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INVESTING IN UGANDA'S YOUTH



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Uganda Economic Update, 16th Edition

INVESTING IN UGANDA'S YOUTH

December 2020





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Foreword

On the back of the devastating global pandemic, Uganda's growth has slowed considerably. Household incomes have fallen as a result of widespread firm closures, job losses within industry and services – particularly in the urban informal sector – and a movement of labor back to farming. This threatens to reverse the gains Uganda has realized from a gradual structural transformation that shifted labor from rural to urban areas and subsistence agriculture to industrial and service activities, and which in the process supported a steady reduction in poverty over the past three decades. More worryingly, the pandemic may further hamper human capital development and the country's chances of benefiting from its demographic transition.

In parallel to creating jobs for the rapidly growing population, a key challenge facing Uganda's development agenda is the delivery of basic education and health services for all. Uganda's population is projected to increase 60 percent in the next twenty years to around 74 million from an estimated 46 million today, and more than double to around 104 million by 2060. Almost three quarters of these people will be of working age and about half will reside in urban centers. For the country to benefit from this demographic transition, Ugandans must have the skills and good health to be productive and contribute to the country's economic transformation.

It is against this backdrop that I am pleased to introduce the sixteenth Uganda Economic Update, which includes the special topic of 'Investing in Uganda's Youth.' In line with the structure of earlier editions of the Uganda Economic Update series, this report reviews recent economic developments, with particular attention on the effects of the ongoing COVID-19 pandemic, provides an outlook for the macro-economy, and then delves into the special topic.

Investments in the youth over the next five years will significantly shape the future path of the country's prosperity, especially in light of the COVID-19 crisis. If public investments in health and education are not shifted to a higher trajectory over the medium-term, the quality and access gaps for these services will continue growing and catching up at a later stage will prove extremely difficult. The post-COVID recovery will, therefore, require that Uganda accelerate quality education and health service delivery quickly to ensure that its young people have access to the critical basic services they need to make the most of their potential, and that short and longer-term productivity is sustained and enhanced.

Uganda is entering a pivotal stage of its development path, but the gains or dividends from demographic transitions are not automatic and will only materialize if certain conditions are met.

Keith Hansen

Country Director

Kenya, Rwanda, Somalia, and Uganda

Africa Region



Abbreviations

ANC	Antenatal Care	MoFPED	Ministry of Finance, Planning and Economic Development
ART	Antiretroviral Therapy	MSME	Micro, Small, and Medium Enterprise
AU	African Union	NCDS	Non-Communicable Diseases
BADEA	Arab Bank for Economic Development in Africa	NAPE	National Assessment of Progress in Education
BaU	Business as Usual	NIR	National Identification Register
Bbl	Barrel	NPA	National Planning Authority
BoU	Bank of Uganda	NUSAF	Northern Uganda Social Action Fund
COVID-19	Corona Virus 2019	OFID	OPEC Fund for International Development
DFS	Digital Financial Services	OPM	Office of the Prime Minister
DRC	Democratic Republic of Congo	OOP	Out of Pocket
DSA	Debt Sustainability Analysis	o/w	of which
DSSI	Debt Service Suspension Initiative	PERC	Partnership for Evidence-Based Response to COVID-19
DTB	Diamond Trust Bank	PIM	Public Investment Management
DTP3	Diphtheria Tetanus Toxoid and Pertussis	PMI	Purchasing Managers Index
EFU	Energy, Fuels and Utilities	PPP	Public Private Partnerships
EIB	European Investment Bank	PPPH	Public Private Partnerships in Health
EMDE	Emerging Markets and Developing Economies	REPOs	Repurchase Agreements
EU	European Union	RBF	Results-Based Financing
ESSP	Education Sector Strategic Plan	RMNCAH	Reproductive, Maternal, Newborn, Child and Adolescent Health
FDI	Foreign Direct Investment	SAGE	Social Assistance Grants for Empowerment
FID	Final Investment Decision	SARS	Severe Acute Respiratory Syndrome
FY	Financial Year	SCG	Senior Citizens Grant
GDP	Gross Domestic Product	SDGs	Sustainable Development Goals
GER	Gross Enrollment Ratio	SME	Small and Medium Enterprises
GGBH	General Government Budget on Health	SSA	Sub-Saharan Africa
GGHE	General Government Expenditure on Health	TB	Tuberculosis
GoU	Government of Uganda	TIMSS	Trends in International Mathematics and Science Study
HC	Health Center	UBOS	Uganda Bureau of Statistics
HGA	Host Government Agreements	UHC	Universal Health Coverage
HIV	Human Immunodeficiency Virus	UHFPS	Uganda High Frequency Phone Survey
IC	Information and Communications	UNCDF	United Nations Capital Development Fund
IEA	International Energy Agency	UNICEF	United Nations Children's Fund
IFIs	International Financial Institutions	UDB	Uganda Development Bank
IGC	International Growth Center	UNHS	Uganda National Household Survey
IHR	International Health Regulations	UNPS	Uganda National Panel Survey
IITFC	International Islamic Trade Finance Corporation	USAID	United States Agency for International Development
ILO	International Labour Organization	US\$	United States Dollars
IMF	International Monetary Fund	US	United States
ITN	Insecticide Treated Nets	USh	Uganda Shilling
LAYS	Learning Adjusted Years of School	VAT	Value Added Tax
LG	Local Governments	WHO	World Health Organization
LIC DSF	Low-Income Country Debt Sustainability Framework	y/y	Year to Year
MDA	Ministries, Departments and Agencies		
MERS	Middle East Respiratory Syndrome		
MoES	Ministry of Education and Sports		

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KEY MESSAGES



STATE OF THE ECONOMY: SLOW GROWTH IN UNCERTAIN TIMES

Uganda's real GDP grew at 2.9 percent in FY20, less than half the 6.8 percent recorded in FY19, due to the effects of the COVID-19 crisis, and is expected to grow at a similar level in FY21, but **downside risks are high**. Economic activity stalled during the latter part of the fiscal year due to a domestic lockdown that lasted over four months, border closures for everything but essential cargo, and the spillover effects of disruption in global demand and global supply chains due to the COVID-19 pandemic. This resulted in a sharp contraction in public investment and deceleration in private consumption, which hit the industrial and service sectors hard, particularly the informal service sector. On a calendar year basis, real GDP growth is expected to contract by up to 1 percent in 2020, compared to 7.5 percent growth in 2019, and, as a result, real per capita GDP growth is expected to contract by about 4.5 percent. Even if GDP growth rebounds strongly by 2022, the level of per capita GDP is likely to remain well below its pre-COVID trajectory.

As a result of these impacts, the COVID-19 crisis is threatening to reverse some of the gains made on structural transformation and the declining poverty trend of the past decade. This transformation was characterized by a reduction in the workforce employed in on-farm agriculture and a take-off in industrial production, largely in agro-processing. However, following the COVID shock, there have already been widespread firm closures, permanent layoffs

in industry and services, a rapid slowdown of activity particularly in the urban informal sector, and a movement of labor back to farming. At the same time, household incomes have fallen, which is concerning given the high levels of vulnerability to poverty, limited social safety nets, and impacts this might have on human capital development and Uganda's capacity to benefit from its demographic transition.

Despite the reduction in tourism inflows and remittances, the economic slowdown has narrowed the current account deficit, with financing of the external shortfall shifting from FDI to government borrowing. The collapse in consumption and investment due to COVID-19 reduced imports and incomes earned by foreign investors, which narrowed the current account deficit to an estimated 5.9 percent of GDP (US\$2.2 billion) in FY20 from 6.8 percent (US\$2.4 billion) the year before. Meanwhile, higher coffee, maize and gold exports helped offset some of the losses of export revenue caused by the halt in international tourism. Given the 21 percent decline in FDI in FY20, government borrowing replaced FDI in the financing of this external shortfall, which also boosted foreign exchange reserves to over five months of imports in August 2020 and stabilized the Ugandan shilling.

The COVID-related demand shock, together with tax and spending measures to manage the crisis, reduced revenues, increased current spending,

and led to a significant widening of the fiscal deficit. At 7.2 percent of GDP in FY20, this is by far the highest fiscal deficit in the last decade and is a doubling of the average fiscal deficit of 3.6 percent of GDP in this period. This has led to a further deepening of fiscal vulnerabilities. Tax revenues, in GDP terms, are likely to take some time to return to an increasing trajectory, which is worrisome considering that Uganda's levels are already below the Sub-Saharan Africa (SSA) average. Development spending once again undershot targets in FY20, with externally financed investment severely affected by the crisis, resulting in a decline, in real terms, of spending compared to FY19. Depending on the Government of Uganda's (GoU) ability to mobilize external financing, continued heavy reliance on domestic borrowing cannot be ruled out.

Despite the increasing fiscal deficits and expansion of public debt to close to 50 percent of GDP in FY21, Uganda remains at low risk of debt distress, but with heightened vulnerabilities. This is based on the April 2020 joint World Bank-IMF debt sustainability analysis. However, with total debt service (interest and principal due) expected to be above 50 percent of government revenues over the next three years, Uganda faces heightened liquidity vulnerabilities and reduced fiscal space. Moreover, a debt service-to-revenue ratio of this magnitude corresponds to ratios seen in many countries experiencing high risk of debt distress.

The medium-term outlook for Uganda has worsened considerably due to the impact of COVID-19, and risks are tilted heavily to the downside. If the impact of COVID-19 lasts longer globally, or spreads more widely in Uganda, this could deter the recovery in Uganda's exports, adversely impact a rebound in FDI, tourism and remittances, and further depress productivity and hence the domestic economic recovery. Such developments could lead to more severe social

and economic impacts and amplify external and fiscal imbalances. Furthermore, while lower oil prices are beneficial to Uganda's trade balance and real growth outcomes, they also mean increasing risks to investment plans in the Ugandan oil sector, which was expected to start producing and exporting oil by 2024/25. Finally, heightened uncertainty around the 2021 elections, set for January 14, and weather shocks could further exacerbate the aforementioned risks.

To support the most vulnerable and promote a resilient recovery, policy actions in three key areas are needed:

- a) **Preserve and strengthen human capital.** It is imperative to avoid lasting damage to human capital by expanding shock-responsive social protection programs. These programs are an effective means to protect households exposed to increasing shocks, put them in a better position to recover after a shock, and prevent a long-term and often irreversible decline in both physical assets and human capital. Government needs to develop a strategy to ensure children return to school, including proactively re-enrolling children, even those who may have married or became pregnant during the prolonged closure of schools. In addition, larger and smarter investments, complemented by key reforms, are required in the health sector to deal with the direct effects of COVID-19 and ensure continuity of non-pandemic essential services.
- b) **Support and revive small businesses and jobs.** To the extent that it is fiscally feasible, the government could consider extending the relief measures seen by firms as the most effective, including extension of loans, tax payment deferrals, suspension of payments to utilities, and further accelerating repayments of domestic arrears. The cost of capital will remain a burning issue, and



affordable financing will be needed for investing in resilience, recovery and business sustainability beyond the pandemic. Government must also continue to encourage the adoption of digital technologies, support the digital entrepreneurship ecosystem and transition to e-government platforms.

- c) Prudent and transparent fiscal management.** Raising tax revenues is inevitable over the medium term if Uganda wants to avoid significant liquidity pressures. A key first step is to rationalize tax

exemptions as soon as possible and when economic conditions allow. This needs to be accompanied by careful debt management that would rely less on expensive domestic financing and would instead maximize external concessional borrowing. To improve access to concessional financing, particularly from bilateral creditors, government will need to take a more balanced approach with respect to investments in infrastructure and the social sectors.



