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Fiscal Sustainability through deeper reforms to Public Investment Management

Uganda Economic Update, 19th Edition

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Foreword

New shocks hit the Ugandan economy in 2022, just as it was recovering as the COVID-19 pandemic waned and related mobility restrictions were fully removed. Commodity price surges and disruptions to trade and supply chains because of the war in Ukraine worsened a global economy that was dragging under the weight of new waves of COVID-19 in some regions and unwinding of stimulus policies. The outlook for Uganda is now one of slower GDP growth with increased vulnerabilities, including in household incomes and food security. The authorities face the challenge to maintain a delicate balance between policies required to support and sustain a growth acceleration and ensuring stability otherwise the start-stop recovery as shocks evolve, will make it impossible for Uganda to build back better.

It is against this backdrop that I am pleased to introduce the 19th edition of the Uganda Economic Update, which features a special topic of 'creating fiscal space for fiscal consolidation through deeper reforms in public investment.' Fiscal consolidation is needed to rein in high deficits, reduce debt, and ensure stability of the Ugandan economy.

Strengthening the management of Uganda's public investment program is essential for this fiscal consolidation to support long-term, inclusive economic growth. Global experience suggests that the scope for increased efficiency to support economic growth is large. An average country obtains 30 percent less economic output from a given amount of spending on physical infrastructure than does the most efficient country. Up to two thirds of this efficiency gap can be closed through improved institutions, systems, and processes guiding decisions on how to prepare, implement, operate, and maintain public investment projects. To tap into this dividend, many countries are taking more serious steps to improve how they manage their public investments.

In cognizance of variation in country characteristics and environments, the World Bank's engagement in public investment management (PIM) is based in a framework that has drawn good practice management principles applicable to the respective capacity contexts. These principles, termed as the "must-have" features of a PIM system— help to ensure that key risks are appropriately reduced through decision steps and controls that are within most governments' capacity to implement.

Building on the good practices that it has already instituted in the pre-investment phase within this PIMs framework, the Government of Uganda has the opportunity to address persistent problems of low execution of capital budgets, shortened project lifespans, delays in implementation, which waste taxpayers' money through cost and time overruns. The government also needs to strengthen the gate-keeping function, improve project budgeting, and build project implementation capacities.

Better public investment management can support both government's short- and medium-term fiscal consolidation agenda and longer-term structural transformation of the economy.

Keith Hansen
Country Director
Kenya, Rwanda, Somalia, and Uganda
Africa Region

Abbreviations

bbl	barrel
BMAU	Budget Monitoring and Accountability Unit
BoP	balance of payments
BoU	Bank of Uganda
BTI	Business Tendency Indicator
CBR	Central Bank Rate
CFR	Charter of Fiscal Responsibility
COVID-19	coronavirus disease 2019
CPI	consumer price index
CRM	credit relief measures
CSI	construction sector index
DC	Development Committee
DFS	digital financial services
DRC	Democratic Republic of Congo
DRMS	Domestic Revenue Mobilization Strategy
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
ECF	Extended Credit Facility
EMDE's	emerging market and developing economies
FDI	foreign domestic investment
FID	final investment decision
FIs	financial institutions
FY	financial year
GDP	gross domestic product
GEMs	Geo-Enabling method for Monitoring and Supervision
GEP	Global Economic Prospects
GFN	gross financing need
GNI	gross national income
HIC	high-income country
IBP	Integrated Bank of Projects
IC	information and communication
ICT	information and communication technology
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFIs	International Financial Institutions
IMF	International Monetary Fund

LIC	low-income country
LG	local government
MDAs	ministries, departments and agencies
MIC	middle-income country
MIS	management information system
MoFPED	Ministry of Finance, Planning and Economic Development
MSME	micro, small and medium enterprise
M&E	monitoring and evaluation
NDP III	Third National Development Plan
NPA	National Planning Authority
NPLs	non-performing loans
OP	Office of the President
OPM	Office of the Prime Minister
OPEC	Organization of the Petroleum Exporting Countries
O&M	Operation and Maintenance
PAP	Project Appraisal and Public Investment Management
PFM	public financial management
PIM	public investment management
PMI	Project Management Institute
PMI	purchasing managers index
PMBOK	Project Management Body of Knowledge
PMP	Project Management Professional (Certification)
PPP	public-private partnership
SDR	Special Drawing Right
SFIs	supervised financial institutions
SOPs	standard operating procedures
SSA	sub-Saharan Africa
UAE	United Arab Emirates
UBOS	Uganda Bureau of Statistics
UHFPS	Uganda High Frequency Phone Survey
UNHS	Uganda National Household Survey
UNPS	Uganda National Panel Survey
URA	Uganda Revenue Authority
US	United States of America
VAT	value-added tax
WEO	World Economic Outlook

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Executive Summary

State of the economy: Recovery faces new headwinds

With the COVID-19 pandemic waning and the attendant mobility restrictions having eased in late 2021, economic activity gradually gained momentum, before new global shocks hit, including the impacts of the war in Ukraine. Real GDP grew by 4.3 percent in the first half of FY22 supported by a strong and speedy recovery of the service sector upon the re-opening of the leisure and entertainment industry, accommodation, and food services, as well as sustained buoyancy of the information and communications sector. The suspension of activities related to gold exports in this period moderated the growth of the industry sector while agriculture remained at the mercy of the weather. Consumption demand benefitted from the recovery of incomes and employment, while private investments overcame the Omicron related uncertainties to sustain increases in new export and manufacturing orders into the third quarter of FY22. However, rising commodity prices (later heightened by Russia's war on Ukraine), disruptions to trade and supply chains in key supply regions of China (due to a resurgence of COVID-19), and tightening financial markets, disrupted the recovery into the second half of the year. Overall growth for FY22 is estimated at 3.7 percent – below pre-COVID-19 projections of over 6 percent and leaving Uganda's per capita income estimated at about US$850, well below lower middle-income threshold of US$1,045 per person.

Households remain vulnerable to shocks – food insecurity and income losses due to work stoppages in early FY22 have likely been exacerbated by rising commodity prices and increased overall cost of living. In addition to the 11-percentage point fall in employment between the surveys conducted in March/April 2021 and October/November 2021 mainly attributed to COVID-19 restrictions, over 50 percent of households reported an increase in food insecurity, with poor weather conditions also adding to the factors driving this phenomenon. The rising food and fuel prices are likely to have worsened conditions for many households – especially those in urban areas which are just recovering from the severe effects of the COVID-19 lockdowns. Unfortunately, the social protection programs remain limited, and reached only 13 percent of households in October/November 2021. The full reopening of schools after almost two years of closure, augurs well for human capital development. However, authorities still have the challenge of closing the COVID-19 aggravated gap between the children from rural and less privileged households, and their counterparts, who benefitted for virtual learning opportunities during this period.

Credit to the private sector remained subdued, despite the low inflation, and a supportive macro-prudential policy stance at the Bank of Uganda. Bank of Uganda maintained the Central Bank Rate (CBR) at 6.5 percent for ten consecutive months to May 2022 and cautiously phased out credit relief measures, while introducing new liquidity buffer windows to cater for banks or firms that require longer term liquidity support. Monetary tightening will likely raise banks' credit risk which remained elevated and kept growth of credit to the private sector low, at an average of 4.9 percent in the first nine months of FY22 – almost half the growth realized in the corresponding pre-COVID-19 period. Asset quality may further deteriorate after the COVID-19 Liquidity Assistance Program expired on May 31, 2022, Credit Relief measures – which have continued to support sectors that were most hit by the pandemic and lockdowns – expire in September 2022, and the BoU has started tightening policy to address increasing inflationary pressures. Whereas credit growth likely remained sluggish through the second half of FY22, risks leaned towards more inflationary pressures, BoU raised the CBR by a full percentage point to 7.5 percent. This reveals the difficult task already facing monetary policy of maintaining a delicate balance between curbing inflation pressures due to rising commodity prices and depreciation pressures as portfolio outflows intensify and supporting the private sector to remain on the recovery path.

For the first time since the pandemic broke out, the current account strengthened during FY22, on the back of stronger exports and slower imports. Sluggish domestic conditions, rising costs and disruptions to supply chains in source

countries cut net imports of goods and services by almost 3 percentage points of GDP. Yet, an extraordinary performance of exports – bolstered by coffee which reached a 30-year record shipment of 1.99 million bags in the first quarter – partially offset the suspended gold exports on account of a new export levy and retraction in travel inflows and remittances. The surge in oil imports and transport prices into the second half of FY22 has likely kept the current account deficit at about 8.5 percent of GDP for the full year, largely financed by net external borrowing and drawdown of foreign exchange reserves.

Despite revenue shortfalls, the fiscal deficit has been lower than planned on account of the under-execution of the development budget. While revenue collections missed the target by 0.8 percent of GDP, expenditure plans did not materialize mainly due to under-execution of the development projects reflecting weaknesses in public investment management. This could further slow economic recovery, which hinged on public investments as private investments crawl on under the effects of the shocks. The fiscal deficit is expected to decline to 7.4 percent of GDP for FY22, consistent with the fiscal consolidation plan, but will remain above the targets on the Charter of Fiscal Responsibility (CFR) path, the achievement of which, is further constrained by weakening budget credibility. Meaningful fiscal management will require limiting use of supplementary budgeting to genuine emergencies, curbing accumulation of domestic arrears, improving budget transparency by reducing allocation to classified expenditures, and addressing the rising costs of public administration.

Fiscal consolidation is needed to rein in debt and create space to respond to shocks that could hurt recovery. Against the background of low tax revenues and increasing expenditure, Uganda's public debt could reach about 53 percent of GDP in FY22, above the CFR target of 52 percent and alongside heightened liquidity pressures as debt service takes an increasing share of revenues. At moderate risk of debt distress, Uganda is also undertaking measures to enable it rein-in debt to within desired thresholds, improve transparency and strengthen overall fiscal sustainability, all of which aims to improve debt sustainability and limit crowding out of the private sector. Given the slow pace of private investments, the lowering of fiscal deficits ought not to come at the expense of public investments needed for recovery and longer-term growth.

The short-and medium-term economic outlook for Uganda remains uncertain, with the recovery path facing hurdles and risks. Optimism about acceleration of growth following the waning pandemic and full re-opening of the economy, as well as the clearer outlook for Uganda's oil production following the signing of the Final Investment Decision in February 2022, has been checked by new shocks, particularly rising commodity prices. Under the baseline scenario, real GDP growth is estimated at about 5.1 percent in FY23, which is almost half a percentage point below the World Bank December 2021 forecast, mainly due to increased inflation pressures and expectation for monetary tightening, tighter global financial markets, and increased uncertainty, among others. Nonetheless, the risks are heavily tilted downwards, including the potential for new waves of COVID-19 (given that just about 24 percent of the population is fully vaccinated), new disease outbreaks such as Ebola hemorrhagic fever or monkeypox, and a deeper and protracted effect from a worsened global economy related to the war in Ukraine and sanctions on Russia. Moreover, Uganda remains vulnerable to climate shocks, regional insecurity, and the slow implementation of projects. Heightened shocks would potentially lead to rising fiscal pressures and jeopardize the planned fiscal consolidation path.

To shift from the fragile economic growth to a more resilient and inclusive recovery requires attention to the following four priority areas:

(i) ***Accelerate the vaccination effort*** to avoid the resurgence of COVID-19 and related consequences.

(ii) ***Adopt targeted interventions*** to support the vulnerable while accelerating building of the foundation for a shock responsive social protection system, including a national social register to ensure quick and efficient reach out to target populations once shocks hit, stronger digital payment platform for efficient and transparent distribution of support, and a disaster risk financing strategy. Labor-intensive public works programs need to be developed to help those willing to work but have fallen out of employment due to shocks.

(iii) ***Maintain prudent fiscal and debt management to support the fiscal consolidation agenda*** in tandem with the Charter of Fiscal Responsibility, by minimizing domestic financing of the deficit, reducing domestic arrears, maximizing concessional financing, rationalizing expenditure, and closely monitoring all sources of fiscal risks, including SOEs financial performance, National Social Security Fund pension restructuring, and lending schemes.

(iv) ***Adopt a cautious monetary tightening stance in the face of rising inflationary pressures*** to maintain an appropriate balance between curbing inflation pressures and supporting the private sector and the economy to remain on the recovery path. This will call for a close monitoring of financial system stability as well as closer coordination of monetary policy actions with fiscal operations.

Sustaining this recovery over the longer term will require accelerating structural reforms to (i) strengthen revenue mobilization through the implementation of the DRMS; (ii) improve public investment management; (iii) rationalize public expenditure to support faster, sustainable, and inclusive growth by investing strongly in human capital development; and (iv) improve the trade and business environment (tapping into prospects of regional integration initiatives including the African Continental Free Trade Area) and green investments. This will also require adhering to the fiscal anchors included in the Charter of Fiscal Responsibility.

Special focus: Creating space for fiscal consolidation through better public investment management

Given the government's resolve on fiscal consolidation, increasing the efficiency of the capital budget provides a tangible and sustainable option to pursue this agenda. With up to 56 percent of the budget spent on non-discretionary items, Uganda's budget is quite 'rigid' and hence in general terms, more difficult to adjust in the short to medium term, when compared to other SSA countries where this share is much smaller, at 48 percent. This rigidity has increased as government assumed increased roles and functions that have evolved over time to become institutional and policy caps, and make it difficult to adjust the budget. With this challenge, it becomes important to increase the output off each shilling spent in the budget. The dividend that can be reaped from improving the institutions, systems, and processes guiding decisions on how to prepare, implement, operate, and maintain public investment projects is significant. According to IMF estimates, an average country obtains 30 percent less output in terms of physical infrastructure for a given expenditure than the most efficient countries. Up to two thirds of this efficiency gap could be clawed back through improved PIM institutions (IMF, 2015).

Cognizant of the benefits that would accrue to closing the efficiency gap, the Government of Uganda embarked on reforms that have administratively improved the pre-investment stages of its public investment management (PIM) system. These included setting up a dedicated department in MoFPED to spearhead the PIM reforms. This department has developed and promoted the use of standard guidelines and user manuals for project preparation and appraisal, national parameters to aid in project and program appraisal, as well as criteria for selecting projects into the public investment program (PIP) – all of which aim to streamline the process for preparation of public projects. To strengthen the *gatekeeping* function for public projects, an inter-ministerial/inter-agency arrangement – the Development Committee (DC) chaired by Permanent Secretary and Secretary to Treasury of MoFEP – was constituted as an independent reviewer of project proposals before they enter the national budget. The guidelines that underpin the DC processes and project section criteria are publicized, and an integrated bank of projects was set up to digitalize information across the entire project cycle and

aid the appraisal function of the DC. Capacity enhancement effort in project preparation and appraisal, as well as selected strategic areas of procurement has preceded a sustainable capacity development drive started through the Makerere University PIM Centre of Excellence.

These reforms have brought some good practices to Uganda's PIM system. The usefulness of a standard process for entering projects into the national budget, supported by guidelines for government officials to prepare projects, and a systematic process for reviewing and appraising the projects before they are included in the budget, cannot be underestimated. The effects of these reforms are already visible in the improved quality of projects submitted by MDAs to the Development Committee for approval and admission into the PIP. Moreover, the percentage of projects that are underpinned by a cost-benefit analysis (CBA) out of the total entering the PIP, while still low, has improved from 10 percent by 2015, to 37 percent for FY21, as reported by MoFPED. While the gatekeeping function is yet to ensure that all new projects entering the budget are properly studied and appraised in line with the standardized process, it has also stopped some 'bad' from entering the system – out of the 222 project proposals that were considered by DC during FY20, 19 were rejected at concept stage and only 122 made it into the PIP for that year.

Notwithstanding the progress achieved in the PIM process, several challenges remain. There are instances in which measures and guidelines have not been adhered to. According to the Auditor General's Report for FY20/21[1], out of a sample of 371 projects in the public investment program, 245 projects (66 percent) with total project values of UGX643.4 trillion, did not have feasibility studies undertaken before they were allocated financing. It is also noted that capacities would need to be enhanced in some MDAs to even understand the studies that have been done by external agents. Some externally funded projects have not followed national guidelines and aspirations when undertaking feasibility studies. On top of this, other challenges crop up during the project cycle, such as securing the right of way after projects have started implementation; inadequate counterpart funding to facilitate elements of projects that would ideally be funded by government under externally funded projects; and poor operation and maintenance of assets that have been created. Section 23 of the Public Finance Management Act (Amended 2015) imposes a legal requirement for multi-year commitments to support a lifetime projects financing that, in most cases, requires more than one year to be executed. Yet not all projects are funded systematically. As a result, cost- and time-overruns on projects; high commitment fees in case of externally funded projects, and shortened life span of projects due to poor operation and maintenance of created physical assets persist. The Auditor General's Report for FY20/21 again noted that out of a sample of 371 projects in the PIP, 342 projects (92 percent) with budgets totaling UGX39 trillion had gone past their planned exit periods, with some extended by more than 12 years and only 40 percent of the projects in the PIP were still within their expected time.

It is evident that the improvements around the administrative processes of the pre-investment phase of PIM are being discounted by challenges in critical areas, including project prioritization and selection, budgeting, and implementation. These must be addressed urgently to raise value for money in delivery of projects and support the envisaged fiscal consolidation agenda. On the one hand, challenges with project prioritization and alignment to the achievement of program (previously sectoral) objectives, remain. And since the programs poorly define and do not appropriately cost their priorities, they also fail to drive the investments that are financed externally. On the other hand, actual implementation is constrained because budget allocations do not fully cover the costs of implementing ongoing projects through genuine multi-year commitments, while the budget takes on new projects. This is further exacerbated by budget cuts during budget execution and the fact that projects are often not ready for implementation, as well as weaknesses in procurement and contract management, all of which contributes to poor value for money in the delivery of public investments.

The reforms over the past five years focused on improving quality of projects at entry, and they had envisioned critical success factors identified in 2015 that still need to be completed. First, government has started working on a PIM policy to formalize the administrative reforms that have already been put in place, and a basis for strengthening the legal framework, including the gatekeeping function. Before it reaches finality of strengthening the legal framework, the reforms that have been undertaken remain administrative actions that could be reversed or ignored without any consequence. Second, although the capacity building effort has commenced, further work will still be required to create

1. MoFPED 2022, February.

the pool of resources needed to manage projects across the entire PIM cycle. For instance, project preparation and appraisal skills need to be entrenched in all programs, MDAs, and different levels of government, and the project managers that are critical players in project implementation need to acquire modern project management skills. The PIM Centre of Excellence at the Makerere University will need to be nurtured to maturity to ensure a sustainable and affordable mode of building these capacities. Third, the project preparation fund to ensure that priority projects undergo feasibility and/or pre-appraisal studies while awaiting inclusion to the PIP, has recently been set up in NPA, which is a major step. Such a fund will need to put in place a proper implementation and governance structure to sustainably address the funding challenges in project preparation. Lastly, beyond the pre-investment stage, the rest of the PIM cycle (especially project implementation and asset management) must be improved if projects are to yield the expected dividend.

Beyond the critical factors of success identified in 2015, there is work to be done across the various stages of the PIM process to further strengthen the gatekeeping function, improve budgeting, and close gaps in implementation of projects. First, the gatekeeping function can be strengthened by introducing a legally binding "Seal of Quality" at the end of the appraisal stage to signify readiness of project proposals for financing, and to strengthen the formal authority of the PAP Department to match it with the importance of its function. Second, budgeting for projects must improve. Allocation of resources for projects must use the project life cycle approach and also close the gaps in budgeting for operational and maintenance costs. To promote the culture of project maintenance, each project must have at its appraisal, the ex-ante appraisal forecasts of both the project's capital and operational expenditures. And finally, Uganda must improve the implementation phase by building project implementation capacities (including procurement and contract management skills) while at the same time, strengthening and streamlining the M&E functions of the PIM System.

PART 1

STATE OF THE ECONOMY

Recovery Facing New Headwinds

Global trade volumes grew 10 percent in 2021, surpassing the pre-pandemic levels. This trend was reversed during the first quarter of 2022 due to increased supply bottlenecks

1. RECENT ECONOMIC DEVELOPMENTS

1.1 New shocks derailing the global economic recovery[2]

1. The war in Ukraine has introduced new shocks to the recovery of the global economy, which was dragging under the weight of new waves of COVID-19 in some regions and unwinding policies in others. The global economy grew by 5.5 percent during 2021, reversing the COVID-19 driven contraction of 3.1 percent in 2020. Waning COVID-19 infections (Figure 1) and improvements in overall economic conditions sustained the recovery into 2022. However, a variety of factors – and most recently the spillover effects of the Russian-Ukraine war – are slowing global economic activity. In the US, GDP growth may falter further due to worsening supply chain disruptions, domestic inflationary pressures, and rising interest rates as the Federal Reserve Bank unwinds liquidity support and tightens monetary policy.[2] The Euro area faces major headwinds because of the substantial direct trade, financial, and migration ties with Russia and Ukraine, neighboring countries in Eastern Europe, the South Caucasus, and Central Asia. Moreover, several major economies in Europe depend on Russia for natural gas and oil, hence they have suffered major economic setbacks as the war progresses and economic sanctions bite. In Asia, a re-surgent COVID-19 pandemic and reinstitution of mobility restrictions, regulatory reforms, and an unclear stance on the Ukraine war, has raised uncertainty and further weighed down pressure on economic activity in the region. These risks add to those related to inequalities in vaccine access and vaccination rates (Figure 2) that could spur new variants, as well as new disease outbreaks such as the monkey pox virus,[4] all of which could constrain economic recovery. Overall, global growth is expected to fall below the forecast of 4.4 percent and 3.1 percent in 2022 and 2023, respectively (Figure 3), due to disruptions in trade and financial flows, rising commodity prices, displacement of people and a dent in market confidence arising from the Russian-Ukraine war.

