National Budget Conference

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Statement by the Local Development Partners Group

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Right Honorable Prime Minister

Honorable Minister of Finance, Planning and Economic Development

Honorable Ministers

Honorable Members of Parliament

Representatives of Civil Society Organizations and the Private Sector

Members of the Diplomatic Community

Distinguished Participants

Ladies and Gentlemen,

On behalf of the Local Development Partners Group, I wish to thank you, Right Honorable Prime Minister, for inviting us today to the *National Budget Conference* for Fiscal Year 2020/2021. This is an important event, which will set the tone for key policy and spending discussions over the best part of the next year. We, as Development Partners, will use this opportunity to identify and discuss ways of strengthening our partnership and coordination to support you in sustaining and accelerating development outcomes in Uganda.

Once again, the budget conference follows a successful *Economic Growth Forum* in late August that was structured around accelerating economic growth for shared prosperity. This is very similar to the theme of the *FY20/21 Budget Strategy* of "*Industrialisation for Job Creation and Shared Prosperity*". We are particularly pleased that *Jobs* is featured more prominently, as job creation is arguably the most pressing challenge in the country today. We do also look forward to seeing how the proposals from the *Growth Forum* are taken forward in the next budget.

When considering the broad challenges and opportunities this budget confronts, I will highlight five issues today that Development Partners believe are important to keep in mind.

First, recent economic growth has not been sufficient or inclusive, and is not creating the level of jobs required. Uganda continues to maintain macro economy stability in the face of uncertainty in the global economy: low levels of inflation, a stable balance of payments position, a broadly stable foreign exchange rate and adequate foreign exchange reserves. This stability – alongside a range of other factors including good weather – has maintained growth levels of over 6 percent in the last two years; and the growth outlook is very positive for the medium term.

However, Uganda has one of the world's highest population growth rates, with almost half of its people under the age of 15. As a result, once population growth is accounted for, the economy's average annual per capita growth is significantly reduced. According to the latest Household Survey (2016/17), between 2012 and 2016 the poverty rate also increased to 21.4 percent, an increase that resulted in around 1.4 million Ugandans slipping into poverty. Uganda also needs to generate about 600,000 new wage jobs per year to cater for the young people leaving the education system. This isn't being met; as noted in the *Budget Strategy*, only about 75 thousand new wage jobs are being created each year. Raising the quality, as well as the rate of growth, will be critical to ensure that the economy is better placed to support the aspirations of all Ugandans. The theme of this year's *Budget Strategy* on "*Industrialisation for Job Creation and Shared Prosperity*" is, therefore, welcome.

Although it makes sense for Uganda to primarily look to achieve this through *Agro-Industrialisation*, we should not lose sight of the many preconditions for industrialisation that are still poorly developed. At the level of agro-production and productivity, including service delivery to farmers, there are still enormous gaps which need to be narrowed if raw materials are to be made available to agro-industry. Instead of overly focusing on *Agro-Industrialisation*, we need to equally consider elements of the full value chain from the farm to processing, and then marketing and trade.

Second, the next budget needs to be better anchored around NDPIII's medium-term growth and development objectives. We commend the government for the work it has done in reviewing the performance of NDP II and preparing NDP III. While there has been an improvement in alignment of the budget to the NDPs, concerns remain in several areas that need to be addressed (some have also been identified in the latest (April 2019) compliance report of the *National Planning Authority*):

- Although *human capital development* is again a priority intervention in the *FY20/21 Budget Strategy*, Uganda has been allocating a declining share of its budget to social sectors despite a growing youthful population; and much lower than the average for East African countries. As a result, the earlier progress on human development is showing signs of stagnation and, if continued, may cause a reversal of some of this progress. Development partners make a significant contribution to these sectors, but we cannot substitute for government leadership and resources. Thus, we would like to have a constructive dialogue on shifting the way we work together in these critical areas, and thereby maximise the sustainability of our support.
- Although work has been done to strengthen *public investment management*, much still needs to happen to ensure the heavy investment in infrastructure delivers the maximum possible impact for growth and poverty. New projects that were not in NDPII continue to be developed without a clear understanding as to whether the right choices are being made. In terms of implementation: challenges in land acquisition continue to slow project implementation and lead to cost overruns; allocating financing to projects that are not ready has crowded out implementation of NDPII-ready projects and pressing needs in other sectors; and several expired projects are still in the *public investment plan*, thus holding resources that could be used for other priorities.
- During the 13th and 14th *Joint Transport Sector Review Workshops* it was agreed that budget allocations for *road maintenance* would rise to 24 percent of the roads budget in FY19/20. However, based on the budgetary allocations for FY19/20, this wasn't the case. Road development still takes the biggest share of the budget, at 90 percent, with road maintenance only allocated 7 percent. As a result, current road maintenance financing can only meet about 26 percent of the needs, leaving a big chunk of the road network unattended to. This presents a precarious situation for the sustainability of the roads asset base if it can't be maintained adequately. Over the medium term, the proportion of roads in fair to good condition will decrease, while that in poor condition will increase. At the same time, the backlog of maintenance is growing and will result in higher replacement costs of the road asset in future. Government needs to quickly find a more effective way of mobilising financing for road maintenance.
- For years *operational and investment funding for local governments stagnated*, undermining the availability of funding for local governments to invest in and run basic services. We welcome the successive increases in the 2018/19 and 2019/20 budgets