INVESTING IN UGANDA'S YOUTH

Uganda is entering a pivotal stage of its development path. The population is currently estimated at 46 million and will most likely rise to around 104 million by 2060. Close to 70 percent of the future population will be of working age and about half will reside in urban centers. This presents an enormous opportunity to invest in education and health so that the soon-to-be working age population will have the skills and health necessary to be fully productive and contribute strongly to the country's development. At the same time, this sharp increase in the size of the population will aggravate the country's many ongoing challenges in the delivery of basic education and health services. For Uganda to benefit from the demographic dividend, the country will require not only substantial resources to serve a larger population and achieve significant improvements in quality, but even greater resources if the current low access rates

and quality are to be elevated. If investments in health and education are not shifted to a higher trajectory in the short term, the access and quality gap will keep increasing over time and catching up at a later stage will prove extremely difficult.

Under a 'Business as Usual' (BaU) scenario, which maintains current quality and access levels to public services, the physical inputs and fiscal effort will need to increase considerably to provide services for Uganda's growing population. Currently, only one-third of Ugandan students complete the 7-year primary cycle and gross enrollment rates in secondary schools have stagnated at around 30 percent for decades. To just maintain these current rates for the growing population, the total cost of providing education services (primary and secondary) will increase from US\$480 million in 2019 to an average of US\$833 million during the period 2020-2025.

Similarly, the expenditure needed to provide basic health services to the growing population in line with the current 44 percent coverage rate will rise from US\$703 million in 2020 to US\$914 million by 2030.

Under an 'Achieving the Sustainable Development Goals' (SDG) scenario, where quality and access levels are enhanced, an even greater fiscal effort will be required. For Uganda to reach the goals set by the government (which are aligned to the SDGs), the status quo or BaU scenario is inadequate and will not ensure that Uganda's young population accumulates the human capital required to attain its full productive potential. To meet the Education and Sports Sector Strategic Plan (ESSP) targets for the 2020-2025 period, the education sector budget will need to almost double to US\$979 million per year. At the same time, to get on track to meet the universal health coverage goals by 2030, the required resources need to be increased from US\$1.4 billion in 2020 to US\$1.8 billion by 2030 (a two-fold increase compared to the BaU scenario).

Fully mobilizing such resources under current circumstances is increasingly difficult. Accordingly, education and health budgets will need to be more effectively managed. As elaborated below, this will require an emphasis on enhancing quality through better systems and controls, a greater role for the private sector and increased support from development partners.

EDUCATION

Given the shortages in primary and secondary schools, implementation of a cost-effective and demand-driven school construction strategy along with quality enhancements is paramount.

Expanding at such a large scale and rapid pace requires judicious improvements in quality and more cost-effective and sustainable school infrastructure investments, including better utilization of existing infrastructure, reduction in construction costs where possible, larger schools to achieve economies of scale, and the creation of multi-purpose spaces.

Simultaneously focusing on raising education standards in lagging regions and underserved populations is important to address equity concerns in the distribution of public education services.

The continued upward trend in financing of local governments (LGs) to provide teachers in the least staffed areas needs to be sustained to address equity concerns. However, recruiting teachers alone will not solve Uganda's problem of deficient learning-adjusted years of school (LAYS).¹ Therefore, additional inspectors will need to be recruited to meet a ratio of one inspector to 40 schools. Capitation grants for primary and secondary schools will also have to continue to increase, enabling schools to distribute instructional materials to teachers and maintain facilities. In addition, financial incentives linked to school performance will need to be tested and phased in.

The revision of teacher utilization and deployment policies and practices, especially under the new lower secondary education curriculum, are required to enable school managers to distribute work more efficiently.

¹ The learning adjusted years of schooling (LAYS) is a macro-level concept introduced by the World Bank that combines quantity and quality of schooling into a single easy-to-understand metric of progress. LAYS are calculated by multiplying the expected years of schooling by the ratio of the most recent harmonized test scores to 625, where 625 corresponds to advanced attainment on the Trends in International Mathematics and Science Study (TIMSS) test.



The latter goes hand in hand with strengthening teacher supervision to minimize absenteeism and improve the quality of teaching.

The introduction of strategic and systemic reforms and investments will allow the government to better allocate resources and achieve substantial savings. The biggest efficiency gains will come from improved deployment of teachers, investing in the drivers of learning and putting in place incentives to strengthen learning. In particular, this entails focusing on improving teacher quality and motivation, and increasing the support for school supervision. Shortages in teachers and schools can also be addressed by diversifying low-cost service delivery platforms through investment in remote learning, including distance education and online learning at the secondary level.

Increasing education sector funding is an urgent priority to address chronic underfunding and manage the demographic pressures. Uganda's public education expenditure as a share of total public expenditures has decreased from 15 percent in FY12/13 to 10 percent in FY19/20, which also reflects the extent to which per pupil funding is not keeping up with the demographic pressures. Government needs to gradually increase public spending on education as a share of the national budget to re-align it with the regional average and international norms. Furthermore, given the shrinking fiscal space as a result of COVID-19, better leveraging of non-state resources is even more critical. Introducing a sustainable public-private partnership (PPP) strategy, especially at the secondary level, will help allay the fiscal burden currently placed on the public sector. The development of a policy framework for governing and regulating non-state actors is a necessary first step in developing such a strategy.

HEALTH

Providing Uganda's growing population with basic health services will be essential to guarantee their productive potential and ensure the country benefits from a favorable demographic transition. For this to happen, the national policy of expanding access in line with the SDG goals needs to be supported by robust efforts to: a) increase the level and improve the organization of resources directed to the health sector; and b) improve allocative and technical efficiencies in this sector.

Enhance private sector participation and contributions to leverage additional resources for the health sector. While it might be difficult to reach the Abuja Target of increasing the general government expenditure on health as a proportion of general government expenditure to 15 percent, GoU should explore options to increase the current level of 6.4 percent. Beyond donor contributions, an adequate core public funding of health not only increases coverage, it also enhances the government's stewardship and oversight of interventions in the sector. At the same time, government's formulation of the Public-Private Partnership in Health (PPPH) policy was a bold step for enhancing private sector participation and contributions to the health sector. It would be beneficial, however, to further strengthen the PPPH, especially in areas where government investment is low.

Increasing the efficient deployment and use of resources is critical to generate savings in the health budget and create a more sustainable system. With inefficiencies accounting for the loss of between 20 to 40 percent of healthcare resources in the country (World Health Report, 2010²), enhancing the efficiency of spending in the sector

² This was a fundamental global report and new country-specific studies on efficiency in the health sector still lump the range of waste between 20 to 40 percent.

is paramount. Deepening the implementation of results focused budgeting and purchasing approaches is one way to improve efficiencies. The government's adoption of program-based budgeting will potentially enhance efficiency in resource allocation, as it aligns spending with program objectives. Ideally, this should be coupled with the nation-wide adoption of Results-Based Financing (RBF) as a strategic purchasing mechanism involving both the public and private health facilities. Simultaneously, it is important to regularly monitor the effectiveness of the deployed resources (including human resources, infrastructure, equipment and medicine) and implement corrective measures in real-time. Improving management, maintenance and repair of equipment and enhancing staff time at task are two critical efficiency enhancing areas that also need to be pursued further. Scaling up the digitalization of business processes in health service delivery, management of healthcare resources, training of personnel and procurement can also help to improve efficiency.

Strengthening health promotion and disease prevention through multi-sectoral collaboration. Since over 70 percent of the disease burden in Uganda is preventable and prevention measures are far cheaper than treatment in per capita terms, investing in this area can also produce significant financial savings and health gains.

ENHANCING THE AGENCY OF GIRLS AND WOMEN

This report considers the population projections, and implications of these projections, without any fertility adjustments. When fertility adjustments are considered³ this reduces the fiscal costs of both the BaU and SDG scenarios; quite substantially when trying to achieve the SDG scenario. Key to any fertility adjustment, however, is enhancing the agency of girls and women. Educating girls, empowering women, enhancing access to reproductive health services and employing women are central to harnessing the potential benefits of the demographic transition.



³ For further information, see the full report: World Bank (2020b, October)



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PART 1

STATE OF THE ECONOMY



1 RECENT ECONOMIC DEVELOPMENTS

1.1 COVID-19 has devastated the global economy⁴

1. The global economy is still reeling from the COVID-19 shock, which has led to a steep recession in many countries. The number of COVID-19 cases continues to rise, with varying rates of contagion across different regions. By mid-September 2020, the number of cases worldwide exceeded 30 million. The health crisis, combined with containment measures to slow the spread of the virus, halted economic activity in many regions and is likely to have adverse effects on longer-term productivity. The World Bank forecasts a 5.2 percent contraction in real global growth in 2020, the deepest recession in eight decades, and an unprecedented revision to the World Bank's pre-crisis expectation of 2.5 percent growth (Figure 1). This contraction reflects increased global integration and the degree of disruption of global supply chains, travel, commodity markets and financial markets. Large parts of service sectors are closed, and manufacturers have cut production due to the demand contraction and shortages of intermediate inputs and labor.

2. The COVID-19 virus broke out in emerging markets and developing economies (EMDEs) with a significant lag compared to developed countries, limiting its impact in 2020. Nevertheless, the consequences of the crisis in EMDEs, which seems to be accelerating in some

parts, are likely to be severe and protracted.⁵ The crisis has particularly impacted low-income households, especially in urban areas, endangering the significant progress made in reducing global poverty since the 1990s. According to the UN,⁶ the crisis has pushed an additional 150 million children into “multi-dimensional poverty” – defined as deprivation in at least one or a combination of education, health, housing, nutrition and water or sanitation.



4 This section is based on: World Bank, Global Economic Prospects, June 2020; World Bank, Global Prospect Group, Global Monthly Update, July 2020 & August 2020; and IMF, World Economic Outlook Update, June 2020

5 Advanced economies are projected to shrink by 7 percent in 2020, compared to 2.5 percent for EMDEs. However, amidst abundant uncertainties, these impacts may be even greater for EMDEs if there are larger domestic outbreaks, where there is greater exposure to international spillovers (particularly to global commodity and financial markets, global value chains and international tourism), and where there are larger pre-existing challenges such as informality.

6 UNDP (2020)

Figure 1: Global growth projection, 2019-21 (% y/y)

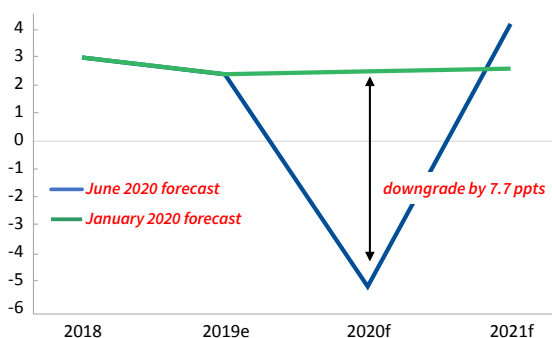
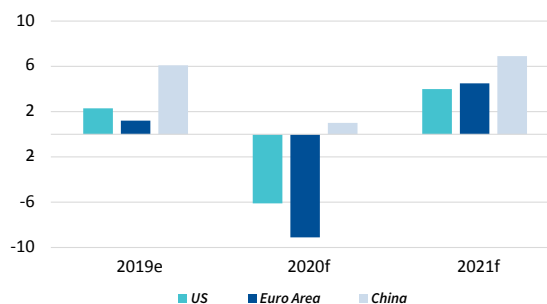


Figure 2: Real GDP growth – US, EU & China (% y/y)



Source: GEP, January and June 2020

3. In the baseline scenario, the global economy is projected to grow by 4.2 percent in 2021, helped by policy support and with economic activity returning to a “new normal”. This scenario assumes that the pandemic fades in the second half of 2020, which is a strong assumption surrounded by significant uncertainties, and that policy measures⁷ and containment efforts⁸ are only gradually unwound. The former is set to help sustain the recovery in global manufacturing and services and facilitate the continued easing of borrowing costs in financial markets observed since April 2020 (Figure 3). With more countries easing trade restrictions that had been imposed at the beginning of the pandemic, the Purchasing Manger’s Index (PMI) for new export orders was close to 50 in August (compared to around 30 in April), global commercial flights have more