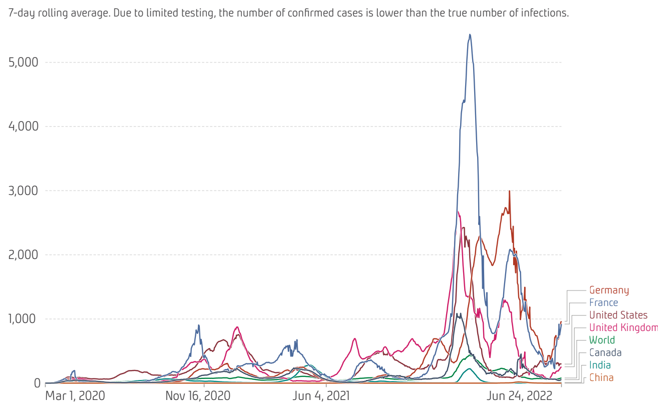
The global economy growth during 2021, reversing the COVID-19 driven contraction of 3.1 percent in 2020

2. World Bank 2022, January; World Bank 2022, June.

3. U.S. GDP growth forecast has been revised to 3.2 percent for 2022 and 2.1 percent for 2023, from 3.9 and 2.7 percent, respectively during the GEP January forecast

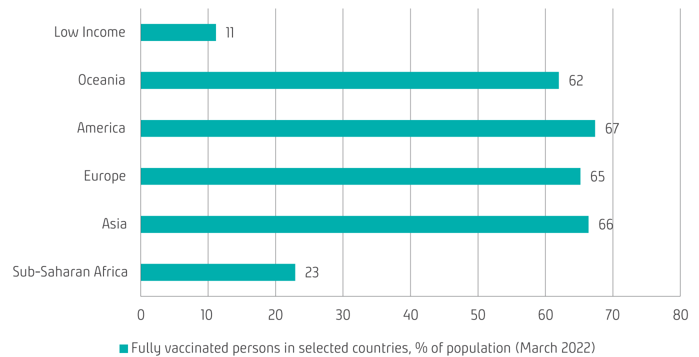
4. During May 2022, the World Health Organization reported a new monkeypox virus in 12 Member States that are not endemic for the virus.

Figure 1: COVID-19 new daily reported cases



Source: Our World in Data

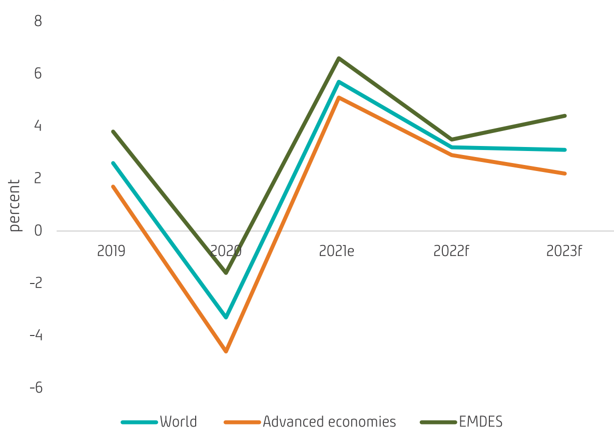
Figure 2: Fully vaccinated in selected regions (% population, March 2022)



Source: Our World in Data

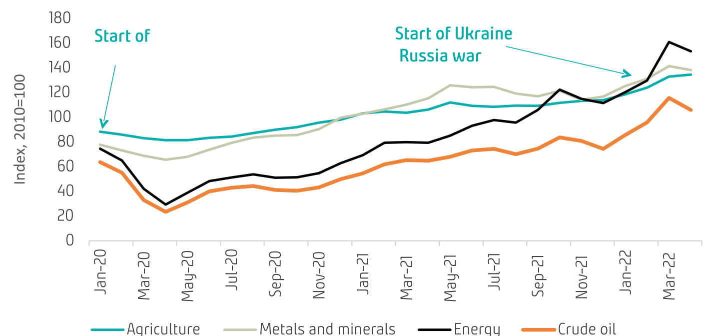
2. Slower global trade (predating the Russia-Ukraine crisis) and tightening financial markets are weighing on consumption and investments. Global trade volumes grew 10 percent in 2021, surpassing the pre-pandemic levels, but this trend was reversed during the first quarter of 2022 due to increased supply bottlenecks, increasing costs (especially for energy and gas) and slower demand for manufactured goods, especially in advanced economies. The global PMI manufacturing new export orders index dropped below 50 for the first time since mid-2020. After a modest recovery in 2021, the trade in services remained below pre-pandemic levels into early 2022. This sector remains sensitive to renewed constraints due to recurring waves of COVID-19 infections and corresponding mobility restrictions, rising costs and lower demand – especially from Europe – due to increased uncertainties arising from the Russian-Ukraine war. Financing conditions that had tightened as advanced economies and emerging markets and developing economies (EMDEs) stepped up anti-inflationary measures, faced more pressures since March 2022 as sanctions against Russia intensified (Figure 4). Amid the ongoing waves of the pandemic and supply bottlenecks, tightening financial conditions will dampen economic activity and cause unprecedented capital outflows from EMDEs causing currency depreciation pressures and a spiral of inflation. In February, Goldman Sachs' global financial conditions index had reached 100.7 – the highest since February 2016.

Figure 3: Slower global growth into 2022 and 2023



Source: World Bank

Figure 4: Commodity prices and global inflation



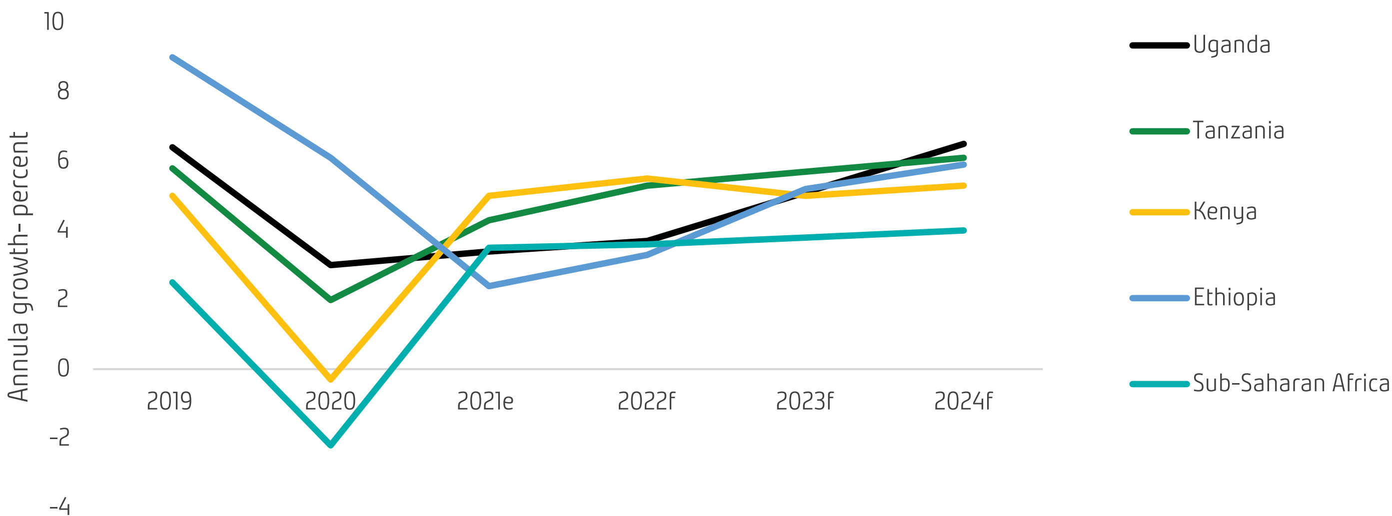
Source: World Bank

3. Commodity price surges are fueling inflationary pressures that were rising prior to the war in Ukraine. Driven by logistical bottlenecks, a shortage of intermediate inputs, and the sluggish supply of energy commodities, inflation in advanced nations and emerging markets has reached levels last seen during the 2008 global financial crisis and 2011, respectively. Global inflation reached 7.9 percent in January 2022 – the highest in 40 years.[5] Since February 2022 (the start of the war in Ukraine), price increases have been large for commodities of which Russia and Ukraine are key exporters; European natural gas prices rose by 50 percent, coal prices by more than 25 percent, and wheat prices by around 30 percent. Crude oil prices that rose 67 percent during 2021,[6] reached a 10-year high of US$130 per barrel in March before settling around $100–110 range, and remain under pressure due to supply constraints, shortage in supply from Russia and Ukraine, and OPEC reluctance to buffer supply stocks. Food inflation also shot up to a monthly record high of 5.7 percent in February 2022 and continued to rise as the war choked off supplies of key food commodities. Prior to the war, Russia accounted for 18 percent (largest global exporter) of wheat exports and 14 percent of fertilizer exports; while Ukraine held 40 percent of the world's seed oil exports, 13 percent of corn exports, and 7 percent of wheat exports.[7] Heightened inflation is hastening shifts to faster monetary tightening in the advanced and emerging economies, and heightened the risk of stagflation, poverty, and inequality.

1.2 Sub-Saharan Africa lagging[8]

4. Sub-Saharan Africa's economy grew by 4 percent in 2021, reversing the contraction of 2.2 percent recorded in 2020. This recovery was supported by accommodative policies in most of SSA countries, gradual easing of COVID-19 restrictions along with improved vaccination, improving commodity prices, increase in global trade, and favorable weather conditions for agriculture. As a result, private consumption and investments started picking up to boost aggregate demand. On the supply side, services recovered strongly following the battering suffered during the pandemic. However, the pace of recovery on the continent has so far remained below the world average. While COVID-19 cases have reduced drastically across the continent, and COVID-19 mobility restrictions have been removed, SSA's growth is not expected to drastically accelerate, due to fiscal tightening and the withdrawal of liquidity support, increasing financing costs as markets tighten, and increasing commodity prices and inflationary pressures. An output gap of about 4.5 percent in FY23, relative to the pre-pandemic forecasts will keep employment and prospects for poverty reduction low.[9]

Figure 5: Growth in SSA and selected East African countries



Source: World Bank
Note: Ethiopia, Uganda GDP growth rates are on a fiscal year basis (July to June).
"e=estimate and f=forecast"

5. World Bank 2022, March.
6. World Bank 2022, May.
7. World Bank 2022, June and UNCOMTRADE
8. World Bank 2022a, April
9. World Bank 2022, June

5. Slow vaccination in SSA remains a key risk to sustained economic recovery and social economic development. SSA has endured four waves of COVID-19 with the latest being the highly transmissible but less severe (in terms of illness and deaths) Omicron. With the sustained reduction in the number of new cases and deaths, restrictions have been lifted and community mobility has rebounded past pre-COVID-19 levels. However, the region remains unprotected against COVID-19. As of the end of March 2022, only 15.3 percent of the SSA region population was fully vaccinated, and with just seven nations having met the target of having at least 40 percent of its adult population fully vaccinated by end 2021. The pace of vaccination would have to increase nine-fold if the continent is to achieve the target of 70 percent rate of vaccination by June 2022. The low vaccination rate is linked to, inter alia, low vaccine access (predominantly foreign supplied), vaccine mistrust by the populace, limited resources (financial and human capacity), and roll out capacity.

6. Commodity price shocks, slower global trade and tightening financial conditions pose new risks to the SSA region. If they materialize, overall economic growth – that had been projected to remain below 4 percent in 2022 and 2023 – may be lower. This will be in addition to the lingering effects of COVID-19 and uncertainty amidst low vaccination rates, political tensions in large economies like Ethiopia, heightened climate change shocks, global geopolitics, contagion of global outlook and limited policy space buffers.

7. Eastern Africa is expected to fare better, with growth likely to pick up considerably as vaccine coverage expands, supply chains normalize, and domestic demand improves. Besides South Sudan, all of Uganda's other main trading partners in the region (Kenya, the Democratic Republic of Congo, and Rwanda) are expected to grow by about 4.5 percent or more annually from 2022 onwards (Figure 5), building on the stronger than anticipated post lockdown recovery that was driven by favorable terms of trade, large public investments and good weather. However, there are significant risks to these projections, as limited access to safe water and sanitation facilities, urban crowding, weak health systems, and large informal economies – all alongside uncertain progress in vaccine roll out and insufficient fiscal space – pose challenges to a sustained containment of the virus. Therefore, large-scale community transmission could still cause deeper and protracted disruptions to recovery, even as countries sustain easing restrictions both domestically and across their borders. These economies also face a worsening global environment, including to the terms of trade, and rising inflation due to the war in Ukraine.

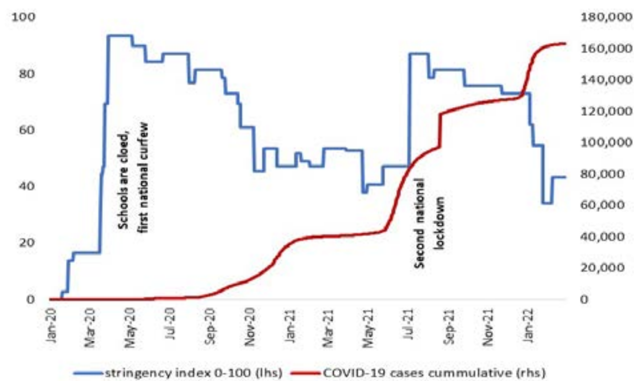
1.3 Uganda's economy rebounded strongly from the slump in the first quarter of FY22

8. Uganda seems to have weathered the COVID-19 virus for now. After two major waves of COVID-19 during FY21, the third – occurring mid FY22 was more temperate albeit highly transmissible (Omicron). By March 30, 2022, Uganda was recording only 150 cases per week, compared to the peak of 719 and 1,449 cases per week during the first and second (Delta) waves. While the cumulative reported cases stood at 163,892 with 3,595 deaths by end March 2022, it is estimated that at least 60 percent of Uganda's population had been infected with COVID-19 at least once.[10] Effective January 2022, Uganda had removed all COVID-19 restrictions, allowing the opening of schools, bars, religious sites, and any other large gatherings, in addition to easing restrictions on public transportation in taxis and boda-bodas; Uganda's Stringency Index dropped to less than 40 percent, from above 80 percent through the first half of FY22 (Figure 6).

9.However, vaccination rates would need to be stepped up to further reduce the potential for a resurgence of the pandemic. The vaccination program, which started in March 2021, recently gained momentum as the government intensified the accelerated mass vaccination campaigns, also supported by the World Health Organization and other partners. However, only about 10.8 million people – representing about 23.6 percent of the country's population and about 49 percent of the target population – had been fully vaccinated to-date.[11] Uganda's vaccination rate remains low – even relative to East African peers, including Ethiopia and Rwanda (Figure 7). The scale of vaccination continues to be challenged by supply chains, logistical and financing constraints, with limited coordination between public and private stakeholders to ensure an efficient and equitable COVID-19 vaccine distribution, access, and uptake.

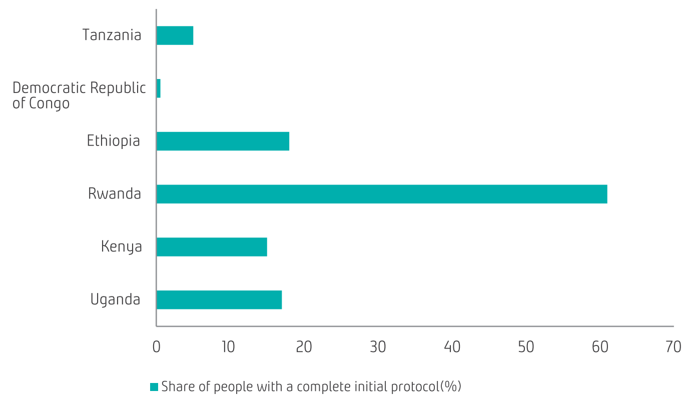
5. World Bank 2022, March.
6. World Bank 2022, May.
7. World Bank 2022, June and UNCOMTRADE
8. World Bank 2022a, April
9. World Bank 2022, June
10. Our World in Data (https://ourworldindata.org)
11. Our World in Data. https://ourworldindata.org

Figure 6: Cumulative number of COVID-19 cases in Uganda and evolution of Stringency Index (January 2020 to December 2021)



Source: Source: WHO, Oxford COVID-19 Government Response Tracker, Blavatnik School of Government, University of Oxford.

Figure 7 COVID-19 vaccine roll out (share of population fully vaccinated) in Uganda



Source: Our World in Data

Note: Stringency index varies from zero to 100 with higher values indicating more stringent government policies.

10. Following the slowdown of the COVID-19 pandemic and easing of the attendant mobility restrictions, economic activity gradually gained momentum in the first half of FY22. Real GDP grew on a year-on-year basis at 4.3 percent in the first half of FY22, which was lower than 7.9 percent in the second half of FY21, but a strong rebound from the decline of 0.6 percent during the corresponding half of FY21 (Figure 8 and Table 1). Although Omicron introduced some uncertainty, the economy rebounded in early 2022, buoyed by the reopening of schools, lifting of all mobility restrictions, and a milder third wave of infections. However, the effects of the Russian-Ukraine war, and especially through commodity prices, introduced new shocks (see Box 1), that likely slowed growth in the second half of FY22. Overall growth for FY22 is estimated at 3.7 percent.[12]

Figure 8: Uganda's real GDP growth (quarterly sector contributions % y/y)

Source: UBOS

12. This estimate is one percentage point lower than UBOS estimate of 4.7 percent.

11. Whereas consumption growth has remained the main driver of growth, the positive effects of a gradual lifting of pandemic related restrictions are being offset by rising prices. Given the second lock down and corresponding work stoppages (see section 1.4), slow credit growth (section 1.5) and poor performance of the agriculture sector, consumption growth is expected to have decelerated during the first half of FY22, compared to the growth of over 7 percent in FY21. The recovery following the slowdown in COVID-19 and opening of the economy, has probably been offset by the impact of increased food and consumer goods prices into the second half of the year.

BOX 1

The Impact of the War in Ukraine on Uganda and Policy Responses

The invasion of Russian forces on Ukraine, which started on February 24, 2022, has had different levels of social and economic effects across the world. There has been an unprecedented array of sanctions imposed by 'big' countries on Russia's investments in firms and individuals, financial transactions, sovereign debt, and trade. Commodity prices have increased sharply on top of a steep rise since the beginning of 2022, due to disruptions in production (particularly in Ukraine), trade diversion, and supply chain blockages. Financial markets have tightened, and migration and refugee seekers reached record levels in Europe, as Ukrainians ran to safety.

The transmission of these war effects to Uganda has been seen in the volatile and rising commodity prices – especially for energy and wheat which are key exports for Russia and Ukraine. Under the current sanctions, Russia's oil production is estimated to reduce by 2.5 billion barrels a day, which is 30 percent of its pre-invasion exports and 3 percent of global supply. Whereas a combination of diversion of oil to other countries, use of strategic petroleum reserves, release of inventories by the International Energy Agency members, and additional production from OPEC members may close the deficit, prices are expected to continue rising as some of these measures will take time to execute. The World Bank Commodity Price Outlook for April 2022a/ forecasted a 42 percent increase in the average Brent Crude oil price in 2022. This may even rise higher if European sanctions are agreed. Similarly, weaker grain production in Russia and Ukraine, as well as higher production costs, including for energy, chemicals, and fertilizers, is exerting pressure on prices of agricultural products. Russia and Ukraine account for a quarter of the global production of wheat, which has been disrupted by new quotas and restrictions of Russia's fertilizer exports, and the blockage of Black Sea passages through which Ukraine exports 90 percent of its grains. Hence wheat prices are projected to rise 42.7 percent during 2022, before they moderate into 2023, as production is substituted into other sources. Beyond these indicative magnitudes, the impact on a country would depend on the duration of the crisis, and direct exposure to these commodities. An assessment of the possible impacts of these price changes (as baseline) against a high price scenario benchmarked on the increases seen during the 2007-08 food and fuel price shocks is summarized as follows:

Inflation effects: Higher imported inflation is expected. By April 2022, retail prices for petroleum products with a weight of 20 percent in the CPI, already rose 30 percent over their 2021 level, before the passthrough to other consumer and producer goods and services, including transport costs. Wheat, while carrying a small share in the overall consumption basket, could manifest through substitution as consumers – both within Uganda and the region – turn to other grains. Overall inflation could rise by a full percentage point over the previous forecasts, but more strongly, by between 4.5 to 10 percentage points under the high case scenario (price increase of over 60 for oil and wheat).

Trade impact: Net petroleum products and crude oil imports accounted for about 11.5 percent of Uganda's total goods imports in 2021. Unless volumes reduce in response to the price rise, these net-imports could increase in the range of 0.7 to 1.1 percent of GDP. Similarly, Uganda's net wheat imports, accounting for about 3.3 percent of total goods imports in 2021, could increase by between 0.2 to 0.4 percent of GDP. Although the overall trade impact of an increase in wheat prices is likely to be more muted than for the increase in oil prices, almost half of the wheat imports have traditionally been sourced from Russia and Ukraine, which accounted for 28 and 21 percent in 2019. Nonetheless, this region provided a relatively small share (jointly about 10 percent of total food imports), which means there are other products and markets that could substitute for these wheat imports. The net increase in imports, amounting to between 0.9 and 1.5 percent of GDP for both products will curtail the improvement of the current account deficit, currently expected at 8.1 percent (FY22) and 7.3 percent (FY23) of GDP. This is notwithstanding the improvement in commodity exports as their prices increase too.

	Oil (petroleum products & crude)		Wheat (unmilled & meslin)		Total (range)
Price increase (% above 2021 avg.)	Baseline (42%)	High (60%)	Baseline (42.7%)	High (80%)	
Increase in net-imports (US$ million)	336	480	99	186	435-666
Increase in net-imports (% of GDP)	0.74	1.06	0.22	0.41	0.96-1.47
Share of forex reserves (end-2021)	7.76	11.09	2.29	4.30	10.05-15.4
Share of tax revenues (FY22f)	5.96	8.52	1.76	3.30	7.72-11.8
Share of expenditures (FY22f)	3.35	4.79	0.99	1.86	4.4-6.6

Fiscal effects – Revenues may increase due to the increased import bill, especially for oil imports which have a low price elasticity. There are currently no fuel subsidies in place, so there's no expectation that the government would absorb the oil price shock. If the government were to consider absorbing the shock – say by cutting taxes, providing subsidies or goods in kind, like it did under COVID-19 – the full cost would translate into a share of FY22 expenditures of about 2.8 to 4.8 percent, which would defer the fiscal consolidation agenda. The fiscal deficit, that is expected to improve to 7.4 percent (FY22) and 4.7 percent (FY23) of GDP, could shift closer to 8 percent and 5 percent, respectively, if imports slow down and hence lower revenues. Should government decide to accommodate the commodity price shock (i.e., maintain fuel, grain, and fertilizer prices below market costs), fiscal expenditures could increase by between 3 and 8 percent over FY22 projections. On the other hand, tightening of global financial conditions could lead to a decline in the Treasury securities holdings of offshore investors (US$809 million at end-2021), thereby putting pressure on Treasury yields and the exchange rate. Further depreciation of the shilling – which already depreciated by about 8 percent between early February and end May 2022 – would also have additional inflationary impacts and put a greater burden on debt servicing costs given that external debt makes up about two thirds of public debt.

