	1,221.0	1,197.4	1,410.2
Current Expenditure	644.1	654.2	645.9	646.1	818.3
Development expenditure	437.0	411.6	509.9	566.1	594.6
External	359.0	327.4	364.4	374.4	345.0
Domestic	78.0	84.2	145.5	189.7	249.6
Net lending	2.6	1.7	65.2	(14.8)	(2.7)
Fiscal Deficit (commitment)	(40.9)	(70.8)	(178.8)	(129.6)	(248.8)
Fiscal Deficit (Excluding Grants)	(386.7)	(369.6)	(553.3)	(582.8)	(697.4)
Fiscal deficit (Cash basis)	(85.4)	1(30.9)	(40.6)	(184.5)	(307.8)
As a percentage of GDP					
Fiscal Deficit (Commitment)	(0.7)	(1.3)	(3.3)	(2.5)	(4.4)
Fiscal Deficit (Excluding grants)	(6.5)	(6.8)	(10.3)	(11.2)	(12.6)
Fiscal Deficit (Cash basis)	(1.4)	(2.4)	(0.8)	(3.6)	(5.5)

1 The figures were converted to US$ using the period average exchange rates.

Source: Economic Commission for Africa from official sources