REPUBLIC OF UGANDA

MID TERM REVIEW (MTR) OF THE THIRD NATIONAL DEVELOPMENT PLAN (NDPIII)

Economic Policy Management

Uganda Vision 2040

NPA National Planning Authority

JANUARY 2023

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with Support from

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Acronyms

BUBU	Buy Uganda Build Uganda
CNDPF	Comprehensive National Development Planning Framework
CPI	Corruption Perception Index
GDP	Gross Domestic Product
GNI	Gross National Income
HCI	Human Capital Index
MDA	Ministry, Department, Agency
MFPED	Ministry of Finance, Planning and Economic Development
MIS	Management Information System
MTEF	Medium Term Expenditure Framework
MTR	Mid Term Review
NDPI	National Development Plan I
NDPII	Second National Development Plan
NDPIII	Third National Development Plan
NPA	National Planning Authority
NRM	National Resistance Movement
PEFA	Public Expenditure and Financial Assessment
PIAP	Programme Implementation Action Plan
PIFS	Public Investment Financing Strategy
PIM	Public Investment Management
PS	Policy and Strategic Direction
PSI	Policy Supported Instrument (IMF)
SDG	Sustainable Development Goal
SMART	Specific, Measurable, Achievable, Results-focused, Time-bound
TPD	Tax Policy Department
UBOS	Uganda Bureau of Statistics
UDB	Uganda Development Bank
UDC	Uganda Development Corporation
UIA	Uganda Investment Authority
URA	Uganda Revenue Authority
USD	United States Dollars

Executive Summary

Recent Economic Developments

1. **Performance of the real economy in the first two years of the NDPIII was below the planned targets and this had ramifications on the overall economy.** While real GDP growth averaged 6.4 percent in FY2017/18 and FY2018/19, following the covid-19 pandemic and other challenges such as floods and locusts' invasion in FY2019/20, real GDP growth significantly fell to 3.0 percent. Despite the realised real GDP growth being lower than the planned targets during the two years of NDPIII implementation, the economy is slowly recovering albeit the current challenges emanating from the external shocks.

2. **Slow implementation of public investments contributed towards the low growth outturns**. The NDPIII growth was assumed partly to be driven by public investments especially in the 69 core projects and other attendant projects. As at March 2022 out of the 69 core projects, only 33 projects (48 percent) were under implementation with only 4 projects (6percent) on schedule while 29 (42 percent) were behind schedule. Some of the projects that are behind schedule include: the oil refinery; the East African Crude Oil Pipeline (EACOP); standard gauge railway; rehabilitation of the meter gauge railway; and a number of road infrastructure projects such as the Kibuye-Busega-Mpigi Highway, Kampala-Jinja Express Highway among others.

3. **Using Gross National Income as an indicator, Uganda is yet to attain middle-income status[1].** NDPIII aimed at transforming Uganda to attain lower middle-income status, with a targeted GDP per capita of USD 1,198 by 2024/25. The NDP III ambition was to attain GDP per capita of USD 936 in 2020/21. However, available data from UBOS revealed that GDP per capita increased to USD 1,051 in 2021/22. To attain middle income status would require sustained increase in real growth for the next two years.

4. **During the first year of the NDPIII, Government pursued an expansionary fiscal policy, with the fiscal deficit rising to 9.1 percent of GDP above the NDPIII**

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[1] Middle income status requires sustained increase of Gross National Income between USD 1,036 and USD 4,045.

target of 7.8 percent of GDP. This was mainly driven by the rise in government expenditure to 23.3 percent of GDP as compared to the planned spending of 20.8 percent in FY 2020/21. The higher spending was due to the unforeseen need for more government spending to mitigate the spread of COVID-19, provide adequate support to the health sector to manage the large number of infections as well as social economic assistance to the masses and support economic recovery. Consequently, the debt ratios increased from 41percent of GDP in FY 2019/20 to 52.7 percent of GDP in 2021/22, much higher than the NDPIII target of 45.7 percent of GDP and higher than the debt benchmark of 50 percent. Furthermore, the ratio of interest payments to domestic revenue increased from 16.9 percent in FY 2019/20 to 20.6 in FY 2020/21, rising further above the 15 percent benchmark. The higher debt service burden has considerably reduced the available fiscal space of the budget.

5. **Financing the deficit has increasingly been from domestic sources at a very high cost to government.** The NDPIII's plan to finance the planned deficit of 7.82 percent and 6.18 percent of GDP in FY 2020/21 and FY 2021/22 was to source a large proportion of financing from external sources, particularly 5.48 percent of GDP and 4.12 percent of GDP respectively from external sources while the rest was to be financed from domestic sources. The deficit financing strategy greatly differed from the NDPIII with more financing sourced from domestic sources as compared to external sources which has had negative ramifications to private sector development. The MTR established that high domestic borrowing was partly driven by financing of the supplementary budget requests within the financial years and revenue shortfalls.

6. **Monetary policy has been underpinned by the desire to maintain macroeconomic stability.** The Bank of Uganda (BOU) has been implementing monetary policy under an Inflation Targeting monetary policy framework. BOU monetary policy framework ensured price stability during the first year of the NDPIII implementation. Recent surge in commodity prices internationally has resulted into considerable build-up of inflation. Inflation outlook continues to be uncertain owing to the following factors: (i) global inflationary pressures owing to high world food and energy prices; (ii) tight monetary policy being pursued by advanced countries which could intensify portfolio outflows from frontier markets such as Uganda; (iii) high prices in global markets which could further weaken the Uganda shilling, and; (iv) disruptions in global supply

chains. These risks have further dampened the prospects for higher economic growth, weakened consumer confidence and led to higher exchange rate volatility. To address these challenges of worsening economic outlook, the monetary authorities tightened monetary policy by raising the CBR from 6.5 percent in May 2022 up to 9 percent in August 2022.

7. **Uganda's external position worsened in FY 2020/21, with the current account deficit to GDP increasing drastically from 6.7 percent in FY 2019/20 to 9.5 percent in FY 2020/21**. In particular, the trade deficit widened by 26 percent to USD 3,048.9 million from USD 2,402.1 million in FY 2019/20. There was a drastic increase in the growth of exports receipts recorded at 38.6 percent, with exports rising to USD5,275 million from USD 3,807.1 million in FY 2019/20. The rise in exports receipts was driven by the rise in gold exports receipts which increased by 101 percent. Export receipts declined by 23.5 percent to USD 4,034.9 million in FY 2021/22. The lower export receipts were mainly due to the halt in gold exports by exporters as a result of a levy of 5 percent on every kilogramme of refined gold and 10 percent on unprocessed gold for export imposed by Government in 2021. Imports increased by 34 percent in FY 2020/21, to USD 8324.3 million, from a decline of 9 percent in FY 2019/20. International reserves increased from 4.75 months of imports of goods and services in FY 2019/20 to 4.82 months of imports of goods and services in FY 2020/21, rising above the NDPIII target of 3.3 months of imports.

Key Findings

8. **Growth outcomes have been hampered by exogenous shocks and slow implementation of infrastructure projects.** The MTR recommends a review of the underlying assumptions driving the plans. National Development Plans should be prioritized within the context of realistically mobilising resources to finance and implement them.

9. **In light of the recent challenges due to the pandemic and surge in commodity prices, the assumptions under pinning the NDPIII will need to be revised**. The MTR reviewed all the underlying assumptions and for the remaining half of the NDPIII growth projections should be revised down. Discussions with the fiscal and monetary authorities also signal conservative estimates of growth. Based on the re-

prioritization of resources within the plan the MTR projects growth to average 5.2 percent during the period 2023/24-2024/25. This therefore means that the NDPIII growth projections averaging 7 percent in the last two years of implementation cannot hold and should be revised downwards to the MTR average of 5.2 percent.

10. **Commitment to the charter of fiscal responsibility is yet to be demonstrated in the remaining half of the NDPIII**. The intentions of the Charter are to provide Government's fiscal policy objectives in the next five years that will ensure sustainable delivery of the country's goal of socioeconomic transformation resulting in increased household incomes and improved quality of life of Ugandans. The MTR recommends using the Charter of Fiscal Responsibility as an anchor to enforce fiscal discipline. Frequent use of supplementary budgets not matched with domestic revenues should be discouraged.

11. **The MTR notes with concern the further narrowing of fiscal space available for development spending.** Interest payments in the total budget now amount to 20 percent. Spending allocated to the development budget is 10 percent of GDP. While infrastructure development has been at the core of fiscal policy for the past 12 years and justifiably so—the MTR notes there is need to reprioritise infrastructure projects within the programs with a possibility of phasing them over a longer time if government is to meet its targets in the charter of fiscal responsibility.

12. **The NDPIII revenue strategy was aimed at improving compliance and efficiency in tax revenue collections by implementing the Domestic Revenue Mobilization Strategy (DRMS**). Progress on the DRMS reforms has been mixed with some reforms yet to be implemented. Of the 26 DRMS interventions tracked, seven (27%) registered good performance, nine fair (35%), and 10 poor (38%). Some challenges are also noted including: (i) non-implementation of strategic DRMS interventions; (ii) inadequate specialised training conducted by TPD and URA staff; (iii) low technical staffing levels at both TPD and URA, and; (iv) limited access to necessary data by the TPD and URA.

13. **Performance of revenue collections is still way below its potential**. During the last two years of implementation of the NDPIII, revenue has averaged at 13.3 percent of GDP. Besides, the contribution of tax revenues to the total budget has also continued

to decline from 70 percent in FY2018/19 to 59 percent in FY2021/22, pushing government to costly borrowing either domestically or externally. It is estimated that the potential revenue collection is between 16-18% of GDP highlighting a significant gap to be covered in revenue collection. The Plan's focus was to strengthen administrative efforts to improve revenue performance in line with the country's potential revenue by providing better training and resources to URA to modernize and expand ICT capability and other necessary tools.

14. **A weak fiscal-social contract between citizens and government continues to limit growth of the revenue tax base**. The MTR strongly recommends that government should strengthen links between tax and spending decisions, as well as budget transparency. The MTR also notes that some progress has been made in developing and implementing a comprehensive tax expenditure framework to properly evaluate all tax reliefs and allowances. The MTR recommends that wider consultations on tax policy design should be embraced and prioritized prior to drafting tax policies into laws and to avoid tax policy reversals.

15. **Tax revenues have remained stagnant owing to the restriction of the tax base largely on industry and services sectors and limited collection from agriculture related activities**. This has resulted into a high tax burden of complying tax payers in industry and services, leading to closure of enterprises as informed by representatives of traders. While the agriculture sector remains largely subsistence with farmers operating at a small scale, MTR also found that commercial agriculture (crop production and animal husbandry) is also emerging and largely untapped as a tax base. To avoid setting up regressive tax policy measures targeting the agriculture sector, government should register large commercial farmers with the objective of widening the tax base.

16. **In a quest to attract investments, Uganda offers generous tax incentives and exemptions albeit at the cost of further erosion of its tax base**. The MTR would recommend rationalizing these tax incentives and exemptions and where necessary use them judiciously targeting productive sectors. The tax foregone through these incentives has remained stagnant during the past two years estimated at 1 percent of GDP. A comprehensive assessment of the beneficiary companies in terms of their

contribution towards other taxes, employment and exports where applicable should be undertaken.

17. **Due to the delays of adjusting to program-based planning and budgeting in 2020/21, resources under the NDPIII were allocated based on sectors.** Based on the Certificate of Compliance, alignment of the NBFP for FY2020/21 and the NDPIII was only compliant at 48.0 percent. Agriculture, Tourism, Social Development and Local Government Sectoral allocations in the NDPIII and the NBFP were fully aligned. Other sectors such as Public Administration, Legislature, Accountability, and Defence and Security were allocated resources way above what was planned for in the NDPIII. This practice continues to undermine the role of planning.

18. **Budget alignment according to programmes and NDPIII has been mixed**. A case can be made that variations were partly due to the fact that the underlying assumptions of the NDPIII should also be changed owing to the external shocks and new emerging security challenges in neighbouring countries. Governance and security programme received the bulk of the budget at 16.7 percent followed by human capital development at 16.5 percent and interest payments at 16.4 percent in 2021/22.

19. **The deviations between the NDPIII and the budget also emanate from the approach used to cost the plans.** The MTR found that there were limited consultations between the NPA and MoFPED during the costing process of the PIAPS. While NPA conducted various consultations on the PIAPS, most MDAs expressed dissatisfaction on the top-down approach that was used by NPA. For budgeting purposes, MoFPED expressed concerns on the quality and frequency of changes of PIAPS, and with some lacking indicators which complicates the budgeting process. This lack of buy-in of PIAPS from the MDAs has compromised both budgetary processes and implementation.

20. **To further align the budget with the NDP, the MTR concurred with the recommendation from Budget department that MoFPED should only provide budget ceilings to the programs.** Program secretariats should be at the centre of allocating resources within their programs. This is how program secretariats would have a need to meet and prioritize their spending. To achieve this, it will require fully

functioning programme secretariats to be in place and which are resourced annually through the budget.

21. **Strengthening program cost estimation for budget preparation should be made a priority and mainstreamed within government.** The MTR found that there are several costing centers resulting into different versions of MTEF based at the NPA and MoFPED which are later compared for alignment. The assumptions underlying the allocation of resources within the PIAPS are not guided by any unit costs—but rather by expenditures on similar activities or actions in the past. MoFPED, in liaison with NPA, Public Service and OPM as members should establish and verify the unit costs on programme inputs and the corresponding service delivery standards.

22. **To enhance budget efficiency the MTR found an urgent need to introduce annual spending reviews (expenditure tracking) prior to the budget process.** These reviews should be used as partly the basis for prioritizing resources in allocation of resources. Spending review refers to the systematic scrutiny of existing expenditure to identify, in particular, options for cuts by drawing on both program evaluations (the review of specific services provided by government) and efficiency reviews (which focus on reducing the cost of delivering services). Without spending review, the risk is that programs which are ineffective, low-priority or which have outlived their usefulness will continue to draw on public resources. Positive feedback under the spending reviews will also motivate MDAs to lift their performance towards programme outcomes. In this context, spending reviews should be integrated within the budgeting process and cycle and should be conducted annually. Given the enormous work of undertaking these reviews annually—there could be a discretionary targeted approach where programs expected to yield significant savings are reviewed. OPM should play the leading role in undertaking these program spending reviews.

23. **In light of the existing fiscal constraints, existing waste built over time under incremental budgeting, the MTR strongly recommends government to adopt zero-based budgeting (ZBB).** Budget efficiency will be achieved through adoption of zero-based budgeting. For government use, this planning and budgeting technique endeavours to redirect efforts and funds from lower priority current programs to higher priority new programs, improve efficiency and effectiveness, and reduce spending. As well, ZBB are set to prevent regular budget creeping behaviour that

emphasizes inflationary adjustments. Therefore, for budget to be translated into concrete development and growth there must be a real forecast of goals or targets at all the tiers of governments.

24. **To fully adopt the program-based planning process, the MTR recommends changes to the budget formulation process**. There should be a link between the programme secretariats, MoFPED and OPM during this consultative process. The challenges of local governments to formulate their BFPs emanated from the fragmented adoption of programs within the budget formulation processes. Once MoFPED determines the ceiling for the various programs, there should be an iterative process between MoFPED and programs in the allocation of resources to the priority sectors.

25. **Frequent supplementary budgets continue to undermine planning and budgeting processes.** While supplementary budgets are provided for under the PFM Act with a limit of 3 percent to the total approved budget, this has increasingly been violated over the years. The number of supplementary requests has continued to increase from 177 in the FY 2017/18 to 1,011 in the FY 2019/20 and leaped to 1,322 by first half of the FY 2021/22. Total supplementary expenditure by the central government increased from UGX 1,682.81 Bn in the FY 2017/18 to UGX 4,270.48 Bn in the FY 2021/22. The MTR also noted that 75 percent of supplementary expenditures were predictable and could have been planned for in the budget. This points to the fact that there is a missing link between planning and budget processes. In addition, 91% of supplementary expenditures have been financed by mainly suppressing MDA expenditures. This undermines the spirit of planning and budgeting. The MTR recommends adherence to the PFM Act especially by properly planning for predictable expenditures with a view to contain supplementary budgets within 3 percent of the total budget.

26. **Domestic arrears have continued to rise despite Government efforts to reduce them over the years**. By the end of 2021, the 2022 Office of the Auditor General Report reported a further increase in the stock of domestic arrears from UGX 1 trillion in FY15/16 to UGX 4.65 trillion in FY2020/21. The rise in arrears has been mainly attributed to fiscal indiscipline, poor financial management and weak system controls (MoFPED, 2021). The large amount of domestic arrears poses a risk towards fiscal

sustainability as it disguises the actual size of the fiscal deficit, and reduces the impact of fiscal policy (MoFPED, 2021). In addition, arrears pose a reputational risk to Government which can affect the country's credit risk ratings.

27. **As government embarks on fiscal consolidation to meet its targets in the charter of fiscal responsibility there is a need to reprioritize spending**. As highlighted in the background to the budget, the first call on resources over the remaining period of the NDPIII will target the following interventions that: (i) have higher multiplier effects and dependencies; (ii) directly linked to addressing household poverty and food security; (iii) are in position to aid quick economic recovery (directly impact production and consumption); and, (iv) in alignment with the operationalization of the Parish Development. In light of this criteria, the MTR undertook simulations where there is some prioritization of resources and focusing more on agro-industrialization, energy and water for production. This simulation results into a higher growth path averaging 5.2 percent within the available resource envelop and without necessarily resulting into higher debt. Exports under this scenario also increase by an average of 6 percent improving the debt liquidity indicators for Uganda's capacity to pay debt.

28. **There are vulnerabilities with Uganda's debt portfolio.** Even though some debt burden indicators remain below their indicative thresholds, they have increased compared to the previous DSAs. More risks include: (i) increasing debt service; (ii)increasing weighted average interest rate risk owing to huge appetite for costly domestic debt; (iii) reducing average time to maturity of the portfolio; and, (iv) reducing maturity risk. The debt service as a proportion to total budget is also indicative of narrowing gap to accumulate further debt. There is limited space for further borrowing based on the DSA done by MoFPED. Based on the ratio of PV of debt to exports, further excessive borrowing will push the country to a high-risk category between the period 2022 and 2026.

29. **Government should start exploring other options to finance large infrastructure projects whose economic returns may not be viable in the short run but with enormous social benefits.** Uganda is currently rated at B+ by Fitch and Standard and Poors rating agencies. At the backdrop of these ratings, the MTR recommends that the Government considers alternative financing models. These include issuing long-term Infrastructure Bonds, community-based PPPs, climate finance, Islamic finance among

others as provided for in the PIFS. Government has finalized the infrastructure bond framework that will operationalise and guide issuance. Government should also mobilize large surplus spending institutions to finance infrastructure projects, such as pension funds, particularly the National Social Security Fund (NSSF). Other emerging financing options which are particularly targeting green growth investments should also be explored. An example in this context is the the Green Bond, a type of fixed income instrument, specifically, earmarked to raise funding for climate-related and environmental projects. Public Private Partnerships have been embraced in the previous plans as a mode of financing to complement traditional sources. The MTR noted that there are still challenges for Uganda to benefit from PPPs given their complexity. Skills development in project finance, legal provisions for contracts, contract monitoring based on outcomes should be prioritised. Lastly, to fully benefit from Islamic Finance, government of Uganda would need to fully embrace the requirements of this financing option so as to adequately tap into all opportunities available to both private and public sector. This will require reviewing the existing legal, and institutional framework to identify constraints and devise measures to overcome them. The MTR also noted other emerging forms of financing particularly pre-financing projects. Discussions with various authorities pointed to various risks for this form of financing and being more costly to government than direct borrowing.

30. **Credit to the private sector has increased, but at a slow rate compared to the growth over the NDPII period**. The period July 2019 to date demonstrates the extent to which government has aggressively been borrowing from the domestic market at the expense of private sector credit growth and also way out of line with other monetary aggregates. The MTR notes that this is a worrying trend that needs to be reversed if government is to promote private sector development as well as support macroeconomic stability.

31. **To address the cost of credit challenge, the MTR recommends further capitalization of UDB** as this will enable it to address the high cost of credit especially for small and medium enterprises and enabling the bank to provide loans with long term maturity especially for industrialization which requires patient capital. In addition, for government to meaningfully play a role under the quasi-market

approach, UDC needs to be further capitalized if it is to invest in larger impactful projects such as iron and steel, oil and gas, petrochemical and fertilizer production.

32. **Fiscal expansion over the past three years has resulted into rapid increase of public debt is restraining implementation of monetary policy.** Given the current level of debt service, this constrains the conduct of monetary policy, inducing the central bank to pay growing attention to reducing the costs of servicing the public debt, especially domestic debt. Notwithstanding urgent and unplanned for expenditures which usually emerge through supplementary budgets and financed through domestic borrowing, there is a need to enhance better coordination between fiscal and monetary authorities as the monetary policy space to maintain macroeconomic stability is being narrowed by such actions.

1.0 Introduction

1.1 Background

33. This report presents the findings of the midterm review (MTR) of Uganda's third National Development Plan (NDP III) on the economic management thematic area, which forms one part of the six parts of an independent mid-term review of NDPIII, 2020/21 to 2024/25, commissioned by the National Planning Authority (NPA). The five other thematic areas of the MTR are: policy and strategic direction; program design and institutional framework; partnerships; monitoring and evaluation framework; local economic development; as well as an overall synthesis report.

34. The terms of reference for the review emphasised the importance of highlighting the challenges encountered during the two years of implementation of the plan and of making recommendations for the remaining period of the NDPIII. The recommendations are also expected to inform the development of NDP IV.

Uganda's Macroeconomic Policy/Vision

35. The over-riding aim of Uganda's economic policy is sustained economic growth and transformation from a least developed country (LDC) to a middle-income country. Within this framework, Uganda Vision 2040 has been formulated as a long-term development planning framework to provide development paths and strategies to operationalise Uganda's Vision statement which is *"A Transformed Ugandan Society from a Peasant to a Modern and Prosperous Country within 30 years"*. The Vision 2040 is conceptualized around strengthening the fundamentals of the economy to harness the abundant opportunities within and outside the country, including her geographical location and trade that are to date considerably under-exploited.