Growth effects – Real GDP growth effects may be graver than included in our current forecast if higher global inflation and subsequent tightening lowers global demand for Uganda's exports, and raises input costs for agriculture and industry, such as cement. It is also unclear how the Russian war and subsequent sanctions would affect investments into preparing for oil production by 2025 – while the Russian consortium, RT Global Resources – the best bidder for the financing and construction of the $4 billion oil refinery – had walked away from the deal in 2016, they re-expressed interest in 2021 to support the construction, albeit under different terms. Financing of the pipeline could also be further constrained by the tightening financial markets, rising environmental concerns, and uncertainty.

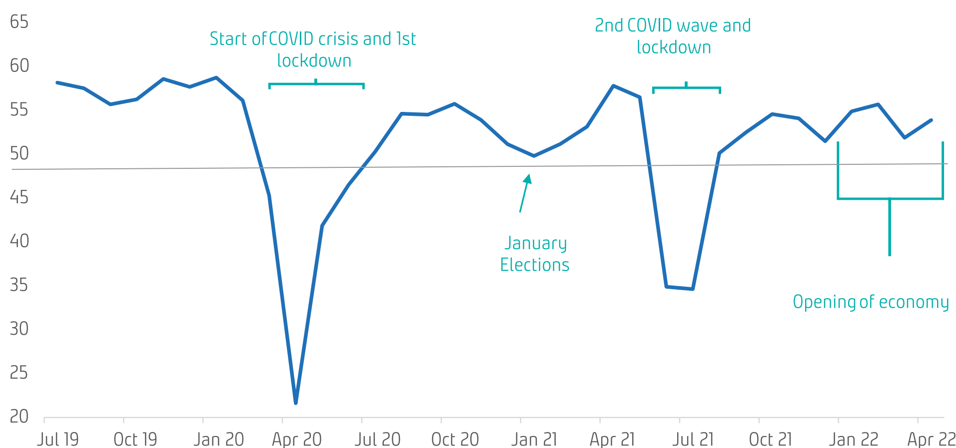
Households' effects – Higher commodity prices will raise the cost of food. In addition to substitution effects as Ugandan grain finds market in the region, food production will be heavily impacted by rising transport prices and fertilizer costs, with severe consequences to food security.

Policy response so far – The government has so far allowed the markets to adjust to these commodity price shocks. According to President Museveni's May 2022 State of the Economy Address, there will be neither tax cuts nor subsidies. To stem inflationary pressures and passthrough of the commodity price shocks, the Bank of Uganda raised the Central Bank Rate by a full percentage point and signaled further action should the pressure on domestic inflation persist.

Notes: a/ World Bank, 2022c, April.

12. Stronger demand growth has been supported by private sector investment which, in contrast to the decline during FY21, recovered into the first eight months of FY22. Even though it has been the main driver of capital formation in FY21, public investment moderated given the underexecution of the capital budget during the first half of FY22. Because of the COVID-19 containment measures and resultant uncertainty, as well as risk aversion by banks and sluggish growth in FDI (see section 1.6), private investments declined by 5 percent during FY21. The gradual opening of the economy until January, when all activities – including the entertainment industry and schools – could operate freely, supported continuous improvement in the business conditions through the first half of FY22, as depicted by the Bank of Uganda's Business Tendency Index (BTI).[13] Since then, Uganda's headline PMI remained above 50 percent for nine consecutive months. During this time, new orders and purchasing activity remained buoyant, while output grew for all sectors (mining, manufacturing, wholesale, retail, and services) except construction and agriculture. However, after reaching the peak of 55.7 percent in February 2022, the index was down at 53.9 for April 2022 (Figure 9), due to the impact of rising energy prices and transport costs – partly on account of the effects of the war in Ukraine. Investment in buildings and other structures remained larger than in equipment, with implications to the level of productivity gains generated.

Figure 9: Uganda PMI (>50 = improvement since previous month)



Source: IHS Markit

13. The strong recovery of the services sector benefitted from the gradual lifting of the COVID-19 restrictions, particularly on the education, accommodation and food services, recreational and professional services sectors. The sector grew by 8 percent during the first half of FY22, compared to the decline of about 3.4 percent in the same period of FY21. The buoyancy in the information and communication (IC) activities has continued, with the sector growing at almost 36 percent in the first half of FY22, sustaining the growth of FY21, when firms and households adapted to the use of online solutions to ensure continuity of business and daily life amongst COVID-19 mobility restrictions. The three sectors that suffered most from operating and mobility restrictions, have rebounded strongly as the economy started to re-open. Even before the full re-opening of schools and learning institutions, the education sector expanded sharply in the first and second quarters, leading to more than a 43 percent expansion in the first half of FY22. Despite the limited operating hours (a curfew between 9pm and 5am was not removed until January 2022) and with only a gradual recovery in tourism, the art, recreation, and entertainment grew by over 30 percent compared to the previous year, and the accommodation and food services sector sustained the recovery that had been witnessed in the last quarter of FY21. On the other hand, activity has not stabilized in most other services sectors, with a notable decline during the first and second quarters of FY22, reversing the growth of 11.3 percent in the fourth quarter of FY21. This reflects the recurrent logistical challenges, both domestically and in the main supply chains. At the same time, the transport and storage sector declined by 4.4 percent in the first quarter before slightly improving into the second quarter.

13. Bank of Uganda. Business Tendency Index (BTI)

Table 1: Uganda - Real GDP Outcomes

	FY21	FY20		FY21				FY22	
		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	share of GDP	y/y growth rates							
AGRICULTURE	**23.3**	**-1.3**	**5.5**	**6.8**	**6.8**	**-0.6**	**0.6**	**3.9**	**-1.0**
Cash crops	2.5	17.3	-1.7	5.0	7.3	5.8	14.7	15.0	7.9
Food crops	12.3	-11.2	12.6	11.0	10.5	-8.3	-5.5	0.1	-7.8
Livestock	3.4	8.5	7.4	7.9	7.8	7.2	8.2	7.8	7.9
Agriculture support services	0.0	-1.5	-15.0	-8.1	-9.8	27.7	18.4	11.3	7.3
Forestry	3.5	4.4	-2.3	-4.7	0.6	6.4	9.5	14.2	6.8
Fishing	1.6	-10.0	-15.6	-14.9	-5.1	-9.2	-5.3	8.0	-3.9
INDUSTRY	**26.4**	**1.9**	**-10.1**	**-2.6**	**-2.1**	**2.7**	**17.7**	**0.3**	**6.8**
Mining & quarrying	1.4	0.0	-34.8	25.2	-15.4	-14.5	48.9	-47.0	148.8
Manufacturing	15.0	-1.0	-13.9	-3.0	-4.6	1.9	17.9	-8.5	-6.3
Electricity	1.4	16.9	-1.6	6.8	7.1	7.2	25.7	12.5	13.0
Water	2.3	4.2	4.0	4.6	4.9	4.6	5.0	5.6	6.0
Construction	6.2	5.9	-2.7	-13.9	3.6	6.8	16.2	39.6	6.2
SERVICES	**43.7**	**1.4**	**-5.7**	**-4.4**	**-2.4**	**5.4**	**13.8**	**7.0**	**8.9**
Trade & repairs	8.3	-3.2	-11.9	-2.2	-6.8	-3.1	11.2	-8.2	-1.7
Transportation & storage	3.0	-2.3	-10.7	-8.2	-3.5	1.5	10.4	-4.4	0.2
Accommodation & food service	2.5	-2.9	-46.0	-25.9	-19.8	2.8	82.8	9.0	27.4
Information & communication	2.2	20.1	6.3	-2.4	-1.9	16.5	39.1	34.9	36.8
Financial & insurance	3.0	9.6	-7.1	3.2	-1.0	10.1	21.7	-3.7	-1.2
Real estate activities	6.7	6.1	9.5	5.7	8.0	1.4	0.8	-0.8	-0.7
Professional, scientific & technical	2.1	-26.4	-21.9	-35.1	-12.0	60.1	33.6	63.8	36.9
Administrative & support service	2.0	1.7	-1.9	-2.2	-2.8	8.0	6.9	7.3	6.8
Public administration	3.1	15.0	17.8	8.3	13.0	25.5	3.5	15.9	9.5
Education	4.0	0.8	1.5	-18.0	-12.9	-1.8	15.6	50.2	43.8
Human health & social work	3.4	2.8	-5.9	13.1	9.6	0.8	4.2	-12.1	2.0
Arts, entertainment & recreation	0.2	-7.9	-27.2	-27.6	-23.4	-19.2	30.1	36.7	34.9
Other service activities	2.5	0.9	0.8	1.0	2.2	3.7	4.9	5.3	-14.4
Activities of households	0.8	2.8	2.7	2.7	2.7	2.7	2.8	2.8	2.8
ADJUSTMENTS									
Taxes on products	**6.7**	**-0.6**	**-24.4**	**-1.6**	**-3.1**	**-3.8**	**43.2**	**-8.8**	**-3.3**
GDP AT MARKET PRICE	**100.0**	**0.8**	**-5.7**	**-0.7**	**-0.4**	**2.8**	**13.2**	**3.5**	**5.2**

Source: UBoS

14. The recovery of the industrial sector has been bumpy, even though it benefitted from a resurgence in mining and quarrying, and a sustained growth in utilities. The industrial sector grew by over 3.6 percent in the first half of FY22. Although below the double-digit growth rates in the first half of the last few fiscal years during the pre-COVID period – and far lower than the 9.7 percent of the second half of FY21 – this rate of growth is a significant improvement on the more than 2.7 percent contraction of this sector during the first half of FY21. The surge (almost 40 percent growth) in construction observed in the first quarter was cut short to 6.2 percent in the second quarter, also reflected in the UBOS Construction Index which declined between April and December 2021.[14] The decline is due to, in part, the lower access to bank credit as

14. *https://www.ubos.org/wp-content/uploads/statistics/CSI_December_2021Tables.xlsx*

risk aversion within the banking sector increased in response to increased non-performing assets (see section 1.5). Furthermore, the low implementation of the planned public capital projects registered particularly sluggish activity within the civil works, water projects, and roads (gravel and paved) areas. In contrast to improved levels of business confidence in other sectors, fewer trade disruptions, and more open regional borders, manufacturing declined by 7.2 percent in the first half of FY22. The mining and quarrying sector grew by almost 150 percent in the second quarter of FY22, compared to a steep contraction of about 47 percent in the first quarter. This growth has been driven by a surge of activity in the gold mining sector, as gold dealers anticipated a positive outcome from the negotiations with government to reduce the tax levied in July 2022 (see Box 2), and as the number of artisanal and small-scale miners grows. This will likely result in a boom of gold exports in the second half of FY22.

15. Agriculture has realized a boost from cash crops yet remains volatile due to weather variability, hence growing by a mere 1.8 percent during the first half of FY22. Overall, the sector rebounded strongly during the first quarter of FY22, propped by cash crops output, forestry, and fishing. Notably, growth in cash crops was boosted by the continued reaping of improved coffee exports (see section 1,6) due to improved farming methods, as well as good weather.[15] As coffee production slightly reduced during the subsequent quarter, total cash crops growth dropped to 11.1 percent during the first half of FY22, but above the previous two half years. Growing at 10.3 percent during the first half of FY22, the forestry has cemented a recovery from the COVID-19 related slump during the corresponding period of FY21. However, poorer weather over the first half of FY22 adversely affected the production of food crops, which are less resilient and are yet to adopt better farming practices to manage the weather and effects of climate change. Food crop production further declined by 2.7 percent in the first half of FY22, compared to 6.7 contraction in the period before, which could continue to adversely affect livelihoods, given that many who had lost jobs in non-farming sectors because of the COVID-19 crisis – particularly the urban and informal poor – had shifted to the agriculture sector as a buffer (see Section 1.4). The fishing sector continues to face trade disruptions – the value of fish exports declined by 13 percent in the first quarter of FY22 – as well as sectoral challenges such as poor-quality fish stock (e.g., too few adult fish), limited access to feeds, and trade in illegal and unrecorded immature fish. Given the continued scanty rains into the second season, overall agriculture growth is expected at 3.4 percent, slightly lower than 3.8 percent achieved in FY21.

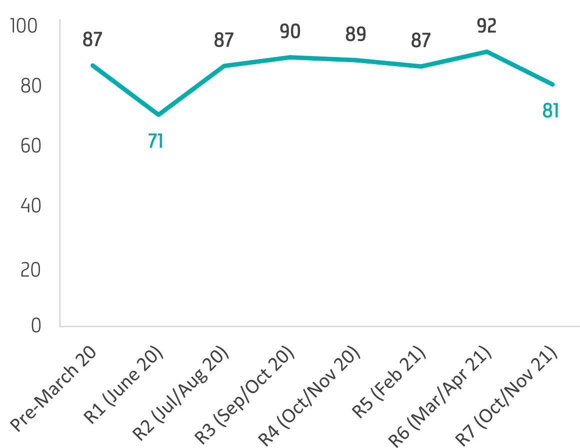
15. Due to better anticipated financial benefits from cash crops, the adoption and use of improved technologies and practices (e.g., variety, optimal plant populations, and better cultural practices) for cash crops is generally higher than for food crops. This enables cash crops to better withstand weather abnormalities than food crops (usually annuals).

1.4 New shocks exacerbating households' vulnerability to poverty[16]

16. Many households have remained vulnerable amidst COVID-19 related mobility restrictions and new shocks. In addition to the rapid increase in poverty during the first 10 months following the COVID-19 onset,[17] the Uganda High Frequency Phone Survey (UHFPS) reveals increased vulnerability around subsequent lockdown periods due to employment income losses and food insecurity around lockdown periods. Even as these may have ameliorated as the economy fully opened, the new food and energy price shocks, are likely to reduce real consumption and push more people into poverty.

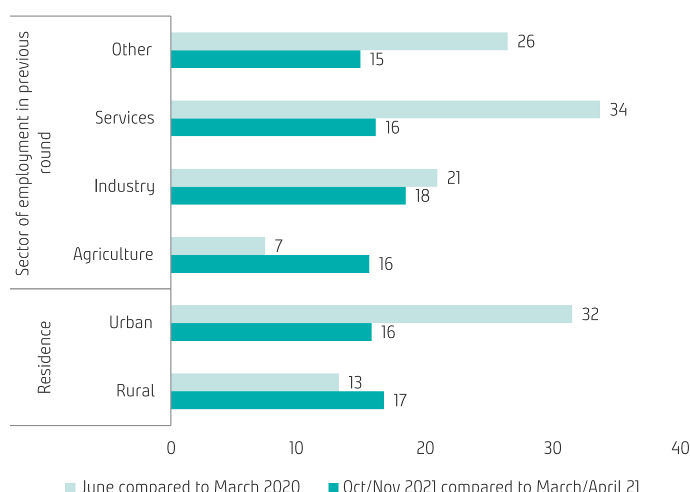
17. During the first half of FY22, employment dropped below pre-COVID-19 levels, but weather shocks became important in explaining work stoppages. According to the October/November 2021 UHFPS, carried out after the second lockdown, employment fell by 11 percentage points, compared to the March/April 2021 levels, which reversed the full recovery from the effects of the first lockdown (Figure 10). While this decline was less severe, it was more universally distributed across locations and economic sectors, compared to the first national lockdown where the highest burden fell on the urban workers and those services sector (Figure 11). A lower number – about 62 percent compared to 89 percent in June 2020 – reported having lost employment due to factors directly related to COVID-19, such as business closing due to COVID-19 restrictions, being ill/quarantined, movement restrictions, and furlough. These differences could be explained by the strictness of the first lockdown, even though it was shorter, and a stronger ability to adjust to mobility restrictions during the second lockdown. Furthermore, some losses reported in October/November 2021 could be related to seasonality and prolonged dry spells observed in different parts of the country in 2021. The contraction is corroborated by Uganda Revenue Authority's Pay as you Earn trends,[18] as well as the PMI data depicting a reduction in employment in both wholesale and retail sectors during the first half of FY22 before it started improving.

Figure 10: Working status of respondents across rounds, % of all respondents



Source: UHFPS, World Bank staff calculations.
Note: Only the same respondents across seven rounds were included.

Figure 11: Work stoppages by residence and economic sector, % of respondents worked in previous rounds



16. This section draws from the Uganda High Frequency Phone Surveys (UHFPS). To track the impacts of the COVID-19 pandemic on households in Uganda, UBOS – with support from the World Bank – has conducted seven rounds of the Uganda High Frequency Phone Survey (UHFPS) between June 2020 and November 2021. The survey was conducted every few months and attempted to recontact the entire sample of households that had been interviewed during the 2019/20 round of the Uganda National Panel Survey (UNPS) – where phone numbers for at least one household member or a reference individual exist.

17. According to the Uganda National Household Survey 2019/20 – which covered both the pre-COVID-19 period (September 2019–February 2020) and the COVID-19 period (June-November 2020) – poverty has increased from 27.5 to 32.7 percent respectively. Since both periods cover different months and could be subject to seasonal changes, we have tested robustness of poverty numbers by post-stratifying survey weights in both periods to resemble the rural/urban and regional distribution of the annual data. Results qualitatively remained the same.

18. URA 2022, March.

18. Fewer non-farm family businesses closed in October/ November 2021 compared to six months earlier, but almost two-thirds of businesses reported lower revenue. The share of households with open non-farm family businesses declined only slightly from 43 percent in March/April 2021 to 41 percent in October/November 2021, still reversing the positive trend observed in previous rounds. Moreover, many operating businesses reported less revenues in October/ November 2021 compared to the previous round. Thus, family business revenues were lower for 65 percent of households compared to revenues in March/April 2021. This was much higher than the decline in revenues in March/April 2021 when only 24 percent of households had family business revenues lower than in previous rounds.

Figure 12: Evolution of severe and moderate composite Food Insecurity Experience Scale[19] across all rounds, % of household members

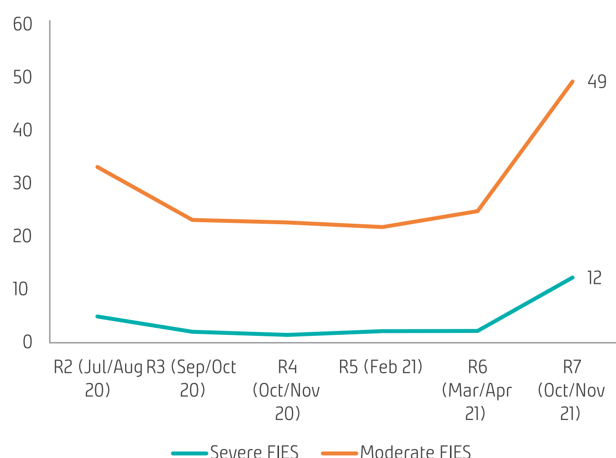
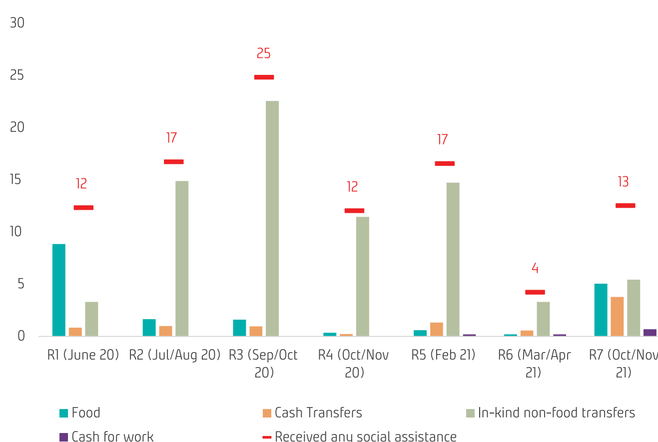


Figure 13: Incidence of social assistance programs across rounds, % of households



Source: UHFPS, World Bank staff calculations.

19. Food insecurity indices increased sharply in October/ November 2021, following the second lockdown. Almost half of household members indicated being moderately insecure and about 12 percent being severely food insecure (Figure 12). In addition to the second lockdown which started in June 2021, other factors such as poor weather conditions and the corresponding poor agriculture sector's performance (as discussed in section 1.3) explain the increased food insecurity. This is being exacerbated by the increasing food inflation, especially as key staple food like maize, find alternative markets, following the rising cost of wheat and grains, due to the war in Ukraine.

20. Food and cash transfers increased during the October/ November 2021 round, but the social protection programs remain limited in coverage and design to mitigate impact of shocks on the vulnerable. Overall, access to any type of social assistance increased from four percent in March/ April 2021 to 13 percent in October/November 2021 (Figure 13). This was driven by the increased incidence of food and cash transfers, which covered five percent and four percent of households in October/November 2021, covering especially the Northern and Eastern regions. In-kind non-food aid (soap, mosquito nets and masks) was more prevalent in the Northern and Eastern regions, while cash transfers were more prevalent in the Western region. About 63 percent of respondents mentioned preference for cash transfers, compared to 21 percent for free food, and 16 percent for the balance covering cash for work, subsidized credit, and other types of aid. Despite these preferences, in-kind non-food assistance has remained the main source of social support (except when food transfers were distributed in Kampala and neighboring areas at the beginning of the pandemic to mitigate its negative socio-economic impacts). Direct cash transfers have been extremely small and prior to October/ November 2021 survey, reached no more than one percent of households.

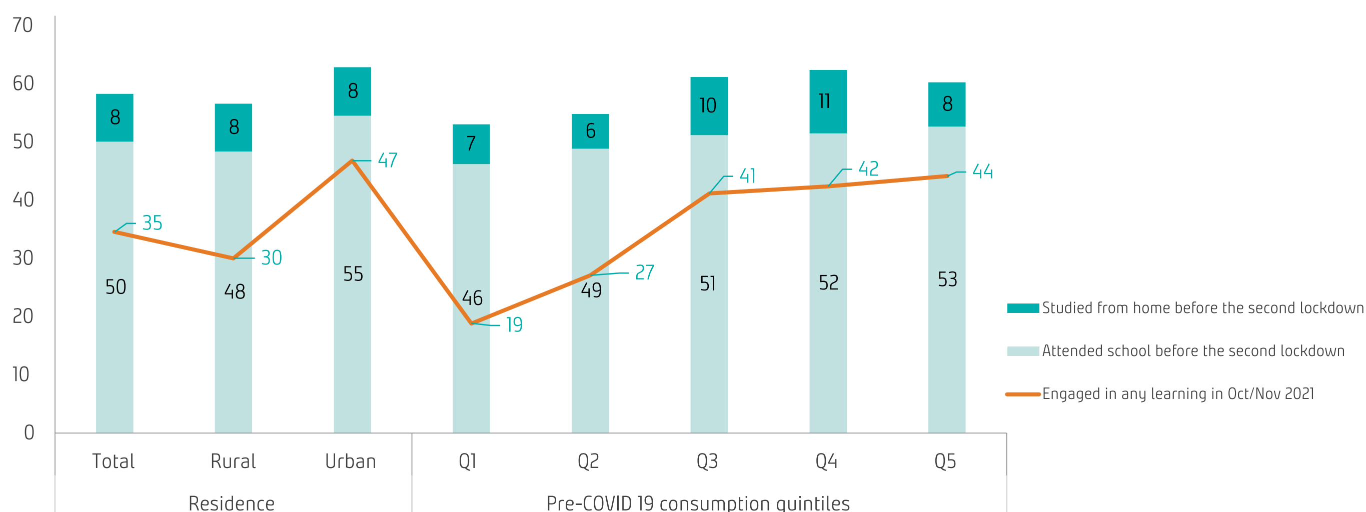
21. Persistent high inequalities in access to education remain a key threat to human development in Uganda during and most likely after the pandemic. The gradual re-opening of schools in early 2021 led to an increase in school attendance

19. Food Insecurity Experience Scale (FIES) is experience-based measures of household or individual food security. The FIES Survey Module consists of eight questions regarding people's access to adequate food.

to 50 percent and eight percent studying from home just before the second lockdown in June 2021. In October/November 2021, when schools were closed again after the second lockdown, only 35 percent of children aged 3–18 years were engaged in any learning/education activities.