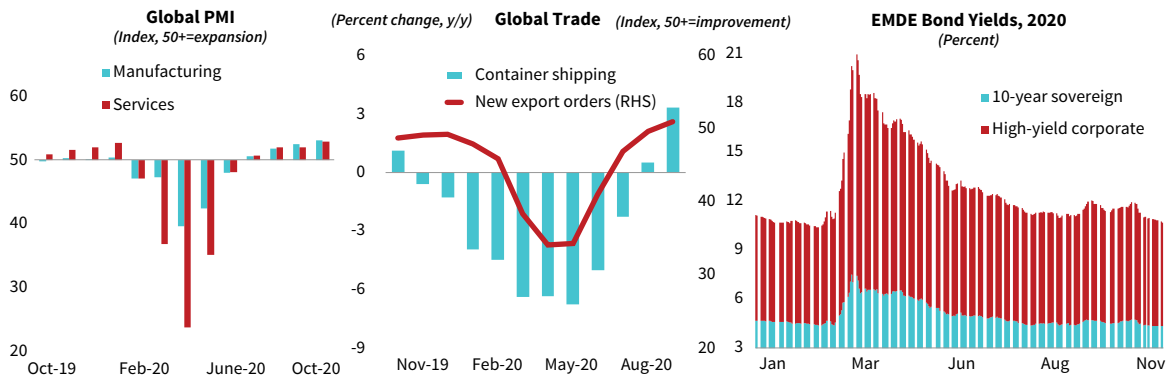
than doubled since April, and the volume of container shipping started increasing in July. Even so, uncertainties surround the extent of supply disruptions, changes in consumption spending patterns, behavioral changes (such as people avoiding service suppliers, public transportation and traveling), and commodity price volatility. Furthermore, even with the improved growth rate in 2021, the level of global output will be at a lower level than before the crisis. This global recovery will also have two distinct features compared to the recovery from the 2009 financial crisis. First, China is not repeating its large infrastructure stimulus of 2009, which means that global activity and commodity prices are not getting the same lift they did in the wake of the global financial crisis. In addition, India is suffering a deep recession, unlike 2009 when its GDP growth was positive.

7 Policy responses to counter deteriorating economic and financing conditions include: (i) monetary policy responses such as liquidity provision; temporary loosening of reserve requirements for banks; policy interest rate cuts; establishment of temporary swap lines with the U.S. Federal Reserve to provide U.S. dollar liquidity (e.g. Brazil and Mexico); foreign exchange market interventions; and asset purchasing programs (e.g. Chile and Colombia); (ii) fiscal stimuli packages (e.g. Chile, Colombia, Costa Rica, Panama, Peru, Uruguay and across the Caribbean), including social assistance measures, support for small businesses, additional health sector spending, extension of tax deferrals, and loans and utility payments.

8 Containment measures have included domestic lockdowns, curfews, and closure of borders and airports, with the aim of minimizing human movement and hence curtailing the spread of the virus.



Figure 3: Global prospects – recovering activity, weak trade and stabilizing financial markets



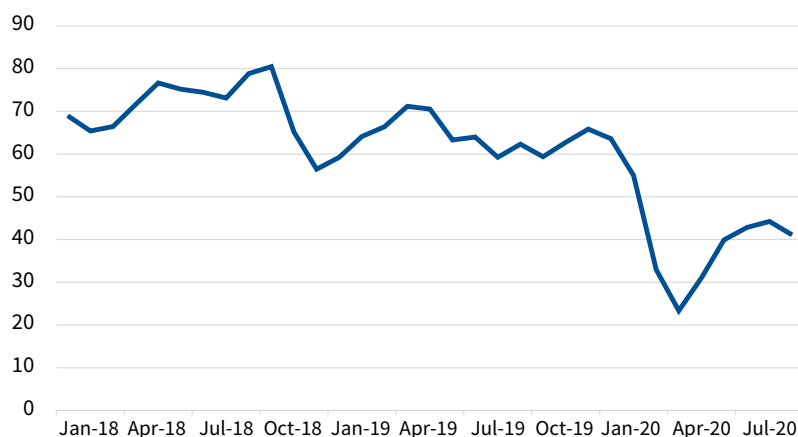
Source: Bloomberg, Haver Analytics, Institute of Shipping Economics and Logistics, World Bank
 Notes: **Left Panel** – manufacturing and services are measured by Purchasing Managers’ Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation is August 2020. **Center Panel** – figure shows 3-month moving averages. New export orders measured by manufacturing PMI. Last observation is July 2020 for container shipping and August 2020 for new export orders. **Right Panel** – 10-year sovereign bond yields are computed summing the J.P. Morgan Emerging Market Bond Index spreads and the U.S. 10-year government bond yields. High-yield corporate bond yields are represented by the effective yields of the ICE BofAML High Yield Emerging Markets Corporate Plus Index.

4. Since June 2020, commodity prices have rebounded somewhat, led by crude oil which has risen from a low of US\$23 per barrel (bbl) in April, 2020 (Figure 4).⁹ Oil prices had been bolstered by expectations that mitigation measures associated with COVID-19, which affect demand for oil, will be less severe than previously anticipated. A second wave of infections and new lockdowns across Europe has changed this. The International Energy Agency (IEA) now expects a fall in demand of 8 million barrels per day in 2020, which is 5 percent less than the year before. It also expects a drop in energy-related investments of 18 percent in 2020. Crude oil prices are thus expected to average US\$41/bbl this year and US\$44/bbl in 2021.¹⁰ Such price levels are still, however, well below the estimated breakeven price of US\$60 for oil production in Uganda and may negatively affect the country’s prospects for becoming an oil producer within the next four to five years.¹¹ In IEA’s downside scenario energy demand will only

return to pre-crisis levels in 2025. There has also been a rebound in global prices for metals and minerals, which has been stimulated by China’s industrial recovery. That said, the rebound is not as pronounced as the one seen in 2009 driven by the Chinese infrastructure stimulus. Gold has continued to do well – benefitting from its safe-haven status – with its price increasing 25 percent during the period January to September 2020. This has been a positive development for Uganda given that refined gold has become the country’s leading export product over the past two years. Meanwhile, the rise in agricultural commodity prices that started in May 2020 has been modest. For example, coffee prices have been volatile and the average price of Robusta coffee in 2020 is still below the average price in 2019. The risks to food price forecasts are large in both directions and depend on the speed at which the pandemic is contained, and mitigation measures are lifted.

9 World Bank Commodity Price Data (October 2020)
 10 World Bank Commodities Price Forecast (October 2020)
 11 Patey (2015)

Figure 4: Crude oil, Brent (US\$/bbl)



Source: World Bank Commodity Price Data (October, 2020)

5. The pandemic could have a longer-term effect on productivity and long-term growth potential. COVID-19 could significantly affect productivity through multiple channels, including lower levels of investment in the medium-term, erosion of human capital as schooling is interrupted and workers are laid off, and a retreat from global trade and supply linkages. Looking at country experiences from past epidemics (SARS, MERS, Ebola, Zika), investment and output per worker remained on average 9 percent and 4 percent lower, respectively, over the three post-epidemic years (Loayza et al, 2020). Certain industries, such as tourism, are likely to be depressed for many years given the collapse in the number of visitors and closure of businesses, and possible changes in tourist behavior going forward. As the crisis pushes global potential GDP down to a lower trajectory, the pace of poverty reduction is also likely to slow, with further implications for human capital development and productivity.

1.2 Sub-Saharan Africa has been pushed into its sharpest recession on record¹²

6. Economies in the SSA region are projected to shrink by an average of 3.3 percent in 2020, before recovering to 2.1 percent in 2021. The pandemic hit the region much later, but has spread to all countries, with identified infections reaching over a million by mid-September 2020. In response, SSA countries imposed varying degrees of lockdowns, including sealing of borders, curfews and other mobility restrictions. Combined with a rapid slowdown in demand by trading partners in the first and second quarters of 2020, falling commodity prices, and reduced tourism receipts and remittances, these measures have severely disrupted the functioning of SSA economies. This has also been aggravated by heightened investor risk-aversion, which has spurred large capital outflows from the region and increased sovereign

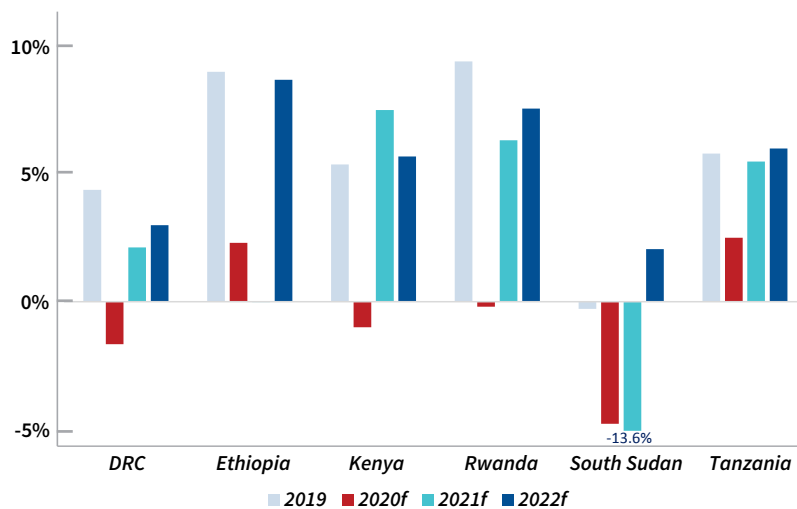
¹² This section draws from Africa's Pulse, World Bank, October 2020.



borrowing costs. Countries that have large tourism sectors, are dependent on commodity exports and/or face fiscal vulnerabilities are expected to be the hardest hit. South Africa and Nigeria, the largest economies in SSA, are projected to shrink by 7.2 and 4.1 percentage points, respectively, compared to last year. Many resource-exporting

economies are expected to contract due to the fall in commodity prices in the middle of 2020. Growth in agricultural commodity exporters, like Uganda, has also stalled – although they have been partially insulated by sharply lower prices of industrial commodity imports.

Figure 5: Real GDP growth in Eastern Africa, including Uganda’s main regional trading partners (percent y/y)



Source: World Bank staff estimates
 Note: e = estimate; f = forecast; Ethiopia and South Sudan are fiscal-year-based numbers

7. Growth will likely start recovering across eastern Africa from 2021 onward as COVID-19 infections are contained, supply chains normalize, and domestic demand picks up. Besides South Sudan, all of Uganda’s other main trading partners in the region (Kenya, Democratic Republic of Congo (DRC) and Rwanda) are expected to experience reasonable growth in 2021 (Figure 5). However, there are significant risks to these projections, as limited access to safe water and sanitation facilities, urban crowding, weak health systems, large informal economies, and insufficient fiscal space will pose challenges to

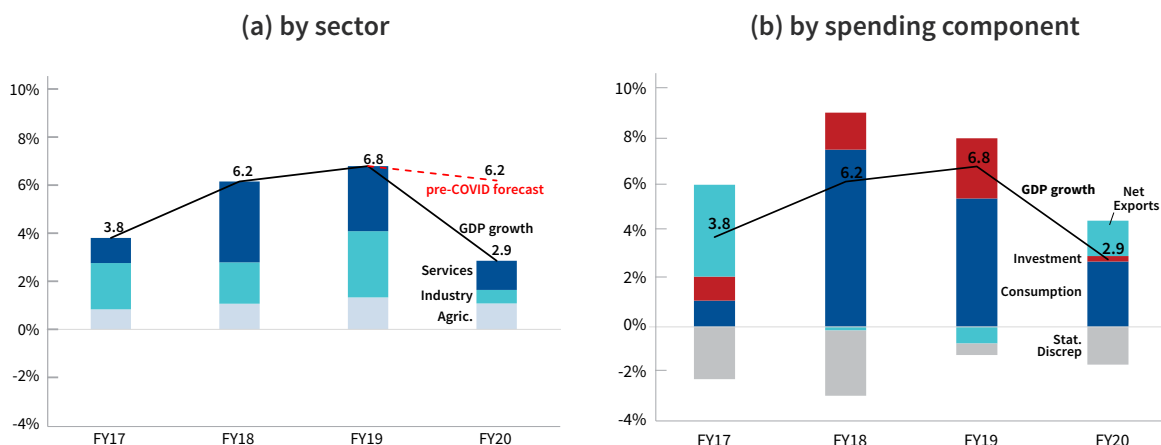
a sustained containment of the virus. Therefore, large-scale community transmission could cause deeper and protracted disruptions to these economies, even as countries start easing restrictions to entry through international airports and borders.