36. The Vision 2040 identifies nine specific opportunities: oil and gas, tourism, minerals, ICT business, abundant labour force, geographical location and trade, water resources, industrialization, and agriculture. On the other hand, the fundamentals include: infrastructure for (energy, transport, water, oil and gas and ICT); science, technology, engineering and innovation; land; urban development; human resource; and peace, security and defence.

37. The Vision 2040 strategy adopts a quasi-market approach, which includes a mix of Government investments in strategic areas and private sector market-driven actions. Government has committed to promote and encourage Public-Private Partnerships (PPPs) in a rational manner, and invest in areas of strategic and national interest with potential to stimulate the establishment of secondary and tertiary industries. Some of these industries require large amounts of capital, have high risks and long turn-around times, and may thus be less attractive to the private sector alone; the involvement of Government through PPPs can potentially help to mitigate some of these disadvantages. In addition, the Government will continue to pursue outward-oriented policies by encouraging inward foreign investment, and exports with high value addition, as well as pursuing sound macroeconomic policy and management.

38. Government is committed to exploiting Uganda's location to develop it into a regional hub for industrial production, trade and transit, and air transport. To exploit these opportunities, Government has undertaken to invest in integrated state of the art infrastructure development and maintenance in the areas of energy generation, road and railway infrastructure connecting to all major border points. This will be achieved in partnership with the neighbouring countries, South Sudan, Kenya, DRC, Rwanda and Tanzania. The Vision 2040 is operationalised through five-year NDPs and Sector Development Plans. As such, NDPs each of 5 years are envisaged to support the transformation of Uganda's economy from a low-income, subsistence agriculture base to a diversified, prosperous country within 30 years. At the moment Uganda has gone through NDP1 for the period 2010/11 to 2014/15, NDPII for the period 2015/16 to 2019/20 while NDPIII to be implemented over 2020/21 to 2024/25 has just entered its third year of implementation.

39. Specifically, NDPIII is underpinned by a macroeconomic strategy whose overall goal is to accelerate and sustain inclusive economic growth, while maintaining macroeconomic stability and debt sustainability. The macroeconomic strategy for the NDPIII therefore is to enhance the impact of public investment on growth through implementation of policies that foster efficiency in public investment, increase domestic revenue mobilization efforts and maintain price stability. Specifically, the macroeconomic objectives include: (i) Poverty reduction from 21.4 percent to 18.5 percent; (ii) Achieving an accelerated economic growth rate at about 7 percent by FY2024/25; (iii)

Increase in the stock of jobs by an annual average of about 512,000; (iv) Fostering price stability by maintaining core inflation within the target band of 5 percent +/- 3; (v) Keep a market determined foreign exchange rate; (vi) Ensure that an appropriate level of reserves in terms of months of imports of goods and services is achieved (EAC target at least 4.5 months); (vii) Pursuing a prudent fiscal policy with the aim of supporting macroeconomic stability consistent with regional and domestic fiscal rules—this includes a ceiling on debt to GDP of 50 percent in present value terms and a gradual achievement of a fiscal deficit of 3 percent by FY 2024/25, and; (viii) increasing domestic revenue average annual growth of 0.5 of GDP percentage points.

1.2 Objectives of the MTR

40. The purpose of the NDP III MTR on the economic management thematic area is to assess the progress made against set objectives and results, identify challenges and emerging issues and recommend specific actions to address them in the remaining period of NDP III. It includes details of policy actions undertaken as per commitments in the NDP III, economic performance outcomes, and identifies where policy commitments have been met or not.

41. The thematic report is aimed at generating information and documenting progress in implementing Uganda's national economic vision. The MTR assessment focuses on the efficiency and efficacy of the national economic governance and management framework in terms of enhancing opportunities and poverty reduction for the ordinary citizen's welfare.

42. The MTR assessment of the NDP III economic management thematic area covers five broad areas, namely:

(i) Real Economy: this involves documentation of Uganda's economic growth, including analysis of the contribution of key sectors of the economy, drivers of the growth, recent commodity price surge and implications of Covid-19 on the economy.

(ii) Fiscal Sector Performance: assessment of fiscal policies of the NDP period and its performance in terms of tax revenue, NDP III funding and government expenditure, domestic resource mobilization efforts and debt levels and sustainability.

(iii) Monetary Sector Performance: assessment of the monetary sector, including progress with achieving key monetary sector targets of macroeconomic stability in terms of inflation, exchange rates, credit to the private sector and money supply.

(iv) External Sector Performance: assessment of the performance of the external sector in terms of trade (exports and imports of goods and services), and external funding on NDP III priorities through debt and other instruments.

(v) Key findings of the consultative process and the need to reprioritize spending.

1.3 Scope of MTR

43. Overall, the mid-term independent review of the NDPIII sought to assess the level of its implementation, within the framework of the envisaged strategic direction, economic and social structural changes and emerging challenges and opportunities. The NDPIII MTR endeavours to redirect the country through the reprioritization process towards recovery of the economy through a review of the:

i) Assumptions of the Plan after the COVID 19 effects on the economy;
ii) Macroeconomic framework;
iii) Targets of the plan;
iv) Implementation arrangements of the programme-based approach;
v) Programme performance including attendant projects;
vi) Financing arrangements; and
vii) Reprioritization of key interventions, projects and actions.

The midterm review does: (1) provide an early signal of the NDPIII's relevance, coherence, effectiveness, efficiency, impact, and sustainability; (2) collect performance indicator data; (3) assess whether the Plan is on track to meet results and targets; (4) review the results frameworks and theory of change; and (5) identify any necessary mid-course corrections.

1.4 Approach

44. The MTR of the economic management thematic area has mainly relied on desk review and analysis of official statistics and published reports of the Government Ministries Departments and Agencies (MDAs), especially the Uganda Bureau of Statistics (UBOS), Bank of Uganda (BOU) and the Ministry of Finance Planning and Economic Development (MoFPED). The following process was followed in preparing this report:

(i) Review of literature on Uganda's Economic Management framework, including the economic management strategy of NDP III, and evaluating its dynamics over the last 2 years.

(ii) Collection of secondary data and analysis. The assessment made use of official statistics, databases and published reports of Government and international organisations. The data sources used include UBOS, BOU, Uganda Revenue Authority (URA) reports, MOFPED, and Ministry of Trade Industry and Cooperatives (MOTIC) reports, among others.

(iii) Undertake economy-wide modelling of the recent shocks especially COVID-19 and commodity price shocks to inform the new policy discourse on the need to reprioritise spending and changes in policies.

(iv) Drafting the report, focusing on generating evidence and understanding of consequences of the economic management strategy as outlined in NDPIII and how it has been implemented during the first two years of the NDPIII.

45. The approach of the economic management MTR assessment is to assess the extent to which the macro-economic co-ordination that was instituted between MoFPED, NPA and BoU is supporting the macro-economic objectives and targets of the NDP III. The theme also looks broadly at the extent to which the economy has performed, the case for the current rate of performance, and if current rates of growth are sufficient to meet the NDP III targets. The assessment also interrogates the extent to which the economic management reforms were implemented, the results of these reforms and the impact they had on public expenditure management and accountability in the first two years of NDPIII.

46. Within the above are the overarching evaluation questions, the economic management thematic report followed the following review questions:

EM1	To what extent has the Covid-19 and the Ukraine crisis affected the Macro-economic framework? In particular, growth projections/outlook & attainment of Lower middle-income target, fiscal performance (revenues, expenditures and financing), monetary

	& External developments and debt.
EM2	In light if the challenges of Covid-19 and the Ukraine crisis, is the current macroeconomic framework still valid? If not what needs to be changed?
EM3	Has the current macroeconomic framework enhanced price stability? Given the current commodity price increases what should be done for the remaining three years to avoid further erosion of the gains achieved in the past due to stable macroeconomic environment?
EM4	To what extent have NDPIII financing arrangements been fulfilled? These include: (DRMS, Oil related resources, PPPs, South to south Cooperation, Domestic private sector, diaspora)
EM5	To what extent have NDPIII priorities been effectively budgeted for, financed and monitored? (the extent to which the budget is aligned to NDP priorities)? To what extent have supplementary expenditures affected the NDPIII.
EM6	What has been the implication of budget cuts (and sub-optimal delivery?) on the NDPIII implementation?
EM7	What reforms have been implemented to improve economic management in the past 2 years?
EM8	To what extent has implementation of macroeconomic policies led to job creation
EM9	Are the current Domestic resource mobilization reforms enhancing private sector growth
EM10	Is the current fiscal stance and debt levels sustainable?

EM1 1	Has the monetary policy stance during the past two years supported growth, poverty reduction and private sector development?
EM1 2	What reprioritization should be done under the MTEF for the remaining 3 years of NDP3?

1.5 Structure of the Report

47. The report is organised in three parts. Part one presents preliminary information which includes the title page, table of contents, acknowledgment, list of abbreviations and an executive summary.

48. Part two is the main body or report text. The main text is organised in five chapters which comprise:

(i) Chapter 1 that explains the context in which the economic management thematic area report for the mid-term review has been prepared including the background to the MTR itself, economic management framework and NDP III strategy, the approach that has been used in preparing the thematic paper, and the way in which the paper has been organised.

(ii) Chapter 2 presents the situation analysis for the real, fiscal, monetary and external sectors over the first half of NDP IIIand the re-modelled simulations for the remaining period;

(iii) Chapter 3 presents key findings of the consultative process in the various areas of economic management;

(iv) Chapter 4 draws together the main conclusions and makes recommendations.

49. Part three contains appendices or supportive information for the main text such as reference documents and detailed analysis tables.

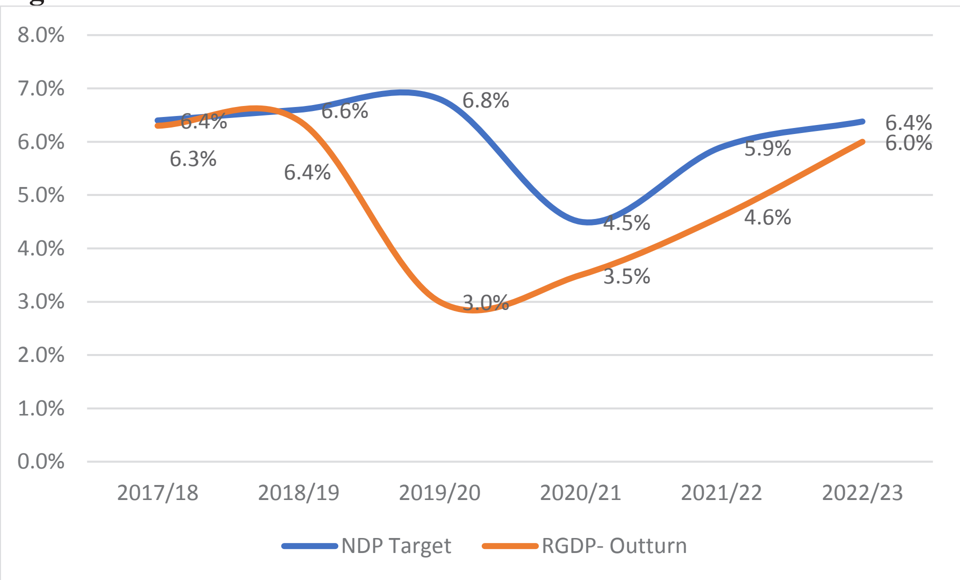
2.0 Situation Analysis

2.1 Real Sector Developments

50. **Overall, the performance of the real economy in the first two years of the NDPIII was below the planned targets and this had ramifications on the overall economy.** While real GDP growth averaged 6.4 percent in FY2017/18 and FY2018/19, following the covid-19 pandemic and other challenges such as floods and locusts' invasion in FY2019/20, real GDP growth significantly fell to 3.0 percent. The country witnessed two lock downs, in March 2020 and June 2021, as ways of controlling the spread of the pandemic. The lock-down measures had far reaching consequences on the economy as they disrupted production, distribution of supplies, investment decisions and in some ways national and household consumption spending. The current surge in commodity prices and the need to contain inflationary pressures has made it more challenging to attain the earlier forecasted growth rates in the region of 6-7percent for the remaining years of the NDPIII.

51. **Despite the realised real GDP growth being lower than the planned targets during the two years of NDPIII implementation, the economy is slowly recovering albeit the current challenges emanating from the external shocks.** In FY 2020/21 the country registered 3.5percent growth compared to 3.0percent in FY2019/20. The economy continued on an upward growth trajectory in FY2021/22 as it grew at 4.6 percent albeit below the planned targets (Figure 1).

Figure 1: Planned versus Real Gross Domestic Product Outturns FY2017/18-22/23



Source: UBOS and NPA

52. **Slowness in implementation and management of public investment cycle contributed towards the low growth outturns**. The NDPIII growth was assumed partly to be driven by public investment especially in the 69 core projects and other attendant projects. As at March 2022 out of the 69 core projects, only 33 projects (48 percent) were under implementation with only 4 projects (6percent) on schedule while 29 (42 percent) were behind schedule. Some of the projects that are behind schedule include: the oil refinery; the East African Crude Oil Pipeline (EACOP); standard gauge railway; rehabilitation of the meter gauge railway; and a number of road infrastructure projects such as the Kibuye- Busega-Mpigi Highway, Kampala-Jinja Express Highway among others. Besides, there are some 2 projects that are ready for implementation but awaiting financing and these are the establishment of the steel industry and the Uganda Digital Acceleration Program which are all critical in accelerating growth and industrialization. It should be noted that the low budget releases, budget cuts and expenditure suppressions undertaken by Government in a bid to redirect resources to health related and emergency expenses brought by COVID-19 partly contributed to low execution of projects to spur growth.

53. **Based on Gross National Income per capita which is widely used as an indicator, Uganda is yet to attain the middle-income status.** NDPIII aimed at transforming Uganda to attain lower middle-income status, with a targeted GDP per capita of USD 1,198 by 2024/25. The NDP III ambition was to attain GDP per capita of USD936 in 2020/21. However, available data from UBOS revealed that GDP per capita increased to USD1,051 in 2021/22. To attain middle income status would require sustained increase in real growth for the next two years. The MTR also recommends that UBOS should also start measuring and reporting GNI as its internationally accepted as an indicator to measure income status. There is also a need to use other measures such as Human Asset index and Economic Vulnerability index for the future assessments of the plan in 2024.

Table 1: GDP per capita at constant 2016/17 prices

	2020/21	2021/22	2022/23	2023/24	2024/25
GDP per capita (USD)- actual	992	1,051			
GDP per capita (USD)- NDP III targets	936	991	1,049	1,116	1,198

Source: UBOS and NPA

2.2 Fiscal Developments

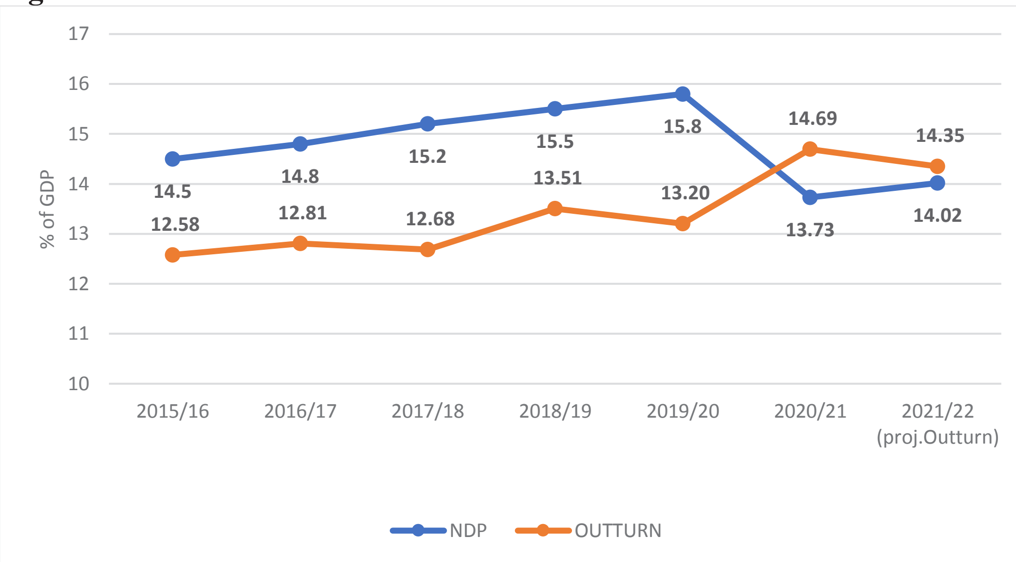
54. **The NDPIII fiscal policy was aimed at maintaining macroeconomic stability and supporting inclusive job-rich growth, while preserving debt sustainability**. This was to be achieved through; i) Continued investment in public infrastructure to accelerate inclusive growth while enhancing efficiency in public investment by implementing the Public Investment Management Policy and Strategy; and ii) Increasing revenue mobilisation by implementing the Domestic Revenue Mobilisation Strategy (DRMS) to reduce reliance on debt and ensure debt sustainability. In light of this, the fiscal strategy was to ensure that the fiscal deficit remains within sustainable levels over the medium to long-term, with the fiscal deficit gradually declining to below 3 percent of GDP by FY 2024/25. The strategy was also to ensure that; the debt to GDP ratio remains below 50 percent; the ratio of interest payments to domestic revenue remains at less than 15 percent; expenditure to GDP averages at 19.6 percent between FY 2020/21 and FY 2024/25; and tax revenue to GDP is increased by 0.5 of GDP per fiscal year.

55. **During the first year of the NDPIII, Government pursued an expansionary fiscal policy, with the fiscal deficit rising to 9.1 percent of GDP above the NDPIII target of 7.8 percent of GDP.** This was mainly driven by the rise in government expenditure to 23.3 percent of GDP as compared to the planned spending of 20.8 percent in FY 2020/21. The higher spending was due to the unforeseen need for more government spending to mitigate the spread of COVID-19, provide adequate support to the health sector to manage the large number of infections as well as social economic assistance to the masses and support economic recovery. Consequently, the debt ratios increased from 41percent of GDP in FY 2019/20 to 52 percent of GDP in FY 2021/22, much higher than the NDPIII target of 45.7 percent of GDP and higher than the debt benchmark of 50 percent. Furthermore, the ratio of interest payments to domestic revenue increased from 16.96 percent in FY 2019/20 to 20.55 percent in FY 2020/21, rising further above the 15 percent benchmark of Government of Uganda’s Public Debt Management Framework (PDMF). The higher debt service burden has considerably reduced the available fiscal space as 20 percent of the budget is projected to be spent on interest payments in 2022/23.

56. **In Financial year 2021/22, Government continued with the expansionary fiscal policy stance to fund economic recovery, with the fiscal deficit amounting to 7.3 percent of GDP as compared to the NDPIII target of 6.2 percent of GDP.** The higher deficit was driven by higher than planned spending, estimated at 21.5 percent of GDP as compared to the NDPIII target of 20.2 percent of GDP.

57. **The NDPIII revenue strategy was aimed at improving compliance and efficiency in tax revenue collections by implementing the Domestic Revenue Mobilization Strategy (DRMS**). The Plan's focus was to strengthen administrative efforts to improve revenue performance in line with the country's potential revenue by providing better training and resources to URA to modernize and expand ICT capability and other necessary tools. The revenue and grants outturn for FY 2020/21 and FY 2021/22 surpassed the NDPIII. This is explained by the fact that the country received more inflows in form of grants (1.32 and 1.10 percent of GDP) as compared to the projection of 0.74 and 0.81 percent of GDP in FY 2020/21 and FY 2021/22 respectively to support the mitigation of the impact of the pandemic. In addition, more tax revenues estimated at 13.38 and 13.25 percent were collected as compared to the planned target of 12.9 and 13.2 percent of GDP respectively for the same period (Figure 2). The increase in tax revenues by 1 percent of GDP in 2020/21 was as a result of increased enforcement in the collection of arrears, implementation of the Electronic Fiscal Receipting Invoice System (EFRIS) and digital stamps for selected manufacturers.

Figure 2: Performance of Revenues and Grants



Source: NPA and MoFPED 2022

58. **Financing the deficit has increasingly been from domestic sources and this has come at a very high cost to government.** The NDPIII's plan to finance the planned deficit of 7.82 percent and 6.18 percent of GDP in FY 2020/21 and FY 2021/22 was to source a large proportion of financing from external sources, particularly 5.48 percent of GDP and 4.12 percent of GDP respectively from external sources while the rest was to be financed from domestic sources. The deficit financing strategy greatly differed from the NDPIII with more financing sourced from domestic sources as compared to external sources which has had negative ramifications to private sector development. In particular, domestic financing constituted 4.6 percent of GDP as compared to the external financing that was estimated at 4 percent of GDP in FY 2020/21. Similarly, of the total 7.3 percent of GDP deficit financing in FY 2021/22, 4 percent was sourced domestically while 3.3 percent of GDP was external financing. Of the total domestic financing resources, 2.4 percent of GDP was bank financing while 1.5 percent of GDP was non-bank financing (Table 2). The MTR established that high domestic borrowing was partly driven by financing of the supplementary requests within the financial year and revenue shortfalls.