Participation in education and learning activities remained very unequal, with children in urban areas, and from the wealthiest pre-COVID-19 consumption quintiles, having much higher chances to study compared to children in rural areas and from the poorest quintiles.

Figure 14: Share of children engaged in any learning/education activities before the second lockdown in June 2021 and in October/November 2021 (% of children aged 3–18)



Source: UHFPS March/April 2021, WB staff calculations.

1.5 Bank of Uganda shifts to monetary tightening as inflationary pressures mount

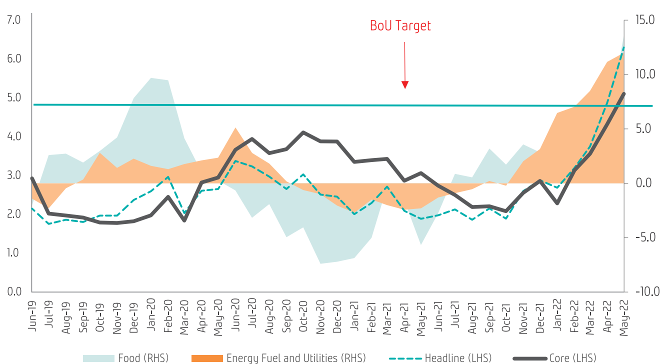
22. Inflation that had remained within the BoU target for more than two years, shot to 6.3 percent in May 2022, due to pressure from rising global commodity prices, supply disruptions, and elevated shipping costs. Steady appreciation pressures over the past two years had partly shielded the economy from imported inflation. Furthermore, although some sectors, like education, witnessed price escalation as they fully re-opened in the third quarter of FY22, this was moderated by the deflation pressures in information and communication, recreation and sports, and transport as occupancy rates returned to normal. However, a gradual rise in the energy sector inflation to 12 percent in May 2022, was due to the liquid energy inflation – petrol and diesel prices which rose by 54 and 36 percent, respectively – between November 2021 and May 2022, also pushed by rising international oil prices (see Figure 16), albeit with a lag. Food and beverage inflation had also jumped to 11 percent by May 2022. As the global economy reels from the effect of the Russia-Ukraine war and particularly the rising commodity prices (see section 1.3 and Box 1) and the possible depreciation of the shilling as capital flows out of frontier markets, threats to inflation are rising. Overall inflation could jump above 8 percent in June 2022 – the closing month for the year.

23. Monetary actions stabilized financial markets, but only a few sectors are benefitting through increased credit. Prior to the June interest rate hike, the Bank of Uganda (BOU) maintained the policy rate at 6.5 percent for ten consecutive months, effective June 2021, sustaining a dovish monetary policy stance, alongside carefully phased liquidity support

measures.[20] Interest rates in the interbank money market, government securities market, and on commercial bank deposits remained within the same ranges in the first half of FY22, as they were on the previous period (Figure 17). On the other hand, lending rates remained high and volatile, and had peaked at 20 percent in the second quarter of FY22, as banks adjusted their pricing to increased non-performing assets. Banks also became more risk averse, approving only 56 percent of loan applications during the quarter ending December 2021, compared to 70 percent before COVID-19. Loan approvals were lowest in sectors with elevated asset quality deterioration – particularly the real estate and utilities sectors. This risk aversion, combined with the high cost of credit and operational difficulties for businesses, continues to constrain the growth of private sector credit (Figure 18).

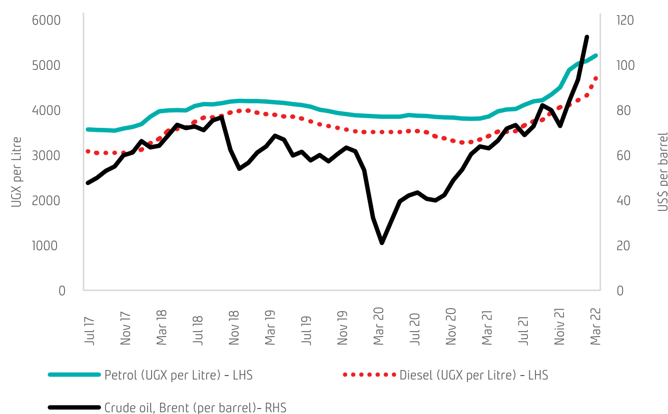
In real terms, annual private sector credit growth averaged 4.9 percent in the first nine months of FY22, compared to 9.3 percent and 9.4 percent in the corresponding periods of FY21 and FY20. Credit to the manufacturers of building and construction materials, basic and fabricated metal, and non-metallic products, has recovered strongly. Yet growth of credit to trade and business sectors remains low, even as some businesses benefit from COVID-19 support. Positively, in line with the fiscal consolidation effort (see section 1.6), government net borrowing from the banking system decelerated during the first half of FY22 – dropping to an average of 8 percent in the second quarter of FY22, compared to 40 percent during the same period in FY21.

Figure 15: Inflation developments 2019-2022 (% per year)



Source: UBOS

Figure 16: International Brent crude oil price versus liquid energy prices in Uganda

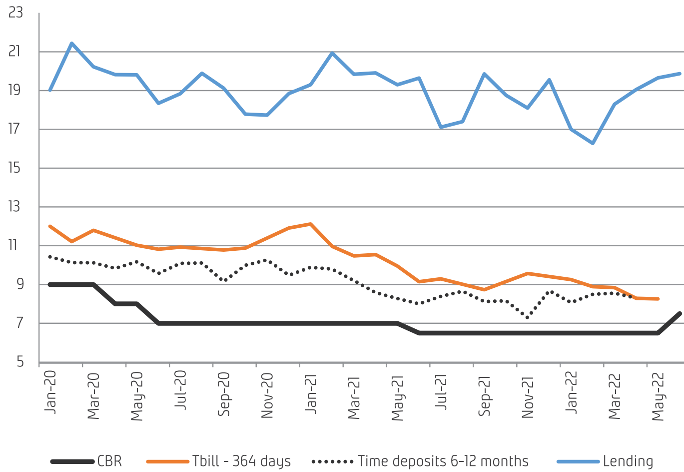


Source: World Bank Commodity Prices, BoU

24. Monetary policy faces a growing uphill task of maintaining a delicate balance between curbing inflation pressures and supporting the private sector and economy to remain on the recovery path. Pressures have intensified from the rising commodity prices and depreciation pressures as portfolio outflows intensify. On the balance of risk leaning towards more inflationary pressures, BoU raised the CBR by a full percentage point to 7.5 percent. Credit to the private sector that has still been struggling, may decelerate and thereby lower investments and growth.

20. In addition to the COVID-19 Liquidity Assistance Program (2020-2021) which expired May 31, 2022, the BoU supported FIs through (i) The credit relief measures (CRM) facility which exceptionally permitted supervised financial institutions (SFIs) to restructure loans of all borrowers affected by the pandemic, until September 2021. (ii) Extended CRM to sectors that remained under lockdown for a prolonged time, including education and hospitality between November 2021 and September 2022.; and (iii) The Emergency Liquidity Assistance Program (since January 2022) for financial institutions requiring liquidity of longer tenor.

Figure 17: Policy and market rates (percent per annum)



Source: BoU

Figure 18: Private sector credit growth (y/y percentage change)

Source: BoU

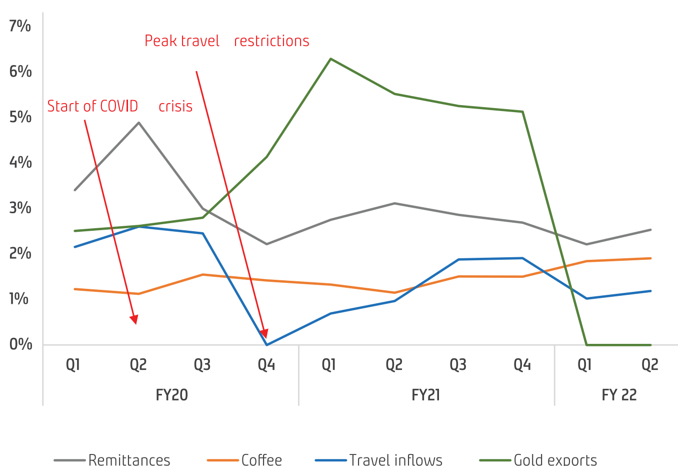
25. On the back of adjustments in the macro-prudential policy measures, developments in liquidity conditions in the banking system were mixed through the first half of FY22. By December 2021, the liquid assets were 48 percent of total deposits, compared to 50.7 percent a year earlier. Even though the BoU has phased out the credit relief measures cautiously, bank credit risk remained elevated, hence the modest pickup in lending by supervised financial institutions, as discussed above. This reflects bank and customer concerns about the rate of recovery and asset quality. Non-performing loans (NPLs) for banks stood at 5.3 percent of total gross assets in December 2021, the level attained a year earlier, but were lower than 6.5 percent recorded by end September 2021. This ratio remains higher for credit institutions, at 8.6 percent, and micro-deposit taking institutions at 10.1 percent, and could also increase as the macro-prudential measures unwind, which could curtail credit growth and hence real GDP growth. Asset quality may further deteriorate after the credit relief measures – which have continued to support sectors that were most hit by the pandemic and lockdowns – expire in September 2022, and as the BoU starts tightening policy to address increasing inflationary pressures. Going forward, monetary policy must maintain a delicate balance between curbing inflation pressures – that could arise from rising commodity prices and stronger demand with the reopening of the economy – and supporting the private sector and economy to remain on the recovery path.

1.6 Current account strengthened as import growth slowed

26. The current account deficit strengthened for the first time since the pandemic started, but due to factors that could constrain acceleration in economic activity. The reduction to 7.4 percent of GDP in the first half of FY22, from 9.9 percent of GDP during the corresponding half of FY21 was alongside a slump in trading activity (represented by the total value of exports and imports) to almost half that recorded in FY21. With airport arrivals slowing down during this period,[21] travel inflows also reversed the recovery from the pandemic witnessed in FY21, to only US$349 million – far lower than what was received in the earlier six months, and less than two-fifths of the pre-COVID-19 total. Nonetheless, the deficit in goods and services reduced to 9.7 percent in the first half of FY22, from 12.3 percent in FY21 and 11.6 percent of GDP in H2 of FY21. Meanwhile, remittances also declined somewhat in line with the changed global economic activity and amounted to about US$530 million, which is 55 percent of pre-COVID-19 levels (see Table 3). Over the full calendar year 2021, the current account deficit narrowed by 1.4 percent of GDP, from 9 percent in 2020.

27. The sluggish domestic conditions, rising costs and disruptions to supply chains slowed imports for both consumption and investments. Notwithstanding the sustained real appreciation of the shilling – recorded at 1.9 percent (year on year) by February 2022 – imports declined due to lower demand and disruption of supply chains in some source countries like China's major economic hubs (Shanghai, Shenzhen, Dongguan, and Changchun) following Omicron variant breakout and mobility restrictions (as discussed in section 1.1). Machinery, equipment, vehicles, and accessories cut 10 percent of value of the previous year, while minerals remained below the boom quantities realized over the past two years on account of the tax levy on gold exports imposed at the beginning of FY22 (see Box 2). The increase in some private imports (particularly oil imports) due to higher prices notwithstanding,[22] total merchandise imports amounted to US$3.2 billion – more than 20 percent below levels attained in the first half of FY21.

Figure 19: Uganda: Key export and transfer inflows (percent of GDP)



Source: BoU

Figure 20: Uganda: Financing of current account (US$million)

Source: BoU

21. Civil Aviation Authority.

22. By the second quarter of FY22, the oil price index for Uganda was 79 percent above its value a year ago.

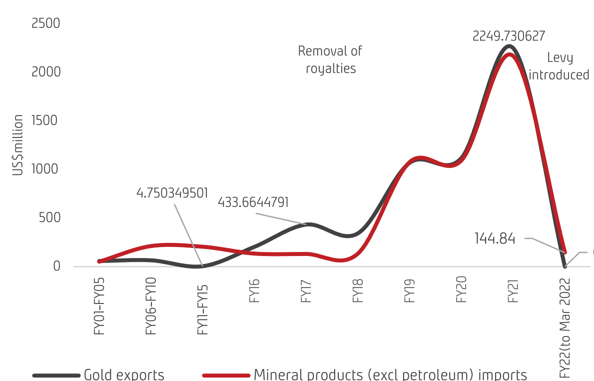
BOX 2

How Efforts to Raise Revenue Halted Gold Exports

Uganda's trade in gold received a boost in 2017, when the government removed all royalties and kept an export tax of 5 percent and a tax of 1 percent on locally produced and imported gold, respectively. The aim was to attract raw gold, irrespective of the source, into the first ever gold refinery that was inaugurated in the same year, and hence grow the country's potential as a regional center for processing gold. Whereas the refinery already helped grow exports tenfold to US$433 by FY17, from the average of less than US$5 million per year in the preceding half-decade (FY11-FY15), the royalty removal was followed by a boom that has seen gold exports reach US$2250 million by FY21 (34 percent of total exports). Uganda's own source of raw gold is still small deposits accessed through artisanal mining. The refinery and attractive tax regime attracted raw gold from other countries, particularly the Democratic Republic of Congo and South Sudan, hence imports of gold (captured as imports of mineral products) were crucial for the boom in exports.

In April 2021, when the government announced its tax proposals for FY22, it included a levy of US$200 per kilogram of gold production and export tax of 5 percent and 10 percent of the value of refined and unrefined gold exports, respectively. In turn, gold dealers refrained from producing and exporting gold, insisting that the government reviews the levy. Following negotiations between government and gold producers/exporters, the government tabled a Mining and Mineral (Amendment) Bill before Parliament in February 2022. The bill proposes that the levy is reduced to $100 per kilogram of refined gold while there will be no export tax on unrefined gold. Once passed into law, the revision in the gold taxation regime is expected to re-open the trade and smelting of gold that has been recorded at zero through the full three quarters of the FY22.

Box 2 Figure 1: Evolution of gold trade FY01 to FY22



Similar developments have been witnessed in Rwanda, following the introduction of a tax levy on gold during FY22, which has essentially brought the gold trade and smelting to a halt. Like Uganda, Rwanda's gold industry essentially imports all its gold, processes it, and then exports all the output.

Source: Compiled by staff from various sources including BoUand MoFPED documents.

28. Even as gold exports stalled during the first half of FY22, other exports contributed to the recovery in economic activity amidst the second wave of COVID-19 and subsequent lockdown. Coffee exports performed extraordinarily well, with export volumes hitting a 30-year record of 1.99 million bags in the first quarter of FY22, despite the average price of US$1.78 per 60kg bag – 36 percent of the pre-COVID-19 prices.[23] On the back of improved domestic production practices, this development augurs well for economic recovery, employment, and poverty reduction. Even though coffee export volumes declined by 22 percent in the second quarter due to weather distractions and related poor harvest, the total value of US$419 million earned during the first half of FY22 was 64 percent above the values fetched during the first half of FY21. Coffee export volumes remained low into January and February 2022, and the improvement could further be interrupted by Uganda's withdrawal from the International Coffee Organization Agreement in February 2022 as well as a not too transparent[24] contracting of a new private firm to have priority rights on all coffee produced before export could reverse the recent progress, with a raft of legal amendments. Apart from gold exports that recorded zero value as the sector continued negotiations on the new tax levy on gold exports, other non-coffee exports grew by 17 percent and at US$1131 billion during this period, surpassed the pre-pandemic levels.

Table 2: Balance of Payments

	FY19/20				FY20/21				FY 2021/22	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Current account balance (CA)	**-6.3**	**-4.6**	**-10.3**	**-8.9**	**-9.9**	**-13.1**	**-7.0**	**-13.5**	**-8.3**	**-8.5**
Goods and services, net	**-9.4**	**-9.5**	**-13.2**	**-11.8**	**-12.6**	**-16.2**	**-9.7**	**-16.4**	**-10.4**	**-11.5**
Exports	15.7	17.5	18.7	12.7	16.0	17.3	19.6	20.9	8.9	9.5
o/w coffee	*1.3*	*1.3*	*1.8*	*1.5*	*1.5*	*1.3*	*1.6*	*1.8*	*2.1*	*2.1*
o/w travel	*3.6*	*3.9*	*3.3*	*0.0*	*0.5*	*1.3*	*2.0*	*2.2*	*1.2*	*1.3*
Imports	25.1	26.9	31.9	24.6	28.6	33.5	29.3	37.3	15.6	17.4
o/w oil	*2.5*	*2.8*	*3.0*	*1.7*	*1.7*	*2.2*	*2.3*	*2.9*	*2.3*	*3.0*
o/w government imports	*1.0*	*1.2*	*1.7*	*1.0*	*1.8*	*1.2*	*0.7*	*1.8*	*0.8*	*0.8*
Primary income, net	**-1.8**	**-1.6**	**-2.3**	**-1.8**	**-1.9**	**-1.7**	**-2.0**	**-1.9**	**-1.8**	**-1.7**
o/w public interest payments (debit)	*0.5*	*0.2*	*0.3*	*0.3*	*0.6*	*0.2*	*0.7*	*0.3*	*0.5*	*0.4*
Secondary income, net	**4.8**	**6.4**	**5.2**	**4.7**	**4.6**	**4.9**	**4.7**	**4.9**	**4.0**	**4.7**
o/w personal transfers (credit)	*3.7*	*5.5*	*3.4*	*2.4*	*2.9*	*3.2*	*1.4*	*1.6*	*2.6*	*2.8*
Capital account balance (KA)	**0.1**	**0.4**	**0.2**	**0.1**	**0.5**	**0.8**	**0.4**	**0.2**	**0.5**	**0.3**
Financial account balance (FA)	**3.5**	**2.4**	**7.2**	**6.7**	**10.4**	**4.5**	**7.3**	**9.6**	**-11.9**	**-4.8**
Direct investment, net	3.0	3.3	2.7	2.3	2.2	2.3	2.4	2.4	-3.2	-3.7
Portfolio investment, net	-0.8	-1.3	-0.6	-1.1	-0.9	1.0	0.0	2.2	-0.3	1.1
Other investment, net	1.2	0.4	5.1	5.4	9.1	1.2	4.5	7.0	-8.4	-2.3
o/w Government loans, net	*1.3*	*2.3*	*7.3*	*5.1*	*7.2*	*3.2*	*-0.2*	*5.1*	*1.5*	*5.4*
Disbursements	*1.7*	*2.8*	*8.0*	*5.7*	*8.1*	*3.7*	*1.1*	*5.6*	*2.9*	*5.9*
Repayments	*-0.5*	*-0.6*	*-0.7*	*-0.6*	*-0.8*	*-0.5*	*-1.3*	*-0.5*	*1.4*	*0.6*
Net errors and omissions (NEO)	**2.4**	**2.4**	**3.2**	**3.4**	**0.5**	**7.6**	**-1.6**	**7.1**	**0.6**	**-3.0**
Overall balance (CA+KA+FA-NEO)	**-0.3**	**0.5**	**0.3**	**1.3**	**1.5**	**-0.1**	**-1.9**	**2.4**	**-3.6**	**0.4**
Financing	**0.3**	**-0.5**	**-0.3**	**-1.3**	**-1.5**	**0.1**	**1.9**	**-2.4**	**3.6**	**-0.4**
Central bank net reserves (- increase)	0.3	-0.5	-0.3	-7.8	-1.5	0.1	1.9	-5.3	-3.6	0.4
Use of Fund Credit	*0.0*	*0.0*	*0.0*	*6.5*	*0.0*	*0.0*	*0.0*	*2.9*	*0.0*	*0.0*
Memorandum GDP, nominal (in mil US$)	*9386*	*8705*	*8022*	*7711*	*9684*	*9144*	*8809*	*8809*	*9899*	*10390*

Source: Bank of Uganda and World Bank staff estimates

23. BoU 2022, April

24. Uganda Parliament is reviewing the deal with Uganda Vinci Coffee Company signed by Government in February 2022 but has come under criticism for not consulting all stakeholders. By April 25, 2022, the contract was still under scrutiny by the Trade Committee of Parliament.

29. The current account deficit was financed mainly through public borrowing, largely on concessional terms. Even as international companies continue grappling with recovery, FDI to Uganda recovered strongly to US$682 million (equivalent to over 3.0 percent of GDP) in the first half of FY22, compared to US$460 million similarly received in the first and second half of FY21, but likely to amount to 2.7 percent of GDP for FY22. The recovery was supported by equity and intercompany loan inflows, as well as the reinvestment of earnings. Net government borrowing, on the other hand, reduced to US$684 million or 3.1 percent of GDP in the first half of FY22, which was 31 percent below the amount attained during the corresponding period of FY21. Budget support inflows increased to US$430 million during this period (supported by a disbursement of US$125 million under IMF's ECF program) but could not fully offset the large decline in project disbursements, as project delivery remains slow due to execution problems (as discussed in Section 1.7). Furthermore, whereas some of these loans went to BoU to reinforce foreign reserves, the level of these reserves further dropped to US$4.4 billion or 4.2 months of import cover in December 2021, from 4.4 months in June 2021. This happened as BoU sold more than US$300 million during the quarter ended December 2021 to smoothen the market. As the shilling value deteriorated again and market became jittery into the last quarter of FY22, the room to build reserves through purchases of foreign exchange from the market, also shrunk.