1.3 Uganda's growth stalled in 2020 due to COVID-19¹³

8. Uganda's real GDP grew at 2.9 percent in FY20, less than half the 6.8 percent recorded in FY19, mainly due to the effects of the COVID-19 crisis (Figure 6).¹⁴ Following strong growth of about 8 percent in the first two quarters of FY20, the economy was severely affected by COVID-19 in the following two quarters. Economic activity stalled during the latter part of the fiscal year due to a domestic lockdown that lasted over four months, border closures for everything but essential cargo, and the spillover effects of the disruption in global

demand on Ugandan exports. As a result, real GDP grew by 1 percent during the third quarter ending March 2020 and contracted by 6 percent during the final quarter of the fiscal year (Figure 7). Thus, FY20 growth was well below the pre-COVID projection of 6.2 percent (Figure 6a).¹⁵ The outcome is even worse on a calendar year basis, with real GDP growth expected to contract by up to 1 percent in 2020, compared to 7.5 percent growth in 2019. This is close to Kenya and Rwanda's expected contraction in 2020 of 1 and 0.2 percent, respectively (Figure 5). In per capita terms, real GDP in Uganda will contract for the first time in a decade by about 4.5 percent in 2020.¹⁶

Figure 6: Sources of real GDP growth in Uganda (percent y/y)



Source: UBOS, World Bank staff estimates

Note: The statistical discrepancy is an adjustment factor to ensure any omissions or differences in source information used to measure GDP from the income, production and expenditure sides are accounted for and the final GDP numbers are aligned.

13 By the end of October 2020, Uganda had recorded over 12,000 cases of COVID-19 and 108 deaths, with an increasing number of new cases each day and widespread community transmission.

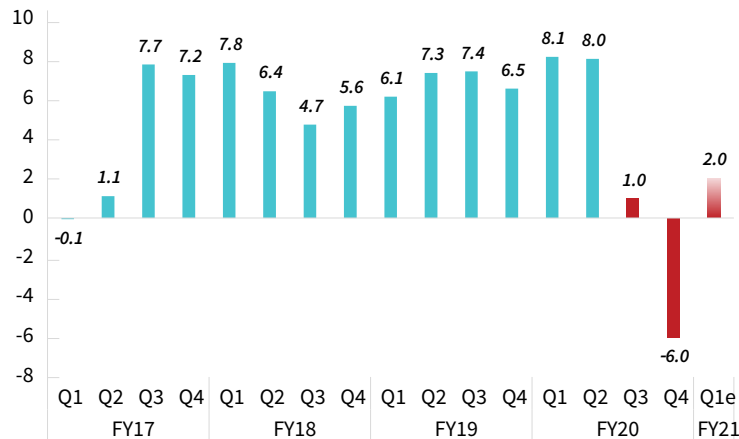
14 Uganda's fiscal year is from 1 July to 30 June of the subsequent year. For FY20, this is from 1 July 2019 to 30 June 2020.

15 World Bank (2020a, January)

16 This assumes a population growth rate of 3.6 percent in 2020.



Figure 7: Quarterly real GDP growth in Uganda (percent y/y)



Source: UBOS and BoU
 Note: Q1 FY21 is an estimate

9. On the demand side, the slowdown in growth was driven by a sharp contraction in public investment and deceleration in private consumption (see Figure 6b). The slow execution of spending on infrastructure projects, including in the nascent oil sector, was further impeded by the pandemic and resulted in a steep fall in public sector fixed capital formation by over 20 percent in FY20 compared to the previous year. Private investment growth, in contrast, remained resilient and grew at 9.6 percent, almost the same rate as the year before. This was supported by reasonable activity in the construction sector, which benefitted from preferential treatment during the lockdown as workers could remain on site in certain instances. However, private investments into transport equipment and other machinery fell by 20 and 7 percent respectively, due mainly to lower foreign financing (especially from companies in Europe and China) caused by the recession in source countries. This contributed to the fall in activity in the mining and manufacturing sectors (as discussed below). Firms also cut staff

and salaries to ease costs as the liquidity squeeze continued.¹⁷

10. COVID-19 containment measures and increased uncertainty slashed growth in private consumption. Mobility restrictions, falling incomes and loss of employment decelerated growth in household consumption from an average of about 7.8 percent over the last two fiscal years to 2.3 percent in FY20. This slowdown occurred mainly in urban areas, where livelihoods were affected by the widespread disruption of retail trade, slowing firm production, and a decimated informal service sector. At the same time, household and business precautionary savings accelerated during the lockdown, as both demand, time and savings deposits rose consistently by more than 17 percent from April to August, in real terms (year-on-year). This uptick may, however, only be temporary and could revert as the impact of the crisis continues and households, in particular, start dipping into savings to augment lost income (see Section 1.4).

17 Socio-Economic Impact of COVID-19 in Uganda, United Nations Uganda, June 2020

Table 1: FY20 Real GDP
(percent change y/y unless otherwise indicated, selected sub-sectors)

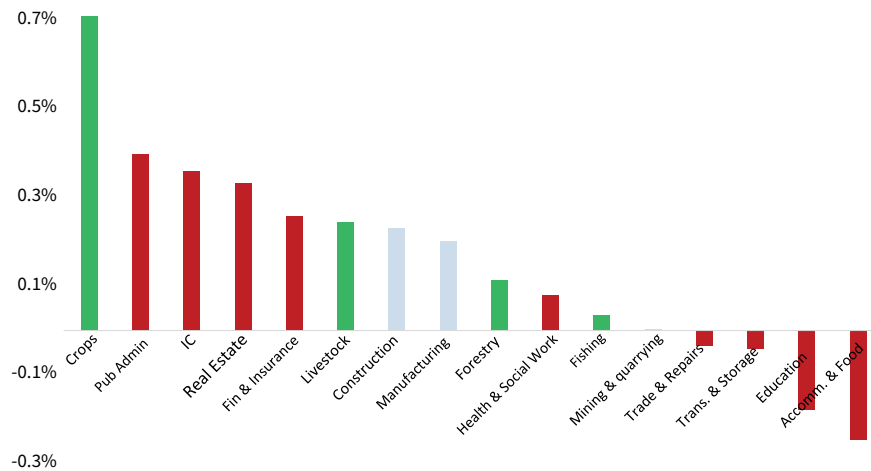
	Growth rate	% share of GDP
GDP	2.9	---
AGRICULTURE, FORESTRY & FISHING	4.8	24.8
Cash crops	7.2	2.6
Food crops	4.5	13.0
Livestock	7.9	3.5
Forestry	3.3	3.7
Fishing	1.9	2.0
INDUSTRY	2.2	28.6
Mining & quarrying	0.2	2.0
Manufacturing	1.3	16.2
Construction	3.8	6.6
SERVICES	2.9	46.6
Trade & Repairs	-0.4	9.3
Transportation & Storage	-1.3	3.4
Accommodation & Food Services	-8.5	2.8
Information & Communication	21.9	2.1
Financial & Insurance	9.8	3.0
Real Estate Activities	5.1	7.1
Public Administration	16.2	3.0
Education	-4.0	4.4
Health & Social Work	2.4	3.5

Source: UBOS





Figure 8: Contribution to FY20 growth of 2.9 percent
(selected sub-sectors)



Source: UBOS

Note: Red depicts the services sub-sectors; green the agriculture sub-sectors; and blue the industry sub-sector

11. On the supply side, COVID-19 related shocks affected particularly the industrial sector, which grew only 2.2 percent, compared to 10 percent in FY19 (Table 1 and Annex 1). Growth in manufacturing decelerated to just 1.3 percent in FY20, from 7.8 percent in FY19, due to: (i) international trade disruptions that reduced shipping and raw material availability, especially from China, (ii) closure of regional borders that slowed exports to neighbors, and (iii) a drop in domestic demand. The preferential treatment to the construction sector during the lockdown benefitted mainly the private sector, as construction of buildings and other structures in the public sector shrunk by over 30 percent. Overall, growth in this sector was reduced by more than two thirds – slowing from over 14 percent to 3.8 percent during the same period. As a result, and as shown in Figure 8, the contribution of both the manufacturing and construction sectors to overall growth declined, which is in sharp contrast

to their driving role in Uganda’s industrialization over the last few years.¹⁸

12. The significant contraction in the services sector was in part offset by the strong rebound in information and communications (IC) services (Table 1 and Annex 1). As firms and households adapted to the use of online solutions to ensure some continuity of business and daily life, the IC sector grew by 22 percent in FY20 compared to the average decline of almost 3 percent over the previous two fiscal years. On the other hand, key service sectors contracted, including trade and repairs, transportation and storage, education and accommodation and food services (Table 1). The wholesale and retail trade sector started feeling the pinch of the pandemic as early as February 2020, when traders were unable to replenish inventories given tighter border controls and supply chain disruptions. This was compounded from March onwards by the country-

¹⁸ World Bank (2020a, January)

wide lockdown, including closure of nonessential retail services and mobility restrictions that only spared essential services like supermarkets and groceries. Having grown by almost 6 percent over the previous two fiscal years, accommodation and food services contracted by 8.5 percent in FY20, as recreation, entertainment and tourism came to a standstill.

13. Robust crop output, particularly for cash crops, and impressive performance in the livestock sector contributed to growth of 4.8 percent in the agriculture sector (Table 1 and Annex 1). This was largely due to farming operations being less hindered by mobility restrictions and also as a result of the GoU's continued emphasis on keeping rural-to-urban supply chains open to meet the food demand in urban areas as imports slowed down. Furthermore, with the locust invasion limited to the north-eastern part of Uganda, the country has been spared the worst of the ongoing locust crisis in other parts of Eastern Africa. The favorable overall performance of the agriculture sector also limited the impacts of the COVID-19 crisis on rural livelihoods and seems to have provided refuge for those who lost jobs in other sectors (see Section 1.4).

1.4 Household income is yet to recover and threats to human capital loom large¹⁹

14. Even before the pandemic, Uganda was characterized by high levels of vulnerability to poverty given limited social safety nets that provide only sparse protection against shocks. In addition to the 21 percent of Ugandan households classified as poor,²⁰ about 44 percent of households were considered vulnerable to falling into poverty in the face of a negative shock – even though they are not living below the poverty line.²¹ These shocks can vary from natural disasters and weather events that negatively impact agricultural incomes, health crises, or political and regional instability. At the same time, the coverage and design of social protection programs in Uganda is insufficient to meaningfully shelter the population from shocks, reduce vulnerability and sustain human capital.²² The ongoing COVID-19 pandemic is a severe economic shock, especially for certain sectors of the economy, and is expected to push more Ugandans into poverty.

15. Employment has recovered since the mobility restrictions were eased, though not back to previous levels in urban areas and with a much higher share working in agriculture. Following the restrictions that were put in place in March 2020, about 17 percent of respondents to the June round of the Uganda High Frequency Phone

19 This section draws from the High-Frequency Phone Survey on COVID-19. In order to track the impacts of the pandemic on households in Uganda, UBOS, with the support from the World Bank, launched the High-Frequency Phone Survey on COVID-19 in June 2020. The survey is to be conducted every month and will try 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. Two rounds of data collection were conducted from 3-20 June 2020 (first round) and 31 July-19 August 2020 (second round).