Table 2: Deficit Financing (% of GDP)

Description	2018/19		2019/20		2020/21		2021/22	
	NDPII	Outurn	NDPIII	Outturn	NDPIII	Outturn	NDPIII	Proj. Outurn
Financing:	4.91	4.9	7.48	7.1	7.82	9.0	6.18	7.3
External Financing (Net)	2.81	2.8	4.86	4.0	5.48	4.0	4.12	3.3
Disbursements	3.72	3.7	5.4	4.6	6.29	5.0	5.2	4.3
Budget Support Loans	0.14	0.1	2.73	1.7	2.7	2.2	2.04	1.8
Project Loans	3.58	3.6	2.66	2.8	3.59	2.8	3.15	2.5
Armotization	-0.91	- 0.9	-0.53	- 0.6	-0.81	- 1.0	-1.07	-1.0
Domestic Financing (Net)	0.92	1.9	0.91	3.4	1	4.6	1.03	4.0
Bank Financing (Net)	0.96	1.0	1.3	2.1	1.33	1.6	0.81	2.4
Non-bank Financing (Net)	0.9	0.9	0.92	1.3	1	2.9	0.8	1.5

Source: NPA and MoFPED 2022

2.3 Monetary Sector Development

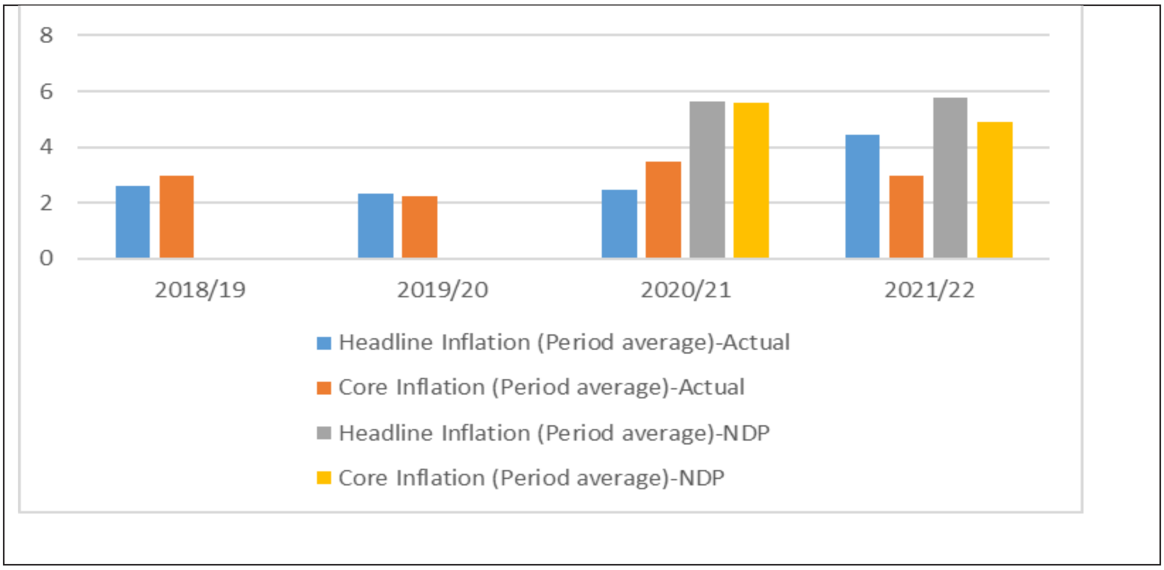
59. **Monetary policy has been underpinned by the desire to maintain macroeconomic stability.** The Bank of Uganda (BOU) has been implementing monetary policy under an Inflation Targeting monetary policy framework since July 2011. In this framework,

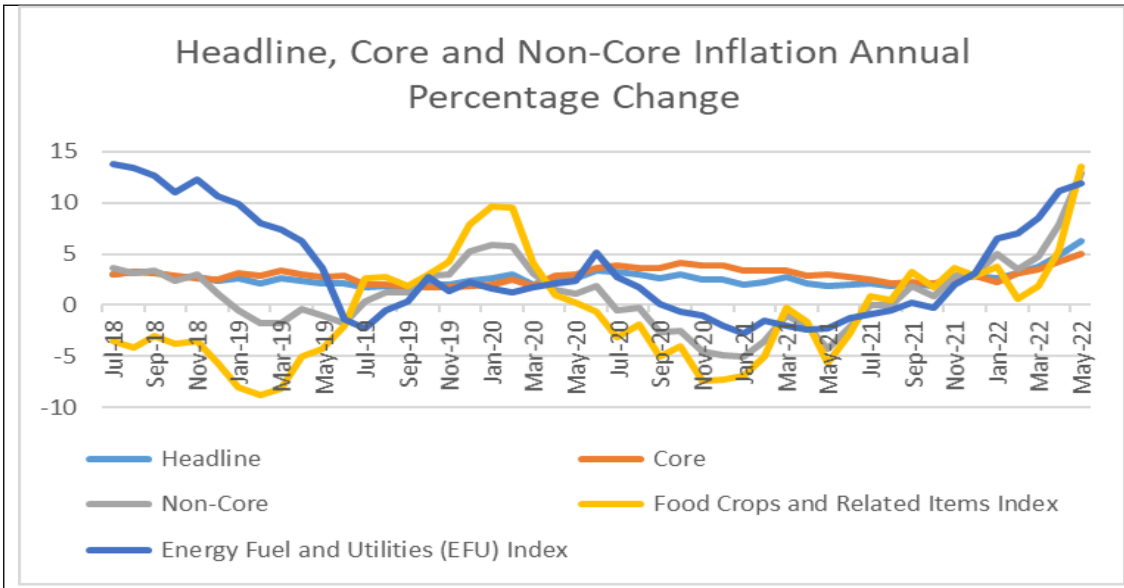
the BOU uses the policy rate to influence the interbank money market rates so that they move in tandem with the movement in the central bank rate (CBR) which in turn should influence other retail interest rates (both short-term and long-term) in the economy.

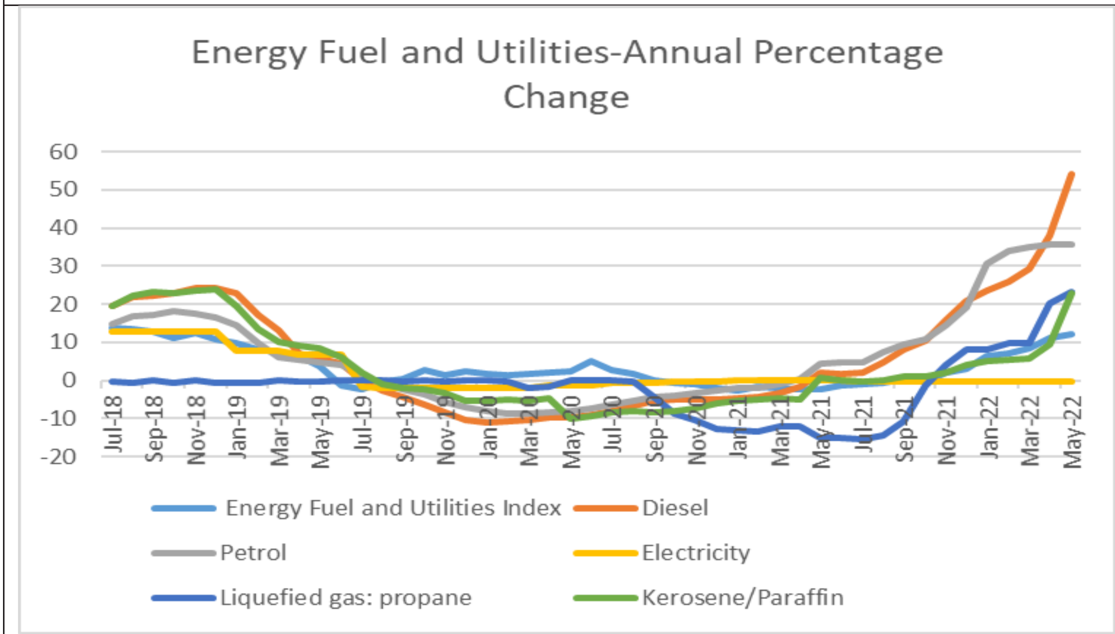
60. The NDP III target was to maintain core inflation within a band centered on 5 percent. The band is currently +/- 2%, resulting in a target range of 3% - 7%. BOU monetary policy framework has ensured price stability during the first year of the NDPIII implementation.

61. **Recent surge in commodity prices internationally has resulted into considerable build-up of inflation (Figure 3)**. Inflation has been increasing rapidly and spreading broadly across the basket of goods and services. Annual headline inflation and core inflation increased to 6.8 percent and 5.5 percent in June 2022, respectively. The key driver for this rapid increase has mainly been from energy related products. Prices of other essential commodities such as soap and cooking oil as a result of supply and demand imbalances that were caused by the COVID-19 pandemic and exacerbated by the Russia and Ukraine.

Figure 3: Actual and NDP Inflation







Source: BOU

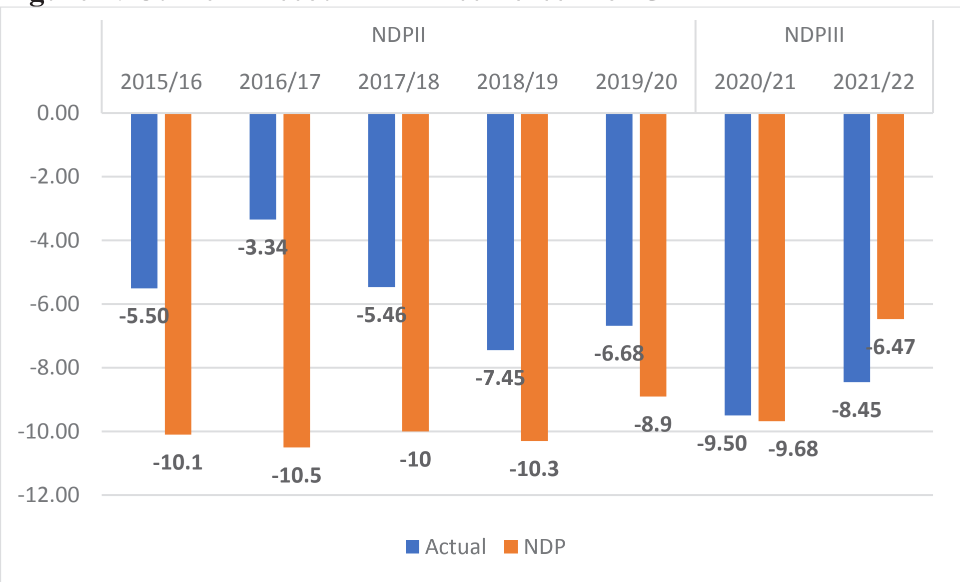
62. Inflation outlook continues to be uncertain owing to the following factors: (i) global inflationary pressures owing to high world food and energy prices; (ii) tight monetary policy being pursued by advanced countries which could intensify portfolio outflows from frontier markets such as Uganda; (iii) high prices in global markets which could further weaken the Uganda shilling, and; disruptions in global supply chains. These risks have further dampened the prospects for higher economic growth, weakened consumer confidence and led to higher exchange rate volatility. To address these challenges of worsening economic outlook, the monetary authorities tightened

monetary policy by raising the CBR from 6.5 in May 2022 to 9.0 percent in September 2022 and maintained the band at +/- 2 percentage points. Further increases in the CBR are also expected until inflation is kept in check.

2.4 External Sector Developments

63. **Uganda's external position worsened in FY 2020/21, with the current account deficit to GDP increasing drastically from 6.7 percent in FY 2019/20 to 9.5 percent in FY 2020/21**. However, this was lower than the NDPIII target of 9.7 percent due to an anticipated worse impact of the pandemic on the external position . There was a slight improvement in the current account in FY 2021/22 marked by a small fall of 1 percentage point as compared the NDPIII envisaged improvement in the external position by 3 percentage points**.** The current account balance was estimated at 8.5 percent of GDP which is above the NDPIII target of 6.5 percent of GDP for this period (Figure 4).

Figure 4: Current Account Balance Percent of GDP



Source: BoU

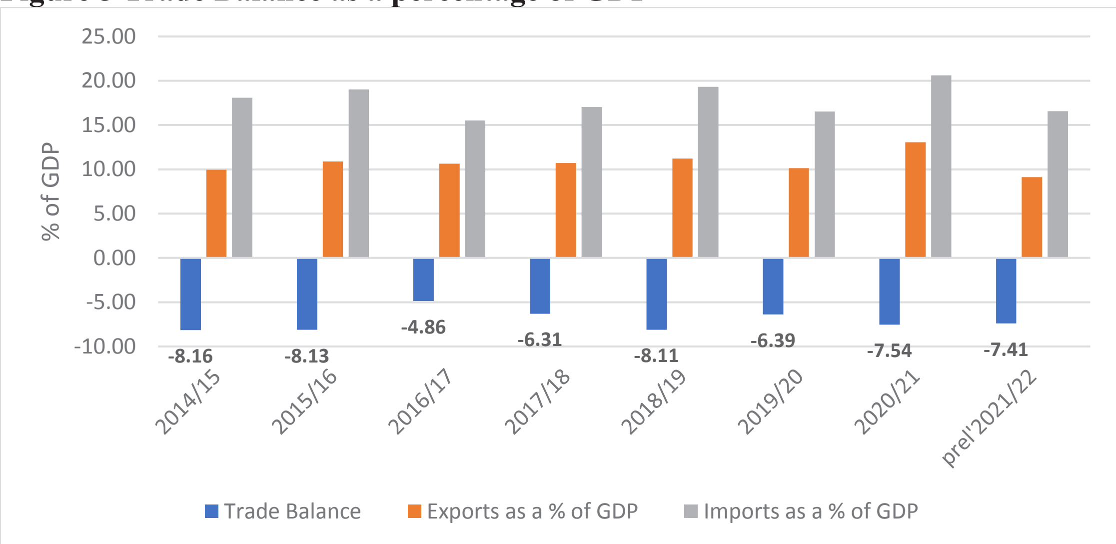
64. **The larger deficit in FY 2020/21 was a result of a worsened position in all the accounts under the current account (Figure 5).** In particular, the trade deficit widened by 26 percent to USD 3,048.9 million from USD 2,402.1 million in FY 2019/20, while the services account deficit increased by 41.2 percent to USD 1895.8 million driven by an 8.3 percent decline in services exports to USD 1422.7million,

coupled with a 14.7 percent increased services imports to USD 3,318.5 million particularly, construction services, transport services, and insurance services.

65. The primary income deficit increased by 7.2 percent from USD 633.5 million in FY 2019/20 to USD 679.5 million in FY 2020/21 mainly driven by increased interest payments on public debt by 46 percent from USD 116.4 million to USD 171.1million**Invalid source specified.**.On the other hand , the secondary income account surplus reduced from USD 1,865.7 million in FY 2019/20 to USD 1,785.1, owing to a decline in remittance inflows from USD 1291.6 million in 2019/20 to USD 1,154.2 million in 2020/21 due to the impact of the pandemic on the diaspora population across the world.

66. **Uganda is a net importer and has maintained a trade deficit for many years (Figure 5).** During the first year of the NDPIII, the trade deficit widened greatly from 6.4 percent of GDP in FY 2019/20 to 7.5 percent of GDP in FY 2020/21 due to a higher increase in imports to GDP estimated at 4.1 percentage points as compared to the increase in exports to GDP which was estimated at 2.9 percent. The imports to GDP were recorded at 20.6 percent of GDP as compared to the exports to GDP which was recorded at 13.1 percent. However, the trade deficit reduced in FY 2021/22 as the imports to GDP more than offset decline in exports to GDP.

Figure 5 Trade Balance as a percentage of GDP



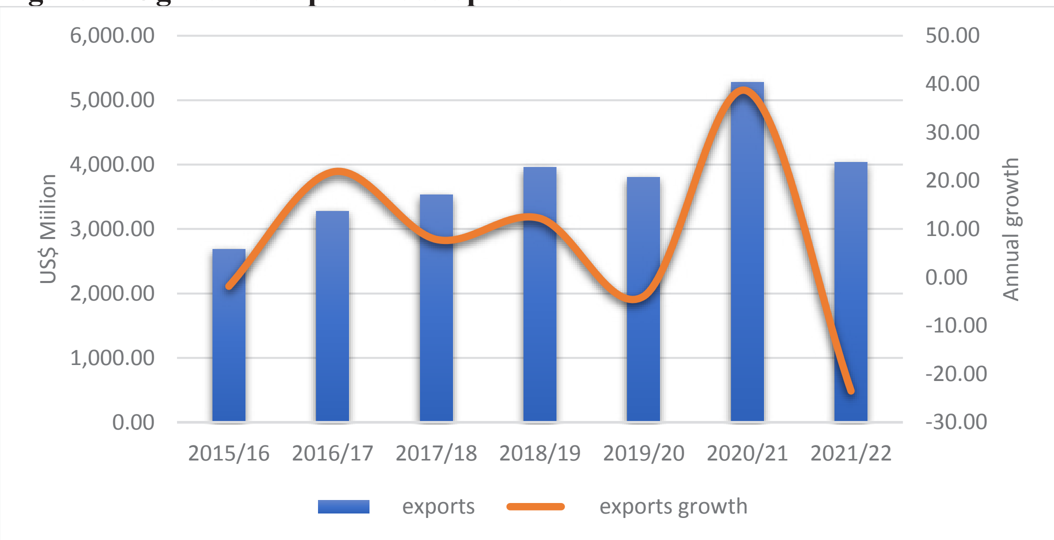
Source: BoU 2022

67. **In the first year of NDPIII, there was a drastic increase in the growth of exports receipts recorded at 38.6 percent, with exports rising to USD5,275 million from**

USD 3,807.1 million in FY 2019/20. The rise in exports receipts was driven by the rise in gold export receipts which increased by 101 percent, as well as beans (117%), flowers (22.5%) and tea (20.4%).

68. **However, the export receipts declined by 23.5 percent to USD 4,034.9 million in FY 2021/22 (Figure 6)**. The lower export receipts were mainly due to the halt in gold exports by exporters as a result of a levy of 5 percent on every kilogramme of refined gold and 10 percent on unprocessed gold for export imposed by Government in 2021. In addition, the decline in tobacco and simsim exports contributed to the lower export receipts in FY 2021/22 as well as maize exports which reduced partly due to the restrictions imposed on maize importation in Kenya.

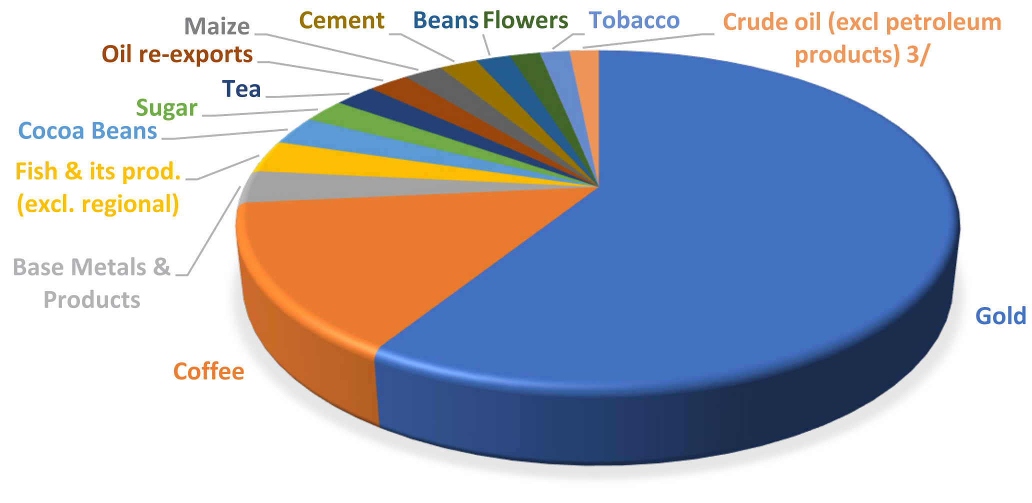
Figure 6: Uganda's Export Developments



Source: BoU 2022

69. Noteworthy is the fact that Uganda's exports are mainly primary products (Figure 7) which have a lower value in the international trade market and therefore result in low export receipts. In addition, primary products are subject to volatile prices due to seasonality of these product which also affects the export receipts of Uganda.

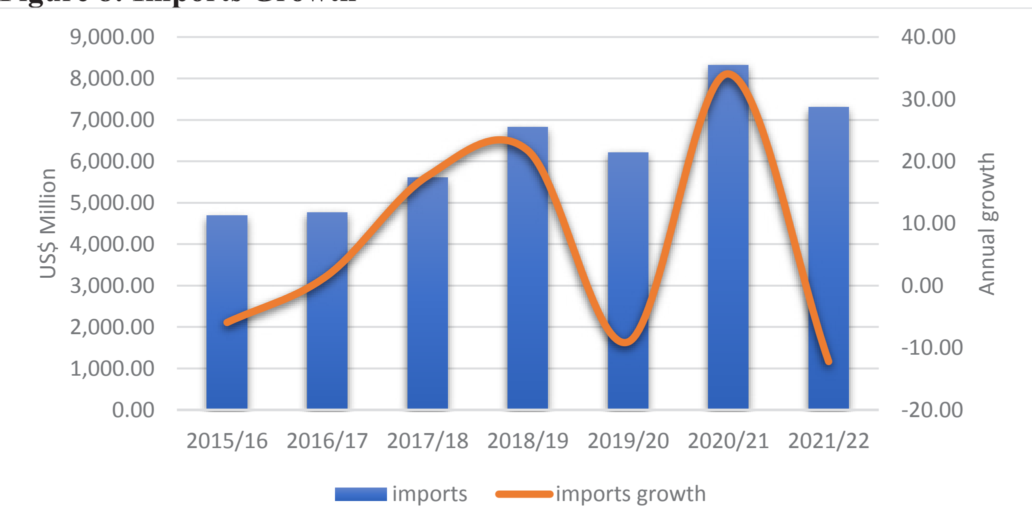
Figure 7: Uganda's Top Exports FY 2020/21



Source: BoU 2022

70. **Imports increased by 34 percent in FY 2020/21, to USD 8324.3 million, from a decline of 9 percent in FY 2019/20 (Figure 8)**. The higher growth in the import bill was driven by private sector imports that increased by 35 percent, mainly resulting from an increased import bill from Arms, Ammunitions and Accessories (363%), Mineral Products (excluding Petroleum products) (98%), Vegetable Products, Animal, Beverages, Fats & Oil (49%), and Base Metals (38%). The rise in the import bill was also due to a 26 percent increase in government imports for projects during the same period. The import bill reduced by 12 percent to USD 7,307.1 million in FY 2021/22, driven by a 29.6 percent decline in Government project imports to USD 337.2 million.