1.7 Fiscal consolidation constrained by revenue shortfalls amidst high recurrent spending

30. Despite the suppressed revenues, a sharp reduction in spending due to fiscal adjustment and underspending of the development budget narrowed the overall fiscal deficit to 5 percent of GDP in the first half of FY22. The fiscal deficit is expected at 7.5 percent for the full FY22, which is still above the target path under the Charter of Fiscal Responsibility (Figure 21). Nonetheless, with a lower fiscal deficit, domestic financing also decelerated (Figure 22) even though the domestic securities issued for budgetary activities still accounted for up to 80 percent of the annual appropriations.[25]

31. Budget support, which strongly returned to Uganda's financing menu as part of the International Financial Institutions' support to the pandemic response, is likely to diminish. In addition to the IMF Extended Credit Facility (ECF) first disbursement of US$125 million during the first half of FY22, the African Export-Import Bank and the African Development Bank disbursed amounts that had been postponed from FY20/21. Whereas further disbursements under the ECF are expected in the second half of the year, such financing is projected to reduce to 3.2 percent of GDP for the full FY22, from the previous year's record 4.5 percent of GDP (Figure 22). A small component of this budget support comes in grants – it contributed about 10 percent of all grants in FY21 but is expected to have reduced to 5 percent in FY22 and subsequently down to 4 percent of grants in FY23.

Figure 21: Fiscal deficit (RHS axis) and total tax revenues and expenditures (% GDP

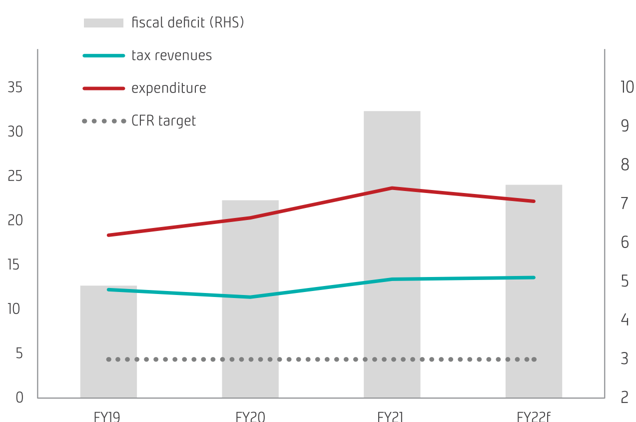
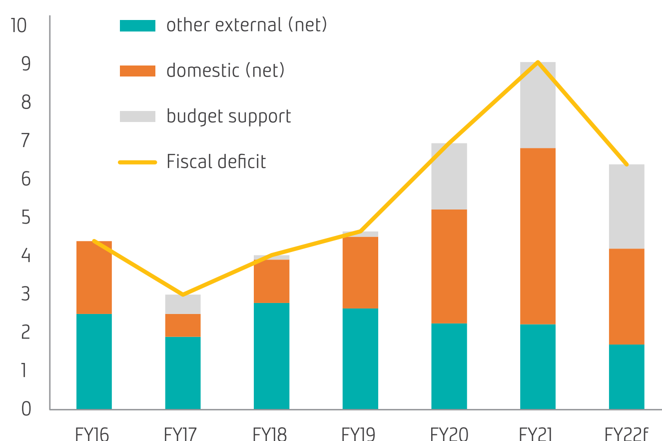


Figure 22: Financing the fiscal deficit (% GDP



Source: MoFPED and World Bank calculations
Note: Although budget support is part of gross external financing, it is included in Figure 22 to give a sense of its trend since the start of the COVID-19 crisis.

25. MoFPED 2022, February.

> Execution of projects continues to be hampered by incomplete project preparations uncoordinated budgeting for the government's own contribution to these projects, poor planning for rights of way and land compensation, poor contract management, and weakness in overall project management.

32. The expiry of the tax-based COVID-19 relief measures, improved tax administration measures and the rebound of economic activity is expected to bolster tax revenue to GDP ratio reaching a projected 12.3 percent for FY22 and above the pre-crisis levels. Despite disruptions in the recovery in economic activity and logistics at the border on account of the July 2021 national lockdown, the URA stepped up efforts to collect taxes following the expiry of the period for COVID-19 crisis response tax measures to support the private sector liquidity in November 2021. A combination of improved tax arrears management and intensified cargo management to curb misdeclaration, helped grow revenues by 16.8 percent during the first half of FY22, compared to the same period in FY21. Nonetheless, domestic revenues missed the national budget target by about 0.8 percent of GDP during the first half of FY22 and the full fiscal year performance is estimated to be below target. Revenues collected from most tax heads in GDP declined compared to the year before – except for import taxes which have been boosted by import price increases. Overall revenues and grants are expected at 14.3 percent of GDP, falling short of the budgeted target of 14.7 percent (see Table 3).

33. The fiscal consolidation has been executed through the development budget which could constrain economic recovery, even as recurrent spending remains above targeted levels. In the first half of FY22, recurrent spending rose to 11.7 percent of GDP, compared to 10.6 percent the previous year. Standing at 107 percent of the planned target, this spending was driven primarily by increased spending on wages, salaries and other employee costs, a spike in transfers to local governments, and higher interest payments on debt, even as domestic financing that had reached 4.6 percent of GDP in FY21, declined to 2.5 percent of GDP. Notably, spending on use of goods and services reduced by 14 percent from the levels utilized in first half of FY21. On the capital side, expenditure cuts – including on projects like the rehabilitation of the Malaba-Kampala Railway Line, Kiira Motors, and renovation of the National Stadium – were to reduce the budget by at least 1.5 percent of GDP through FY22. Even then, with under-execution of roads and bridges projects, the capital spending reached just 57 percent of the targeted plan during the first half of this year. The underperformance was due to the poor execution of both domestically and externally financed investments, which delivered 77 percent and 35 percent, respectively, of what had been budgeted. Execution of projects continues to be hampered by incomplete project preparations (including lacking detailed feasibility studies and/or implementation plans), uncoordinated budgeting for the government's own contribution to these projects, poor planning for rights of way and land compensation, poor contract management, and weakness in overall project management. Meanwhile, domestic arrears payments of UGX 449 billion, almost 60 percent above planned levels, augurs well for private sector liquidity and lowers the risk of loan default in the financial sector if new accumulation has been minimized. Overall expenditure during the first half of FY22 stood at 85 percent of the planned target.

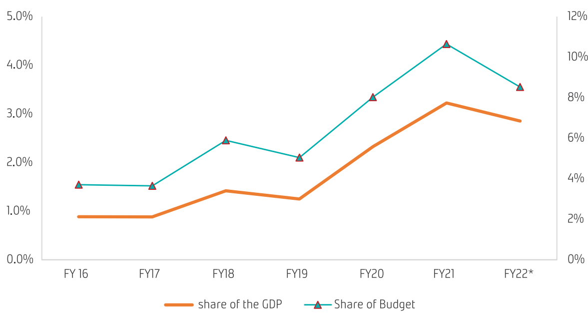
34. Continued use of supplementary budgeting is undermining fiscal consolidation. During the first half of FY22, a supplementary budget amounted to UGX 3.8 trillion (approximately 2.4 percent of GDP) was utilized by the Ministry of Defense, Ministry of Health, and State House, with direct COVID-19-related expenses accounting for only 13 percent of the total supplementary budget. This distribution of is like that observed in the previous two years (Figure 24). If no further supplementary budgets are approved during the rest of the fiscal year, the total so far is equivalent to 8.5 percent of the annual budget, will mark a reduction from 10.6 percent recorded last year, but still above the pre-COVID-19 levels. Supplementary budgeting ought to be limited to unforeseen and unavoidable situations, to avoid distorting the budget process and national priorities.

Table 3: Fiscal developments FY19-FY22

	FY20 Actuals	FY21 Budget	FY21 Actuals	FY22 Budget	FY22 Estimate	FY 23 Budget
Total revenue and grants	**13.2**	**14.9**	**14.4**	**14.9**	**14.8**	**16.1**
Revenue	12.4	13.8	13.2	14.0	13.6	14.8
Tax	11.4	12.8	12.4	13.0	12.9	13.7
o/w Income and profits	*4.2*	-	*4.5*	-	-	-
o/w Goods and services	*5.9*	-	*6.5*	-	-	-
o/w International trade taxes	*1.2*	-	*1.3*	-	-	-
Non-tax	1.0	1.0	0.9	-	-	0.6
Grants	0.8	1.1	1.2	0.9	1.1	1.2
Expenditures and net lending	**20.3**	**23.2**	**23.6**	**21.4**	**22.4**	**23.0**
Current expenditures	10.8	11.2	12.5	11.9	12.7	14.5
Wages and salaries	*3.5*	*3.2*	*3.4*	-	-	*3.2*
Interest payments	*2.1*	*2.6*	*2.7*	-	-	*3.5*
Domestic	1.7	1.9	2.1	-	-	2.8
Foreign	0.4	0.6	0.7	-	-	0.7
Other current	*5.2*	*5.4*	*6.4*	-	-	-
Development expenditures	8.6	10.9	10.1	9.2	9.0	8.5
External	*2.8*	*5.4*	*3.6*	-	-	-
Domestic	*5.8*	*5.5*	*6.5*	-	-	-
Net lending and investment	0.6	0.8	0.4	-	-	-
Hydropower projects	*.5*	-	*0.1*	-	-	-
Recapitalization BoU	*0.1*	-	*0.3*	-	-	-
Other spending	0.3	-	0.6	-	-	-
Clearance of domestic arrears	*0.3*	*0.3*	*0.6*	-	-	*0.4*
Primary balance	**-5.0**	**5.7**	**-6.4**	**-3.6**	**-4.4**	**3.5**
Overall Balance	**-7.1**	**8.3**	**-9.2**	**-6.5**	**-7.5**	**7.0**
Financing	**7.1**	**8.3**	**9.2**			**7.0**
External financing (net)	4.0	6.0	4.5	4.5	3.9	4.1
Disbursements	*4.6*	*6.8*	*5.0*	-	-	-
Projects	2.8	5.0	2.8	2.3	2.6	2.6
Budget support	1.7	1.8	2.2	3.4	2.2	1.5
Repayments	*0.6*	*0.8*	*0.6*	-	-	-
Domestic financing (net)	3.0	2.3	4.6	2.0	2.5	2.9
Banks (net)	*1.6*	*1.3*	*1.7*	*1.0*	*1.4*	-
Non-banks (net)	*1.3*	*1.0*	*3.0*	*0.9*	*1.0*	-
Errors and omissions	0.2	-	0.1	0.1	-	-

Source: MoPFED

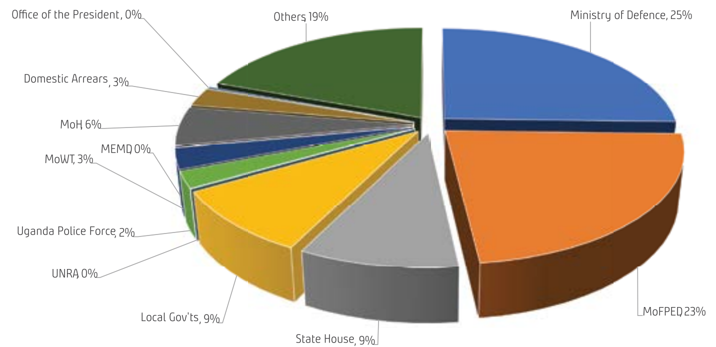
Figure 23: Supplementary expenditures as share of GDP (RHS axis) and as increase above budget (%)



Source: MoFPED

**Note: FY22 relates to H1 value*

Figure 24: Combined allocation of supplementary budget in FY20 and FY21 (as share of GDP)



Source: MoFPED

35. Public debt is reducing space for responding to shocks as it surpasses the thresholds under the Charter of Fiscal Responsibility. On the back of persistent and high fiscal deficits, Uganda debt increased rapidly from 15 percent of GDP in FY17 to 49.1 percent in FY21, the latter lower than had been anticipated on account of the domestic currency appreciation and a lower deficit due to under-execution of the development budget. Nonetheless, debt has increased particularly fast over the past two years[26], partly under the weight of COVID-19, but also building on momentum during the three-year period leading to the COVID-19 pandemic. As a result, and because of reduced capacity to service its service debt, Uganda's risk of debt distress deteriorated from 'low to moderate' in FY21. Even though the fiscal deficit is expected to moderate to about 7.5 percent of GDP for FY22, public debt will have crossed the 52 percent mark on the path under the Charter of Fiscal Responsibility, to 52.9 percent of GDP. This notwithstanding the use of Special Drawing Rights up to the tune of US$250 million during the second half of the year, which are expected to provide financing relief.

36. Liquidity pressures have been exacerbated by the changing structure of debt, towards more non-concessional borrowing. The ratio of total debt service to exports revenue and grants, is expected to rise to 40.5 percent for FY22, from 34.6 percent in FY21. This is driven by the high interest payments rising to 23 percent of domestic revenues during FY22, from 20 percent and 17 percent in FY21 and FY20, respectively. Consequently, the effective interest rate (current-year interest payments divided by previous period debt stock) is expected to reach 2.4 percent in FY22. With domestic borrowing increasing to over 35 percent of the total financing sources, 79 percent of interest payments was due on this type of debt. This exposes the budget to vulnerabilities and limits fiscal space for other critical priorities – the central government interest payment bill of close to 3 percent of GDP alone exceeds spending on both education and health (excluding donor projects) in FY20 and FY21. The high level of domestic borrowing is against a low rate of private sector credit growth as commercial banks opt for investments in government securities, instead of the still highly risky private sector (see section 1.5). With the tight liquidity conditions, payment of BoU advances was deferred and debt rolled over, with up to 13 percent of the government securities issued for refinancing maturing debt.

26. IMF-World Bank (2022) indicates that the increase of almost fourteen percentage points in debt over the past two years was primarily driven by external borrowing, with two-thirds of outstanding public debt owed to external creditors (US$13.2 billion or 31.7 percent of GDP). Domestic debt amounts to about US$7.2 billion (17.4 percent of GDP).

2. ECONOMIC OUTLOOK, RISKS AND POLICY ACTIONS

2.1 Recovery being threatened by increased uncertainties

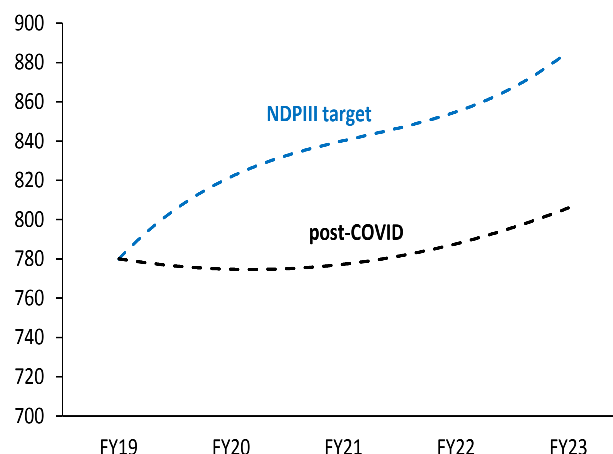
37. Real GDP is projected to accelerate to around 5 percent during FY23 and about 6 percent in FY24, having been slashed by the effects of new shocks fueled by the war in Ukraine. There was an upbeat outlook following the waning of the COVID-19 pandemic and full re-opening of the economy in January 2022 – and compounded by the clearer prospects for Uganda's oil production following the signing of the Final Investment Decision in February 2022 – which now faces new challenges because of rising commodity prices, disruptions to global supply chains, tighter global financial markets, and policy uncertainty. Nevertheless, private consumption is expected to perform better than it did during COVID-19 times. Whereas the recovery in employment and real household income is being discounted by the rising cost of living, the rising commodity prices are expected to boost incomes of cash crop farming households. This will further be supported if the private sector takes advantage of the increasing regional demand whose consumers could substitute away from expensive wheat and oil products due to the disruptions in production and supply chains in Ukraine and Russia. Private and public investments are also expected to increase, supported by increased momentum in the construction of oil related infrastructure, estimated at about US$20 billion, targeting the start of oil production in FY25. Furthermore, Uganda's commodity-based exports, are expected to benefit from the increased commodity prices. These trends are also supported by recent PMI data, which in April 2022 continued to suggest a sustained growth in new export orders and customer demand, new shocks to the global economy notwithstanding.

Private & public investments are expected to increase, supported by increased momentum in the construction of oil related infrastructure

Table 4: Baseline economic outlook (annual percent change unless indicated otherwise)

	FY21	FY22	FY23	FY24
Real GDP growth (baseline)	3.4	3.7	5.1	6.0
Private consumption	4.2	2.8	4.4	4.2
Government consumption	6.1	0.9	-0.6	0.7
Gross fixed capital investment	5.1	4.1	7.0	10.2
Exports (goods & services)	2.6	11.1	12.4	13.3
Imports (goods & services)	8.6	5.3	8.4	8.6
Agriculture growth	3.8	3.4	3.6	4.0
Industry growth	3.4	2.6	6.8	7.9
Services growth	3.3	4.6	4.9	6.9
Inflation (CPI)	2.5	3.7	6.0	5.0
Current account (% GDP)	-10.2	-8.2	-7.9	-7.0
Net FDI (% GDP)	2.1	2.5	2.7	3.3
Fiscal balance (% GDP)	-9.5	-7.5	-5.0	-3.8
Public debt (% GDP)	49.6	52.9	53.5	52.4

Figure 25: Real GDP per capita



Source: *UBOS, NDPIII and World Bank estimates*

Notes: *Gross fixed investment includes both public and private investment*

38. Rising inflation pressures will challenge monetary policy to cautiously manage the fragile recovery in economic activity. The combination of pent-up domestic demand, as economic activity picks up, and rising global commodity prices is exerting pressure on prices. Nonetheless, the output gap is unlikely to close and hence will likely moderate the pace of acceleration of inflation. Monetary response is expected to be carefully calibrated against the lingering effects of the pandemic on private sector finances, a risk averse banking system, and tightening liquidity conditions. Thus, core inflation is projected to climb well over its target to a range of 5-7 percent in FY23, as the economic recovery strengthens, and spillover effects of global commodity prices intensify. Additional inflationary pressures, due to sustained increases in global commodity prices, particularly oil, and/or depreciation pressures as global financial conditions tighten, will see a cautiously tighter monetary policy stance, with central bank policy rate increased gradually, to continue to support overall economic recovery.

39. The troubled global environment could slow the growth of exports, tourism, and remittances which, added to the higher import bill, will put pressure on the current account. For both FY23 and FY24, the current account deficit is projected to be within the range of 7 to 8 percent of GDP, as exports accelerate from improved domestic production, rising global commodity prices, possible substitution of food exports in the region in response to wheat supply shortages, and recovery in gold exports that stalled in FY22 on account of tax level. The weaker global and regional recovery notwithstanding, these factors support a positive outlook for some of Uganda's major exports – such as gold, tourism, coffee, and maize – over the next three to five years. Imports will also continue to grow strongly to support investments in oil production, although their growth has also been discounted due to disruptions to the global supply chains, rising transport costs, as well as effects of the resurgence of COVID-19 and the corresponding lockdowns in key source areas in China. The expected improvement in remittances will be muted on account of slower global growth and thereafter will largely depend on employment recovery in source countries and the extent of the shift of resources to the increasing refugee crisis within European countries on account of the Russian-Ukraine war.[27] The outlook for services (particularly tourism in a post-COVID-19

27. Nearly a third of remittances came from Europe in 2018, led by the UK, Sweden and Germany, whilst nearly a quarter came from the Middle East, led by the UAE (IFAD, May 2021).

> According to the FY23 Budget Draft Estimates, an intensified implementation of the Domestic Revenue Mobilization Strategy – in particular, the tax expenditure reforms and value-added tax legal reform alongside several tax administration reforms – will raise revenue by a full percentage point during FY23.

world) will largely be determined by vaccination trends, evolution of the pandemic (as Omicron in January 2022 demonstrated), and related confidence to ease and lift travel restrictions.[28] Although by January 2022, industry analysts projected that global tourism could return to pre-pandemic levels only by 2024, with some locations recovering faster than others,[29] the Russian war in Ukraine risks hampering the return of confidence in global travel, especially for the U.S. and Europe. A gradual increase in FDI to 2.7 percent and 3.3 percent in FY23 and FY24 respectively, mainly related to oil, will ease the financing needs, minimize government borrowing – partly expected through concessional financing from IFIs – alongside a drawdown of foreign exchange reserves, which could include further use of the special SDR allocation. Financing through non-concessional means is likely to be limited given the negative impact this could have on Uganda's debt profile.

40. Fiscal consolidation will be underpinned by the realization of stronger revenue effort alongside a rebalanced expenditure strategy. Compared to the ambitious path at the beginning of the fiscal consolidation effort, the reduction in the fiscal deficit is expected to be more moderate – from 7.4 percent in FY22 to 5.0 and 3.8 percent of GDP in FY23 and FY24 respectively. According to the FY23 Budget Draft Estimates, an intensified implementation of the Domestic Revenue Mobilization Strategy – in particular, the tax expenditure reforms and value-added tax legal reform alongside several tax administration reforms – will raise revenue by a full percentage point during FY23. After the initial sizable impact, these policy adjustments and administration measures aim to increase revenues in subsequent years by at least 0.5 percent of GDP a year. 30 Compared to the CFR path, the fiscal deficit adjusted a little less than had been anticipated in FY22, but will be expected to adjust steeply - by about 2.5 percent points per year in both FY23 and FY24 - as expenditures decline to 19.4 percent in FY24, from an estimated outturn of 21.7 percent in FY21. 31 Ultimately, this consolidation intends to shift debt back to a more sustainable path32 - peaking at around 52 percent of GDP – consistent with the CFR targets and limiting private sector crowding out. The fiscal consolidation notwithstanding, the increasing shocks underscore the importance of government sustaining efforts to support the recovery and revitalization of key sectors (education and health), which are critical for inclusive growth and poverty reduction. This may require further emphasis on a fiscal strategy that creates spaces for critical spending priorities, as well as continuing to rebalance expenditure away from a focus on hard infrastructure and back to social sectors such as education and health. It will also require government to avoid domestic financing of the deficit, that raises the exposure of the domestic financial system to macro-fiscal risks, as well as accumulation of domestic arrears that harm the private sector. Instead, focus should be on rationalizing expenditure and additional sources of concessional financing.