20 According to the most recent poverty estimates from the UNHS 2016/17, 21 percent of the population were estimated to be below the national poverty line.

21 World Bank (2019, June)

22 The existing direct income support programs in Uganda have low coverage, with the overall reach of the two main programs at only 3 percent of the population (direct income support reaches more than 6 percent of the population in neighboring Kenya), and financing to the sector is limited with spending on the two major programs amounting to only about 0.14 percent of GDP in FY18 (compared to neighboring countries like Kenya and Rwanda who spend 0.4 percent and 0.3 percent of GDP, respectively, on direct income support programs).



Survey (UHFPS) had stopped working and were not receiving any income (Figure 9). Work stoppages were, expectedly, highest in sectors which entail mainly face-to-face interactions such as services, transport and commerce. However, by the August round of the UHFPS, the overall employment rate among respondents had returned to pre-COVID levels, with 87 percent of respondents working. This was strongest in rural areas, where the share of those employed was actually higher than before

March 2020, and among the poorest respondents. At the same time, urban employment levels are yet to fully recover. Notably, by August, the structure of employment had also changed, with a shift in respondents from non-farm economic sectors to agriculture (Figure 10). For example, 16 percent of those who worked in the services sector before March 2020 had moved to agriculture after the lockdown.²³

Figure 9: Share of respondents working (percent)

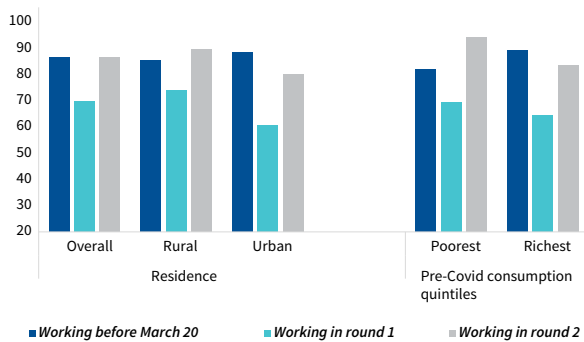
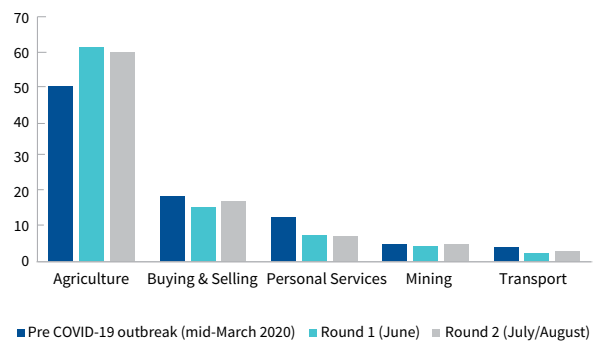


Figure 10: Employment by main economic sectors



Source: UHFPS, Round 1 and 2

16. Household income levels seem to be well below what they were before the pandemic even though employment has recovered. The COVID-19 crisis has negatively affected all income sources, with nonfarm family businesses being particularly badly hit and family farming being the least affected (Figure 11). Subsequent to the COVID-19 outbreak and during the initial lockdown, about 91 percent of households involved in non-farm family businesses suffered income losses (i.e. less or no earnings). At the same time, a contraction in transfers from families within the country was observed among 83 percent of households that

received this type of income in the last 12 months. Although the situation seemed to have improved by August (Figure 11), one must remember that this comparison is being made against the poorer position households were in at June – about three months into the lockdown. For example, 60 percent of households involved in non-farm family businesses were either in the same position or worse off by August than they had been during the initial period of the lockdown. These findings are also corroborated by a host of other work. The International Growth Center (IGC) estimated that about 65 percent of Ugandans had faced

²³ This is only among those who worked both before and after the lockdown measures introduced in March 2020.

significant income losses, equal to about 9.1 percent of GDP.²⁴ In a study undertaken by Bachas et al. that includes Uganda, they predict that less than half of all firms will remain profitable by the end of 2020 and firm exit rates are likely

to double.²⁵ The latest Partnership for Evidence-Based Response to COVID-19 (PERC) data showed that a higher share of respondents in Uganda reported loss of income compared to any other AU Member State surveyed.²⁶

Figure 11: Share of households who had no or less earnings by main income source (percent)

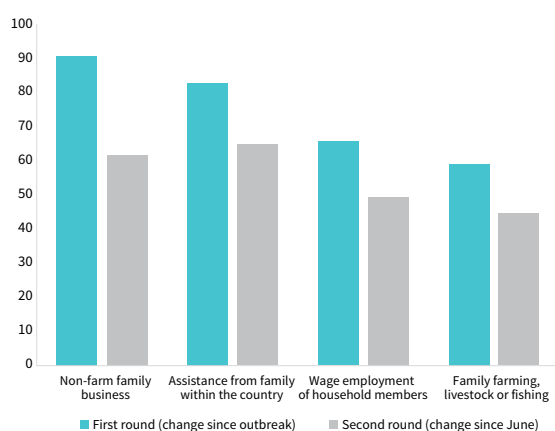
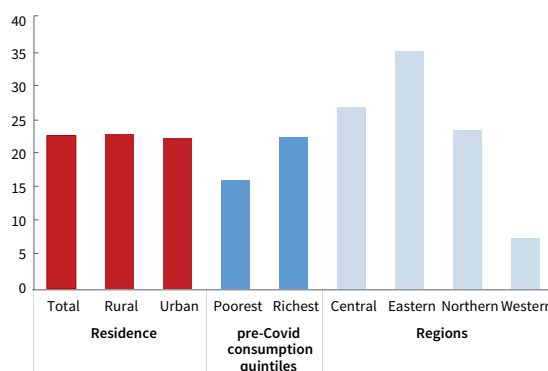


Figure 12: Share of households who borrowed in order to manage during the COVID-19 crisis (percent)



Source: UHFPS, Round 1 and 2

17. Job losses and a reduction in income, coupled with lack of direct cash transfers, forced every fifth household to borrow in order to manage during the COVID-19 crisis (Figure 12). The main reasons for having to borrow were because households could not get assistance from family or neighbors (27 percent), faced reduced sales (25 percent), were unable to sell produce (24 percent) or closed their business (18 percent). The poorest were more likely to borrow because of reduced assistance or an inability to sell produce, while the richest referred more to reduction of sales and business closure. Interestingly, the level of borrowing across rural and urban households was

the same, even though the impact of the shock so far seems to have been higher in urban areas. These numbers are, however, not in line with official figures from the Bank of Uganda (BoU) that show a sharp drop in household borrowing in FY20 (see Section 1.5). This may be because only 12 percent of households borrowed from commercial banks or other credit institutions, whereas almost half of respondents borrowed from friends and relatives.

18. Although agriculture growth figures and initial UHFPS results suggest that the agriculture sector has fared better than other sectors, some

²⁴ IGC (2020)

²⁵ Bachas et al. (2020)

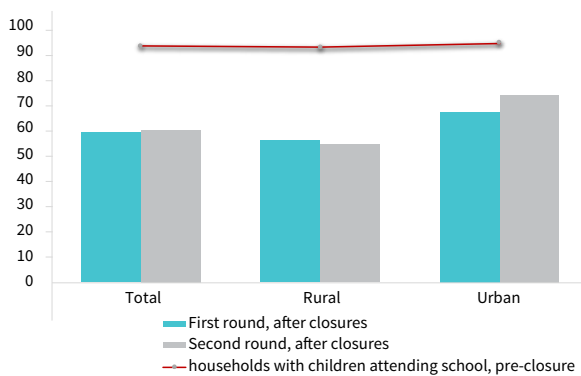
²⁶ PERC is a public-private partnership that supports evidence-based measures to reduce the impact of COVID-19 on African Union Member States. See PERC, August 2020.



of the more vulnerable rural households may be struggling. According to results of the August round of the UHFPS, COVID-19 has had a relatively mild impact on farming decisions and the sale of agricultural products. For example, by August, only 6 percent of households with farms reported that COVID-19 had affected their harvesting decisions, and only 15 percent of farming households who needed to sell agricultural produce in the week before the interview could not do it. On the other hand, recent studies on communities of smallholder farmers in different parts of the country,²⁷ as well as field assessments in the Karamoja region,²⁸ suggest that the COVID-19 crisis is causing serious livelihood impacts; household incomes remain significantly lower than pre-COVID, informal cross-border trade has slowed considerably and a food security crisis is emerging. This is something that will need to be carefully monitored and hopefully additional rounds of the UHFPS will provide updated information.

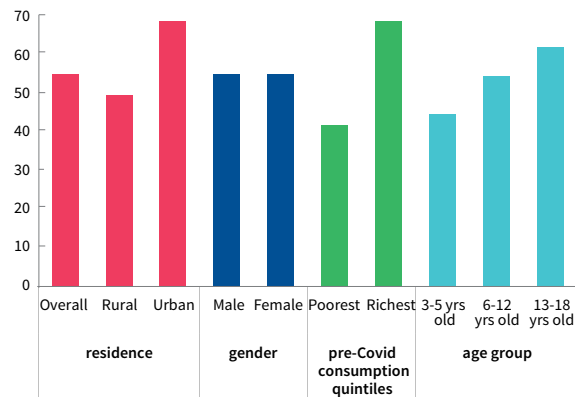
19. COVID-19 is likely to stall the progress Uganda had been making in improving human capital and, therefore, constrain the country's capacity to benefit from its demographic transition. With a rapidly expanding population, now is the time for Uganda to invest in human capital in order to realize the potential gains from its expanding working age population (see Part 2). In this respect, Uganda has recently made progress in several indicators such as increased enrollment in secondary education, and reductions in child malnutrition and maternal and child mortality rates. Although, as shown by the Human Capital Index, children in Uganda still do not reach even half of their human capital potential as adults.²⁹ COVID-19 can potentially worsen this by reducing access to general health services and widening inequality in the access and quality of schooling across urban and rural areas and among the poor and rich.

Figure 13: Share of households with a child (3-18) participating in remote learning (percent)



Source: UHFPS, Round 1 and 2

Figure 14: Share of children (3-18) participating in remote learning (percent)



Source: UHFPS, Round 2

27 Mahmud and Riley (2020) & Heifer International Uganda COVID-19 Impact Study Report

28 USAID (2020)

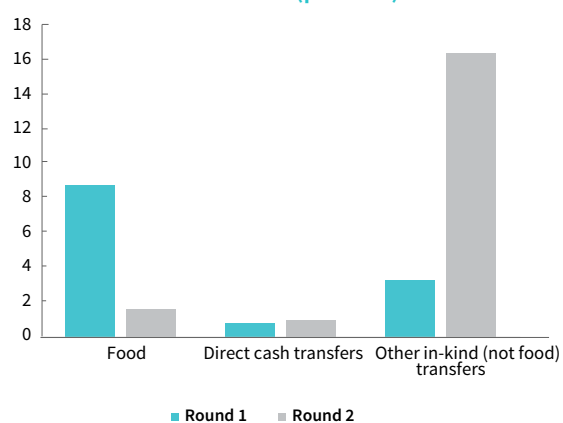
29 World Bank (2020b, September)

20. Access to basic services, including essential health services, has been disrupted during the COVID-19 crisis. In June 2020, 33 percent of households reported that they could not access medication, 18 percent replied that they could not access medical treatment and soap, and 16 percent responded that they were not able to access staple food when needed.³⁰ These results were generally worse for those in rural areas, where access to almost all basic goods and services was lower. However, with limited pre-COVID access indicators, it is difficult to determine the exact impact of the crisis on the lack of access reported in the UHFPS. Nevertheless, the medical findings from the UHFPS are also in line with results from other studies,³¹ which show that a high number (50 percent or higher) of respondents or someone in their household have had difficulties in accessing essential health care services or medicines since the start of the COVID-19 crisis. As a result, the indirect health impact of the COVID-19 crisis could be substantial, with disruptions to suspected malaria cases, general/routine checkups, maternal and child health care, and HIV Treatment (PERC, 2020).