for development, and most significantly operational funding for health and education services. We look forward to the continuation of these increases over the medium term to restore the adequacy of funding for those services. We also encourage government to increase funding for other local government services such as water, agriculture and rural roads, alongside education and health. We are impressed by the improvements in institutional performance of local governments under the *Annual Performance Assessment* in the context of the fiscal transfer reforms. It is now important that reforms are deepened to impact on service delivery, and we welcome plans to introduce performance incentives for health facilities and schools and to support poor performance. We also welcome the inclusion of refugees in NDP III, Sector and District Development Plans, which will further align humanitarian and development interventions with the district plans.

Third, resourcing a budget which can deliver growth and manage debt vulnerabilities requires boosting domestic resource mobilisation efforts. At 14.7 percent of GDP in FY18/19, tax revenues exceeded the revenue target of 14.2 percent. This was also in line with government's ambition of annual revenue increases of 0.5 percent of GDP from new administrative and tax policy reforms. However, much of this increase is due to extracting more revenues from a limited tax base. So, efforts need to be made to expand this base. This includes incentivizing medium and small enterprises to enter the formal market, which may involve a strategy of not taxing them initially and instead taxing them progressively as they grow.

Also, as discussed at the *Economic Growth Forum,* government needs to quickly establish a framework to help manage tax exemptions. These exemptions narrow the base and drain the system of revenues forgone and will make it harder for government to continue achieving its revenue ambitions. Estimates suggest that revenue forgone across all tax sources due to tax exemptions were in the range of 4½ to 5 percent of GDP in FY16/17.

Discussions at the *Growth Forum* also identified very little evidence that these exemptions encourage greater investment, with investment decisions being made on more tangible issues related to the business environment (e.g. availability of appropriate skills). Such a framework to manage exemptions would include rules to assess their efficiency, impact and equity, and to remove them if warranted. Furthermore, developing the private sector and encouraging both domestic and foreign investment needs a more multi-sectoral approach and clearer institutional alignment. It will also require a better understanding of investor incentives.

Fourth, although Uganda remains at low risk of debt distress (according to the WB-IMF debt sustainability assessment) under current policies and expected economic conditions, debt vulnerabilities are significant and increasing. We welcome the commitment by government to keep debt at safe levels. However, if all projects currently included in the investment pipeline were fully implemented on time, remaining below prudent thresholds would be challenging. In addition, an unexpected downturn in GDP growth or increased reliance on non-concessional/commercial borrowing would create additional vulnerabilities. The recent delays to a *Final Investment Decision* in the oil sector are also concerning, given that the heavy borrowing for oil sector-related infrastructure is relying on enhanced repayment capacity from oil exports, which looks set to be deferred. Total debt service (interest and principal due) is also expected to average around 41.5 percent of government revenue over the next six years, until oil revenues ensue.

Apart from prudent borrowing, this also highlights the significance of raising tax revenues, reducing tax exemptions, and limiting the procurement and implementation delays of particularly debt financed projects. Maintaining public debt on a sustainable path will require strengthening the budget process to ensure that budget targets become more binding; that public spending and public debt management become more effective, including maximising concessional borrowing; and that fiscal risks are comprehensively monitored.

Finally, Development Partners are committed to engage more closely in the preparation of the *FY20/21 Budget*. This engagement with government used to be much stronger when several partners were providing budget support, and there was richer and more structured dialogue around policy and spending choices. Given that the budget is the most important means to prioritise and deliver development outcomes in Uganda, we want to start bringing back those levels of dialogue in the preparation of this budget. From our side, this will include providing comprehensive and timely information on on-going and proposed donor support, and engaging closely in the preparation of both the sectoral and national budget framework papers.

Right Honorable Prime Minister, let me conclude by once again thanking you, on behalf of the Local Development Partners, for inviting us to participate in this important conference. We wish you successful deliberations in designing a budget which supports job creation and prosperity, and look forward to discussions on how we, the development partners, can best engage to support sustainable inclusive growth in Uganda.