28. According to the latest UNWTO Panel of Experts, almost half of all experts (45%) continue to see international tourism returning to 2019 levels in 2024 or later, while 43% point to a recovery in 2023 (https://www.unwto.org/news/vaccines-and-reopen-borders-driving-tourism-s-recovery)

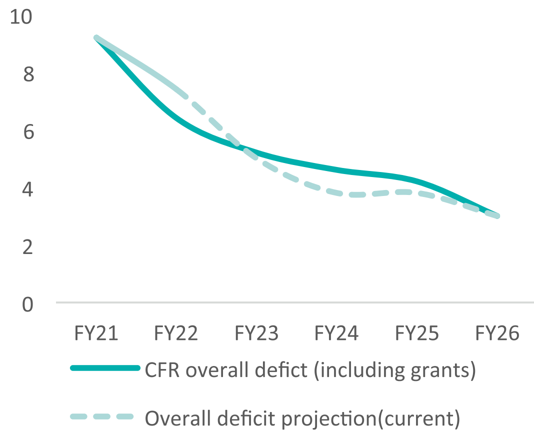
29. McKinsey and Company 2022, April

30. According to the URA, revenue effort will be enhanced through (i) alternative dispute resolution; (ii) implementing of smart business solutions of Digital Tax Stamps and Electronic Fiscal Devices; (iii) leveraging technology to simplify key processes, enhance client support, and and intensify tax education (https://thetaxman.ura.go.ug/revenue-performance/)

31. The FY22 and proposed FY23 budgets include: (i) broad spending cuts, especially to sectors that normally take a large share of the Budget such as Works and Transport (down by 13 percent in FY22) and energy and mineral development (down by over 40 percent in FY22); (ii) scaling down non-essential expenditure such as travel, workshops and seminars; (iii) strengthening of procurement systems to eliminate waste; and (iv) better budget monitoring and use of digital PFM systems to improve efficiencies.

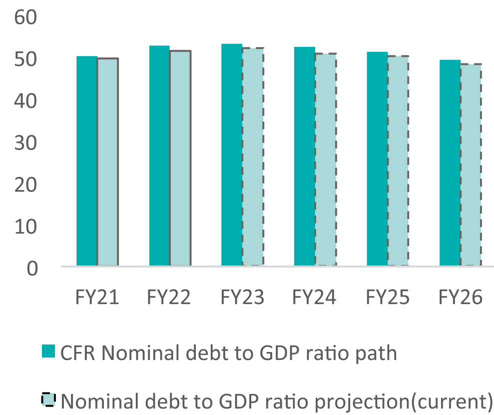
32. Below 50 percent of GDP in nominal terms, as per the new Charter for Fiscal Responsibility FY21/22-FY25/26.

Figure 26: Fiscal adjustment to align to CFR (% of GDP)



Source: MFPED and staff estimates

Figure 27: Debt reduction to align to CFR (%)



Source: MFPED and staff estimates

41. Overall, this growth projection falls more than half a percentage point below that of our December 2021 Economic Update which calls for stronger effort if Uganda is to ascend to middle income status in the near future. Policy makers face new uncertainties and challenges that must be managed cautiously given the trade-offs between rising inflation and supporting the recovery. With lower growth than the pre-pandemic growth projections, the gap between actual per capita income and the NDP III target has widened and the time for Uganda to reach the lower-middle-income target elongated. According to the World Bank Atlas Method (see Box 3), Uganda's per capita income was estimated at US$840 per person in FY21, lower than the threshold of US$1045 for FY22.

BOX 3

Placing Uganda in World Bank's Income Classification

Status: According to the World Bank' Atlas Method, Uganda's per capita income was estimated at US$840 per person during FY21. Uganda's per capita income improved strongly between 2001 and 2011, and the gap to lower middle-income status shrunk to 17 percent, from 75 percent in 1994. Since then, the gap has remained in range of 19 to 26 percent, as growth slowed down alongside a high rate of population growth.

Measurement: To classify countries across income categories, the World Bank Group uses gross national income (GNI), which measures incomes earned by residents, both within and outside the country. This is particularly important because the world is a global village, which implies residents in one country can earn income abroad and nonresidents can earn income within the country. Over the last two decades, the difference between these two variables has been minimal, yet indicating that Uganda's GNI was slightly greater than GDP in the 1990s, while the reverse was true in the 2000s. This implies that the non-resident income earned within Uganda increased beyond the income earned by Ugandan residents outside Uganda in the 2000s.

Calculating per capita income GNI Atlas method: The variables (used to derive GNP per capita, including:

(i) Nominal gross domestic product (GDP) at purchaser's price in current prices (GDP) as estimated by Uganda Bureau of Statistics,

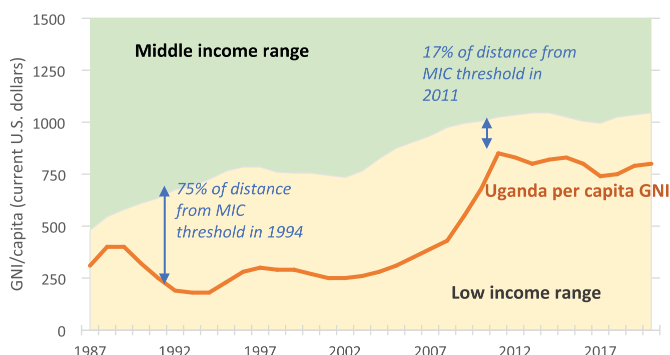
(ii) Net primary income (primary income receivable by resident units from the rest of the world minus primary income payable by resident units to the rest of the world) as estimated within the Balance of Payments statement by Bank of Uganda,

(iii) Mid-year population estimates by the United Nations World Population Prospects, 2019

(iv) A weighted average of the exchange rates of the last three years

(v) Adjustment for inflation, using the Uganda GDP deflator and the SDR deflator inflation, calculated as a weighted average of the GDP deflators of the countries currently included in the SDR). The weights are the amount of each country's currency in one SDR unit, which change over time in line with the composition of the SDR and the relative exchange rates for each currency. The SDR deflator is first calculated in SDR terms, and then converted to U.S. dollars using an SDR to dollar conversion factor that is calculated as average over three years.

Box 3 Figure 1: Uganda's per capita income path 1990–2020



Data sources: As indicated above, the World Bank uses country data for country-based variables, and internationally accepted sources for others.

Application: Every year, the World Bank uses the GNI Atlas method against set thresholds (changed every year) to classify countries into low-income countries (LICs), middle-income countries (MICs) and high-income countries (HICs). The LIC/MIC threshold was raised to US$1,045 for FY22 from US$1,035 in FY21, almost double US$610 in 1990.

The World Bank Board uses the country LIC/MIC/HIC categorization, alongside several other factors, to classify lending terms for a country (i.e., IDA, Blend, or IBRD).

Further information can be found at World Bank:

https://datahelpdesk.worldbank.org/knowledgebase/articles/378832-what-is-the-world-bank-atlas-method

https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups

42. Depending on the evolution of the threshold, Uganda has to work harder to achieve MIC in the next six to seven years. An optimistic scenario with a slower pace of population growth in line with the trend observed over the past five years; and faster GDP growth, peaking at about 10 percent when oil production starts in 2025-2026 and as structural reforms generate greater efficiency gains from investments, including catalyzing private investments, could accelerate Uganda's per capita income to close the gap that has persisted over the last five years. At the same time, failure to reform and/or if hit by a negative shock reducing growth to an average of 5 percent would postpone this achievement to beyond 2031.

43. Achieving middle income status must be accompanied by real change for the population as is also indicated in the country's NDPIII whose goal is to raise incomes of households and improve quality of life. This will require investments in human and physical capital that will engender a sustainable and inclusive economic transformation. The prospects for this shift will also rely on maintaining macroeconomic stability; better supporting the vulnerable, farmers, and small enterprises; increasing the uptake of digital technologies; and more effective use of public resources.

2.2 . Risks remain tilted to the downside

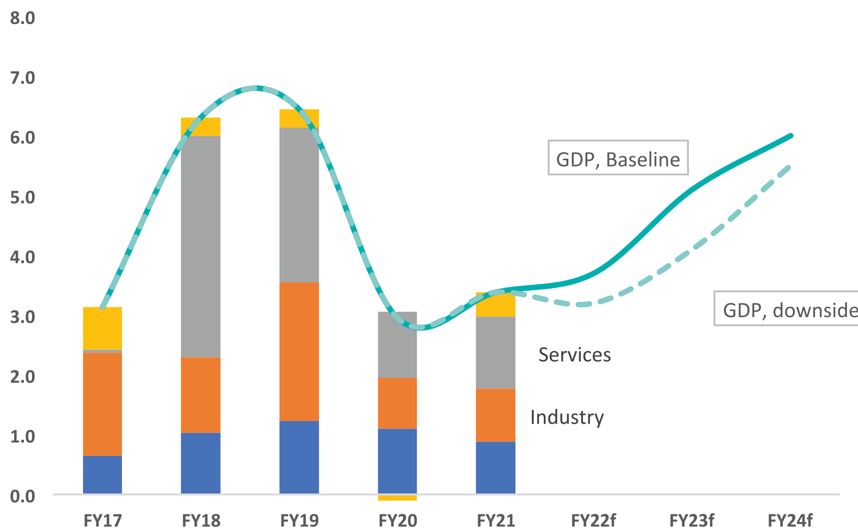
44. The economic outlook over the next couple of years faces significant risks considering the large global and domestic uncertainties. First, is the possibility of new waves of COVID-19 and other disease outbreaks. With just 17.5 percent of the population fully vaccinated, a large proportion of the population remains at risk, should there be a resurgence of COVID-19. Serious waves of infections could be followed with some mobility restrictions, with their attendant effects on the economy and social welfare, especially the education sector that already lost two years, the longest period of closure globally. Second, a more severe deterioration of the global economy and stronger passthrough of its effects could necessitate a tighter monetary policy, which would slow the recovery of businesses and household incomes. This may cause a sharper deterioration in the asset quality of the banking sector and increase cost and constrain further access to finance for firms in the next few years. Third, adverse weather could derail the recovery of the agriculture sector. The increasing frequency of droughts and floods is raising the vulnerability of Uganda's firms, farms, and households given the limited adaptive capacity to natural disasters and climatic stressors; generally low technology adoption rates and limited access to alternative off-farm income streams. Coupled with higher than anticipated input costs due to the war in Ukraine, this could reduce yields, lower export earnings, increase food insecurity, and increase poverty levels, because a large proportion of the population relies on the agricultural sector for livelihoods.

45. Fiscal risks abound due to spending pressures that would require adjustments to desired fiscal consolidation efforts. Beyond revenue shortfalls that could result from shocks, additional spending pressures could arise for the security sector as well as unforeseen requirements to meet the commitment on developing the oil sector ahead of production in 2025, which may throw the fiscal consolidation agenda off course. Moreover, while debt projections are quite sensitive to growth, revenues and exports, the uncertainty around the external outlook, and increased frequency of natural disasters due to climate change, could worsen the country's debt outlook. The most extreme shock,[33] could temporarily push Uganda's debt (both external and public) over its respective thresholds and benchmark of 55 percent for countries with a medium debt-carrying capacity. This would further be exacerbated by a slower-than-expected implementation of reforms, further delays in oil production, a shift in the composition of financing towards non-concessional loans, and the potentially limited capacity of commercial banks to increase their purchase of government securities in response to future shocks.

46. Under a downside scenario, growth may drop further, closer to 4.5 percent in FY23 and recover only slowly towards 5.5 percent in FY24 (Figure 28). This poorer performance could materialize if the spillover effects of the Russian-Ukraine war and related economic sanctions intensify, further worsening the global environment, with adverse consequences for Uganda. These might include a widening trade deficit, as well as lower remittances, tourism, and FDI, including a delay in concluding financing arrangements for oil production – the signing of the FID in early 2022 notwithstanding. This scenario also assumes faster acceleration of commodity prices and stronger spillover into domestic inflation, requiring monetary policy to be more aggressive to curb inflation and thereby slowing the recovery even further.

33. Under the Joint IMF-IDA Debt Sustainability Assessment, debt projections are subjected to various stress tests including reduction in GDP growth, reduction in exports, increase in primary deficit, reduction in official and private transfers and FDI, and materialization of contingent liabilities. The most extreme stress test is the test that yields the highest ratio in or before 2032.

Figure 28: Real GDP growth rate, %



Source: UBOS and staff estimates

Growth may drop further in FY23 closer to

4.5%

& recover only slowly in FY24 towards

5.5%

2.3. Key policy actions to support recovery

47. Uganda's economic recovery and growth acceleration into the medium term is still expected to be fragile, facing a multitude of risks. The rising commodity prices pose new risks to people's livelihoods that have just been recovering from the effects of COVID-19. It also threatens to stall the socio-economic transformation as the likelihood of falling into deeper poverty increases. The fiscal consolidation agenda notwithstanding, the government's interventions are likely to be constrained by the limited fiscal space due to scanty revenues, project execution challenges, and rising public debt vulnerabilities. In line with the analysis above, attention to the following four priority areas is required to sustain a resilient and inclusive recovery:

(i) Accelerate vaccination effort: To avoid the resurgence of COVID-19 and related consequences, accelerating the COVID-19 vaccination program must remain an important policy priority for government. This will guard against a resurgence of the virus and related consequences to the socioeconomic welfare of Ugandans.

(ii) Adopt targeted intervention to support the vulnerable: Whereas government is not planning to distort markets in responding to the rising commodity prices, targeted interventions are required to arrest the increase in poverty and food insecurity, especially in vulnerable population groups. As shocks are becoming more frequent and more intense, building shock responsive social protection systems at the national level has become a critical priority. Government must accelerate efforts to invest and institutionalize the development of a national social registry of vulnerable households (which would enable government to respond quickly, and expand support beyond those who are in the current social assistance programs). Further, strengthening and expanding the digital payment systems will allow efficient and transparent distribution of support to the impacted households. It is also crucial that the government develops a disaster risk financing strategy that strengthens the financial resilience of the country to disasters and allows timely response. Poor and vulnerable households can be supported through labor-intensive public works and livelihoods support activities that reduce negative coping strategies (such as reducing food, distress selling of assets, pulling children out of school). In the longer term, these programs can help households increase income, build assets and resilience.

(iii) Maintain prudent fiscal and debt management to support the fiscal consolidation agenda: Raising revenues and executing the capital budget more efficiently to maximize returns on investments are critical for maintaining fiscal and debt sustainability

in tandem with the charter of fiscal responsibility. Should new shocks disrupt the fiscal consolidation agenda, the government should avoid increasing domestic financing of the deficit, through short term securities that raises the exposure of domestic FIs to macro-fiscal risks, as well as accumulation of domestic arrears that harm the private sector. Instead, focus should be on rationalizing expenditure and additional sources of concessional financing. And whereas government is implementing the Performance and Policy Actions [34] under the World Banks' Sustainable Development Finance Policy, to ensure debt sustainability, it could further enhance debt transparency by putting in place a framework for closely monitoring all sources of fiscal risks, including SOEs financial performance, domestic arrears, National Social Security Fund pension restructuring, and lending schemes, among others.

(iv) Adopt a cautious monetary tightening stance in face of rising inflationary pressures: Monetary policy must maintain a delicate balance between curbing inflation pressures - that have intensified due to rising commodity prices and stronger demand following the reopening of the economy – and supporting the private sector and economy to remain on the recovery path. This will call for a close monitoring of financial system stability and lending to the private sector, as well as closer coordination with fiscal operations.

48. These short- to medium-term recovery macro management policies ought to be integrated with longer term structural reform that will ensure sustainability. This will include accelerating reforms to strengthen revenue mobilization through the implementation of the DRMS; improving public investment management; rationalization of public expenditure to support faster, sustainable, and inclusive growth by investing strongly in human capital development and improvement of the trade and business environment, including through green investments, and tapping into prospects of regional integration initiatives like the African Continental Free Trade Area.

34. The World Bank's Sustainable Development Finance Policy requires countries that have 'moderate' or 'high' risk of debt distress to formulate and implement Performance and Policy Actions to help them work towards reducing this risk and maintain sustainable debt positions. Since Uganda shifted to the 'moderate' category of risk of debt distress, it has formulated and will be implementing policy actions in the areas of debt management to limit the growth of its debt; public investment management to improve efficiency and support fiscal sustainability, and to reform tax policy to expand its tax base.

CREATING SPACE FOR FISCAL CONSOLIDATION THROUGH BETTER PUBLIC INVESTMENT MANAGEMENT

Uganda's increasing fiscal vulnerabilities can be traced to three factors: a low tax effort, disproportionately high current spending, and consistently ambitious capital spending marred by inefficiencies

ADVANCED

Uganda's increasing fiscal vulnerabilities can be traced to three factors: a low tax effort, disproportionately high current spending, and consistently ambitious capital spending marred by inefficiencies

53% of GDP

Total public debt is expected to continue rising by FY24 considering the government's ambitious investment program

3.1 Tracing options for fiscal consolidation

49. Uganda's fiscal and debt variables have deteriorated steadily since 2015, and vulnerabilities are mounting. The fiscal deficit has expanded substantially over the past few years, from 4 percent of GDP in FY16, to 9.2 percent in FY21 – well above the Charter of Fiscal Responsibility that had aimed to keep the deficit at 3 percent by FY21. In parallel, public debt rose considerably, from 22 percent of GDP to almost 50 percent in FY21 (as discussed in section 1.7). The latter occurred despite the rebasing exercise in 2019 that raised nominal GDP by about 17 percent, thereby enlarging the repayment capacity of the country. Total public debt is expected to continue rising to 53 percent of GDP by FY24 considering the government's ambitious investment program. Whereas debt is still sustainable, the debt service ratios are charging above the comfortable threshold and hence reducing the fiscal space for responding to shocks.

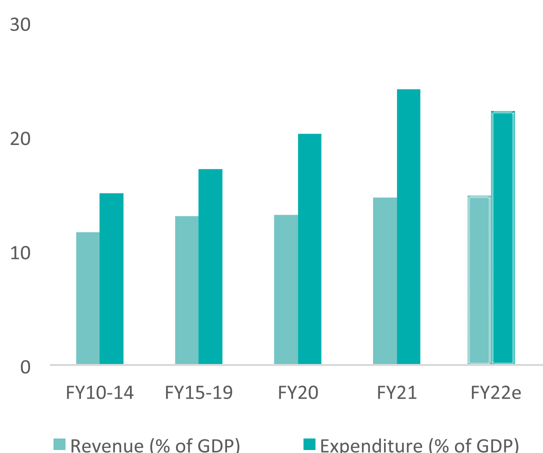
50. The planned fiscal consolidation is critical to rein in these vulnerabilities and ensure fiscal sustainability. Uganda's increasing fiscal vulnerabilities can be traced to three factors: a low tax effort, disproportionately high current spending, and consistently ambitious capital spending marred by inefficiencies. According to the recently published Systematic Country Diagnostic,[35] these three factors have resulted in large primary deficits, which drove the increase in debt. In line with its Charter of Fiscal Responsibility, government expects to reduce the fiscal deficit from 9.2 percent of GDP in FY21 to 3.5 percent into the medium-term. The fiscal policy consolidation path is expected to be realized through increased effort to implement the Domestic Revenue Mobilization Strategy to generate an increase of tax revenue by 0.5 percent of GDP per year and cutting spending in non-priority areas.

51. On the expenditure side, fiscal adjustment could benefit strongly from realignment and rationalization of the capital expenditures, and particularly addressing the inefficiencies in spending and implementation of the capital budget. In absolute terms, public expenditure more than doubled over the last 10 years, hence maintaining pace with economic growth. Growth in

35. *World Bank 2022b, April*

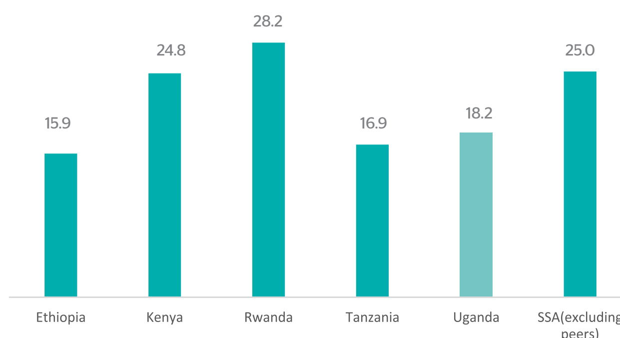
the expenditure to GDP ratio has been more pronounced over the past five years – soaring by over 7 points from 12 percent in FY15 to 19 percent in FY21. Nonetheless, at 18 percent of GDP, Uganda's average government expenditure is lower than the SSA regional average of 25 percent (excluding the peer countries) over this period, particularly because of the low revenue effort. It was also low compared to Kenya and Rwanda with 25 and 28 percent, respectively. And even though Uganda's capital expenditure shot up since FY18, with the share in total spending rising to 28 percent during FY20 and FY21 (Figure 29), its share in GDP has averaged 3.1 percent, and remains lower than that of its peers (Figure 30). This underscores the need to raise the efficiency of the capital budget to generate more economic growth and contribute more strongly to fiscal consolidation and sustainability.