21. School closures have substantially widened inequalities in access to education. Before the COVID-19 closure, the distribution of households with any child (age 3-18) enrolled in educational institutions was relatively equal across place-of-residence (red line in Figure 13) and income groups. After the closure, however, the share of households with at least one child participating in remote learning activities was much lower, and this participation was also unequally distributed across urban and rural areas (Figure 13). In fact, the gap in share of households with at least

one child participating in any education or learning activities between rural and urban areas increased from 11 percentage points in June to 19 percentage points in August. As shown in Figure 14, this gap in participation between the poorest and richest is almost 30 percent. Furthermore, most children faced multiple issues while learning from home, especially those in rural areas. These included lack of skilled instructors and limited access to learning materials from government and their school.

Figure 15: Share of households receiving social assistance (percent)



Source: UHFPS

22. Social assistance for COVID-19 related shocks has been limited to food aid in particular areas and distribution of masks and soap, while direct cash transfers have been insignificant (Figure 15). During the initial period of the lockdown, social assistance was provided mainly in the form of food aid and distributed largely within Kampala.³² This assistance has recently been replaced by other in-kind and non-food transfers (e.g. masks, mosquito

³⁰ Recall period for medical treatment was since the beginning of June 2020, for everything else it was the last seven days

³¹ PERC (2020) & Mahmud and Riley (2020)

³² Food distribution was government's main form of social assistance to the urban poor during the initial COVID-19 lockdown. The first round of this assistance ran from April to June 2020. Follow-up rounds have not yet materialized.



nets and to a less extent soap), particularly in the Northern and Eastern regions. Government is planning to introduce a *Labour Intensive Public Works* program, and has expanded the coverage and rolled out nationally the Social Assistance Grants for Empowerment (SAGE) program to those above 65 years of age. However, given that other traditional coping mechanisms, such as family assistance and remittances, may not be available to the same extent for some time, government may need to consider additional interventions to supplement income that has been lost and try to sustain human capital that is threatened.

1.5 Transport costs have accelerated, and financial sector risks have risen

23. Transport costs accelerated in the post-lockdown period, but were offset by sharper deflation in food crop prices, keeping headline inflation stable at 4.5 percent in October 2020 (year-on-year). After the COVID-related lockdown was lifted in early June, transport prices accelerated by more than 20 percent (Figure 17) from July to September (year-on-year). This likely reflects a hike in transport prices in reaction to the reduced occupancy per vehicle (which was in line with the COVID-19 standard operating procedures), and additional costs from extended transit times and border delays due to COVID-19 testing procedures. Despite the acceleration in transport prices, headline inflation remained stable at 4.5 percent in October 2020. The latter was supported by a further uptick in the deflation of food crop prices to 6.1 percent (year-on-year). Hence, the reduced deflationary pressures seen since September 2019 continued during the lockdown and then accelerated due to a bumper harvest in June 2020. Stable headline inflation was also helped by the deceleration in annual Energy, Fuel and Utilities (EFU) prices to 1.3 percent in October 2020, largely due to a slowdown in charcoal inflation. However,

the lockdown has caused some localized price hikes in urban areas such as Kampala, Jinja and Masaka, thereby eating into the incomes of informal workers and the middle class. That said, the rise in core inflation persists due to both a pre-COVID increase in taxes to encourage import substitution and shortages of non-agricultural imported supplies arising from COVID-19 disruptions to supply chains. These have caused a jump in prices of imported consumer goods. This in turn led to a sharp increase in annual core inflation to 6.3 percent in October from 2.5 percent in March.

24. Despite the sharp rise in core inflation, the central bank loosened monetary policy to counteract the economic shock. With the inflation target set at 5 percent, core inflation was 1.3 percentage points above the target in October and has exceeded the target for the fourth consecutive month. BoU expects above-target core inflation to persist until the elections. However, the economic slowdown, muted demand, income uncertainty and the possibility for an increase in precautionary savings led the central bank to reduce the policy rate further to 7 percent in June, after the 1 percentage point cut in April 2020. From BoU's perspective, this rate cut is also justified due to the negative output gap, with real GDP growth well below potential GDP growth, a situation likely to persist over the next two years given the unfavorable outlook (see Section 2.1). Nonetheless, the decline in collateral quality and the bleak economic outlook are likely to weigh on the effectiveness of the policy rate cut.

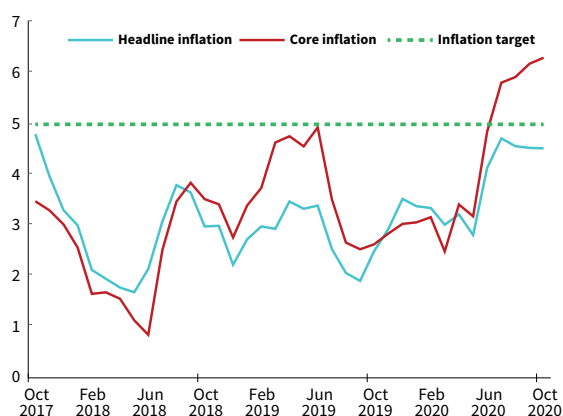
25. Burdened by the economic consequences of the COVID-19 crisis, domestic credit has decelerated sizably since March 2020. Annual domestic credit growth decelerated to about 8 percent in July 2020 (year-on-year), in nominal terms, after reaching a peak in October 2019 of 32 percent (Figure 18). This slowdown was particularly noticeable after March, when lockdown measures

were introduced, and affected mainly credit growth to the private sector. On the other hand, net lending to government remained relatively robust. Following the lowering of the policy rate by two percentage points from April to June, the price of government financing has declined by roughly one percentage point to 8.5 percent for 91-day T-bills and 12.2 percent for one-year T-bonds. Money market rates also fell, reflecting the eased liquidity conditions.

26. Monetary policy actions were coordinated with liquidity support instruments to bolster aggregate demand. Liquidity assistance

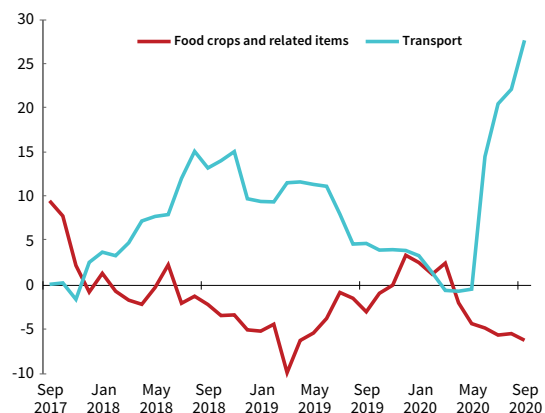
measures undertaken by BoU (see Box 1) also contributed to an easing in conditions, as a total of US\$ 90 billion was accessed by commercial banks through the *Emergency Liquidity* and *Lombard Window* facilities.³³ To align liquidity conditions with the desired monetary policy stance, the central bank also used Repurchase Agreements (REPOs) and reverse REPOs, deposit auctions, and the sale of recapitalization treasury bonds. Additional recapitalization securities worth US\$ 481.7 billion were issued to the BoU in August 2020. This stock of treasury bonds will assist in managing part of the structural liquidity in the system.

Figure 16: Inflation remains below target
(monthly percent change y/y)



Source: Bank of Uganda

Figure 17: Food crop price deflation starting to ease
(monthly percent change y/y)



Source: Bank of Uganda

27. Despite liquidity assistance from the central bank, lending to the private sector has slowed significantly and may severely curtail business recovery. Lending to the private sector decelerated to 6 percent in August (year-on-year), with a marked slowdown since March (Figure 19). Credit growth to households – who hold 17 percent of the total lending to the private sector

– started decelerating in April as the lockdown ensued. By July and August 2020, lending growth to households came to a standstill, recording a growth rate of 0.7 and 1 percent, respectively, in real terms. This is due to a decline in lending for durable goods (such as cars), which has been persisting for a while, and a pronounced slowdown in lending for non-durable goods. Concurrently, as

³³ A Lombard facility grants credit to banks against marketable collateral, usually in the form of certain securities



mentioned in Section 1.3, household and business precautionary savings have further accelerated during the lockdown. This is exacerbating a trend of a higher growth rate in deposits observed since August 2019. Meanwhile, lending to firms has slowed as banks and businesses try to work out the rescheduling of existing loan obligations. Lending to manufacturers actually came to a standstill in February 2020, when the sector started facing challenges with importing input materials; while lending to the trade sector started declining in

June, following the severe contraction of imports in the previous quarter due to the deterioration in private consumption. As discussed in Box 1, the GoU is trying to put in place measures to support lending to a variety of private sector businesses. However, if a recent ruling on syndicated loans is upheld (see Box 2), this could have the opposite effect and put a further constraint on new lending. Furthermore, deteriorating asset quality and hurdles in the legal framework for credit will likely weigh on any measures to support lending.

Box 1: Measures to support the financial sector and sustain private sector credit

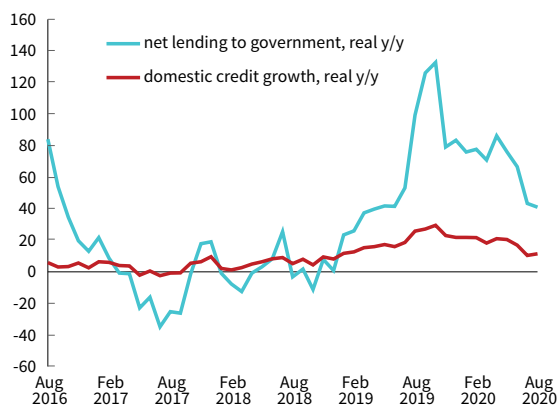
The steep decline in economic activity is a large shock to the financial sector and has prompted BoU to introduce measures to prevent any further destabilization of the sector. In April, the central bank introduced credit relief measures to cushion the economic impact of COVID-19 and to safeguard financial stability. Credit relief measures entailed the following:

- **Reprogramming of financial obligations** until April 2021, for borrowing that had taken place before March 31, 2020. This can include a postponement/reduction of principal and/or interest payments, and an extension of the loan repayment period. All borrowers (including firms and individuals) are eligible for loan restructuring, and approval will be granted on a case-by-case basis, based on an assessment of the economic and financial position of each borrower. The decision to grant any restructuring of credit facilities during the pandemic lies with the respective financial institution. All supervised financial institutions, such as commercial banks, microfinance deposit-taking institutions and credit institutions, have the central bank's permission to reprogram loans.
- **Provision of exceptional liquidity assistance** by BoU to commercial banks that are in liquidity distress for a period of up to one year, and liquidity provision to commercial banks for a longer period through issuance of reverse REPOs of up to 60 days.