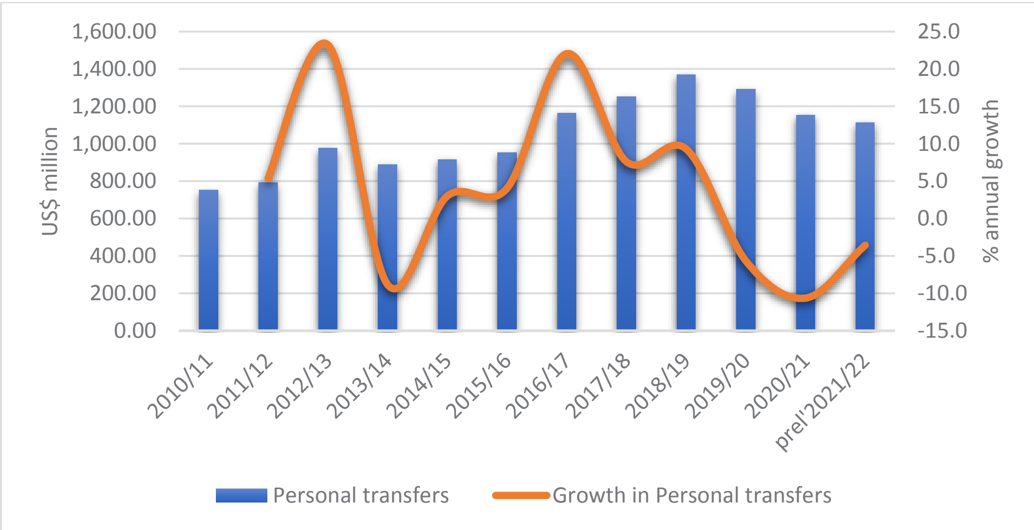
Figure 8: Imports Growth



Source: BoU 2022

71. **Remittances have recorded a downward trend since 2018/19, falling from USD1.36 billion to USD1.11 billion in 2021/22 (Figure 9).** The decline in FY 2019/20 and 2021/22 was attributed to the negative effects of the COVID-19 pandemic on the global economy which affected the incomes of the Diaspora. However, there's a noted improvement in growth of remittances in FY 2021/22 to – 3.6 percent from a decline of 10 percent in FY 2020/21 owing to the move towards economic recovery as the restrictions put in place to contain the COVID-19 pandemic were eased by most economies.

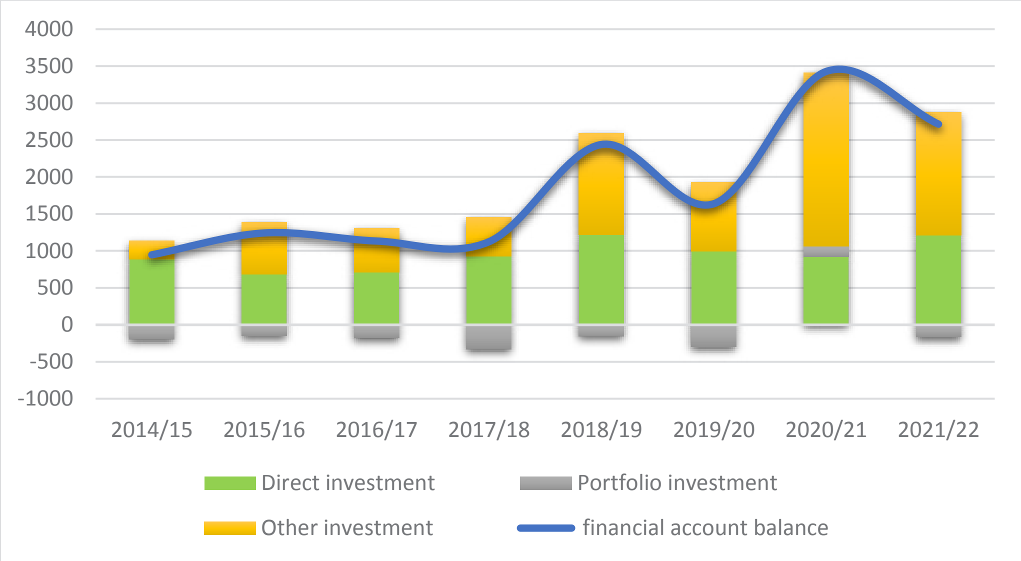
Figure 9: Remittances



Source: BoU 2022

72. **In FY 2020/21 the financial account inflows increased by 109 percent to USD 3,427.7 million, more than offsetting the deficit on the current account (Figure 10).** The increased surplus in the financial account was due to increased capital inflows for budget support and project support to support COVID-19 recovery as well as increased portfolio investments. However, the financial account net inflows declined to USD 2,714.5 million in FY 2021/22, on account of a change from net inflows to net outflows in portfolio investments and a decline in inflows for budget and project support. The financial account balance was insufficient to finance the deficit in the current account.

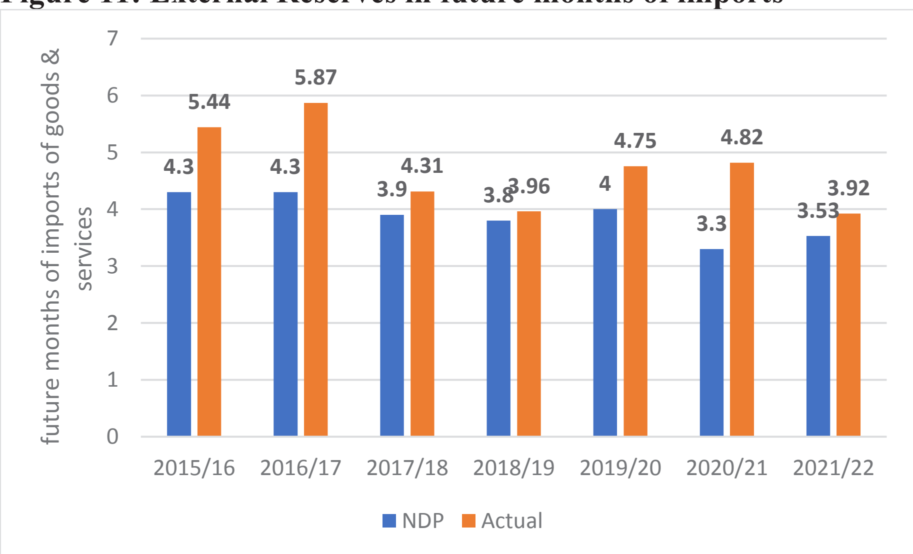
Figure 10: Financial Account Flows in the Balance of Payments



Source: BOU, 2022

73. **Uganda's international reserves increased from 4.75 months of imports of goods and services in FY 2019/20 to 4.82 months of imports of goods and services in FY 2020/21, rising above the NDPIII target of 3.3 months of imports.** The higher stock of reserves was a result of a surplus on the balance of payments arising from increased inflows in the financial account. However, reserves reduced in FY 2021/22 to 3.92 months of imports as there was a draw-down on reserves to contain the recent volatility of the exchange rate. Nonetheless, the reserves remained within the NDPIII target of 3.53 months of imports (Figure 11).

Figure 11: External Reserves in future months of imports



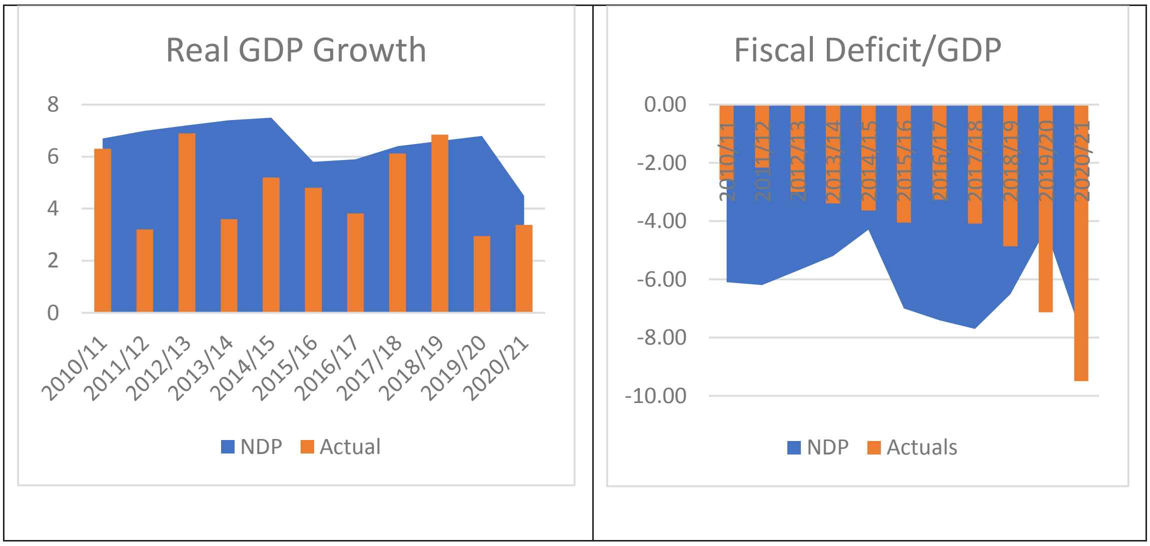
Source: NPA and BoU 2022

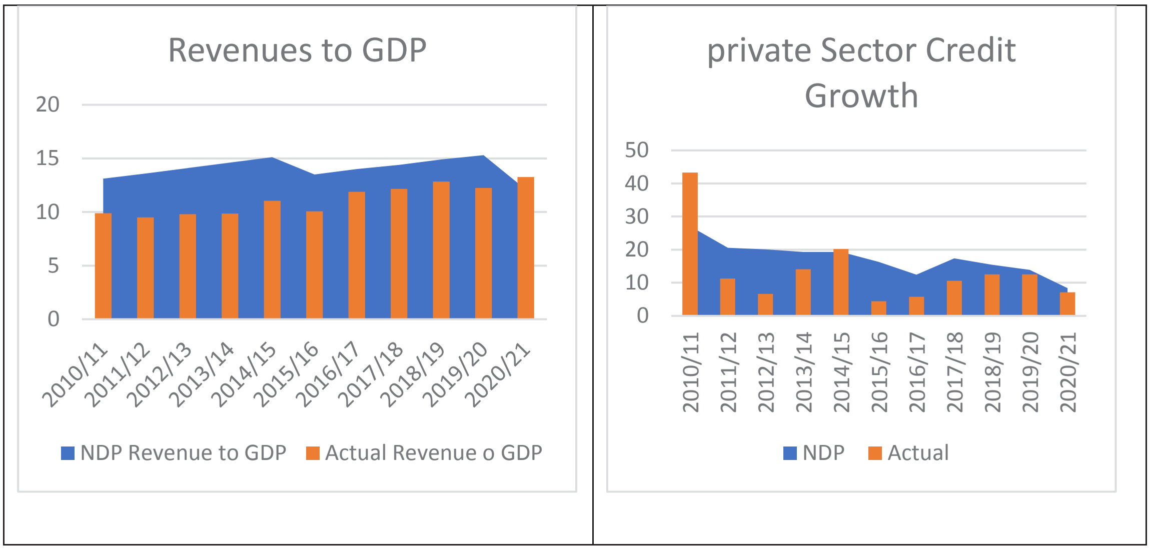
3.0 Key Findings

3.1 Realism of Planning and Underlying Assumptions

74. **Growth has been undermined by external shocks and slow implementation of core projects of the NDPIII**. Growth projections under the NDPs assumed that increasing spending on enablers like infrastructure would result into higher productivity. This has not been realised over the years mainly owing to the following: (i) delays in implementation; (ii) lack of financing for the projects, and; (iii) overly ambitious plans with no clear prioritization or sequencing of projects over time. For instance, at the end of the NDPI period, three out of fifteen projects had some material progress (irrigation systems, Karuma and Isimba Hydro power stations). The remaining projects were at planning, design or feasibility stages. Albeit the challenges in implementation of the core projects in NDPI, NDPII further increased the number of core projects to 39 and at the time of the mid-term review of NDPII only two projects were being implemented satisfactorily. As a result, most core projects were rolled over to NDPIII. Out of the 69 NDPIII core projects, 20 projects are under implementation, 14 projects are still under preparation (Proposal, Profile, Pre-Feasibility, Feasibility), 14 are at project concepts stage and 21 are still at project idea awaiting approval from the Development Committee (DC) by end of the second year of the NDPIII.

Figure 12: Planned and Actual Indicators



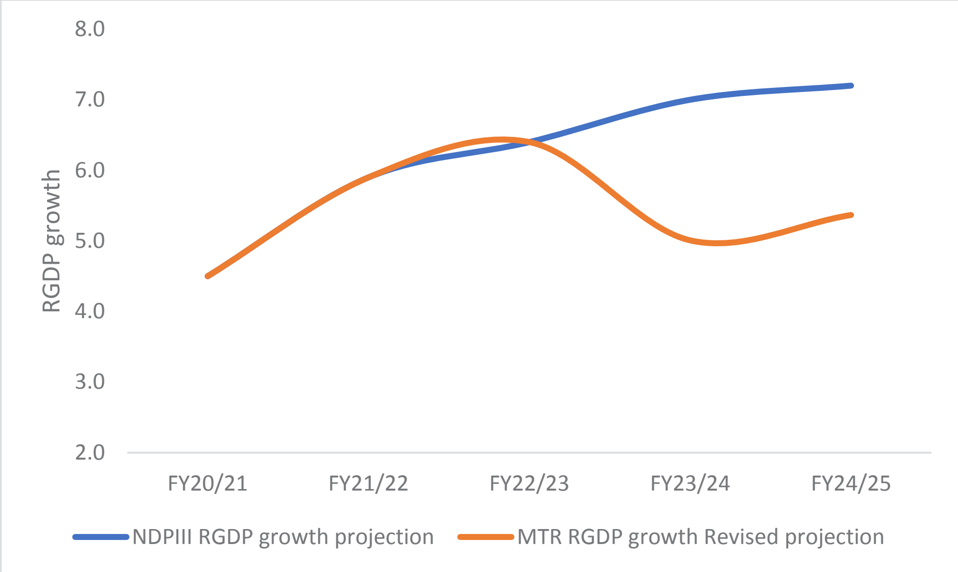


Source: MTR Computations

75. **Actual growth projections have continued to be lower than what has been planned under the NDP.** As a result, the other related macroeconomic targets have also not been met as is demonstrated in Figure 12.. The MTR recommends a review of the underlying assumptions driving the plans. National Development Plans should be prioritized within the context of realistically mobilising resources to finance the plans.

76. **In light of the recent challenges due to the pandemic and surge in commodity prices, the assumptions under pinning the NDPIII will need to be revised**. It was expected that growth would average at 5.2 percent during the first two years of the plan. Actual growth instead averaged at 3.8 percent as the recovery continues to be slow. The slow growth process has undermined governments capacity to collect revenues and therefore implement its programs. This has been translated into higher fiscal deficits more than envisaged in the plan and quick accumulation of debt to finance spending. The MTR reviewed all the underlying assumptions and for the remaining half of the NDPIII growth projections should be revised down. Discussions with the fiscal and monetary authorities also signal towards conservative estimates of growth. Based on the prioritization of resources within the plan (discussed extensively under section 3.9) the MTR projects growth to average 5.2 percent (compared to 7 percent earlier envisaged in NDPIII) during the period 2023/24-2024/25 (see Figure 13).

Figure 13: Revised Growth Projections for NDPIII



Source: MTR Computations using NPA's SDGSIM Model

3.2 Commitment to the Charter of Fiscal Responsibility

77. **Commitment to the charter of fiscal responsibility is yet to be demonstrated in the remaining half of the NDPIII**. The intention of the Charter is to provide Government's fiscal policy objectives in the next five years that will ensure sustainable delivery of the country's goal of socioeconomic transformation resulting in increased household incomes and improved quality of life of Ugandans. The Charter provides some targets on debt financing, fiscal deficits and interest payments as demonstrated in Table 3 .

Table 3: Charter of Fiscal Responsibility and Actual Performance

	2021/22	2022/23	2023/24	2024/25	2025/26
Charter-Fiscal Deficit/GDP	-6.4	-5.2	-4.6	-4.2	-3.0
Fiscal Deficit Actual/Projected (BTTB 2022/23)	-7.3	-5.4	-4.5	-3.6	-2.4
Charter -Debt/GDP	52.7	53.1	52.4	51.2	49.3

Source: MOFPED, 2021

78. The first year 2021/22 shows a deviation from the Charter of fiscal responsibility. It is also projected in the Background to the Budget (FY2022/23) that the fiscal deficit to GDP ratio will be above the target set in the charter. The charter provides for circumstances in which deviations may occur such as natural disasters or unanticipated severe economic shocks such as COVID-19 or the recent surge in commodity prices. However, it also requires the Minister of Finance to publish a report in the gazette and

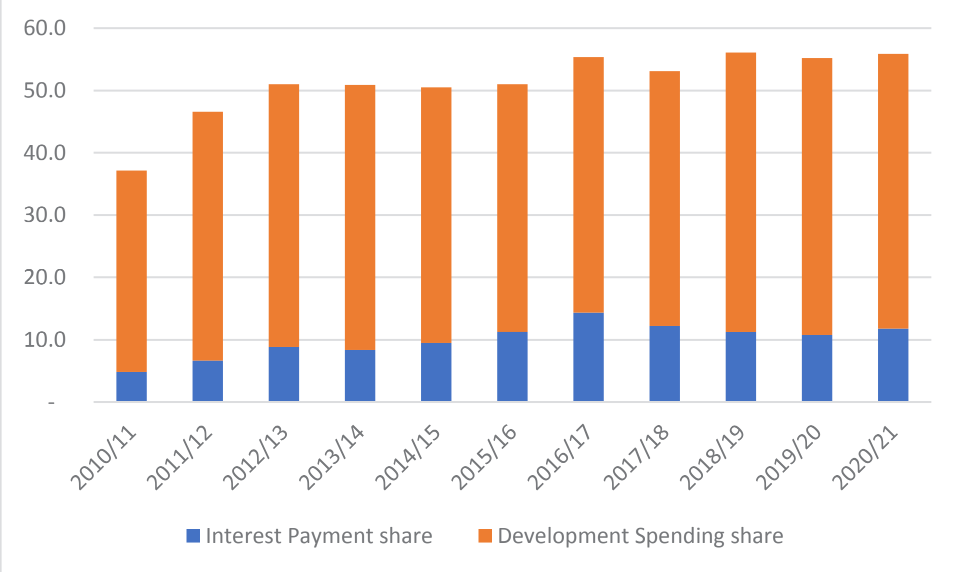
on the website of the Ministry explaining the reasons for the deviation and the adjustments to be done to bring the overall fiscal deficit back to the set path over the remaining financial years.

79. **While the MTR would strongly advocate to the adherence to the Charter of fiscal responsibility—this would require significant reductions in spending and perhaps phasing some projects to be implemented in NDPIV**. At the estimated level of growth of tax revenues to about 15.3 percent of GDP in 2024/25, to achieve 3 percent of fiscal deficit would require reducing the level of spending to 18.3 percent by 2024/25. Given the level of debt service, commitment on projects that are ongoing and the anticipated elections -related spending in 2024/25 and the resources required to finance the Parish Development Model—the MTR notes that commitment to lowering spending to meet the fiscal deficit target as provided for in the charter will require enormous fiscal discipline.

3.3 Fiscal Policy Space and the quest for Infrastructure Development

80. **The MTR notes with concern the further narrowing of fiscal space available for development spending.** Building on the NDPI and NDPII, the NDPIII continues to emphasize further investment in public infrastructure to accelerate inclusive growth while enhancing efficiency in public investment. This has led to a considerable build up in public debt to levels that may soon be unsustainable. Interest payments in the total budget now amount to 20 percent (Figure 14). Spending allocated to the development budget is 10 percent of GDP. While infrastructure development has been at the core of fiscal policy for the past 12 years and justifiably so—the MTR notes there is need to reprioritise infrastructure projects within the programs with a possibility of phasing them over a longer time if government is to meet its targets in the charter of fiscal responsibility.

Figure 14: Share of interest payments and development spending in total budget



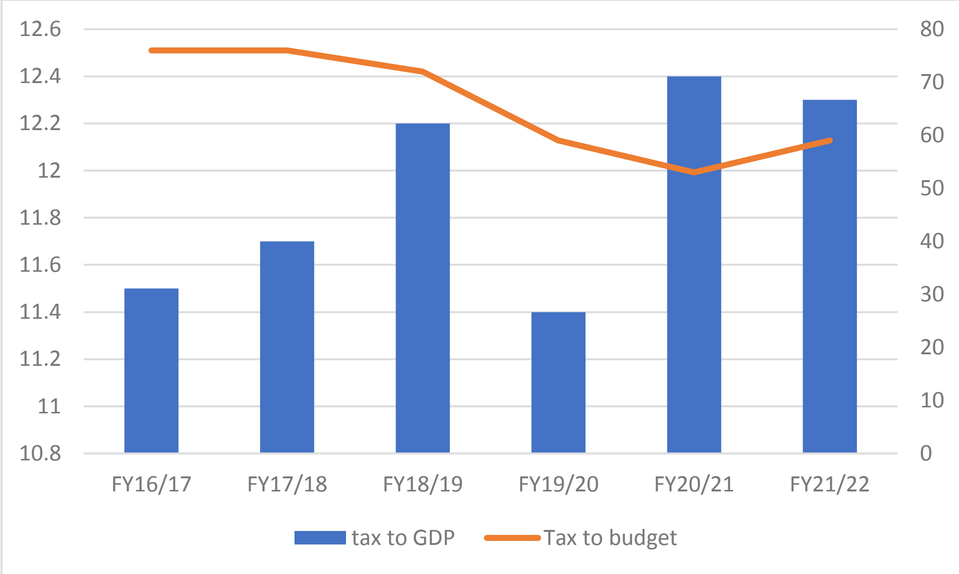
Source: MoFPED, 2022

3.4 Domestic Resource Mobilization Efforts

81. **The NDPIII revenue strategy was aimed at improving compliance and efficiency in tax revenue collections by implementing the Domestic Revenue Mobilization Strategy (DRMS)**. The Plan's focus was to strengthen administrative efforts to improve revenue performance in line with the country's potential revenue by providing better training and resources to URA to modernize and expand ICT capability and other necessary tools.