Figure 29. Trend of total revenues and expenditure (% GDP)



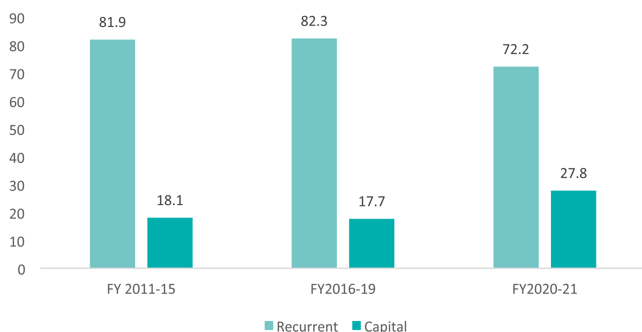
Source: BOOST, WEO 2022, April

Figure 30. General government expenditure in selected regional countries, average 2016–21 (% GDP)



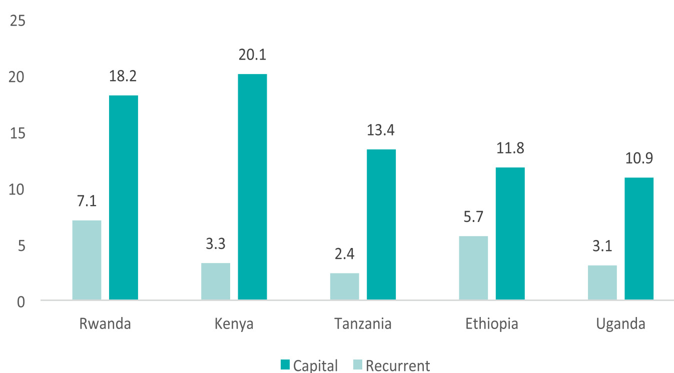
Source: BOOST, WEO 2022, April

Figure 31. Share of Public Expenditure by Category (%)



Source: BOOST, WEO 2022, April

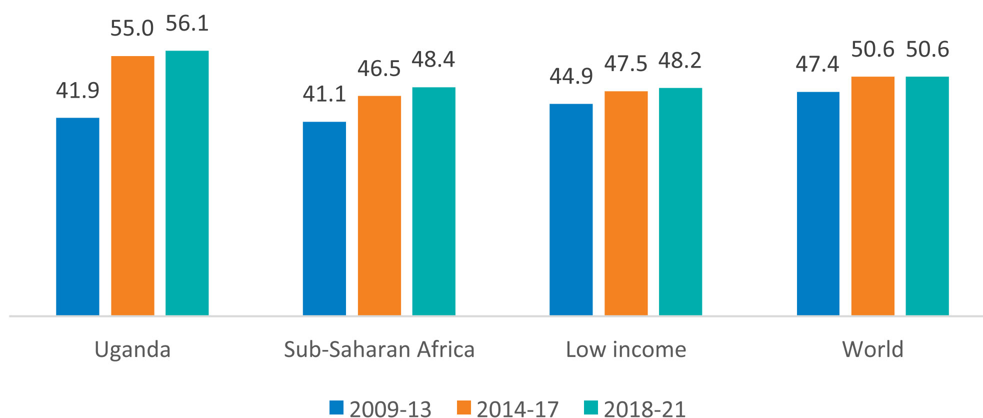
Figure 32. Capital expenditure in selected regional countries, average 2016-21 (% GDP)



Source: BOOST, WEO 2022, April.
** RWA: 2017-21; ETH: 201*

52. Fiscal adjustment will be complicated by fiscal rigidities that require making tough choices, regarding institutional arrangements that have become part of public policy. Analysis of Uganda's budget,[36] depicts that the share of non-discretionary items of the government expenditure, which provides a high-level and broad estimate of budget rigidity, increased to 56 percent during FY09–FY13, from 46 percent over FY18–FY21. While the comparison of rigidity levels with other countries should be interpreted with caution due to differences in their identification and budget structure, regional peers show a lower rigidity composition.[37] Uganda's budget share of non-discretionary items of approximately 56 percent is also far higher than the SSA average of 48 percent. Compared to the average of low-income countries, Uganda still has a difference of eight percentage points, making it a less manageable budget structure in the short-to-medium term (Figure 33).

Figure 33: Fiscal rigidity: Uganda's share of non-discretionary spending in comparison with other regions (%)



Source: BOOST, WEO 2022

53. The planned fiscal consolidation, alongside demands to right-size the public sector, will hinge on increased efficiency of investment to enable more growth. Given the rigidity of the budget and likelihood that the fiscal space for public capital spending will be capped by the fiscal consolidation agenda in the coming years, it becomes important to increase the output for each shilling spent on public investment. There is a significant dividend from improving public investment management (PIM) – the institutions, systems, and processes guiding decisions on how to prepare, implement, operate, and manage public investment projects. The International Monetary Fund (IMF) estimates – based on a survey of the efficiency of PIM systems in a range of countries having gone through PIM assessment – suggest that an average country obtains 30 percent less output in terms of physical infrastructure for a given expenditure than the most efficient countries. Up to two thirds of this efficiency gap could be clawed back through improved PIM institutions (IMF, 2015).

36. World Bank 2022a. Forthcoming.

37. Lower rigidity may not necessarily reflect similar challenges in implementing fiscal policy as some rigidities may be easier to change in a specific country context, depending on the legal and other institutional framework.

3.2 Notable reforms to public investment management but challenges remain

54. Cognizant of the benefits that closing the efficiency gap would bring to its public expenditure and overall fiscal management, Uganda already embarked on a series of reforms to strengthen its public investment management (PIM). The reforms followed a comprehensive multi-year action plan derived from a PIM diagnostic adopted in 2015, [38] to strengthen the preparation, selection, implementation and monitoring of projects. Since then, a dedicated department in MoFPED – the Project Analysis and Public Investment Management (PAP) Department – was established to spearhead the PIM reforms within a clear PIM framework of operation. The key functions of the PAP Department have included developing and promoting the use of standard guidelines and user manuals for project preparation and appraisal, national parameters and economic conversion factors to aid in project and program appraisal, as well as selection criteria for projects into the public investment program (PIP). This would ensure that the same approach and process is used across government in preparation of projects.

55. In line with the requirement of the PIM framework to have an independent reviewer of projects, the Development Committee (DC) was reconstituted to perform the gatekeeping function and build a pipeline of bankable projects. Members of the DC are drawn from most crucial stakeholder institutions in the project management process.[39] The Permanent Secretary and Secretary to Treasury chairs the DC, and PAP is the secretariat. The DC is entrusted with the task of appraising the project proposals submitted by the programs, ministries, or agencies as per a standardized PIMS framework and using specific guidelines for review and approval of investment projects. The main tool of the DC is the Development Committee Guidelines which were published in 2016 and used to review and appraise project proposals for feasibility and viability before they enter the pipeline of ready-to-finance project proposals. To guide the selection of projects out of the pipeline for financing (i.e., into the budget), the DC uses a published criteria for selection of projects into the public investment plan (PIP).[40]

56. Furthermore, to streamline project information and digitalize the appraisal function in MoFPED, an integrated bank of projects (IBP) was set up. The IBP system is the central tool for MoFPED to manage Government capital investments through four interlinked subsystems, which ideally operate as the four decision gates through which a project must pass before it is approved – these include project concept, project profile, prefeasibility study, and feasibility study. The system will interface with other public finance management (PFM) and monitoring systems (including Aid Management Platform, Program Based Budget System, Integrated Financial Management System, e-Government Procurement System, and Prime Minister's Information Management System) to enable tracking of the projects throughout the entire project cycle. These interfaces eliminate duplication and maximize synergies between and across government.

57. The reforms have been followed with a strategic capacity-building effort aiming to improve MDAs' capacities across the PIM cycle. Over 200 government officials drawn from the PAP Department and select MDAs[41] have been trained in project appraisal skills and other critical areas across the PIM cycle, including in procurement and impact evaluation. Government has also set up a PIM Center of Excellence in Makerere University to build capacity in this area sustainably and affordably.

58.These reforms have brought some good practices to Uganda's PIM system. One of the most important developments has been putting in place a standard process for improving the quality of projects that are entered into the national budget. Not only are there guidelines for government officials to prepare projects, but there is also a systematic process for reviewing and appraising the projects before they are included in the budget. Alongside

38. MoFPED 2016.

39. Membership includes Office of the President, Office of the Prime Minister, Office of the Solicitor General, Public Procurement and Disposal of Assets Authority, National Planning Authority and MoFPED.

40. MoFPED 2021.

41. Key MDAs that were trained included MoFPED – PAP/PIM, PPPU, Debt and Cash Policy, National Planning Authority, MLHUD, Uganda Revenue Authority, MoWE, PPDA and Ministry of Agriculture Animal Industry and Fisheries.

these reforms, a comprehensive and authoritative national development strategy is linked to programs and their program implementation action plan. It provides clear strategic guidance on required investments through a list of investment initiatives within the National Development Plan (NDPIII), including their indicative cost. The effects of these reforms are already visible in the improved quality of projects submitted by MDAs to the Development Committee for approval and admission into the PIP. Moreover, the percentage of projects that are underpinned by a cost-benefit analysis (CBA) out of the total entering the PIP, while still low, has improved from 10 percent by 2015, to 37 percent for FY21, as reported by MoFPED. The impacts of some of these reforms may be realized only some time in future, but they raise hope that investments are starting to be managed well.

59. Notwithstanding the progress achieved in putting in place these processes through the implementation of the PIM action plan, several challenges remain. There are instances in which measures and guidelines have not been adhered to. According to the Auditor General's Report for FY20/21,[42] out of a sample of 371 projects in the public investment program, 245 projects (66 percent) with total project values of UGX643.4 trillion, did not have feasibility studies undertaken before they were allocated financing. It is also noted that capacities would need to be enhanced in some MDAs to even understand the studies that have been done by external agents. Some externally funded projects have not followed national guidelines and aspirations when undertaking feasibility studies. On top of this, other challenges crop up down the project cycle, such as securing the right of way after projects have started implementation; inadequate counterpart funding to facilitate elements of projects that would ideally be funded by government under externally funded projects; and poor project operation and maintenance of assets that have been created. Section 23 of the Public Finance Management Act (Amended 2015) imposes a legal requirement for multi-year commitments to support a lifetime projects financing that, in most cases, requires more than one year to be executed. Yet not all projects are funded systematically. As a result, cost- and time-overruns on projects; high commitment fees in case of externally funded projects, and shortened life span of projects due to poor operation and maintenance of created physical assets persist. The Auditor General's Report for FY20/21 again noted that out of a sample of 371 projects in the PIP, 342 projects (92.2 percent) with budgets totaling UGX39 trillion had gone past their planned exit periods, with some extended by more than 12 years and only 40 percent of the projects in the Public Investment Plan (PIP) were still within their expected time.

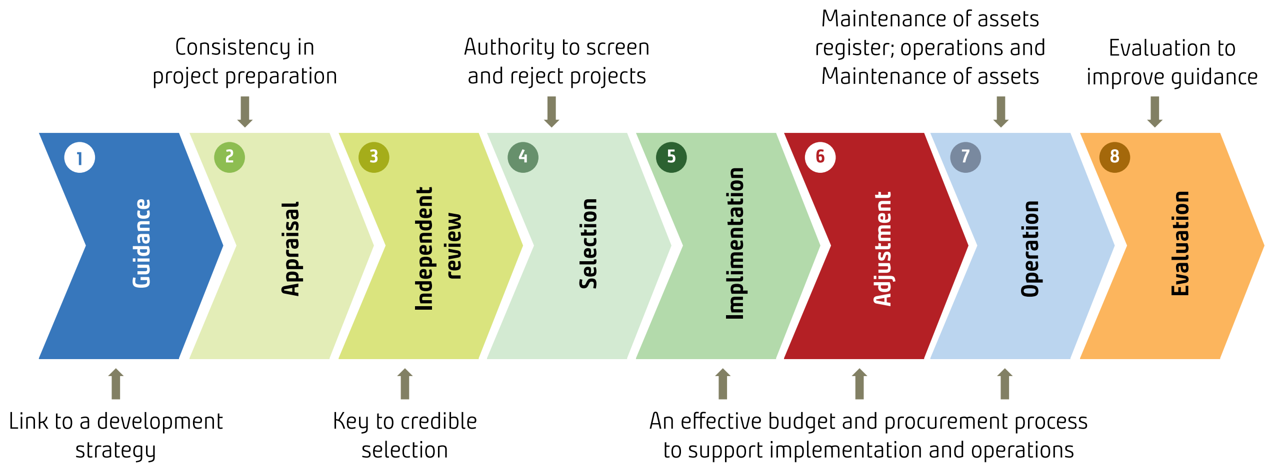
60. The persistent PIM challenges underscore the complexity of reforming PIM frameworks, given the many institutions, processes and mandates that must work together to form a system that is able to manage investments efficiently. It is not sufficient to prepare and appraise projects so that they meet criteria for economic return when the budgetary allocation process would not fund them efficiently. Nor is it useful if implementation weaknesses raise project costs well above the original estimates from the cost-benefit analysis, thereby converting the project into an economically unviable venture. Globally, it is well known that whilst the PIM process is rooted within the theory of economic efficiency that aims to maximize the returns on investment, the practical process of project selection, funding and implementation can be quite political. This introduces another critical aspect that must be well understood because reforms that threaten the status quo can be met with public or covert resistance.

3.3 Identifying gaps in the public investment management system

61. A recent assessment of the PIM system updated the situation analysis to decipher reasons for the remaining gaps and map a way forward for the next phase of actions. As was the case for the 2015 exercise, the diagnostic update used the World Bank's standard for PIM systems framework.[43] It characterizes a formal system of public investment management as one that allows for the transformation of investment ideas into investment projects and, afterwards, into "investment decisions". This system should put projects through a complete project life cycle "filter" to systematically stop bad, uneconomic projects from taking up resources that would otherwise be invested in beneficial, economic projects. To assess the efficiency and effectiveness of a country's PIM system, the framework provides a comprehensive view of the public investment cycle, allowing the identification of institutional and procedural gaps across the eight essential features and functions, now commonly referred to as the "8-Must-Have Functions." (Figure 34 and Box 4)[44]. The subsequent sections summarize the assessment outcomes and gaps at each stage

42. MoFPED 2022, February.
43. Rajaram, A. et al 2014.
44. Ibid.

Figure 34: The public investment management cycle



BOX 4

The 8-Must-Have Functions of a Good PIM System

1. **The strategic investment guidance, project concept development, and pre-appraisal screening:** Broad strategic guidance to guide sector-level decision-makers and preliminary screening to ensure that project concepts meet minimum consistency criteria with the government's strategic objectives and economic classification.

2. **A formal project appraisal process:** A regulated set of project preparation steps that involve pre-feasibility and feasibility studies must be completed before a project can be approved for funding and appropriate methods to guide the technical analysis according to the project's scale and scope.

3. **Independent review of the appraisal:** Review by the corresponding authority (MoFPED, in the case of Uganda) to counter optimism bias – overestimating demand and underestimating costs.

4. **Selection and budgeting:** The final decision on project selection and budgeting using a well-managed budget process and linking the appraisal and the choice of public investment projects to the budget cycle, even if the project evaluation cycle is on a different timetable; verification of project eligibility and priority; scrutiny of forwarding costs and funding during budgeting.

5. **Efficient project implementation:** Scrutiny for implementation realism includes organizational arrangements, procurement planning, a timetable; adequate monitoring systems; and systems for managing total project costs.

6. **Ability to make project adjustments:** Flexibility to allow changes in the disbursement profile – including discontinuation of nonperforming projects – to take account of changes in project circumstances.

7. **Provision for sustainable operation of facilities:** Processes to ensure that a new facility is ready for operation and that the intended services can be delivered on a sustainable basis; requires effective handover of management responsibility for operation and maintenance and upkeep of robust and up-to-date capital asset registers.

8. **Basic completion reviews and ex-post evaluation:** A systematic review of all projects upon completion to assess whether a project was delivered as specified, on time, and according to budget, and to introduce a more sophisticated ex-post evaluation to evaluate the project's outputs and outcomes against objectives established in the design.

Source: Rajaram et al. 2014

1. Strategic investment guidance, project development, and preliminary screening

62. The National Development Plan (NDP) is the highest-level strategy document and provides some guidance for the development of public investment projects. NDP3 has a list of indicative investment initiatives, including their future investment cost estimates. Several strategies and investment plans at the subnational and program levels are coordinated and draw from the NDP3. The National Planning Authority operates a geo-spatial system that will in future provide an overarching strategic framework based on a long-term vision of the spatial development of the country. Strategic documents governing the activities in the various programs are, however, quite general and do not provide specific guidance for the development of public investment projects. Furthermore, project proposals are initiated with reference to high-level strategic guidance, but the project codes in the NDP3 are different from those in the IBP, and hence are not linked to the electronic database of submitted, approved, and on-going projects, making it difficult to distinguish the proportion of projects within the PIP reflecting originally set national priorities from those generated within the sector programs.

63. The PIM Manual for project preparation and appraisal stipulates the format and requirements for initiating and developing project proposals. This provides a standard process for managing project preparation and a systematic process for reviewing and appraising the projects before they are included in the budget. However, practice follows various procedures depending on the type of financing – external donor or domestic budget financing – for the different sectors' PPPs, or at different levels of government. The project preparation guidelines are silent on the procedures run by state-owned enterprises and some local governments feel excluded from the PIM process. Similarly, externally funded projects are prepared according to the standard requirements of the financiers, which sometimes flout the processes that have been established. According to MoFPED, this is sometimes driven by the fact that such projects are supply-driven, hence do not have sufficient roots within government to support the processing. MoFPED will need to strengthen the incentives and penalties as well as sensitize all stakeholders on the need to standardize processes to improve efficiency by removing the inherent institutional fragmentation, duplication, and lack of clarity on procedures and regulations.

64. The PIM manual and IBP provide clear guidelines on project profiling, as well as unified requirements for first-level screening of project ideas for strategic relevance. The first-level screening of project ideas is done at the line ministry or local government level and the program working group (previously sector working groups before FY22). Whereas this exercise is limited to screening proposals for public investment projects for relevance with their respective sector policies, they cannot pass the first gate of the IBP, until they have demonstrated the strategic relevance to national priorities. However, not all SOEs and externally funded proposals for public investment projects are subject to systematic screening. Some of the line ministries review financial plans of SOEs that they control on an annual basis, and these plans include a list of projects, but some ministries and financiers tend to be concerned with the overall capital investment envelope rather than the feasibility of individual projects. In cases where they are externally funded, some project proposals are developed through to approval stage before being exposed to any form of screening.

65. Overall, this phase of public investment management has improved strongly, and hence scores highly in comparison to international comparators, yet several gaps need to be closed. Project preparation could be better guided with sector or program specific manuals and methodologies, including new concepts like sustainable development, green economy, circular economy, resilient infrastructure, climate change, environmental aspects, gender issues, and social inclusion (disabilities). In addition, if program policies and plans as well as their costed objectives are emphasized as guides to investment decisions, it will also attract the externally funded projects to derive their demand from them. The financiers also need to understand the benefits of adhering more to the national process to improve efficiency.

2. Formal appraisal process

66. The manual for project preparation and appraisal conforms to many aspects of international good practice but the actual quality of project appraisal falls short of these requirements due to differential application and capacity gaps. In addition to guidance on writing project concept, project profile, pre-feasibility options, and feasibility alternatives, the manual carries an integrated menu of appraisal options. These include financial, economic, distributive, project selection, risk analysis and management, distributive analysis, cost effectiveness analysis, and public-private partnership project appraisals. Combined with the project preparation templates, guidelines and methodologies, the conversion factor software, and the national parameters, these facilitate the project appraisal process.

67. The PIM manual has worked well for infrastructure programs but requires adjustments to improve guidance for projects with a social development objective (e.g., building schools or hospitals), and to incorporate specific methodologies. The PIM manual was designed mainly for infrastructure projects, hence has had to be adjusted to fit social projects. This has particularly been recognized in respect to the requirement for all projects to have a 70:30 capex/opex ratio, which is not applicable for some projects. It has also been noted by users that the PIM manual provides very generic guidance, leaving lots more subjectivity than would be desired in the process of preparing projects. MoFPED would need to spearhead and supervise preparation of program specific methodologies to streamline the process further. These would include program project preparation and appraisal methodologies with templates, case studies, and training. Moreover, for the roads, a further differentiation of the methodologies is required, including for major highways, urban roads, and rural feeder roads.

68. However, not all projects have been subjected to these sophisticated processes. According to information in the public investment program (PIP), while there has been some increase in the number of projects studying the economic and financial viability of their projects before they requested funding, only 37 percent of projects that entered the PIP in FY21 had undertaken the full cost-benefit analysis, with this number reducing to 21 percent in FY22, due to COVID-19-related projects that could have been processed on unusual terms. This is mainly due to limited capacity, both in terms of funding, tools and human skills.[45] The remarkable capacity building effort that has been spearheaded by MoFPED is yet to create a sufficient pool of such skills across line ministries, state-owned enterprises, and subnational governments. Makerere University's Centre of Excellence in PIM is a significant step in the right direction, to create this capacity sustainably.

69. Given the capacity challenges, resource constraints, and related differential application of the requirements, the quality of feasibility studies varies greatly. Many MDAs outsource their pre-feasibility and feasibility studies, for which they may sometimes not be able to supervise the quality of subcontracted studies. The tools are also expensive and have not yet been afforded to all MDAs. Indeed, some MDAs indicated they carry out stakeholder analysis qualitatively, partial sensitivity analysis and qualitative risk analysis in place of standard quantitative methods (e.g., Monte Carlo simulations). Feasibility studies were generally of better quality in the transport and energy infrastructure projects which included detailed cost estimation, demand analysis, and project alternatives, including the option of doing nothing. These projects also conducted an economic analysis and calculated the net present value (NPV) and internal rate of return (IRR). In fact, the roads sector has, since FY09/10, developed a practice of preparing a pipeline of projects that are funded as finances materializes. More capacity enhancement is needed for other sectors.

70. The PIM Manual and guidelines are cognizant of the need for environmental assessment at appraisal stage of the project cycle, but it would need to incorporate several other practices. The PIM manual provides for environmental module as one of the key building blocks during feasibility studies. The PIM manual and its DC guidelines are silent on climate change and social safeguards. There is an opportunity to improve in the integration of environmental and climate change considerations in the PIM system.

71. Government's established appraisal process has sometimes been sidelined by requirements for donor funded projects, resulting in unequal application and/or parallel and duplicated processes. External financiers have own processes and requirements that some MDAs use as the standard. Whilst some donor requirements use very detailed, specific requirements for construction projects, others either have gaps or fall below the bar that has been set by the government. The current practice ensures that these projects are subject to assessment of their feasibility, including both the financial and socioeconomic viability, the intensity differs and could jeopardize the project outcomes. This also causes delays as it creates parallel channels through which projects are processed. As the administrative processes become entrenched and formalized, it is crucial for development partners to respect the country process, as it will drive more efficiency.

45. World Bank 2022b. Forthcoming. Cost-benefit analysis or discounted cash flow analysis is quite sophisticated. Undertaking an integrated project appraisal would require diverse skill sets across the different components of this analysis. First, a financial appraisal of a public investment project requires strong quantitative skills and knowledge of accounting, taxation, financial math, banking, statistics, and solid financial modelling competencies in Excel. Second, the economic appraisal requires further understanding of applied microeconomics, data analysis (database management), statistics, econometrics, etc. And finally, the risk analysis requires the expert use of Monte Carlo simulation software. Those skills are not available across all MDAs in the Government of Uganda.

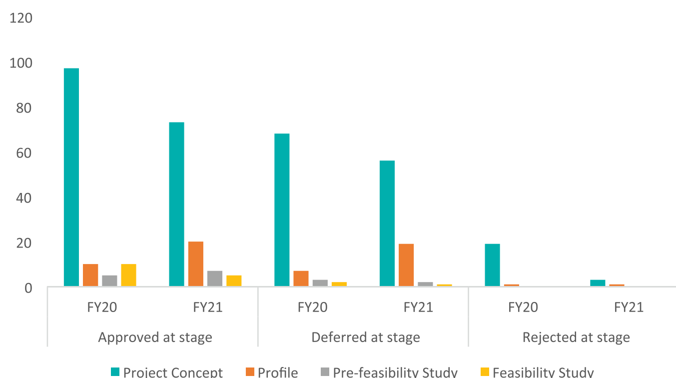
72. A single appraisal process for all projects irrespective of their size, complexity, or risk, has made the PIM process lengthy and cumbersome. So far, the practice of undertaking pre-feasibility and feasibility studies applying integrated project appraisals has been minimal in the Government of Uganda. Adopting thresholds in the project's CAPEX would ease the effort in project appraisal. Thus, small projects would not require a complete cost-benefit analysis and could only fill out an enhanced project concept note providing the project's cost structure. A comprehensive, integrated project appraisal would be mandatory for medium, big and mega-projects and all PPPs. Furthermore, MoFPED would have to develop project-specific project preparation and appraisal methodologies to provide more specific guidance to the MDAs.