In addition to supporting the financial sector, government is also trying to directly enhance credit to the private sector through specific channels for different businesses:

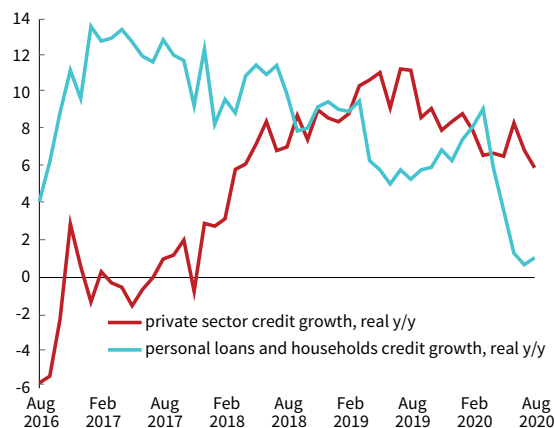
- **Lending to the manufacturing sector** is being supplemented through activities by the Uganda Development Bank (UDB), which was recapitalized by the government and is in the process of receiving lending totaling US\$85.5 million from international lending institutions including BADEA, OFID, EIB, and IITFC for which the GoU is providing guarantees.
- **Establishment of a Small and Medium-Sized Enterprise (SME) recovery fund** to be administered by BoU along similar lines to the Agricultural Credit Facility and targeting small and medium enterprises. The source of funding for this is still to be identified.
- **Providing Emyooga (micro-enterprise focused)** seed money for members of specific Savings and Credit Cooperative Societies (SACCOs) within the informal sector. Funds are to be provided as one-time grant investments to beneficiaries. Parliament has already approved US\$ 50 billion of funding for this.

Figure 18: A slowdown in lending
(percent change y/y, real terms)



Source: Bank of Uganda

Figure 19: Private sector credit growth is slackening, while personal and household credit growth collapsed
(percent change y/y, real terms)



Source: Bank of Uganda

Box 2: A surprising ruling on syndicated loans

A judgement by the Commercial Division of the High Court of Uganda challenging syndicated loans has created uncertainty in the financial sector.³⁴ The Court ruled on October 7, 2020, that Diamond Trust Bank (DTB) Kenya acted illegally by lending funds to a Ugandan firm as part of a syndicated loan together with DTB Uganda. The ruling claims that DTB Kenya was not licensed by BoU – as provided for under the Financial Institutions Act 2004 – to lend funds in Uganda. DTB Uganda has since filed an appeal with the Principal Judge, halting the implementation of the Commercial Court orders directing DTB Uganda and DTB Kenya to refund monies and properties until a final decision is made.

Although BoU has issued a statement indicating that foreign banks can lend to Ugandan entities under supervision of their resident regulators, concerns remain within the domestic financial sector. The ruling comes at a time when businesses need liquidity in their struggle to stay afloat and to bridge the deep recession. Uncertainty regarding syndicated lending is likely to remain until there is an indication as to whether the High Court will revise the decision.

³⁴ Syndicated lending occurs in Uganda when a borrower requires funds that either exceeds the loan capacity or creates too large an exposure for a single bank. Under such circumstances pooling funds and spreading the risk across two or more financial institutions is standard practice.



28. Persistently high interest rates are likely to impede a resilient recovery. Lending rates for local currency loans to the private sector rose from 18 percent in March 2020 to 21 percent in July, with exceptionally high spreads between lending and deposit rates. The weighted average interest rate on deposits in local currency declined during the same period from 4.2 percent in March to 2.4 percent in August. These high spreads have persisted in Uganda for many years now, even during periods of low inflation. At the same time, the financial sector has developed, with several new banks and non-bank financial institutions, which should, in principle, have contributed to increased competition and financial sector efficiency. However, interest rate spreads remain high for several reasons, including high overhead costs (for staff, property, IT and infrastructure etc.), high interest rates on government bonds, and high levels of bank capitalization and profits.³⁵ The central bank and the Ministry of Finance, Planning and Economic Development (MoFPED) recently reformed the government securities market to enhance risk management in the financial sector, increase competition and try to lower borrowing costs. These reforms include, among others, the automation of auction processes to enhance efficiency and price transparency. These measures should help deepen the secondary market, which remains illiquid – trading accounts for only 40 percent of the total outstanding stock of government securities and up to 60 percent of government bonds are held until maturity.³⁶

29. Despite BoU measures, there was a deterioration in the quality of financial sector assets in the latter part of FY20, aggravating Uganda's macro-financial vulnerabilities. Prior to COVID-19, systemic liquidity risk in the banking sector diminished, as liquidity buffers in all institutions improved. Since the onset of COVID-19 however, non-performing loans have risen close to 30 percent in the latter part of FY20, from 4.7 percent at end-December 2019 to 6 percent in June 2020 (Table 2). At the same time, the deteriorating fiscal conditions and rising external risks have increased vulnerabilities. The growing exposure of banks to government debt is also a concern, with potential implications for financial stability. The stock of domestic debt has increased to US\$4.3 billion, the bulk of which is held by commercial banks in the form of short-term Treasury securities. This exposure to sovereign debt contrasts with the deceleration in private sector credit. In addition, commercial banks hold some of the state-owned enterprise debt (estimated at about 7.6 percent of GDP), PPP stock of about 2.3 percent of GDP and other unaccounted for contingent liabilities. That said, BoU's stress tests suggest that in spite of the COVID-19 shock and deterioration of the macro environment, the system's ability to withstand shocks remains firm. This has also been strengthened further by the setting up of a *Standing Lending Facility* by BoU in July 2020, which provides an additional liquidity buffer for the banking system.

³⁵ Jefferis et al. (2020)

³⁶ As a comparison, in South Africa, the most developed security market on the continent, secondary market turnover amounts to 1,200 percent of total outstanding stock of government securities.

Table 2: Financial sector indicators

	2018				2019				2020	
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Capital adequacy										
Regulatory capital to risk-weighted assets	23.8	21.8	21.6	21.6	22.2	22.1	22.1	21.8	21.9	22.7
Regulatory tier 1 capital to risk-weighted assets	21.5	19.7	19.8	19.8	20.4	20.3	20.3	20.1	20.3	21.1
Asset quality										
NPLs to total gross loans	5.3	4.4	4.7	3.4	3.8	3.8	4.4	4.7	5.4	6.0
NPLs to total deposits	3.4	2.8	3.1	2.3	2.5	2.5	2.8	3.0	3.3	3.7
Large exposures to gross loans	36.4	43.2	44.5	42.9	42.6	44.3	45.0	42.8	40.6	42.0
Earnings and profitability										
Return on assets	2.6	2.8	2.8	2.5	2.8	2.7	2.8	2.9	2.8	2.6
Return on equity	15.0	16.7	16.3	14.4	15.9	15.8	16.1	16.8	15.9	15.2
Liquidity										
Liquid assets to total deposits	52.9	46.6	43.9	45.5	44.1	45.5	50.3	48.6	48.8	49.1

Source: Bank of Uganda

1.6 The collapse in domestic demand narrowed sizably the current account deficit

30. The collapse in consumption and investment due to COVID-19 reduced imports and incomes earned by foreign investors, which narrowed the current account deficit to an estimated 5.9 percent of GDP in FY20 from 6.8 percent the year before (Table 3). The trade deficit narrowed slightly to 9.1 percent of GDP in FY20, contrary to expectations. Imports were cut in FY20 by around 3.3 percentage points of GDP compared to FY19, due to COVID-19 containment measures that caused a sharp deceleration in domestic demand, and historically low oil prices. This was matched by a decline in exports to 15.0 percent of GDP (from 18.3 percent). Lower incomes paid to foreign investors and foreign workers, combined with higher transfers received by non-governmental organizations operating in Uganda, improved the primary and secondary incomes balances by 0.8 percentage points of GDP (Table 3).

31. The collapse in domestic demand and historically low oil prices helped reduce imports considerably. Government imports for projects fell by half, given the completion of two dams, accounting for over 40 percent of the decline in total imports in FY20. Despite a 16 percent increase in the volume of oil imports, the value of oil imports alone fell 13 percent (due to the 25 percent drop in oil prices), whereas the value of non-oil imports declined 3.4 percent – including lower imports of machinery and vehicles as the pandemic disrupted investment and business activity. While imports of intermediate and investment goods were heavily affected by COVID-19, the import of consumption goods remained largely unchanged, with possible medium-term consequences for productivity in the manufacturing sector. Meanwhile, imports of other business services, largely technical services for infrastructure developments, jumped (i.e. increased foreign exchange outflows).

32. Higher coffee, maize and gold exports helped offset some of the losses of export revenue caused by the halt in international tourism.



The abrupt halt of international travel in the fourth quarter of FY20 caused net tourism inflows to drop close to US\$350 million below those recorded in FY19, despite record earnings in the first half of FY20, and accounting for close to half of the decline in total export revenues. Meanwhile, coffee exports did particularly well and continued thriving through the pandemic, with a 22 percent increase in exported volumes. The latter occurred despite logistical issues at the Malaba border point due to the lockdown. Large export volumes of coffee more than offset the average decline in prices of around 2 percent in FY20, which comes on the back of a price decline in FY19 equivalent to 9.6 percent. Nevertheless, higher export volumes led to an increase in coffee export earnings by US\$80 million in FY20 compared to FY19, and according to the Uganda Coffee Development Authority, are attributed to both increased coffee production and a drawdown of coffee stocks.

33. The financing of the current account deficit has shifted from non-debt creating FDI inflows to government borrowing (Table 3). While robust during the first half of FY20 (July to December 2019), net FDI inflows were only about US\$400 million in the second half of the fiscal year, a decline of roughly US\$300 million compared to the same period a year ago. This was likely related to the virus outbreak in the main source countries for foreign investments – Europe and China – as well as a downturn in global investor sentiment. As a result, net FDI inflows declined 21 percent in FY20. This slowdown in FDI inflows was offset by government borrowing, largely to finance the budget. Specifically, the government borrowed non-concessionally using a syndicated commercial loan from Stanbic and Trade Development Bank totaling close to US\$0.7 billion in March 2020 and borrowed around US\$0.8 billion from IFIs and bilateral creditors towards the end of the fiscal year.

34. The Debt Service Suspension Initiative (DSSI) provided Uganda with an opportunity to postpone debt service payments of about US\$95 million to bilateral creditors from May to December 2020. In April 2020, the World Bank's Development Committee and the G20 Finance Ministers endorsed the DSSI in response to a call by the World Bank and the IMF for the suspension of debt servicing by poorer countries, in order to free up resources to help manage the impacts of the COVID-19 pandemic. The suspension implies a postponement of debt service payments to a later date, but with no reduction in the value of these payments. Borrowers then commit to use freed-up resources to increase social, health or economic spending in response to the crisis. Beneficiaries also commit to disclose all public sector financial commitments (involving debt and debt-like instruments). While MoFPED made initial requests for the suspension of debt servicing from Paris Club and non-Paris Club creditors, the signing of related Memoranda of Understanding still needs to be finalized.

35. The nominal exchange rate depreciated more than usual during the early part of the COVID-19 crisis (i.e. from mid-February), but had returned to pre-COVID levels by August 2020 (Figure 20). Between February 17 and March 25, 2020, the shilling depreciated 6.1 percent as capital outflows accelerated. In parallel, the US dollar appreciated as capital flows rushed to safe havens. In order to stabilize the market and smooth out excess volatility, the central bank provided an injection of US\$200 million into the market.³⁷ Towards the end of FY20, reserves shot up due to foreign exchange inflows associated with external loans from IFIs and bilateral creditors and reached their highest level since 2017 at 5.4 months of imports (Figure 21).

³⁷ BoU pursues a flexible exchange rate and only intervenes in exceptional circumstances to smooth excessive exchange rate volatility.