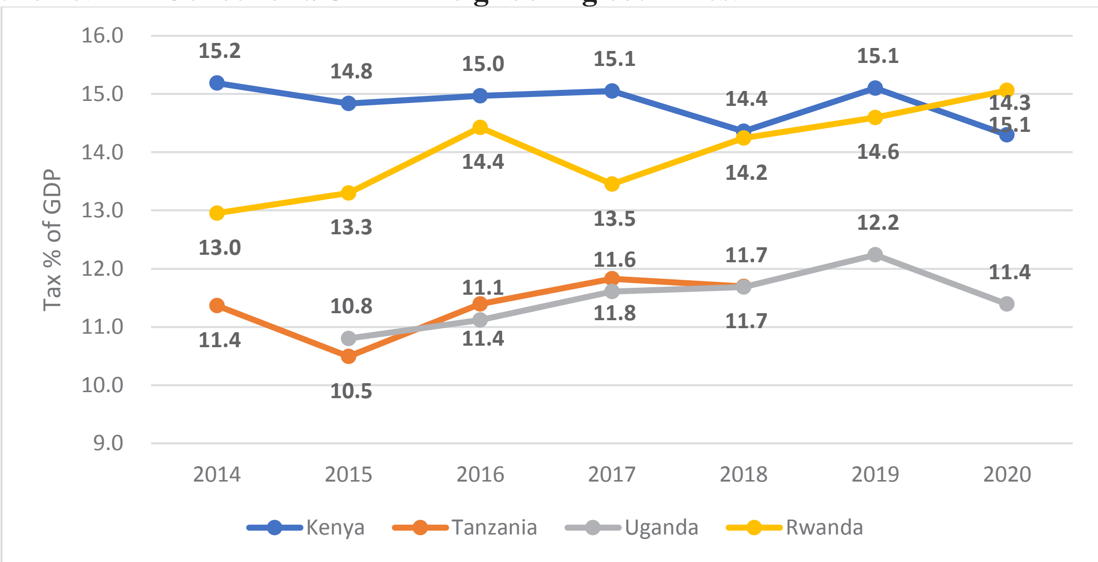
82. **Performance of revenue collections is still way below its potential**. For the past two years of the NDPIII this has averaged at 13.3 percent of GDP. The contribution of tax revenues to the total budget has also continued to decline from 70 percent in FY2018/19 to 59 percent in FY2021/22, pushing government to costly borrowing either domestically or externally (see Figure 15). It is estimated that the potential revenue collection is between 16-18% of GDP highlighting a significant gap to be covered in revenue collection. In addition, compared to the neighboring countries in the region, Uganda's revenue collection effort remains low (see Figure 16).

Figure 15. Tax Revenues as percentage of GDP and total Budget



Source: MoFPED and URA 2022

Figure 16. Tax Collections/GDP in neighboring countries.



Source: World Bank 2022

83. **Low tax collection has constrained the ability for government to deliver on its commitments in the NDPIII**. In light of these challenges, government embarked on the Domestic Resource Mobilization Strategy whose objective was to improve revenue collection by lifting Uganda's tax-to-GDP ratio to between 16-18% during the NDPIII period. A report by MOFPED's Budget Monitoring and Accountability Unit (BMAU) reveals that the overall performance of the DRMS based on the interventions tracked was fair at 61.5%. Of the 26 DRMS interventions tracked, seven (27%) registered good performance, nine fair (35%), and 10 poor (38%). Some

challenges are also noted in the same report including: (i) non-implementation of strategic DRMS interventions; (ii) inadequate specialised training conducted by TPD and URA staff; (iii) low technical staffing levels at both TPD and URA, and; (iv) limited access to necessary data by the TPD and URA. Detailed summary of the progress on DRMS is provided in Appendix 1.

84. **A weak fiscal-social contract between citizens and government continues to limit growth of the revenue tax base**. The MTR as well as the DRMS recognizes that the fiscal social contract has been weakened owing to the following factors: (i) poor service delivery and a perception that government does not provide "value for money"; (ii) limited stakeholder consultations conducted during tax policy development; (iii) lack of high-level political messaging about the value of paying taxes, contributing to low tax morale; (iv) tax incentives creating perceptions of inequity and resentment, and; (v) a strong perception of corruption in Government, from the Ugandan public and the global community, creates low compliance. The MTR strongly recommends that government should strengthen links between tax and spending decisions, as well as budget transparency. The MTR also notes that some progress has been done in developing and implementing a comprehensive tax expenditure framework to properly evaluate all tax reliefs and allowances. The MTR recommends that wider consultations on tax policy design should be prioritized prior to drafting tax policies into laws.

1. **Tax revenues have remained stagnant owing to the restriction of the tax base largely on industry and services sectors and limited collection from agriculture related activities**. This has resulted into a high tax burden of complying tax payers in industry and services, leading to closure of enterprises as informed by representatives of traders. While the agriculture sector remains largely subsistence with farmers operating at a small scale, MTR also found that commercial agriculture is also emerging and largely untapped as a tax base. To avoid setting up regressive tax policy measures targeting the agriculture sector, government should register large commercial farmers with the objective of supporting them and widening the tax base. MTR also recommends that a review of some sectors and their contribution to the tax base such as pharmaceutical products, agricultural chemicals and animal drugs should be undertaken.

2. **In a quest to attract investments, Uganda offers generous tax incentives and exemptions albeit at the cost of further erosion of its tax base**. Key among them are summarized in Box 1. The value of revenue foregone from tax expenditures are estimated at UGX 2,478 bn or 1.56 percent of GDP for the fiscal year 2021/22. The total amount of tax collected during 2021/22 is estimated at UGX 20,877 bn implying that tax expenditures are 11.9 percent of total tax collections (Table 4). The MTR recommend rationalizing these tax incentives and exemptions and where necessary use them judiciously targeting productive sectors. A comprehensive assessment of the beneficiary companies in terms of their contribution towards other taxes, employment and exports where applicable should be undertaken. This would require also strengthening the monitoring mechanisms for the beneficiaries.

Box 1: Investment Tax Incentives and Exemptions

- Investors who make investments of at least USD 50 million for foreigners or USD 10 million for residents are granted a 10-year corporate income tax holiday.
- Manufacturing: a 10-year tax holiday is granted to exporters of finished consumer and capital goods, so long as at least 80% of produce is exported.
- Agro-processing: investors engaged in agro-processing and fulfilling certain narrow criteria are granted an income tax exemption.
- Petroleum and mining: special income tax deductions and exemptions are applied to companies in this sector, such as 100% depreciation of assets acquired for exploration.
- Discretionary exemptions granted to individual companies, which essentially function as private contracts between government and a third party, as well as effective exemptions where Government agrees to pay tax on behalf of a company.

Table 4: Summary of Estimates of Revenue Foregone by Tax Head FY19/20-FY21/22

	FY18/19	FY19/20	FY20/21	FY21/22
Total (UGX bn)	1,703	1,891	2,164	2,478
Total (% GDP)	1.29%	1.35%	1.46%	1.56%
% Total Tax Collected	10.25%	11.29%	11.24%	11.87%
VAT (UGX bn)	415	743	923	1,151
VAT (% GDP)	0.34	0.53%	0.62%	0.72%
Customs (UGX bn)	266	322	352	411
Customs (% GDP)	0.22%	0.23%	0.24%	0.26%
Income Tax (UGX bn)	231	473	449	416
Income Tax (% GDP)	0.19%	0.34%	0.30%	0.26%
Excise (UGX bn)	405	351	438	498
Excise (% GDP)	0.34%	0.25%	0.30%	0.31%

Source: MoFPED

3. **MTR recommends full implementation of tax expenditure rationalization plan FY23/24-FY25/26 which includes**: (i) repealing tax expenditures on capital incomes and unify the tax rate on capital income; (ii) Not to continue providing exemptions for SACCOs; (iii) remove exemptions on supplies of some machinery, tools and inputs for agriculture; (iv) rationalizing excise rates on Tobacco and Wine, motor vehicles and remove excise duty exemptions to investors in excisable goods such as cement; (v) remove exemptions and zero-rates on supply of hotel accommodation, supply of milk supply of fabrics and garments, supply of wet processing operations and garmenting, cotton lint, artificial fibres for blending, supply of billets for further processing, supply of computer software and supply of any goods and services to contractors of hydro-electric power; (vi) repealing provisions in Tax Procedures Code that gives Minister discretion for the government to pay tax on behalf of certain tax payers; (vii) repeal the 10 year tax exemptions; (viii) consider lowering the CIT rate if there is sufficient broadening of the Corporate Income Tax base; and, (ix) removal of exemptions and zero-rates on supply of agriculture inputs, supply of any inputs (feasibility studies and designs, construction materials, earth moving equipment) to a developer of an industrial park or free zone.

3.5 Composition of Spending and Alignment to NDPIII

85. **Due to the delays of adjusting to program-based planning and budgeting in 2020/21, resources under the NDPIII were allocated based on sectors. Based on the certificate of Compliance, alignment of the NBFP for FY2020/21 and the NDPIII was only compliant at 48.0 percent.** Agriculture, Tourism, Social Development and Local Government Sectoral allocations in the NDPIII and the NBFP were fully aligned. Other sectors such as Public Administration, Legislature, Accountability, and Defence and Security were allocated resources way above what was planned for in the NDPIII (see Table 4). This practice continues to undermine the role of planning.

Table 4: Sector Expenditure Allocations (% of Budget)

No.	Sector	2020/21 NDPIII Target	2020/21 BFP Target	%age Deviation	Score
1	Agriculture	3.28%	3.20%	2	5
2	Lands, Housing and Urban Development	0.78%	0.60%	-23	2
3	Energy & Mineral Development	6.29%	8.20%	-30	0
4	Works & Transport	16.12%	19.70%	-22	2
5	Information & Communication Technology	1.25%	0.50%	-60	0
6	Trade and Industry	0.68%	0.60%	-12	3
7	Education & Sports	9.44%	10.90%	-15	3

8	Health	4.07%	5.10%	-25	1
9	Water & Environment	3.75%	4.50%	-20	2
10	Social Development	0.6%	0.60%	6	5
11	Defence & Security	8.05%	9.50%	-18	2
12	Justice, Law and Order	7.36%	5.90%	-20	2
13	Public Sector Management	2.72%	2.40%	-12	3
14	Accountability	5.02%	6.10%	-22	2
15	Legislature	1.88%	2.20%	-17	2
16	Public Administration	2.31%	3.50%	-51	0
17	Science, Technology and Innovation	0.6%	0.50%	-11	4
18	Tourism	0.58%	0.60%	3	5
19	Local Government	3.68%	3.50%	-5	5
20	Other (Interest Payment Due)	21.53%	11.90%	-45	0
	Overall score				48.00

Source: NPA, 2022

86. **Budget alignment according to programmes and NDPIII has been mixed**. A case can be made that variations were partly due to the fact that the underlying assumptions of the NDPIII were inadvertently affected by external shocks and new emerging security challenges in neighbouring countries. As shown in Table 5 below, in FY 2021/22 the governance and security programme received the bulk of the budget at 16.7 percent followed by human capital development at 16.5 percent and interest payments at 16.2 percent. The recent budget of FY2022/23 portrays a similar trend where the priority is governance and security allocated 20 percent and human capital development (which includes education, health, and water and sanitation subprograms) are allocated 21 percent. Integrated transport and energy which remain key enablers to enhance productivity are allocated 18.4 percent. As demonstrated in section 3.9 there is a need to reallocate and reprioritise resources within the budget for the last two years of NDPIII to enhance production especially for agriculture and agro-industrialization program. Small deviations from the plan are for the programs of mineral development, tourism, manufacturing and petroleum. These small deviations may not necessarily point to the question of misalignment—but rather on the classification of programs and their readiness to absorb public funds.

Table 5: NDPIII and Budget Allocations 2021/22-2022/23

PROGRAMMES	FY 21/22 UGX billions		FY 22/23 UGX billions		FY 21/22 Percent Allocations		FY22/23 Percent Allocations	
	NDP3	NBFP	NDP3	NBFP	NDP3	NBFP	NDP3	NBFP
Agro-industrialisation	1,721	1,410	1,732	1,799	3.5	3.4	3.1	5.6
Mineral Development	515	49	651	36	1.0	0.1	1.2	0.1
Sustainable Development of Petroleum Resources	683	106	852	149	1.4	0.3	1.5	0.5
Tourism Development	613	179	731	182	1.2	0.4	1.3	0.6
Natural Resources, Climate Change, Environment, Land and Water Management	1,899	462	2,088	890	3.8	1.1	3.8	2.8
Private Sector Development	544	559	653	661	1.1	1.4	1.2	2.0
Manufacturing	481	54	594	79	1.0	0.1	1.1	0.2
Integrated Transport Infrastructure and Services	3,827	3,988	5,385	4,856	7.7	9.7	9.8	15.0
Energy Development	943	900	1,159	1,108	1.9	2.2	2.1	3.4
Digital Transformation	645	79	727	218	1.3	0.2	1.3	0.7
Sustainable Urbanisation and Housing	825	63	952	428	1.7	0.2	1.7	1.3
Human Capital Development	5,901	6,832	6,029	6,920	11.9	16.5	10.9	21.4
Innovation, Technology Development and Transfer	594	271	582	24	1.2	0.7	1.1	0.1
Community Mobilisation and Mindset Change	722	57	811	73	1.5	0.1	1.5	0.2
Governance and Security	6,951	6,892	5,786	6,480	14.0	16.7	10.5	20.0
Public Sector Transformation	3,476	325	3,847	208	7.0	0.8	7.0	0.6
Regional Balanced Development	3,889	1,215	4,228	1,066	7.8	2.9	7.7	3.3
Development Plan Implementation	1,883	1,100	1,916	1,028	3.8	2.7	3.5	3.2
Administration of Justice		221	768	384	-	0.5	1.4	1.2
Legislation, Oversight & Representation		698	881	687	-	1.7	1.6	2.1
Interest Payments Due	13,651	6,675	14,742	5,088	27.4	16.2	26.7	15.7
Other Non-discretionary spendng		9,159			-	22.2		
TOTAL	**49,763**	**41,296**	**55,114**	**32,361**	100.0	100.0	100.0	100.0

87. **Resources should be allocated to growth enhancing programmes**. As shown in Table 5, in FY 2021/22 the governance and security programme received 16.7 percent of the budget followed by human capital development at 16.5 percent and interest payments at 16.2 percent. The recent budget of FY2022/23 portrays a similar trend where the priority is governance and security allocated 20 percent and human capital development (which includes education, health, and water and sanitation subprograms) are allocated 21 percent. Integrated transport and energy which remain key enablers to enhance productivity are allocated 18.4 percent. Allocations to the programmes supposed to be growth enhancing like agro-industrialization, mineral development, private sector development and manufacturing receive 9 percent of the total budget. Resources should be geared towards the productive programmes to resuscitate growth and create jobs. Investments under the PDM should also be growth enhancing rather than being a cash transfer. To enhance efficiency gains, there is a need to undertake intensive follow-up of resources through the Apex platform. This

follow up of resources should be championed by OPM, OP, MoFPED and NPA. This could be done on a quarterly basis to ensure that resources are put to effective use.

88. **The deviations between the NDPIII and the budget also emanate from the approach used to cost the plans**. The MTR found that there were limited consultations between the NPA, MoFPED and Programmes (in this case MDAs as programmes at the time were not existent) during the costing exercise. Whereas NPA conducted various consultations on the Program Implementation Action Plans (PIAPS, most MDAs expressed dissatisfaction on the top-down approach that was used by NPA. For budgeting purposes, MoFPED expressed concerns on the quality and frequency of changes of PIAPS, and with some lacking output indicators which complicates the budgeting process. This lack of buy-in of PIAPS from the MDAs has compromised both budgetary processes and implementation.

89. **The MTR concurred with the recommendation from Budget department that MoFPED should only provide budget ceilings to the programs.** Program secretariats should be at the centre of allocating resources within their programs. This will empower program secretariats and there will be a need to meet and prioritize their spending. To achieve this, it will require fully functioning programme secretariats to be in place and which are resourced annually through the budget. Competition for resources within the program would require that the secretariats are all based at the OPM for proper coordination and implementation of the program. Programs being in charge of resource allocation would also entail modifying the budget cycle as shown in Figure 17. Using spending reviews highlighted below and performance of programs, MoFPED should only prioritize resources at the level of programs.

90. **Strengthening program cost estimation for budget preparation should be made a priority and mainstreamed within government.** The MTR found that they are several costing centers resulting into different versions MTEF as espoused in the NDP and MoFPED which are later compared for alignment. The assumptions underlying the allocation of resources within the PIAPS are not guided by any unit costs—but rather by expenditures on similar activities or actions in the past. There is an urgent need to streamline unit costs on programme inputs and the corresponding service delivery standards. Therefore MoFPED, in liaison with NPA, Public Service and OPM should ensure to establish the unit costs on programme inputs and the corresponding service delivery standards**.** Program secretariats should then work

closely with this unit to cost their programs as they allocate resources to their PIAPS. Unit costs are supposed to be used in budget preparation to calculate program expenditure requirements as a function of the quantity of services to be delivered to the public.

3.6 Budget Efficiency and Spending Reviews

> **Spending Review Cycle: The Canadian Example**
>
> The Government of Canada introduced a new expenditure management system in 2007 as part of an ongoing commitment to better manage government spending. This system aims to ensure value for money for all government spending. A key pillar of this system is the ongoing assessment of all direct program spending, or strategic reviews. Through the Strategic Review process, the Government systematically assesses the relevance and performance of every program on a cyclical basis. From this review, the organization identifies five percent of spending for reallocation from its lower performing, lower priority programs. This system is combined with a system of targeted strategic reviews based on the selection by ministers and the Treasury Board Secretariat of selected programs for review

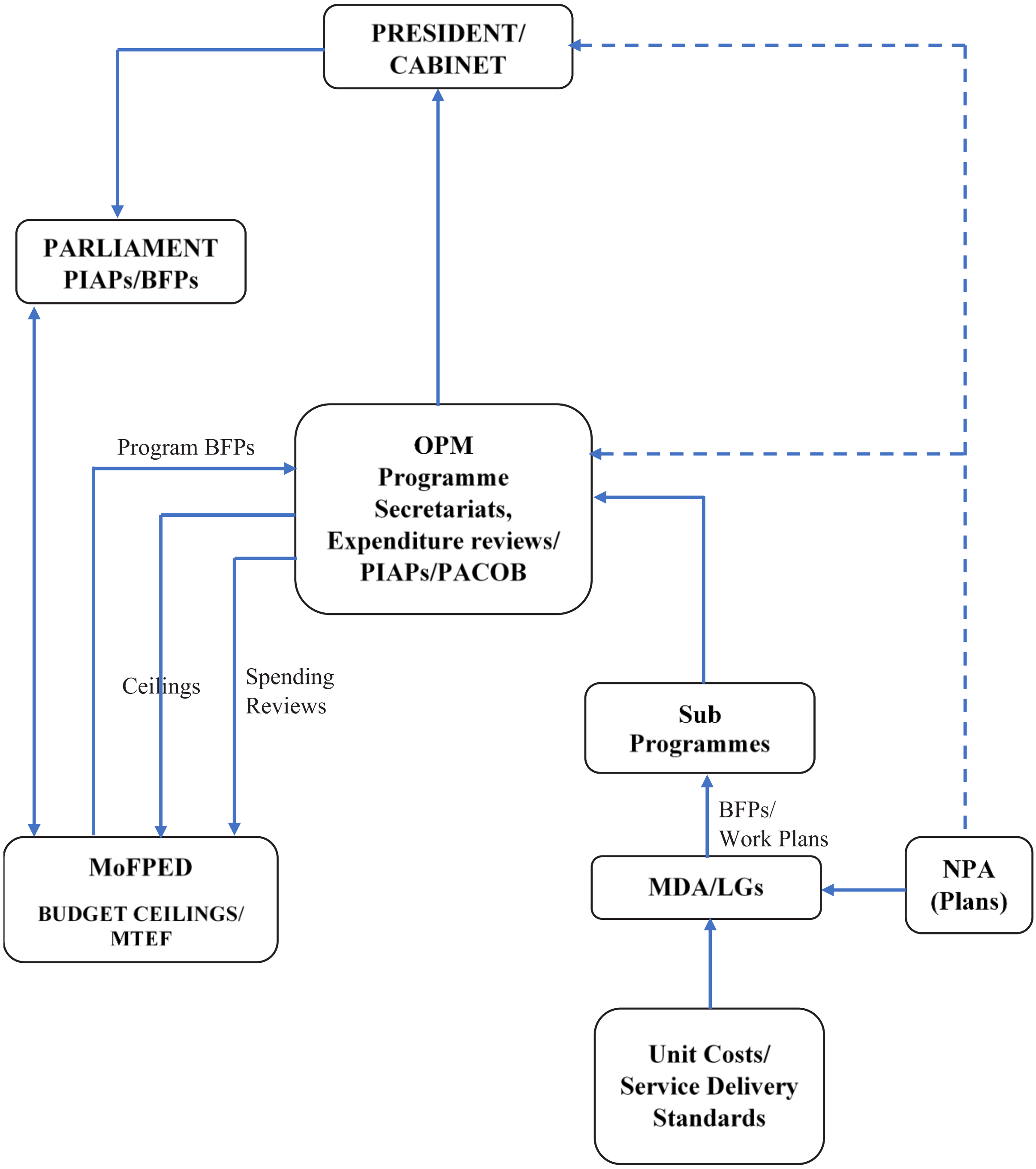
91. **To enhance budget efficiency the MTR found an urgent need to introduce annual spending reviews prior to the budget process.** These reviews should be used as partly the basis for prioritizing resources in allocation of resources. Spending review refers to the systematic scrutiny of existing expenditure to identify, in particular, options for cuts or increase by drawing on both program evaluations (the review of specific services provided by government) and efficiency reviews (which focus on reducing the cost of delivering services). Currently BMAU focuses more on use and absorption of resources by programs and their performance on interventions. Spending reviews include systematic *priority* analysis – in other words, the systematic identification of programs or elements of programs which could be revised *because they are low or high priority*. Without spending review, the risk is that programs which are ineffective, low-priority or which have outlived their usefulness will continue to draw on public resources. Positive feedback under the spending reviews will also motivate MDAs to lift their performance towards programme outcomes. In this context, spending review should should be integrated within the budgeting process and cycle and should be conducted annually. Given the enormous work of undertaking these reviews annually—there could be a discretionary targeted approach where programs expected to yield significant savings are reviewed. OPM should play the leading role in undertaking these program spending reviews.