73. Overall, the appraisal function has made major strides, but generally capacity and funding challenges are holding back gains to the PIM process. Government must sustain the capacity-building effort and adopt a more sustainable and efficient approach to financing project preparation, including feasibility studies and introducing thresholds for projects that will require feasibility studies, while incorporating stronger avenues for both climate appraisal criteria and social/ environmental criteria in the process.

3. Independent review of appraisal process

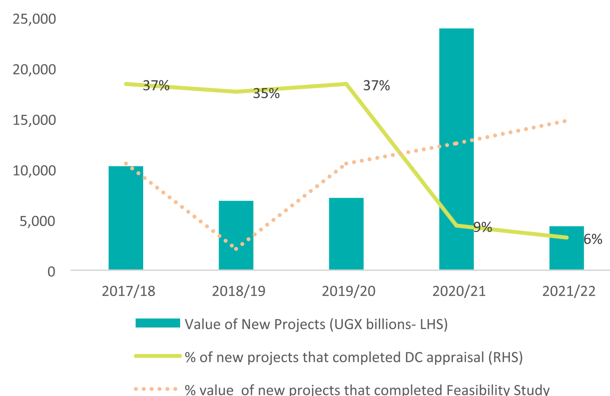
74. The Development Committee (DC) is the independent reviewer and gatekeeper of GoU. This mimics the good practice for projects to be subjected to an independent scrutiny. Through its technical sub-committee, the DC assesses projects for their economic viability, although the extent and depth to which this is done is not clear. The strategic case for projects is undertaken by the main DC as the final "gatekeeper", and hence provides the no-objection for the project to proceed into the PIP for consideration for funding. Projects can be approved, fully rejected, or rejected with comments for revision at the four decision gates. This has provided some form of handholding, mentoring, and capacity enhancement for project teams which are guided by the DC to improve on their project proposals. At the same time, projects are also rejected – out of 222 project proposals that were considered by DC during FY20, 19 were rejected at concept stage, one at profile stage (Figure 35). Nonetheless, even prior to the COVID-19 disruption, only about 37 percent of new projects in the PIP completed the DC process, which indicates that some projects are proceeding even if they have not been cleared by the DC (Figure 36), suggesting that the DC is not properly performing its gatekeeper role. Indeed, the DC process would need to mature and adopt a standard process with an official or formal 'Seal of Quality' provided by the Minister of Finance at the end of this process - including binding limits on what type and what proportion of projects can be allowed to jump the processes or queue. Sometimes projects are allowed to do this because of 'special' considerations, including urgency for loss of funding in the case of externally funded projects or directives.

Figure 35: DC appraisal process in FY20 and FY21



Source: MoFPED

Figure 36: New projects in the public investment program and the DC process



Source: MoFPED

75. Overall, the independent review function is good, but its gatekeeping authority would need to be enhanced to close the gaps. While the composition of experts in the Committee allows to assess the economic case of the projects, the extent and depth to which this occurs in practice is unclear. The projection of the workload and requirements on DC members could overload their capacity. At the same time, while the DC has exercised its authority and rejected some projects, not all projects in PIP have completed the DC process, which is indicative of gaps in the gatekeeping function. This function could strengthen with a formal "Seal of Quality" to clearly separate projects that have been appraised and approved by the DC, alongside clearly stipulated thresholds, and implications for violation of the process.

4. Project selection and budgeting

76. Selection of projects for funding is executed by DC, following the endorsement of quality of the project. This process has been further streamlined after the DC formulated and adopted the criteria for selection of projects for financing starting FY22. The criteria, which include strategic readiness, implementation readiness (e.g., access to right of way, land acquisition, and procurement plans among others), promise to address delays that have still been experienced when projects enter the budget not 'shovel-ready.' Nonetheless, it is not clear whether projects that have not fulfilled these conditions cannot enter the budget.

77. Budgeting for public investment projects is done within the context of a five-year Medium Term Expenditure Framework (MFTEF), but further improvements would be required. The capital and current budget elements are integrated within a medium-term budget horizon. However, the outer year estimates are re-generated on a yearly basis and the MTEF is thus not operating as a rolling framework and plays only a minor role in the setting of the annual budget ceilings for subsequent years. Furthermore, capital expenditures (capex) and operational expenditures (opex) are separated in the MDA budgets, which leads to underbudgeting of operation and maintenance (O&M), especially in the roads sector. Several MDAs also indicate that maintenance of completed assets has been a challenge because the O&M for capital projects is not systematically included in the budget. The multi-year ceilings on ministry or investment program capital expenditure are only indicative, but not binding.

78. There are other practices that make budget financing inefficient, including drip financing and incremental financing. While drip-financing of ongoing legacy projects is very inefficient, as is the use of past allocations to guide budgets for projects. The latter practice introduces a substantial amount of sluggishness into the budgetary process or fiscal rigidity that excludes any evaluation of the fit between current spending patterns and stated policy goals. It also results in programs receiving funding long after their purpose and goals have become obsolete. This is not helped by the cash rationing of the cash flow committee at the vote level rather than the project level, which further encourages the practice of project drip-financing. This practice also leads into underbudgeting operation and maintenance (O&M) expenses. The move into performance-based budgeting, effective FY23, is expected to improve expenditure control, raise efficiency, and enhance performance, given its focus on performance targets, which trigger funds allocation once met. In addition, implementation of the selection criteria for projects into the budget will reduce drip-financing as it requires that projects are only recommended for codes if their multi-year requirements fit in the available MTEF.

79. The on-going effort to review the portfolio of projects to exit projects that either stalled or ran their course will rationalize the portfolio and greatly improve budgeting. The IBP/PIP provides a complete overview of the portfolio of projects across financing sources. The operation and maintenance module of the IBP, only completed in FY22, will provide information on many characteristics, and performance of ongoing projects. This will be instrumental in providing a central location to build a complete inventory of public investment projects, which could be used to assess the performance of the portfolio and the financial obligations to complete projects. It will be important to define and institutionalize the procedures and criteria for the review and exit of projects (as is done for their selection into the budget) to rationalize the portfolio and make room for new projects – including by terminating, curtailing, or speeding up projects.

80. Overall, budgeting for projects remains a major problem, and contributes to the time overruns and failure to maintain investment assets. The new selection criteria must be implemented strictly as it promised to ensure that no new projects should enter into the budget unless the readiness criteria are met, and the existing ongoing projects have been budgeted for in full over the MTEF. Sufficient budgeting for O&M requires keeping track of your stock of physical assets, linking them to cost centres/programs in the budget, and ensuring those cost centres/programs have adequate funding for O&M.

5. Project implementation

81. Project implementation continues to be a challenge reflected by the execution rates. The central government's capital budget execution rates averaged 65 percent over the period FY16–FY20, compared to 55 percent over the past five years, which indicates the weaknesses in ability to plan and execute investment projects efficiently. Most projects which started during FY16 and planned to last four years, extended their planned duration by 1–4 years. Externally funded projects particularly face delays in completion, with some having taken twice as much time as originally planned. An assessment of the World Bank funded projects revealed that in some cases there were bottlenecks between approval of the project concept and completion of the feasibility study; in two cases there were time lags between finalization of technical documentation and selection for financing; and while procurement processes show fewer delays than one might expect, the award of the contract took almost 10 months in one case.

82. While implementation of projects is a responsibility of MDAs across government, there is not a single governmental body to guide, supervise and regulate project implementation. No entity establishes standards for project management nor supervises MDAS and LGs to ensure set standards are met. There is neither an entity that promotes compliance with the standards, nor actively engages in the improvement of project management standards. Therefore, there is no standardization in project execution. Civil engineers know PMI® [46] and PMBOK®,[47] but PMBOK standards are not formally used nor demanded by the GoU. Public officials with a PMP certification are very scarce.

83. The requirements for public investment project monitoring and reporting are not centrally defined, which results in a lack of updated information and overview of the full public investment project portfolio. Various bodies within government collect project information for their own needs, but these are not unified as they rely on standalone applications coupled with manual updates using ad hoc reporting formats. The Budget Monitoring and Accountability Unit (BMAU) under its mission of enhancing the implementation and performance of projects, monitors the project budgetary outlays and the physical advance of projects, both in quantity and quality. BMAU has specialists in roads, energy, water, agriculture, human resources, ICT, education, health planners and certified accountants. However, recommendations from these reports are partially implemented. Furthermore, given its staff size and budget, BMAU cannot monitor all public investment projects; therefore, has to be selective, and hence mainly target big and problem projects. Even then, this financial information and indicators on physical progress of investment projects are not accompanied with performance information to enable tracking of whether the projects achieve their stated objectives. Without this overview, government cannot review and revisit on-going projects across the portfolio and to make timely adjustments to the course for projects which are off-track.

84. The policy and regulatory framework for public procurement has been kept up to date alongside a strong institutional arrangement, yet procurement remains a major issue in implementation of projects. A procurement policy approved in 2019, has a supporting law – the Public Procurement and Disposal of Assets Act, last amended in 2021. A department responsible for policy formulation and oversight sits in MoFPED, while Procurement and Disposal of Public Assets Authority provides regulatory oversight on public procurements. Open competition is the default method for public procurement, and the Law on Public Procurement requires project procurements to be based on annual procurement plans. Pilots for a new e-procurement system are ongoing before the final system is rolled out across government. For externally funded projects, procurement procedures are defined by the related agreements and contracts.

85. Nonetheless, procurement challenges abound. For the case of World Bank funded projects, implementation is heavily affected by delays in preparation of bidding documents; delays in environmental and social safeguard studies; contractors' non-performance through not resourcing programs and poor workmanship; delays in payment of service providers constraining cash flow to support construction; implementation agency staff not being familiar with procurement regulations and changes of procurement staff within the project delivery units, which result in loss of knowledge built under previous projects; design changes during implementation stage resulting in time and cost overruns; submission of forged documentation in the bids and misrepresentation of qualification requirements by contractors; bid tampering resulting in other wise unqualified bidders being awarded contracts and subsequent time overruns; and skill gaps in preparation of technical requirements and contract management. [48]

46. PMI® is Project Management Institute Certification. The Project Management Professional (PMP)® Certification from PMI is an acclaimed industry-recognized certification for project managers.,

47. PMBOK® is a guide to project management body of knowledge

48. World Bank 2022, April

86. Overall, this stage of public investments in Uganda remains the biggest weakness in the Uganda's PIM system, and it must be one of the key next challenges to tackle. Capacity must be built across government to support the procurement function to manage not only the process to the point of award of contract, but also contract management and supervisions. The new e-governmental procurement system will need to be harmonized and integrated with the IBP. And government to explore technology to improve project implementation. The Building Information Modelling (BIM) – which is the foundation of digital transformation in the architecture, engineering, and construction (AEC) industry – is one such venture to explore for managing investments in infrastructure programs.

6. Project monitoring and adjustment

87. The existing systems for M&E in GoU focus mainly on monitoring and, to a lesser extent, evaluation and analysis. The Office of the Auditor General (OAG) carries out value-for-money audits and ex-post audits for significant capital projects, and Parliament scrutinizes these. However, project audits are different in scope and emphasis from ex-post evaluations. There is no clear policy and practice of subjecting multi-year projects to review the original business case during project implementation when costs, delays, design changes, or demand changes exceed some specified level. There is no evidence of large projects being significantly re-designed, scaled down, or cancelled.

88. MoFPED has started reviewing existing projects that are no longer relevant in the PIP, as part of the activities on the DC calendar which is shared with all MDAs. The respective stakeholders are also invited to the DC when their projects are being reviewed. Nevertheless, some MDAs indicated that the mechanism that triggers such a review is not clear. With the IBP M&E function fully developed, regular reports on financial and physical progress of public investment projects will provide the basis for actively monitoring the project portfolio from the central level. MoFPED will be able to regularly collect the necessary information to monitor projects. However, the procedure for the reassessment of project implementation is not specified and there is no systematic review by the MoFPED of whether a project has undergone major adjustments and the criteria for allowing a project's continued justification if there are material changes to project costs, schedule, or expected benefits.

89. Actual monitoring and supervision of projects can also be enhanced through technological innovations. For instance, several World Bank funded projects are adopting real-time data collection and analysis through the Geo-Enabling method for Monitoring and Supervision (GEMS). The GEMS method, previously developed for hard-to-reach areas, enables project teams to use open-source ICT tools for in-field collection of structured digital data from the field that automatically feeds into a centralized M&E system and MIS. The integrated data can include any kind of indicators, based on tailor-made forms; photos, audio, videos; time and date stamps; and GPS coordinates that allow for automated geo-mapping of the information. Using these tools systematically allows the project to enhance the transparency and accuracy of project planning as well as M&E and third-party monitoring throughout the project cycle. This digital platform allows for remote supervision, real-time safeguards monitoring, and portfolio mapping for coordination across project components and can be linked to the IBP.

7. Project operation

90. There are no specific requirements to guide completion review and ex-post evaluation of public investment projects. As a result, there are weaknesses in the process of handover of assets and establishing accountability for their ongoing management and use to deliver services. Governmental assets are registered but not necessarily managed. Some assets are handed over to the operating entity but stay idle due to nonexistent legal frameworks, mismatch in complementary investments, and over-optimistic demand forecasts for the project assets. Many capital assets are under-utilized or poorly maintained due to a lack of operations or maintenance funding. There are several cases where assets are not fit for purpose when handed over for service delivery. Clear guidelines, manuals and rules need to be developed to guide the operation phase of the PIM system

8. Basic completion reviews and ex-poste evaluation

91. There are no specific requirements in place to guide completion review and ex-post evaluation of public investment projects. Only a few projects, predominantly externally funded, carry out essential ex-post project reviews. The service delivery unit under the OPM and the Accountant General's Office institutes a board of survey to monitor public assets. Some MDAs also monitor public assets under their responsibility, and other external agencies do surveys on public assets. Ex-post evaluations are done very infrequently in the GoU, even though such analyses could

be instrumental in informing future actions on other projects. Ex-post evaluation can check whether projects delivered the benefits expected from them at the time, as well as inform on which projects did better and which performed worse than expected, and why. Therefore, an ex-post evaluation policy and methodology should be formulated, espousing a gradual adoption, primarily focusing on the more critical projects in the first stage and graduating to more products as the system matures. The idea is to have a conceptual framework demonstrating the impacts of infrastructure projects on society and a typology of effects for investment projects in the infrastructure sectors and the timeframe of the impacts.

3.4 Some options for further improvements in Uganda's PIM system

92. There have been some genuine improvements around the administrative processes of the pre-investment phase of PIM in Uganda, but the challenges in critical areas, including project prioritization and selection, budgeting, and implementation need to be addressed urgently to raise value for money in delivery of projects and support the envisaged fiscal consolidation agenda. On one hand, challenges with project prioritization and alignment to the achievement of program (previously sectoral) objectives, remain. And since the programs poorly define and do not appropriately cost their priorities, they also fail to drive the investments that are financed externally. On the other hand, actual implementation is constrained because the budget allocations do not fully cover the costs of implementing ongoing projects through genuine multi-year commitments, while the budget takes on new projects. This is further exacerbated by budget cuts during budget execution and the fact that projects are often not ready for implementation, as well as weaknesses in procurement and contract management, all of which contributes to poor value for money in the delivery of public investments.

93. The first set of reforms focused on improving quality of projects at entry, and they included critical success factors identified in 2015 that need to be completed. First, government has started working on a PIM policy to formalize the administrative reforms that have already been put in place, and a basis for strengthening the legal framework, including the gatekeeping function. Before it reaches finality of strengthening the legal framework, the reforms that have been undertaken remain administrative actions that could be reverted or ignored without any consequence. Second, although the capacity building effort has commenced, further work will still be required to create the pool of resources needed to manage projects across the entire PIM cycle. For instance, project preparation and appraisal skills need to be entrenched in all programs, MDAs, and different levels of government, and the project managers that are critical players in project implementation need to acquire modern project management skills. The PIM Centre of Excellence in Makerere University will need to be nurtured to maturity to ensure a sustainable and affordable mode of building these capacities. Third, the project preparation fund to ensure that priority projects undergo feasibility and/or pre-appraisal studies while awaiting inclusion to the PIP, has recently been set up in NPA, which is a major step. For sustainability, such a fund will need to put in place a proper implementation and governance structure to sustainably address the funding challenges in project preparation. Lastly, beyond the pre-investment stage, the rest of the PIM cycle (especially project implementation and asset management) must be improved if projects are to yield the expected dividend.

94. Beyond the critical factors of success of back in 2015, there is work to be done across the various stages of the PIM process (see Table 4), the crucial issues to address relate to strengthening the gatekeeping function, budgeting, and implementing projects. First, the gate-keeping function can be strengthened by introducing a legally binding "Seal of Quality" at the end of the appraisal stage to signify readiness of project proposals for financing, and to strengthen the formal authority to the PAP Department to match it with the importance of its function. Second, budgeting for projects must improve. Allocation of resources for projects must use the project life cycle approach and also close the gaps in budgeting for operational and maintenance costs. To promote the culture of project maintenance, each project must have at its appraisal, the ex-ante appraisal forecasts of both the project's capital and operational expenditures. And finally, Uganda must improve the implementation phase by building project implementation capacities (including procurement and contract management skills) while at the same time, strengthening and streamlining the M&E functions of the PIM System.

> The PIM Centre of Excellence in Makerere University will need to be nurtured to maturity to ensure a sustainable and affordable mode of building these capacities.

Table 4: Options for strengthening the cycle of public investment management in Uganda

Investment guidance, project development, and preliminary screening	• Incorporate at planning stage, a system for conducting a pre-appraisal analysis of investment initiates (pre-screening phase) before entering them into the NDP-03. Such a system would also generate a project code that can be traced to the rest of the project system within the IBP. • Establish a capex threshold to support a fast-track process for projects that meet certain characteristics (less challenging projects in terms of demand analysis, technical design and low budget). • Update the project preparation guidelines with elements of the project that have become critical, including gender, circular economy, climate change, and intersectoral projects, that require a joint action taken by multiple government entities. • Develop internal capacities for project preparation, especially at a subnational level if they are to engage in project preparation and screening at the local government levels
Formal project appraisal	• Develop sector-specific project preparation and appraisal methodologies, including updates of the national parameters to incorporate missing elements. • Update the PIM manual with new critical issues including climate change, gender, green growth, resilient infrastructure, and social inclusion. • Provide dedicated and specific resources for project preparation, including setting up the project preparation fund. • Step up efforts for building capacity of MDAs and public officials in financial modelling, economic analysis and risk analysis. The Makerere University CoE should provide the formal process to train and develop public officials' skills in project preparation and appraisal to strengthen the in-house capacity in line ministries and other agencies.
Independent review of the appraisal	• Introduce a legally binding "Seal of Quality" at the end of the appraisal stage to signify readiness of project proposals for financing. • Integrate the Bank of Projects (IBP) to the new e-Government Procurement System (EGP). The procurement system gives codes to project contracts, but the system must ensure that all the contracts belonging to the same project are tracked back to their originating project. • Strengthen the formal authority to the PAP Department to match it with the importance of its function. Organizationally, this could be possible if PAP Department and the PPP Unit are unified under the same umbrella. Alongside this, enhance the functionality of the PAP Department by instituting a PIM Technical Unit to continuously provide strategic thinking for the Unit including developing new technical tools and methodologies, and shadow prices for project appraisal.
Project selection and budgeting	• Improve the process of allocating resources for operational and maintenance costs. Projects should not be separated into capital budgeting independent from their current budgeting. Each project must have its appraisal, and that ex-ante appraisal forecasts both the project's CAPEX and its OPEX. This also promotes the culture of project maintenance. • Institute a system for continuous re-assessment of the GoU project portfolio (PIP pipeline) to ensure they remain up to date and ready for financing. • Establish a mechanism within the budget process of ensuring the DC-approved project proposals can go through the selection criteria to implementation-readiness (including accessing rights of way, undertaking compensations, environmental permits, and preparing work and procurement plans). • Accelerate the development of infrastructure corridors as one option to alleviating the land challenges with infrastructure projects.

Project implementation	• Streamline the M&E functions of the PIM System to address oversight overlap because of different mandates and eliminate duplication in M&E tasks, which fatigues the MDAs. • Improve the coordination of monitoring function. MoFPED, the NPA, OPM, and OP should coordinate to remove to create synergies and the IBP and the O&M System must be compatible and synchronized to ensure harmonization of project codes. • Enforce the PMI®'s PMBoK® Project Management Body of Knowledge standard for project implementation. In this regard, BMAU should adopt concept of Earned Value Management to control and have the complete picture of the projects. • Adopt and enforce standardization for project execution. Engineers are conversant with PMI® and PMBOK®, yet these standards are not formally used nor demanded by the GoU. The pool of public officials with a PMP certification should be increased to support project implementation. And PMP certification should be included in biddings to incentivize contractors with PMP certified personnel and build demand for those professionals. • Introduce and enforce sanctions to public officials' incompetence or outright corruption in project preparation and execution.
Project adjustment	• Establish automatic triggers to underperforming projects. • Re-think the procurement controls and project implementation guidelines to control for changes in the project scope, and consistency with the DC initially approved project parameters
Facility operation and asset management	• Impose an effective process for handover and institutionalization of accountability for effective facility operation. This will clarify mandates and responsibilities for reporting and controlling of expenditure commitments and the timely release of funds, after the project construction is completed to service delivery. • Establish an asset register that espouses the facility management preservation of value to maximize the return from the assets. This can build on the Accountant General Office's efforts, which is so far exclusively for accounting. • Improve budgeting for maintenance and repairs, as part of the management function for the assets, by strengthening multi-year budgeting and to capture project cost through their life cycle.
Project evaluation and impact assessments	• Formulate and adopt an ex-post evaluation policy and methodology, including a conceptual framework on the impacts of infrastructure projects on society. • Impose a formal and straightforward process and responsibilities for ex-post evaluations. • Establish a mandatory requirement for short-term ex-post evaluation and reports. A standard project completion report (close-out) should be done for all investment projects by their respective MDAs

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