3.7 Incremental and Zero-Based Budgeting

92. Government has relied on the use of incremental approach while allocating resources. Such an approach fails to consider whether a particular item or intervention is still required or whether the amount currently incurred is justifiable. The justification for increased expenditure is the increased costs of inputs and sometime inflation. This incremental approach may not incorporate a careful evaluation of the level of services being offered especially under the current program approach where the budget process is under the old votes. Once an item appears in the budget at inception, its inclusion in future budgets is taken for granted and only incremental changes in the item are considered. In this type of situation, attention is therefore focused on the marginal or incremental difference between this year's budget and last year's budget. At the end of the year all unspent money is returned to treasury.
93. **In light of the existing fiscal constraints, existing waste built over time under incremental budgeting, the MTR strongly recommends government to adopt a clean slate type of budgeting known as zero-based budgeting (ZBB).** Unlike incremental budgeting, zero-based budgeting does not start from the previous year's budget level. Existing operations are studied, and continuance of the operation or activity must be justified on the basis of its usefulness and its need to the goal of government. For government use, this planning and budgeting technique endeavours to redirect efforts and funds from lower priority current programs to higher priority new programs, improve efficiency and effectiveness, and reduce spending. As well, ZBB are set to prevent regular budget creeping behaviour that emphasizes inflationary adjustments. Therefore, for the budget to be translated into concrete development and growth there must be a real forecast of goals or targets at all the tiers of governments.
94. **To fully adopt the program-based planning process, the MTR recommends changes to the budget formulation process**. There should be a link between the programme secretariats, MoFPED and OPM during this consultative process. The challenges of local governments to formulate their BFPs emanated from the fragmented adoption of programs within the budget formulation processes. Once MoFPED determines the ceiling for the various programs, there should be an iterative process between MoFPED and programs in the allocation of resources to the priority sectors.

Figure 17: Budget Preparation Process and Spending Reviews

PROGRAM-BASED BUDGETING INSTITUTIONAL FRAMEWORK

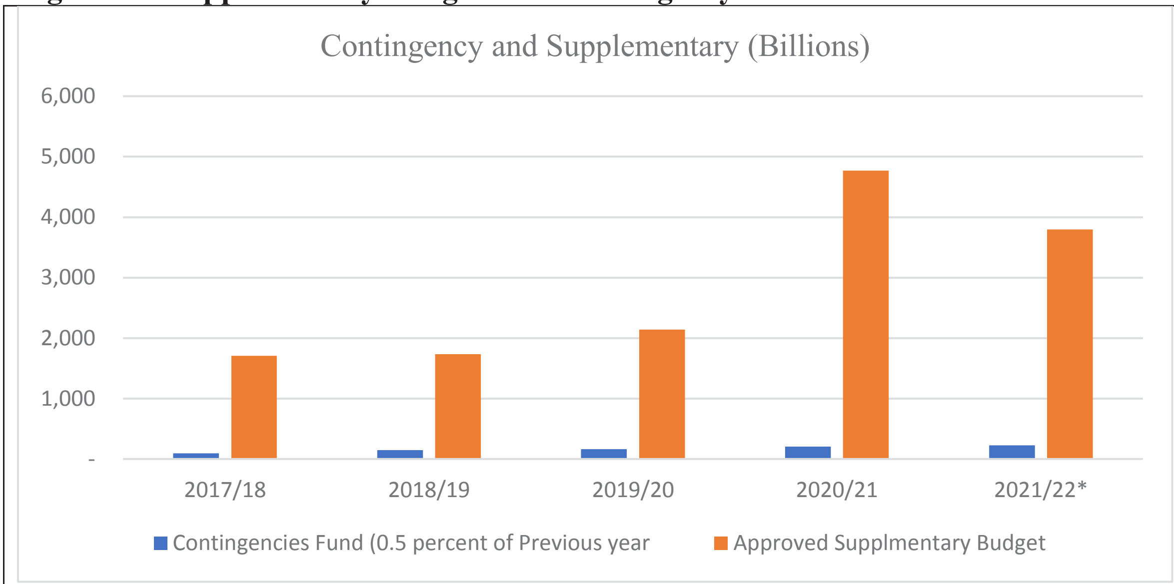


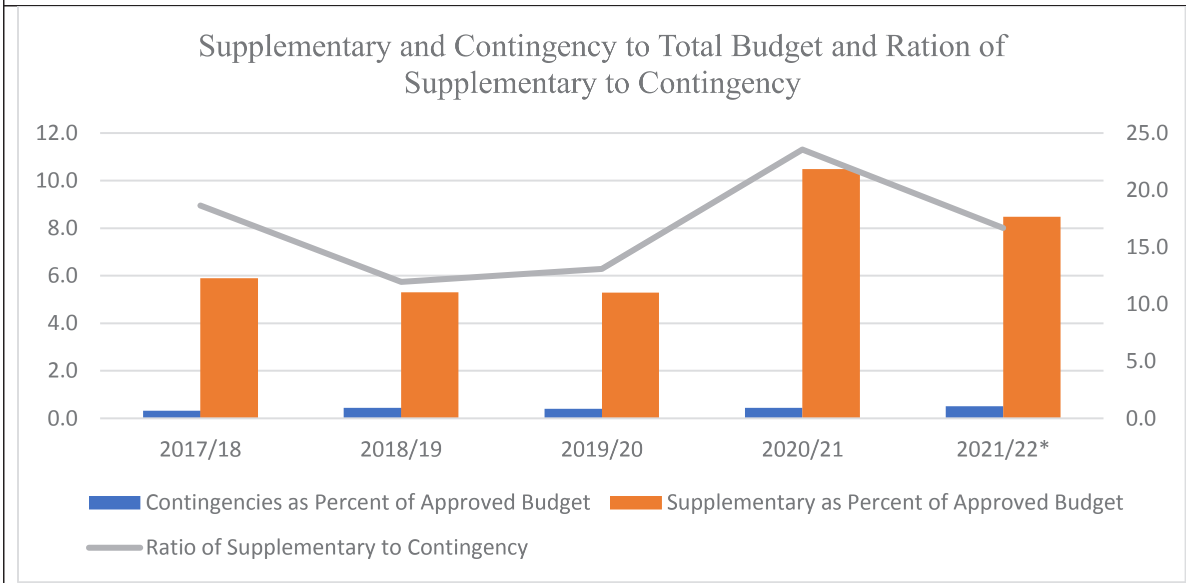
3.7 Supplementary budgets and Planning Processes

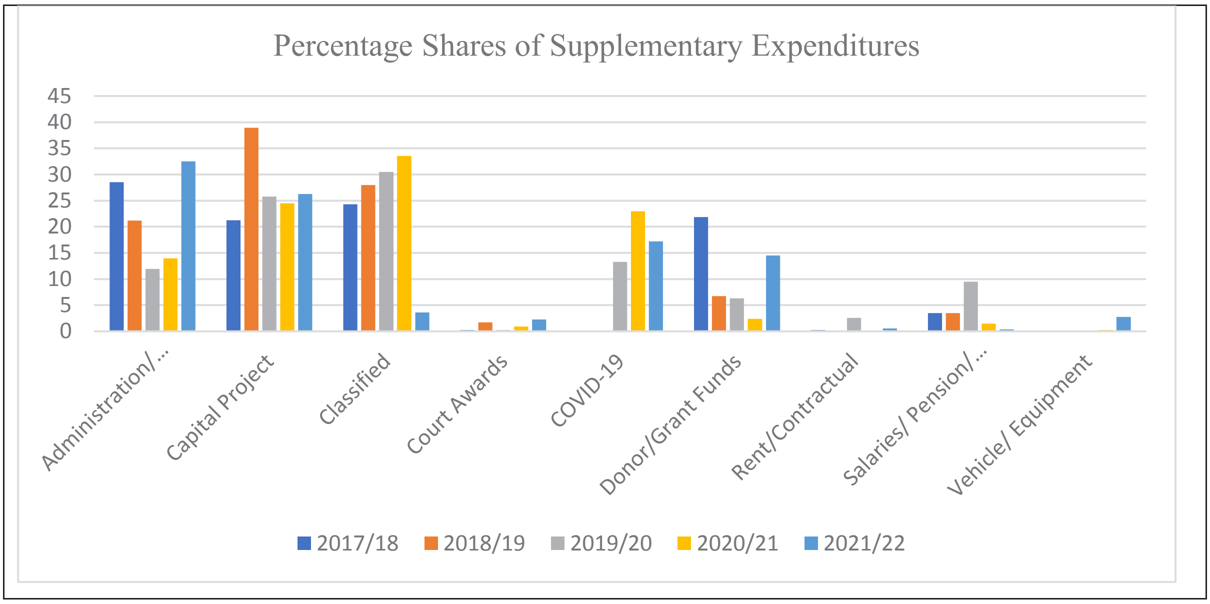
95. **Frequent supplementary budgets continue to undermine planning and budgeting processes**. While supplementary budgets are provided for under the PFM Act with a limit of 3 percent to the total approved budget, this has increasingly been violated over the years. The number of supplementary requests has continued to increase from 177 in the FY 2017/18 to 1,011 in the FY 2019/20 and leaped to 1,322 by first half of the FY 2021/22. Total supplementary expenditure by the central government

increased from UGX 1,682.8 Bn in the FY 2017/18 to UGX 4,270.48Bn in the FY 2021/22. The MTR also noted that 75 percent of supplementary expenditures were predictable and could have been planned for in the budget. In addition, according to section 26(1) of the PFM Act, the ratio of the appropriation to the contingencies fund to appropriation for supplementary expenditure is expected to be 1:1. As shown in Figure 18, this ratio has ranged from 12 to 23 which is way above what is provided for in the PFM Act.

Figure 18: Supplementary Budgets and Contingency Fund







Source: MoFPED, 2022.

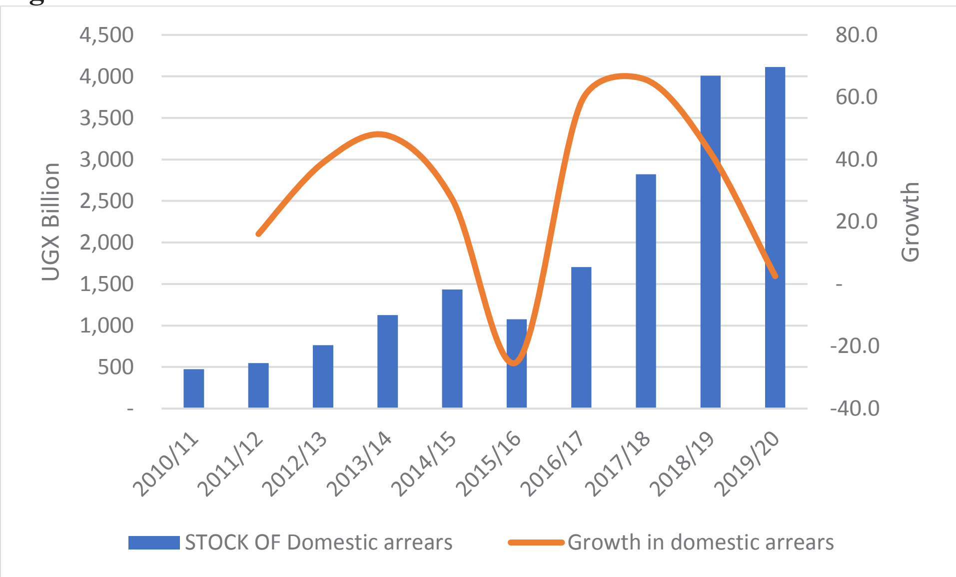
96. **The bulk of the supplementary budgets are appropriated on capital projects, donor spending, administration/operations and classified expenditures contributing 83 percent of the total supplementary expenditure.** The MTR also notes that 75% of the supplementary expenditures of the top four expenditures under supplementary was predictable. This points to the fact that there is a missing link between planning and budget processes. In addition, 91% of supplementary expenditures have been financed by mainly suppressing MDA expenditures. This undermines the spirit of planning and budgeting. The MTR recommends adherence to the PFM act especially by properly planning for predictable expenditures with a view to contain supplementary budgets within 3 percent of the total budget.

3.8 Domestic Arrears

97. **Domestic arrears have continued to rise despite Government efforts to reverse the trend over the years**. By the end of 2021, the 2022 Office of the Auditor General Report reported a further increase in the stock of domestic arrears to UGX 4.65 trillion (see Figure 19). The rise in arrears has been mainly attributed to fiscal indiscipline, poor financial management and weak system controls (MoFPED, 2021). The large amount of domestic arrears poses a risk towards fiscal sustainability as it disguises the actual size of the fiscal deficit, and reduces the impact of fiscal policy (MoFPED, 2021). In addition, arrears pose a reputational risk to Government which can affect the country's credit risk ratings. They also have an impact on economic activity since businesses, especially SMEs' funds are tied up which affects business

operations. They increase the cost of Government as suppliers will charge higher prices to cater for the delays in payment in addition to the interest and penalties Government will pay for delayed payment. Clear guidelines should be provided to MDAs restraining them on committing domestic arrears.

Figure 19: Stock of Domestic Arrears 2010/11 to 2019/20



Source: OAG, 2022

3.9 Reprioritization of Spending and Growth Implications

98. As government embarks on fiscal consolidation to meet its targets in the charter of fiscal responsibility there is a need to reprioritize spending. As highlighted in the Background to the Budget (FY2022/23), the first call on resources over the remaining period of the NDPIII will target interventions that: (i) have higher multiplier effects and dependencies; (ii) directly linked to addressing household poverty and food security; (iii) are in position to aid quick economic recovery (directly impact production and consumption); and, (iv) in alignment with the operationalization of the Parish Development Model.

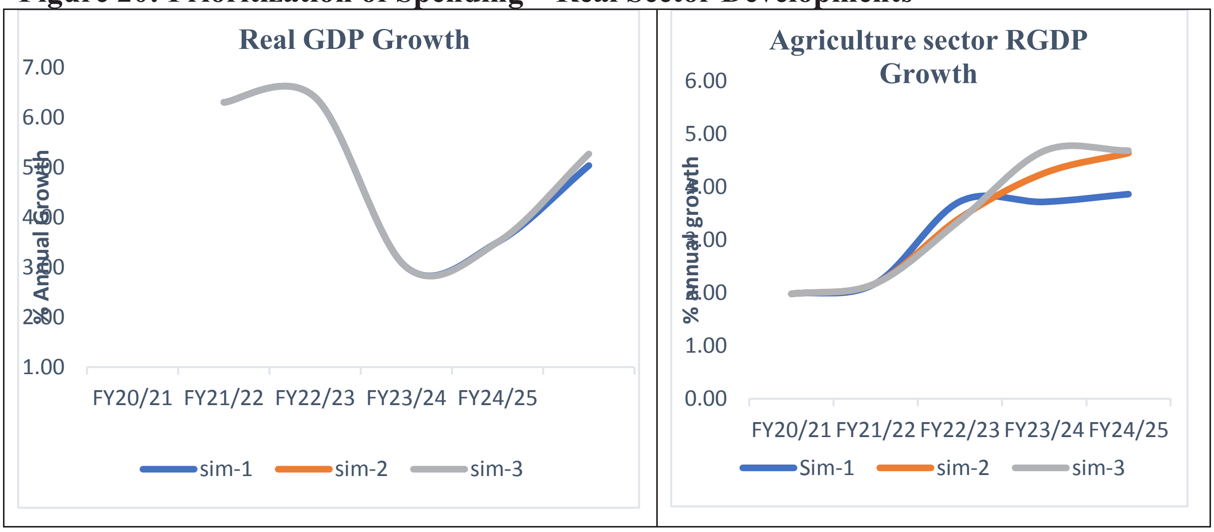
99. In light of the criteria above, the MTR modelled three simulations to guide the reprioritization process. The first simulation (Sim1) assumes that allocation of resources (shares as a ratio to GDP) remains the same as in 2022/23 and there is no attempt at reallocating resources within and across programmes. It is also assumed under this scenario, that revenues would increase by 0.5 percent of GDP annually. Under Sim1 it is also assumed that there is some fiscal consolidation in the last two years of the plan. We do not assume any revenues from oil resources as consultations

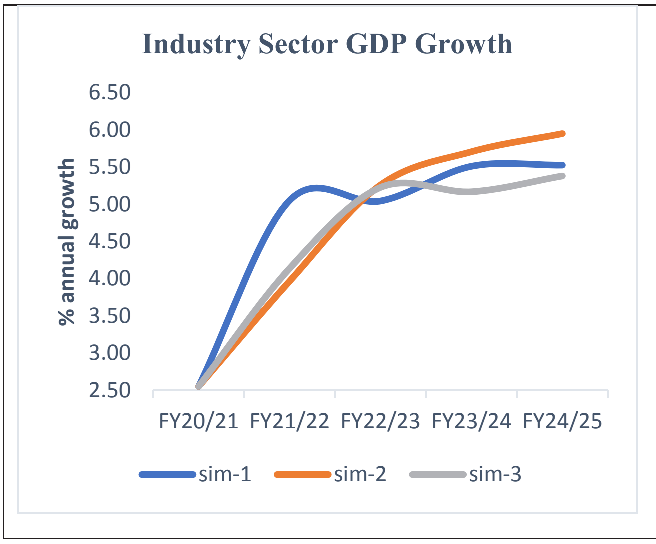
suggest that they will come on board in 2025/26. The second simulation (Sim2) assumes some prioritization of resources within agro-industrialization, manufacturing, energy and water for production. The total spending is assumed to remain the same as in Sim1 only that resources have been reallocated within and across programs. The third simulation Sim3 is where there is no reallocation but rather an increase in spending to the integrated transport, energy and transport.

100. Public investment on the infrastructure projects is assumed to have an impact on the productivity of other programs such as agro-industrialization, minerals, light and heavy manufacturing. The marginal productivity of government investments is assumed to be 0.1 and this combined with the improvements in productivity as a result of program interventions provides various growth outcomes.

101. Of the three simulations, the MTR recommends SIM2 where there is some improved growth after reallocation of resources. Growth would average at 5 percent in the last two years of the NDPIII. Whereas SIM3 yields higher growth, it is not desirable because it threatens fiscal sustainability since it also results into higher fiscal deficits and implicitly increased debt accumulation. SIM2 results into higher growth for the agriculture and industrial sectors. Exports under this scenario also increase by an average of 6 percent. In addition, agriculture grows by 4.7 percent, industry by 5.9 percent and services by 5.2 percent (see Figure 20).

Figure 20: Prioritization of Spending—Real Sector Developments





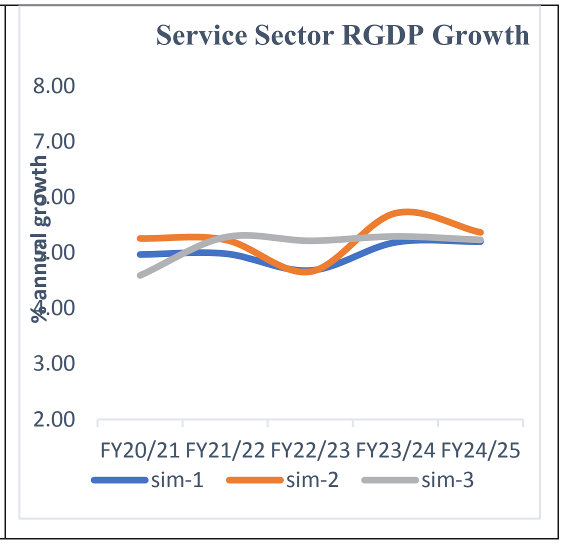
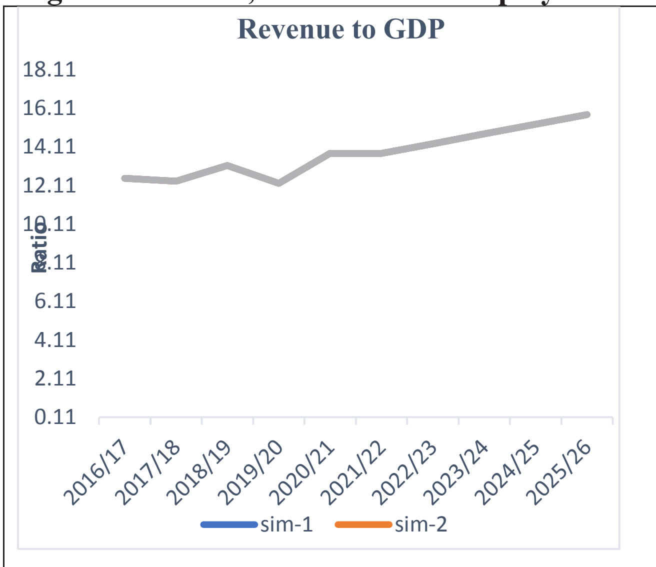
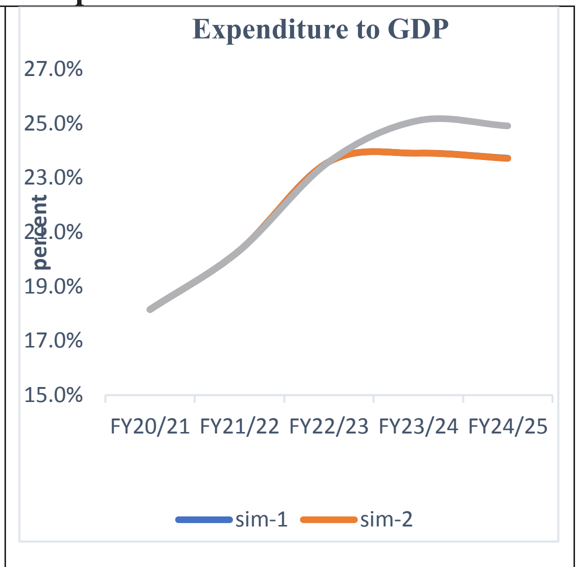
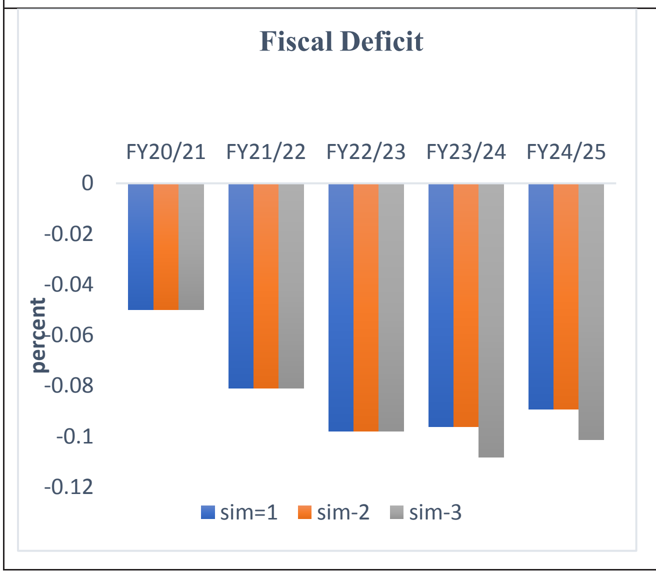
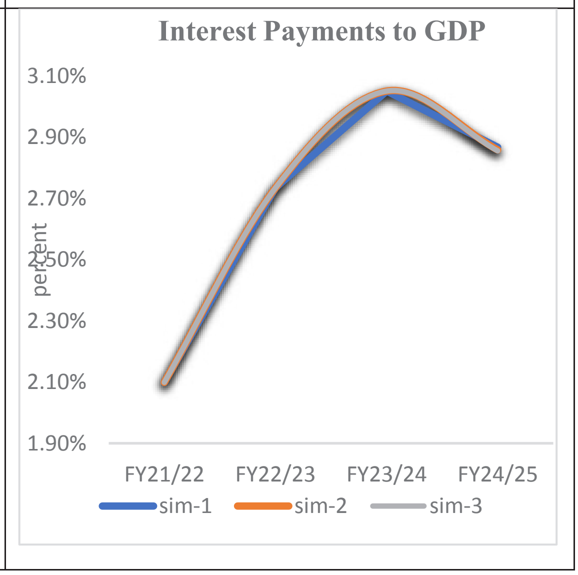


Figure 21: Fiscal, External and Employment Developments









Source: MTR Computations based on NPA's SDGSIM Model

3.10 Debt levels and sustainability

102. **There has been considerable buildup of public debt during the first two years of the NDPIII**. Public debt increased from USD 19.54 Bn (UGX69,512 Bn) in FY 2020/21 to USD 20.98 Bn (UGX 78,799 Bn) in FY 2021/22. As a share of GDP, public debt increased from 47percent to 48.6percent over the same period. The increase in debt was largely driven by revenue shortfalls and sluggish economic recovery following the easing of COVID-related restrictions. Public debt is projected to further increase peaking at 53.1 percent in June 2023, before declining to below 50 percent over the medium term. The increase in debt over the past few years, exacerbated by the COVID-19 pandemic, has resulted in the deterioration of the risk of debt distress from low to moderate. Nevertheless, debt is projected to remain sustainable over the medium to long term, underpinned by higher revenues following the full implementation of the DRMS, as well as the onset of oil production by 2025/26.

103. **While Uganda remains at low risk of debt distress, significant vulnerabilities loom large** (see the accompanying Debt Sustainability Analysis). Even though debt burden indicators remain below their indicative thresholds, they have increased compared to the previous DSAs. The debt service as a proportion to total budget is also indicative of narrowing gap to accumulate further debt. The positive outlook is shrouded with spending pressures and contingent liabilities which could push public debt above unsustainable levels.

104. **While the MTR notes that the rapid growth in the debt stock was for justifiable causes—it is equally concerned that at this pace of debt accumulation, there may be challenges sustaining it within the medium term**. The recent DSA done in 2021 by MoFPED shows that public debt is within sustainable levels over the medium to long term—this is based on very ambitious assumptions of full recovery in GDP growth (7 percent in the medium term); slowdown in borrowing as some infrastructure projects wind up; positive impact of scaling up investments in the oil and gas sector, and; further increase in revenue growth backed up by the DRMS (0.5 percent additional revenues per year). The MTR recommends a complete review of the assumptions used for the forthcoming DSA given the recent developments especially: (i) growth outlook; (ii) fiscal outlook and government's commitment

towards consolidation of spending; (iii) re enue performance and full implementation of the DRMS; (iv) increased financing fr grants related to CoVID-19.

105. Given the recent changing comp tion of public debt and more reliance on non-concessional borrowing this has con with various risks. These risks which are summarized below are well elaborated in DSA.

(i) Interest payments as a share of GDP se to 3 percent in June 2022 up from 2. percent in June 2020 and largely refle the higher interest payments on domesti debt

(ii) Owing to the increased contraction of non-concessional loans, the weighte average interest rate (WAIR) of the bt portfolio increased to 6 percent i June 2022 up from 5.6 percent in J e 2020.

(iii) Owing to increased uptake of ex nal non-concessional financing wit shorter maturities, the average tim o maturity of the portfolio continue to decline, falling from 10.3 years June 2020 to 9.6 years in June 202 depicting increased exposure to re ancing risks.

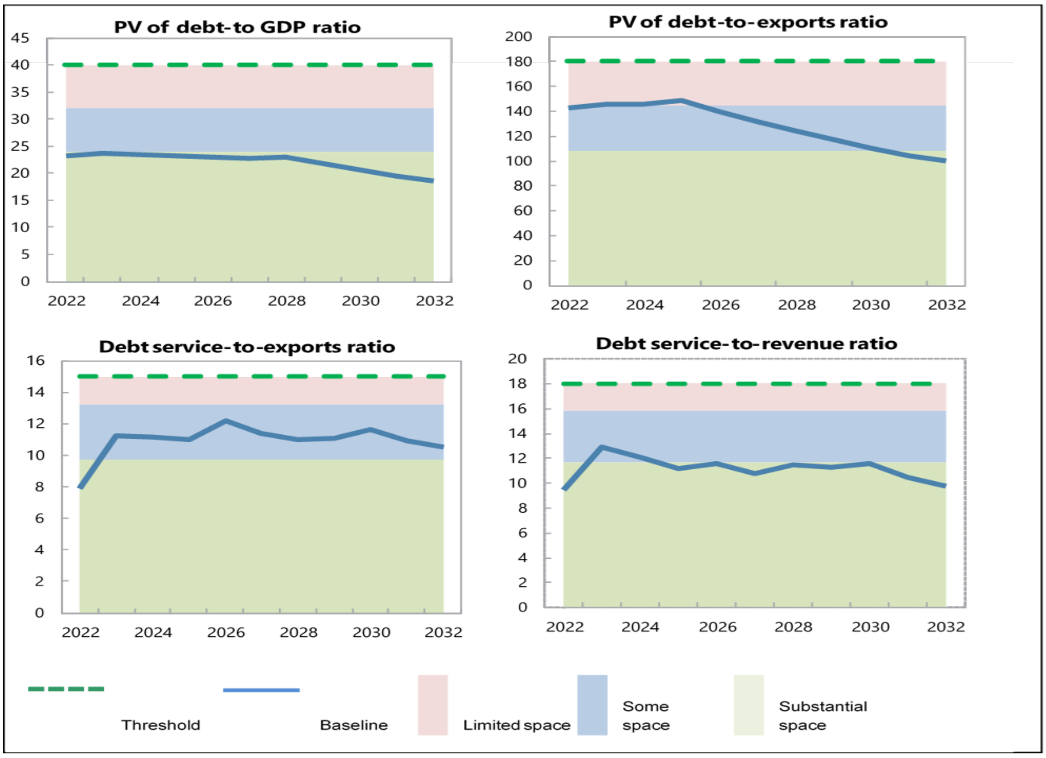
(iv) Due to larger contraction of var le rate loans in the FY2020/21, th average period a debt portfolio l be subjected to new interest rates declined to 9.2 years in June 2021 m 9.9 years the year before.

(v) External debt maturing in one yea as a percentage of reserves increase from 6.5 percent in June 2020 to 9 percent in June 2021 partly due to t large take up of commercial loans th short grace periods in recent year

106. **There is limited space for f ther borrowing based on the DS done by MoFPED. Based on the r o of PV of debt to exports, furth excessive borrowing will push th country to the high-risk catego between the period 2022 and 202** (see Figure 22). The MTR therefo strongly recommends that governme should fully commit to the charter within sustainable levels. The practi

development partners to meaningfully support the various programs through concessional and grants financing.

Figure 22: Public Debt Risk Assessment



Source: MoFPED

3.11 Alternative Forms of Financing the Budget

107. **Given the large financing requirements of projects that are being implemented in NDPIII and the limitations of borrowing as the country hits the debt ceiling—it is unlikely that Uganda will be able to raise these resources only from concessional borrowing and tax revenue efforts**. It is imperative that Government also starts exploring other options to finance large infrastructure projects whose economic returns may not be viable in the short run but with enormous social benefits. Uganda is currently rated at B+ by Fitch and Standard and Poors rating agencies. The key driver for these ratings includes prudent macroeconomic policies combined with a renewed focus on infrastructure investment. At the backdrop of these ratings, the MTR recommends that the Government undertakes the full implementation of the Public Investment Financing Strategy (PIFS) which identifies and maps several alternative financing options to NDPIII programmes. Among the viable alternative financing options consider are the following:

108. **Issuance of Infrastructure Bonds:** Bonds provide an alternative to traditional funding, making infrastructure debt more accessible to a wide array of institutions. At the backdrop of this development, Government should consider issuance of a Euro

bond in international markets. The size of this bond will depend on the financing needs that are not fully covered under by concessional or semi-concessional borrowing. Also, considerations of the costs and risks associated with such financing instruments should be taken into account. This will also require careful planning and preparations on the part of Government to ensure that proceeds are used immediately after issuance of the bond. According to the World Bank[2], Uganda has a financing gap of about USD 1.4 billion a year for infrastructure investment. Accordingly, preliminary estimates suggest that Uganda can initially issue a bond of US 7 billion dollars to be entirely used for infrastructure development over a five-year period. Government can also initiate project specific infrastructure bonds to finance infrastructure projects and municipal infrastructure bonds to finance municipal and new city infrastructure needs. Government has finalized the infrastructure bond framework that will operationalise and guide issuance.

109. **Use of Pension Funds**: Pension funds have not made progressive investments in infrastructure – especially in those sectors with the potential for high returns and stable and long-term cash flow and inflation-protection possibilities. While the government is expediting the development of the pension sector and implementing the Capital Markets Master Plan, it should also mobilize domestic currency financing by establishing syndicates of commercial banks and large surplus institutions to finance infrastructure projects, such as pension funds, particularly the National Social Security Fund (NSSF).

110. **There are new emerging financing options which are particularly targeting green growth investments.** An example in this context includes the Green Bond, a type of fixed income instrument, specifically, earmarked to raise funding for climate and environmental projects.

111. **All the National Development Plans have embraced Public Private Partnerships as a mode of financing to complement traditional sources particularly tax revenues and borrowing.** The PPP Act of 2015 provides the operational framework for scaling up the utilization of the PPP financing modality in

2 https://www.worldbank.org/en/country/uganda/publication/leveraging-public-private-partnerships-to-plug-ugandas-deficit-in-infrastructure-finance

the country. The Act elaborates various strategies through which PPPs should be implemented including: (i) Undertake due diligence through rigorous assessments to gauge the viability of the project; (ii) building capacity of the PPP unit and other relevant contracting authorities to enable them to prepare, appraise, and provide better oversight; (iii) setting up a Project Development Facilitation Fund to support project preparation and prepare a robust PPP pipeline; (iv) implement the guidelines for management of contingent liabilities; and, (v) mobilise local currency financing from syndicate source such as commercial banks, and large surplus institutions like Pension Funds to finance PPPs. By 2021, total investment commitment under PPPs was around USD 5 billion. The MTR noted that there are still challenges for Uganda to benefit from PPPs given their complexity. Skills development in project finance, legal provisions for contracts, contract monitoring based on outcomes should be prioritised.

112. **To fully benefit from Islamic Finance, government of Uganda would need to fully embrace the requirements of this financing option so as to adequately tap into all opportunities available to both private and public sector.** This will require the following: (i) reviewing the existing legal, and institutional framework to identify constraints and devise measures to overcome them; (ii) undertake an asset stock determination process to identify suitable assets and, associated cash flows to back transactions; (iii) ensure strict adherence to the PIMS process, as potential investor appetite is likely to remain focused on investment grade structures of the financier; (iv) build capacity and secure appropriate technical assistance and training; and (v) create platforms to raise awareness, build consensus and secure buy-in from key stakeholders.

113. **The MTR also noted other emerging forms of financing particularly pre-financing projects.** Discussions with various authorities pointed to various risks for this form of financing. Contractors borrow on behalf of government to execute projects and this has turned out to be very expensive compared to government borrowing directly.

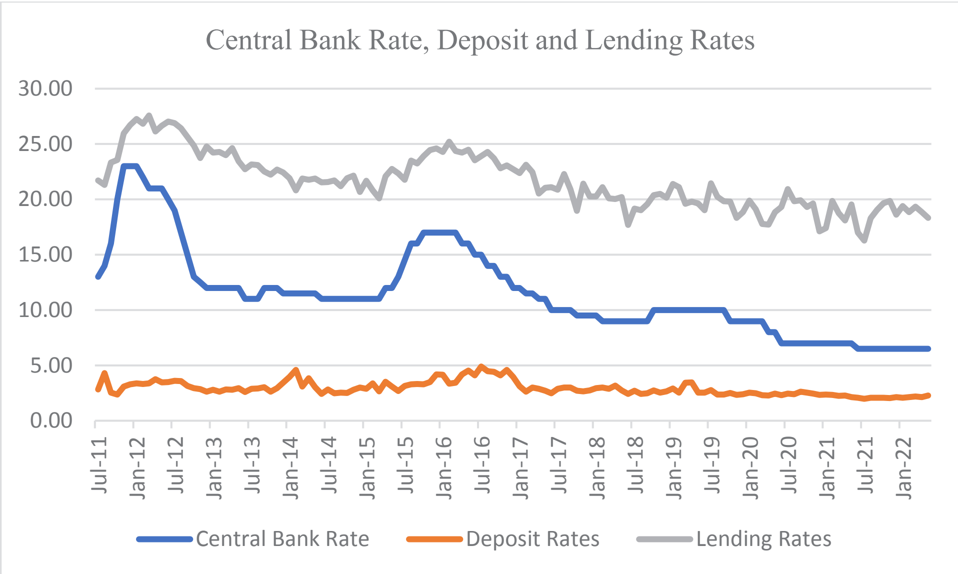
3.12 Monetary policy and Private Sector Development

114. Monetary policy has been underpinned by the desire to maintain macroeconomic stability. The Bank of Uganda (BOU) has been implementing monetary policy under an Inflation Targeting monetary policy framework since July 2011. In this framework, the BOU uses the policy rate to influence the interbank money market rates so that they

move in tandem with the movement in the central bank rate (CBR) which in turn should influence other retail interest rates (both short-term and long-term) in the economy.

115. The NDP III target is to maintain core inflation within a band centered on 5 percent. The band is currently +/- 2 percent, resulting in a target range of 3 - 7 percent. BOU monetary policy framework has ensured price stability, and inflation has been contained. Overall, inflation has remained within target range throughout the first two years of the NDPIII period not until recently when monetary policy had to be tightened to contain the surge in prices driven by commodities imported. The CBR rate was increased from 7.5 percent in June 2022 to 9 percent in August 2022 (Figure 23). The increase in the CBR rate has attendant implications of the increasing domestic debt service by government and cost of private sector credit.

Figure 23: Interest Rates

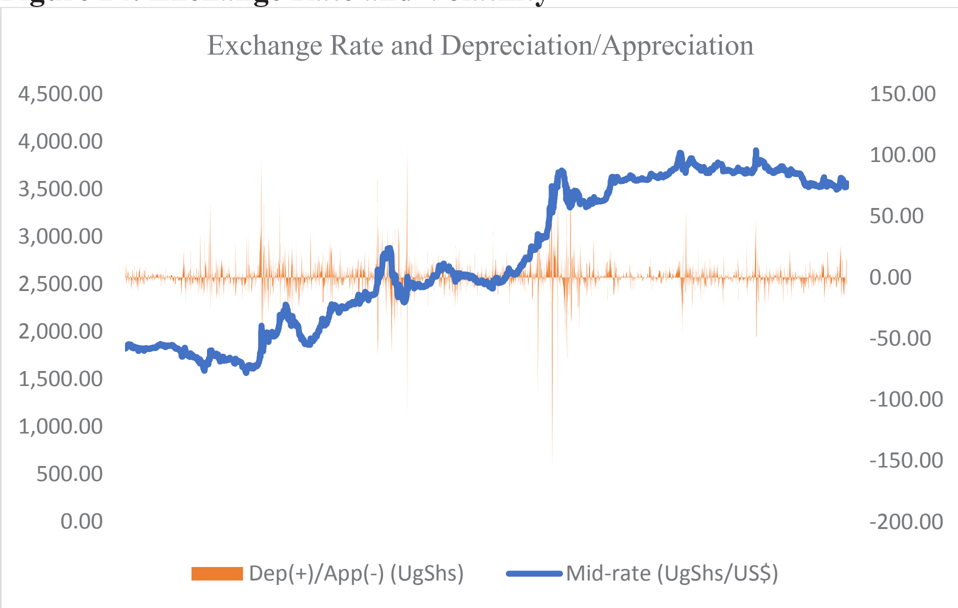


Source: BOU

116. Within the monetary policy framework, BOU has from time to time intervened in the foreign exchange market to sterilize net inflows of foreign exchange, and to ensure adequate reserve cover. However, this is not a primary monetary policy objective and is only done to the extent that it is consistent with interest rate policy and the inflation target. With inflation the primary target of monetary policy, the exchange rate is flexible and responds to supply and demand for the shilling; there is no exchange rate target. However, the ITL framework does incorporate the exchange rate channel and its impact on prices, and the CBR influences the exchange rate as well as domestic interest rates.

117. This notwithstanding, the recent depreciation of the shilling and the fear of this spilling over into domestic prices led the bank to be more proactive by actively intervening into the foreign exchange market. This led to the reduction in international reserves (in months of imports) from 4.6 to 4.1. The MTR noted that there is concern for dwindling levels of available reserves (recommended level is 4 months of imports). This is also exacerbated by the low growth in exports and poorly performing trade balance. Of equal concern are the recent portfolio outflows as investors search for higher yields in other emerging markets.

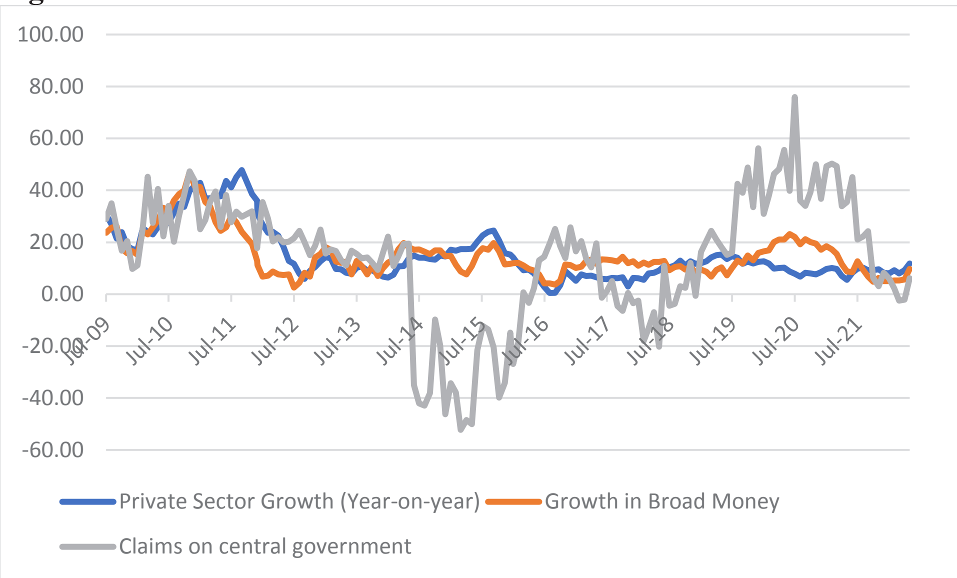
Figure 24: Exchange Rate and Volatility



Source: BOU

118. **Credit to the private sector has increased, but at a slow rate compared to the growth over the NDP II period**. The average growth rate of credit to the private sector during the first two years of the NDPIII was 8.6 percent slightly lower than the NDPIII target of 9.6 percent. The period July 2019 to date (see Figure 25) demonstrates the extent to which government aggressively borrowed from the domestic market at the expense of private sector credit growth and also way out of line with other monetary aggregates. The MTR notes that this is a worrying trend that needs to be reversed if government is to promote private sector development as well as support macroeconomic stability.

Figure 25: Claims on Central Government and Private Sector Credit



Source: Bank of Uganda

119. **Uganda Development Bank (UDB) continues to align its operations in line with NDPIII priorities but is still undercapitalised to make a significant impact especially on small and medium enterprises.** Under the current strategic plan, areas of financing in tandem with NDPIII were identified as: a) agriculture and agro-processing b) tourism c) industrialisation d) infrastructure development, and e) human capital development. As a result of resource constraints, UDB has until now overlooked infrastructure investment while focusing more on agriculture and agro-processing, which together take up 46 percent of UDB's loan portfolio. Of recent, UDB has ventured into heavy industries, for example the steel and tube industries, which today has installed capacity that can produce Standard Gauge Railway grade steel. Taken together with financing to agriculture, agro-processing and other industries constitutes about 60 percent of the UDB loan portfolio. UDB has also recently supported the tourism industry, for example the Boma hotel in Northern Uganda and a hotel in Karamoja. UDB has also supported human capital development through enabling private hospitals to acquire medical equipment and expand physical

infrastructure. Similarly, it has also financed education infrastructure developments. **With regard to infrastructural and oil related investments, UDB has not been engaged to date. However, an infrastructure development function has been established within the bank**.

120. **UDB is also slowly transitioning from short term lending to medium- and long-term lending**. The longest tenure that UDB can lend is 15 years although there is effort to increase it further to at least 25 years. In essence UDB has practically evolved into a development financial institution (DFI), unlike before where it was more interested in financing for example trade. However, it is grossly affected by inadequate resources to meet the demand for long-term credit. While the monthly demand for credit stands at UGX 306 billion, UDB can only meet up to 30 percent of the demand. This suggests that UDB is overly undercapitalized. The under capitalisation of UDB partly explains why 46 percent of its portfolio is biased towards agriculture and agro-processing. Adequately capitalizing UDB will enable the bank to also change its borrowing requirements especially for small and medium enterprises.

121. **For government to play a role through the Quasi-Market approach, the role of UDC would need to be expanded through provision of necessary human and financial resources. UDC needs to focus more on championing large enterprises where there is clear market failures and challenges of getting the private sector to invest.** To-date there are 13 operational projects where government has participated directly and the rest are projects in the pipeline under UDC. Initiatives where government is spending resources are also too small in nature to have any meaningful impact on the transformative agenda of Uganda. Others like in the hospitality industry have limited backward linkages to benefit the larger population and enhance inclusive growth. Government must consider embarking on at least 2-3 large industrial projects in the medium term. Examples of transformative projects where government should have a direct role for the remaining period of NDPIII are: (i) the Iron and Steel for Muko Iron-Ore and other related industries with the objective of setting up an iron and steel based industrial ecosystem for the country—this will result into a spinoff of steel-based industries in the region and absorb the increasing numbers of job seekers; (ii) Government should remain firm on the development of the Oil refinery and also consider investing in the petrochemical industry during the remaining period of the

NDPIII. The MTR also recommends that government passes the enabling laws on use of biofuels. Establishment of large biofuels industry aimed at mixing ethanol with oil would create an enormous market for agriculture products such as maize, sugar and cassava. In addition, this will stabilize prices for petroleum products as well as enhance the incomes of households engaged in maize, sugar cane and cassava value chains. At the moment, maize and cassava produced have no large-scale industrial demand apart for domestic consumption and regional exports in raw form with minimal processing.

122. **In October 2021, Government launched a Small Business Recovery Fund in partnership with Commercial Banks to support small businesses that were adversely affected by the pandemic.** The fund is equivalent to 200 billion with Government and Commercial Banks each contributing 50 percent. The uptake for this fund has been miserably low owing to stringent application procedures and ineligible applicants. There is an urgent need to revise the requirements for eligibility of these funds as well as publicity to market the fund within small businesses.

3.13 Fiscal and monetary policy coordination

123. **Fiscal expansion over the past three years that has resulted into rapid increase of public debt is restraining implementation of monetary policy.** Given the current level of debt service, this constrains the conduct of monetary policy, inducing the central bank to pay growing attention to reducing the costs of serving the public debt, especially domestic debt. As highlighted under the debt section in 3.10—the public debt portfolio notwithstanding being at sustainable levels, also has underlying risks related to interest, exchange rate and maturity risks. Albeit urgent and unplanned for expenditures which usually emerge through supplementary budgets and financed through domestic borrowing, there is a need to enhance better coordination between fiscal and monetary authorities as the monetary policy space to maintain macroeconomic stability is being narrowed by fiscal actions.

3 Conclusions and recommendations

124. **The assumptions underlying the planning process have been hampered by external shocks.** Consultations with Directors and commissioners at MOFPED and

BOU authorities all pointed to the fact that the underlying assumptions of the NDPs should be re-examined in light of the recent economic developments.

Recommendation 1: The MTR recommends a review of the underlying assumptions driving the plans. National Development Plans should be prioritized within the context of realistically mobilising resources to finance the plans.

125. **The assumptions under-pinning the NDPIII need to be revised**. The MTR reviewed all the underlying assumptions and for the remaining half of the NDPIII, growth projections should be revised downwards. Discussions with the fiscal and monetary authorities also signal towards conservative estimates of growth owing to recent economic developments especially the impact of Covid-19 and surging commodity prices.

Recommendation 2: Based on the prioritization of resources within the plan the MTR recommends to revise growth to an average 5.2 percent during the period FY2023/24-2024/25.

126. **There should be demonstrated commitment to the charter of fiscal responsibility for the remaining half of the NDPIII**. The current stock of debt and attendant debt service problems will be unsustainable within two years if left unchecked.

Recommendation 3: The MTR recommends using the Charter Fiscal Responsibility as an anchor to enforce fiscal discipline.

127. **The narrowing fiscal space for development spending owing to debt service obligations is a major concern.** There is a large variation in the priorities of the NDP vis-à-vis the spending provided for in the budget. In addition, there is a need to reprioritise spending in light of the available resources. Given the status of fiscal space and commitment of the resources, re-examination of existing loans is required.

Recommendation 4: The MTR notes there is need to reprioritise infrastructure projects within the programs with a possibility of phasing them over a longer time if government is to meet its targets in the charter of fiscal responsibility. There is also room for reallocation of spending to more productive activities such as agro-industrialization.

128. **Progress on the DRMS reforms has been mixed with some reforms yet to be implemented**. The increase in tax performance of 1 percent was due to the increased enforcements in the collection of arrears.

Recommendation 5: There is room to increase tax revenues to 16-18 percent of GDP through implementation of the outstanding DRMS reforms. **Expediting these reforms would ensure to reach this target by end of NDP4 in 2030.**

129. **A weak fiscal-social contract between citizens and government continues to limit growth of the revenue tax base**. Given the priorities of the current fiscal stance as demonstrated by the shares of spending—the link between social services that directly affect the populations welfare and taxation is weak. The level of corruption within the public sector is also a deterrent to voluntary payment of taxes and further complicates URA's already difficult task.

Recommendation 6: The MTR strongly recommends that government should strengthen links between tax and spending decisions, as well as budget transparency.

130. **Tax revenues have remained stagnant owing to the restriction of the tax base largely on industry and services sectors and limited collection from agriculture related activities**. This has resulted into a high tax burden of complying tax payers in industry and services, leading to closure of enterprises. While the agriculture sector remains largely subsistence with farmers operating at a small scale, commercial agriculture is also emerging and largely untapped as a tax base. Consultations with stakeholders demonstrated that the ever-increasing tax burden on industry and services to support the entire population of the country will overtime erode the small tax base.

Recommendation 7: There should be a deliberate effort to extend the tax base beyond industry and services. Commercial agriculture (especially by large farmers) which is a priority of government should contribute towards the tax base.

131. **In a quest to attract investments, Uganda offers generous tax incentives and exemptions albeit at the cost of further erosion of its tax base**. The tax foregone through these incentives has remained stagnant during the past two years estimated at 1 percent of GDP. A comprehensive assessment of the beneficiary companies in terms of

their contribution towards other taxes, employment and exports where applicable should be undertaken.

Recommendation 8: The MTR would recommend rationalizing these tax incentives and exemptions and where very necessary use them judiciously targeting productive sectors.

132. **Program secretariats should be at the centre of allocating resources within their programs**. This is the only way program secretariats would have a need to meet and prioritize their spending. To achieve this, it will require fully functioning programme secretariats to be in place and which are resourced annually through the budget.

Recommendation 9: To further align the budget with the NDP, the MTR concurred with the recommendation from Budget department that MoFPED should only provide budget ceilings to the programs.

133. **The MTR found that they are several costing centers resulting into different versions MTEF based at the NPA as provided under the NDP and MoFPED which are later compared for alignment**. MoFPED, in liaison with NPA, Public Service and OPM as members should establish the unit costs on programme inputs and the corresponding service delivery standards.

Recommendation 10: Strengthening program cost estimation for budget preparation should be made a priority and mainstreamed within government.

134. **To enhance budget efficiency the MTR found an urgent need to introduce annual spending reviews prior to the budget process.** These reviews should be used as partly the basis for prioritizing resources in allocation of resources. Spending review refers to the systematic scrutiny of existing expenditure to identify, in particular, options for cuts by drawing on both program evaluations (the review of specific services provided by government) and efficiency reviews (which focus on reducing the cost of delivering services).

Recommendation 11: OPM should play the leading role in undertaking program spending reviews which should be the basis for determining the ceilings by MoFPED.

135. Budget efficiency could be achieved through adoption of zero-based budgeting. For government use, this planning and budgeting technique endeavours to redirect efforts and funds from lower priority current programs to higher priority new programs, improve efficiency and effectiveness, and reduce spending. As well, ZBB are set to prevent regular budget creeping behaviour that emphasizes inflationary adjustments. Therefore, for budget to be translated into concrete development and growth there must be a real forecast of goals or targets at all the tiers of governments.

Recommendation 12: In light of the existing fiscal constraints, existing waste built over time under incremental budgeting, the MTR strongly recommends government to adopt zero-based budgeting (ZBB).

136. There should be a link between the programme secretariats, MoFPED and OPM during the budget consultative process. MoFPED should lead the process of determining the ceilings of programs. OPM should undertake expenditure reviews which should be used as a basis to determine ceilings. Once MoFPED determines the ceiling for the various programs, there should be an iterative process between MoFPED and programs in the allocation of resources to the priority sectors.

Recommendation 13: **To fully adopt the program-based planning process, the MTR recommends changes to the budget formulation process**.

137. **Frequent supplementary budgets continue to undermine planning and budgeting processes.** While supplementary budgets are provided for under the PFM Act with a limit of 3 percent to the total approved budget, this has increasingly been violated over the years. Total supplementary expenditure by the central government increased from UGX 1,682.81 Bn in the FY 2017/18 to UGX 4,270.48 Bn in the FY 2021/22. **The MTR Also noted that 75 percent of supplementary expenditures** were predictable and could have been planned for in the budget.

Recommendation 14: **The MTR recommends strong fiscal discipline in line with the NDP and the budget processes. On the same note the MTR recommends adherence to the PFM Act especially by properly planning for predictable expenditures with a view to contain supplementary budgets within 3 percent of the total budget**.

138. **Domestic arrears have continued to rise despite Government efforts over the years**. By the end of 2021, the 2022 Office of the Auditor General Report reported a further increase in the stock of domestic arrears to UGX 4.65 trillion. The rise in arrears has been mainly attributed to fiscal indiscipline, poor financial management and weak system controls (MoFPED, 2021). In addition, arrears pose a reputational risk to Government which can affect the country's credit risk ratings.

139. <u>Recommendation 15:</u> There is an urgent need to keep arrears in check as this continues to erode the reputation of Government and directly cripples private sector development.

140. As government embarks on fiscal consolidation to meet its targets in the charter of fiscal responsibility there is a need to reprioritize spending. The prioritization is based on the following criteria: (i) activities having higher backward and forward linkages; (ii) directly linked to addressing household poverty and food security; (iii) are in position to aid quick economic recovery (directly impact production and consumption); and, (iv) in alignment with the operationalization of the Parish Development. Reallocation of spending from Governance and security to integrated transport, energy and human capital development yields a higher growth rate path compared to the current (FY 2022/23) budget allocations.

<u>Recommendation 16:</u> Given the limited resources, there is an urgent need to prioritize resources within the budget through changes in the composition and phasing of expenditure activities.

141. **While Uganda remains at moderate risk of debt distress, significant vulnerabilities loom**. Even though debt burden indicators remain below their indicative thresholds, they have increased compared to the previous DSAs. These risks include: (i) increasing debt service; (ii)increasing weighted average interest rate risk owing to huge appetite for costly domestic debt; (iii) reducing average time to maturity of the portfolio; and, (iv) reducing maturity risk.

<u>Recommendation 17:</u> Based on the ratio of PV of debt to exports, further excessive borrowing will push the country to a high-risk category between the period 2022 and 2026. MTR recommends that government should be cautious on further excessive borrowing especially non-concessionary debt.

142. **Government should also starts exploring other options to finance large infrastructure projects whose economic returns may not be viable in the short run but with enormous social benefits.** Uganda is currently rated at B+ by Fitch and Standard and Poors rating agencies.

Recommendation 18: At the backdrop of high ratings, the MTR recommends that the Government considers alternative financing models provided in the PIFS. These include issuing long-term Infrastructure Bonds. Government should also mobilize large surplus institutions to finance infrastructure projects, such as pension funds, particularly the National Social Security Fund (NSSF). Other emerging financing options which are particularly targeting green growth investments should also be explored.

143. The period July 2019 to date demonstrates the extent to which government has aggressively been borrowing from the domestic market at the expense of private sector credit growth and also way out of line with other monetary aggregates.

Recommendation 19: The MTR notes that this is a worrying trend that needs to be reversed if government is to promote the private sector development as well as support macroeconomic stability.

Recommendation 20: MTR recommends increasing capitalization of UDC to enanble it implement its Strategic Plan 2020-2030 and UDC Act (by revising the cap to increase the capital limit that currently stands at USHS 500 bn in line with Section 17(2) of the Act) to sufficient funding. There is also need to support UDC to enhance its capacity to prepare bankable projects for utilization of the proposed capitalization in line with the Strategic Plan.

144. **Fiscal expansion over the past three years that has resulted into rapid increase of public debt is restraining implementation of monetary policy.** Given the current level of debt service, this constrains the conduct of monetary policy, inducing the central bank to pay growing attention to reducing the costs of serving the public debt, especially domestic debt.

Recommendation 20: there is a need to enhance better coordination between fiscal and monetary authorities as the monetary policy space to maintain macroeconomic stability is being narrowed owing to the excessive debt burden

Annex 4

Annex 1: Status of DRMS Implementation

Reform	Target-Date	Status
Process reform and institutional changes	19/20-20/21	Following recommendations of the Review on the Tax Policymaking process in Uganda - a package of institutional reforms have been taken on under REAP PFM reforms, under FY 2022/23. This will be commenced by TA on the institutional capacity review and businesses processes.
Reform of the tax policy-making process	19/20	- to be implemeted as a package-
Elevate the status of taxation within MFPED	19/20-20/21	- to be implemeted as a package-
Enhance the analytical capacity of TPD & URA	19/20-20/21	- to be implemeted as a package-
Address TPD structure and staffing/training needs	19/20-20/21	- to be implemeted as a package-
Strengthen partnership with URA and formalise Arrangements	19/20	- to be implemeted as a package-
Value Added Tax reforms		RE-writing the VAT law commenced in collaboration with USAID-DRM4D, havent concluded excempt supplies and zero rated. The new VAT Bill is ready for consideration by Parliament and is evisaged to become effective in FY 2023/24
Maintain principal zero-ratings/exemptions	19/20-20/21	-this has been taken care under VAT Bill -
Review other zero-ratings/exemptions	19/20-20/21	Discussions still ongoing on these provisons
Narrow deeming provisions	19/20-20/21	-this was taken care of under the VAT Bill -
Re-assess registration threshold and rate	19/20-20/21	-this was taken care of under the VAT Bill -
Standardise government best practices	19/20-20/21	-this was taken care of under the VAT Bill -
Corporate Income Tax		

Reform	Target-Date	Status
Maintain support for priority sectors	19/20-20/21	This has been done -yes
Support workforce education/training	20/21-21/22	yes
Rebalance the nominal rate and the incentives, deductions, and depreciation regime	19/20-20/21	changed the depreciation regime
Review and renegotiate over-generous treaty provisions	19/20-20/21	DTAs being re-negotiated based on internation practices
Strengthen international tax rules and enforcement	19/20-20/21	DTAs being re-negotiated based on internation practices
Improve information-sharing domestically and Internationally	19/20-20/21	done
Personal Income Tax	19/20-20/21	There's need to adjust the rates as the bands havent been reviewed in a long time. Rental tax is the one with a problem
Review exemptions and consider alternative Approaches	19/20-20/21	Personal Income taxation has been planned for FY 2022/23
Address thresholds, bands, and rates	19/20-20/21	
Consider scope to encourage saving through PIT	19/20-20/21	
Address weaknesses in rules for taxing rental Income	19/20-20/21	
Incentives and exemptions	19/20-20/21	Review on all tax incentives was commissioned, and work has started, in coraboration with TaxDev and IGC
Consider measures to encourage youth into formal workforce	19/20-20/21	
Establish and publish a Tax Expenditure Governance Framework	19/20-20/21	Done
Excise duties	19/20-20/21	Theres a review to see if it is still effective. It

Reform	Target-Date	Status
		is also being mis-used under some areas like mobile money. A report is being done so that it does what its aimed for. We have to have afew and index
Develop a broader scheme of environmental taxes	19/20-20/21	The recent review of Excise Duty Law takes care of these reforms
Rationalise multiple rates	19/20-20/21	- do -
Introduce and enforce strict regulations for excisable industries	19/20-20/21	- do -
Consider revised approach to inflation adjustments	19/20-20/21	- do -
Extractives industry	19/20-20/21	
Fine-tune the framework for taxing the extractives Industries	19/20-20/21	USAID is working with MoFPED. The ground is being set as we wait for oil
International trade	19/20-20/21	CET review has been concluded
Balance the objectives of export promotion, revenue generation, and support to domestic industry	19/20-20/21	This is ongoing
Improve inter-agency coordination and infrastructure	19/20-20/21	This is ongoing
Non-Tax revenues	19/20-20/21	A comprehensive Finance Bill 2022, had been taken to Parliament, but was not passed as Parliament preferred not the status-quo remain. MoFPED will utilse appropriate regulations
Streamline the policy on NTR	19/20-20/21	Parliament paused a challenge. It is still WIP
Local government taxes	19/20-20/21	
Work with local government to strengthen analysis, monitoring, and reporting	19/20-20/21	Need for increased collaboration so that the same people arent burdened highly

Reform	Target-Date	Status
Donor-funded projects	19/20-20/21	Rationalising of VAT will help this
Review the taxation of donor-funded projects	19/20-20/21	Reviewis ongoing
Digital economy	19/20-20/21	
Address the impact of the digital economy on the tax base	19/20-20/21	There will be collaboration with the banks to tax the people buying - review is ongoing

Source: URA and MOFPED

Annex 2 List of Participants

Sno	Programme	Minister	Other Actors
1	Agro-industrialisation	State Minister for Agriculture	OP, MAAIF, OWC, NAADS, MoFPED, UBOS, EPRC, OPM, UCAA, MEACA, ULGA, UNDP, CSBAG, CDO, UCDA, ACODE, LGs(2), NAGRC & DB, MoICT&NG, Merchandize Uganda, PFSU, DDA, Public Policy Society, WELDE, NPA
2	Manufacturing	Minister of Trade Industry and Cooperatives	UNBS, MoTIC, MoFPED
3	Public Sector Transformation	Permanent Secretary for Public service	NPA, MoPS, MoFPED, Climate Change Action, MoKCC&MA, MoWT, KCCA, PSC, OPM, MoLG, MoFPED
4	Sustainable Urbanisation and Housing	Minister of Lands, Housing and Urban Development	AREA-U, MoLHUD, PSFU, MGL, NHCC, MoKCC&MA, East Africa Food Security Sympos, NBRB, OWC, GGGI, Cities Alliance, MoICT&NG, AFD, MGLSD, CIG, Shelter & Settlements Alternative, MoLG, UN-Habitat, CREDO Management Association of Real Estate Agents, Women Leadership Development, MoPS, National Physical Planning Board, ULGA, UFZA, NPA, MoFPED
5	Development Plan Implementation		PPDA, URA, UBOS, UNBS, UIA, NPA, OPM, UWRSA, PSFU, OP, UNCST, EOC, LGFC, KCCA, UDB, URBRA, MoFPED, MUK, NPC, EPRC, UNCS, Enterprise Uganda, MoTIC, USSIA, UFZA, NIRA, UNDP, MoFPED
6	Digital Transformation	Minister for ICT &NG	NPA, United Cities of Africa, MoICT&NG, UICT, UCC, STI, GCF, Posta UG, NITA-U, PSFU, PIBID, BIRDC, MIIC, GIZ, URA, EPRC, UNATCOM, MoFPED
7	Innovation, Technology and Digital Transfer	Minster for STI	KMC, UNCST, EPRC, MoFPED, OP, UNATCOM, UIRI, PIBID, UICT, EOC, Government Communication Forum, NPA
8	Human Capital Development	Minister of Education and Sports	MOES, FLMES, MOH, UET, UBTEB, UAHEB, DIT, NCDC, ESC, HTVET, UNFPA, IMU, Butabika Hospital, MGLSD, UHI, UNATCOM, DES, MOWE, NPA
9	Natural Resource, Environment, Water and Climate Change	State Minister for Water	UWASNET, MoLHUD, MWE, OPM, UNESCO, UNDP, NFA, ULC, UNMA, MGLSD, MoFPED, NEMA, GGGI, NPA
10	Community Mobilisation and Mindset Change		MoICT&NG, DEI, NLU, KCCA, UNCC, MGLSD, UNFPA, MWE, EMLI, UNESCO, NPA, MoFPED
11	Tourism Development	State Minister for Tourism	MOFA, MTWA, UTA, OPM, UTB, MoWT, MoIA, AUTO, UNRA, NPA, MoICT&NG, MoDVA, UMA, UBC, UWA, KCCA, Uganda Safari Guides Association, UPF, UCAA
12	Legislation, Oversight, and Representation	Clerk to Parliament	JSC, ISO, MUK, OAG, MoFPED, DCIC, ULRC, POU, UHRC, FIA, OPM, GIZ, MoLG, UPS, International Association of Strategy Planning Uganda
13	Governance and Security		NIRA, MoFPED, MoIA, MoLG, NPA, UPDF, JSC, LDC, PPDA, URSB, IG, State House, FIA, MODVA, UPS, URA, EC, OAG, ESO, MEACA, EOC, UPF, MoJCA, NGO Bureau, GIZ, DEI, ISO, JLOS, MOFA, OP
14	Integrated Transport Infrastructure and Services	Minister of Works &Transport	MoFPED, UCAA, KCCA, MEMD, MUK, MoWT, OPM, UNACL, SGR, UNRA, UFZA, POU, ULGA, URC, NPA
15	Mineral Development	State Minister for Minerals	MEMD, UETCL, ACEMP, SAWA Energy, Atomic Energy Council, MoWT, NPA, MoFPED
16	Petroleum Development	State Minister for Minerals	MEMD, UETCL, ACEMP, SAWA Energy, Atomic Energy Council, MoWT, NPA, MoFPED
17	Sustainable Energy Development	State Minister for Minerals	MEMD, UETCL, ACEMP, SAWA Energy, Atomic Energy Council, MoWT, NPA, MoFPED
18	Regional Development	Minister for Local Government	MoLG, NARO, UAAU, ULGA, MoTIC, NPA, LGFC, MoFPED, MoPS, MTWA, OPMA, MWE
19	Private Sector Development	State Minister for Planning	MoTIC, MoFPED, NPA, UEPB, IRA, BOU, UIA, MOFA, Enterprise Uganda, UDB, USSIA, UDC, UMA
20	Administration of Justice	Permanent Secretary for Judiciary	Judiciary, JSC, MGLSD, ODPP, MoFPED, NPA, Tax Appeals Tribunal

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