Figure 20: Nominal exchange rate (US\$/US\$)

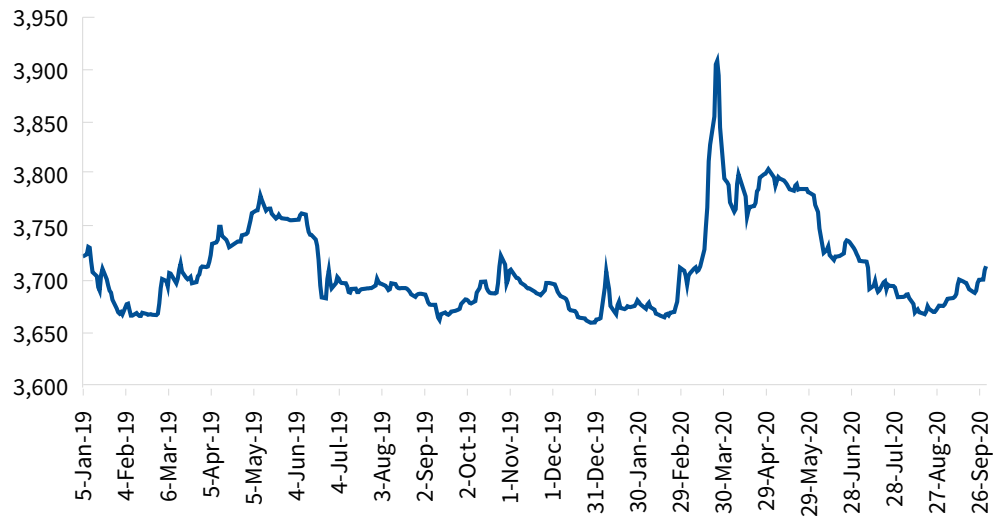
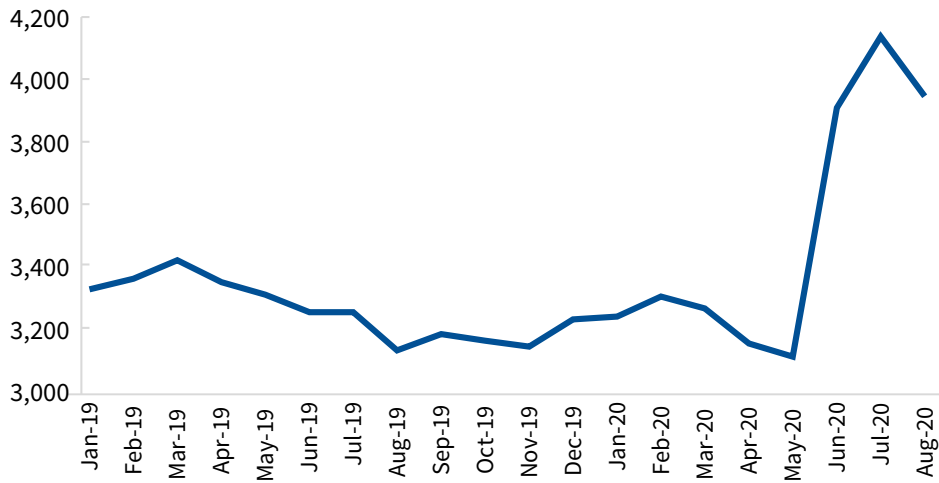


Figure 21: Foreign exchange reserves in US\$ million



Source: Bank of Uganda


Table 3: Balance of payments (percent of GDP)

	FY17/18	FY18/19	FY19/20	FY19/20			
				Q1	Q2	Q3	Q4
Current account balance	-5.3	-6.8	-5.9	-4.9	-3.3	-7.8	-8.0
<i>Trade in goods and services balance</i>	<u>-7.2</u>	<u>-9.2</u>	<u>-9.1</u>	<u>-7.6</u>	<u>-7.6</u>	<u>-10.7</u>	<u>-10.8</u>
Exports	16.9	18.3	14.9	14.8	15.9	17.0	11.7
o/w coffee	1.5	1.2	1.3	1.2	1.1	1.6	1.4
o/w net travel	2.7	3.4	2.3	3.1	3.2	2.6	0.0
Imports	24.1	27.4	24.0	22.4	23.5	27.8	22.6
o/w oil	2.8	2.8	2.3	2.3	2.5	2.7	1.6
<i>Primary income, net</i>	<u>-2.8</u>	<u>-2.6</u>	<u>-1.6</u>	<u>-1.6</u>	<u>-1.4</u>	<u>-1.9</u>	<u>-1.6</u>
o/w public interest payments (debit)	-0.3	-0.3	-0.3	-0.5	-0.2	-0.3	-0.3
<i>Secondary income, net</i>	<u>4.8</u>	<u>5.0</u>	<u>4.8</u>	<u>4.4</u>	<u>5.7</u>	<u>4.8</u>	<u>4.4</u>
o/w personal transfers (credit)	3.8	3.9	3.5	3.4	4.9	3.2	2.2
Capital account balance	0.3	0.3	0.2	0.1	0.3	0.2	0.1
Net borrowing (balance from current and capital a/c)	-4.9	-6.5	-5.7	-4.7	-3.0	-7.6	-7.9
Financial account balance	3.4	6.9	5.6	3.2	2.2	5.6	12.7
Direct investment, net	2.8	3.5	2.6	2.8	2.9	2.4	2.1
Portfolio investment, net	-1.0	-0.5	-0.9	-0.7	-1.2	-0.5	-1.0
Other investment, net	1.6	3.9	3.9	1.1	0.4	3.7	11.5
o/w Government loans, net	3.2	3.3	4.6	1.2	2.0	5.8	10.5
Disbursements	3.9	4.0	5.1	1.6	2.5	6.3	11.1
Repayments	-0.7	-0.7	-0.5	-0.4	-0.5	-0.6	-0.5
Net errors and omissions	1.0	-0.2	1.7	1.3	1.3	2.3	2.2
Overall balance	-0.5	0.2	1.7	-0.3	0.5	0.3	6.9
Financing	0.5	-0.2	-1.7	0.3	-0.5	-0.3	-6.9
Central bank net reserves (- increase)	0.5	-0.2	-1.7	0.3	-0.5	-0.3	-6.9
Memorandum							
GDP, nominal (in mil US\$)	32,912	35,170	37,372	10,242	9,793	8,979	8,358

Source: Bank of Uganda, IMF and World Bank estimates

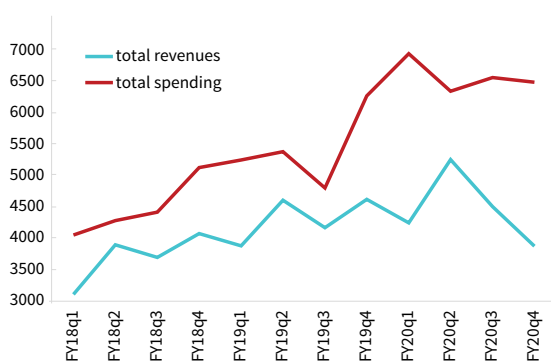
Note: o/w stands for "of which"

1.7 The drop in economic activity and related revenues resulted in a historically high fiscal deficit

36. The COVID-related sharp decline in tax revenues and increase in current spending widened the overall fiscal deficit to 7.2 percent of GDP in FY20 compared to 4.9 percent in FY19. While already below budget in the first half of the fiscal year, when economic growth was still 6.7 percent, revenue performance rapidly deteriorated in the second half of FY20 (Figure 22). The latter

was triggered by both the slowdown in economic activity and the fiscal response to the COVID-19 crisis – largely due to the deferral of tax payments to support private sector liquidity. Meanwhile, total expenditures continued rising in FY20 along the sharp upward trajectory observed in the last quarter of FY19, although the structure shifted from development to current spending (Figure 22 and 23). While development expenditures rose slightly in FY20 (in GDP terms) compared to the year before, current expenditures accelerated as government tried to manage the pandemic.

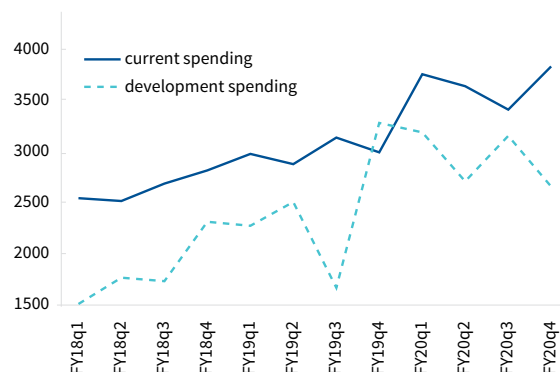
Figure 22: Total revenues and expenditures (US\$ billion, real terms)



Source: MoFPED and World Bank calculations

37. The COVID-19 crisis has further hurt Uganda’s already low level of revenue mobilization. Although below the SSA average, the tax-to-GDP ratio rose continuously from 11.2 percent of GDP in FY16 to 12.3 percent of GDP in FY19 (Table 4). However, in FY20, this ratio reversed to 11.6 percent and is unlikely to return to higher levels in FY21 as the budget is hit by the full-year effect of COVID-19, as opposed to only the final quarter in FY20. Beside the slowdown in economic activity

Figure 23: Current and development expenditures (US\$ billion, real terms)



that negatively affected revenue inflows, the government also introduced tax exemptions and deferrals, with clearly defined sunset clauses, and accelerated the payment of tax refunds in order to support private sector liquidity. Overall, VAT revenues suffered the most, with a drop of 0.3 percent of GDP, and taxes on international trade and excises both declined by 0.2 percent of GDP compared to the year before.


Table 4: Key fiscal indicators, FY16 – FY20 (percent of GDP)

	FY16	FY17	FY18	FY19	FY20	FY20 budget
Total revenue and grants	12.6	12.8	12.7	13.6	13.3	18.5
Revenue	11.5	11.9	12.0	12.7	12.5	17.0
Tax	11.2	11.6	11.7	12.3	11.6	
International trade taxes	1.3	1.3	1.4	1.4	1.2	
Income and profit taxes	3.8	3.9	3.9	4.2	4.2	
Excises	2.3	2.5	2.5	2.7	2.5	
Value-added tax	3.5	3.6	3.7	3.7	3.4	
Nontax	0.3	0.3	0.4	0.4	0.9	
Grants	1.1	0.9	0.6	0.9	0.8	1.6
Expenditure and net lending	16.7	16.1	16.8	18.5	20.4	27.2
Current expenditures	9.2	9.2	9.1	9.4	10.9	12.8
Wages and salaries	3.1	3.1	2.9	3.2	3.5	
Interest payments	1.7	2.2	1.9	1.9	2.1	
domestic	1.5	1.8	1.6	1.5	1.7	
foreign	0.2	0.4	0.3	0.4	0.4	
Other current	4.4	3.9	4.3	4.3	5.3	
Development expenditures	5.9	6.2	6.3	7.6	8.7	14.4
External	2.4	2.3	2.7	3.2	2.9	
Domestic	3.5	3.9	3.6	4.5	5.8	
Net lending and investment	1.5	0.5	1.2	1.1	0.6	
Hydropower projects	0.0	0.0	1.2	1.1	0.5	
Recapitalization BoU	0.0	0.0	0.0	0.0	0.1	
Other spending	0.1	0.2	0.3	0.3	0.3	
Clearance of domestic arrears	0.1	0.2	0.3	0.3	0.3	
Primary balance	-2.4	-1.1	-2.2	-3.0	-5.1	-6.1
Overall Balance	-4.1	-3.3	-4.1	-4.9	-7.2	-8.7
Financing	4.1	3.3	4.1	4.9	7.2	
External financing (net)	2.5	2.4	2.9	2.8	4.5	
o/w disbursements	2.8	2.7	3.6	3.7	5.0	
projects	2.8	2.2	3.5	3.6	2.9	
budget support	0.0	0.5	0.1	0.1	2.2	
o/w repayments	-0.3	-0.3	-0.7	-0.9	-0.6	
Domestic financing (net)	1.9	0.6	1.1	1.9	2.8	
o/w banks	0.9	-0.3	0.2	1.0	1.5	
o/w non-banks	1.0	0.8	0.9	0.9	1.3	
Errors an omissions	-0.3	0.3	0.1	0.2	-0.1	

Source: Ugandan authorities; World Bank staff estimates

38. Although current and development spending rose in FY20, they both remained well below the budgeted levels (Table 4). Current spending jumped 1.5 percentage points in FY20 to 10.9 percent of GDP. This included a 0.3 percent of GDP increase in outlays for wages, as additional temporary staff were hired to enforce the lockdown and equip health facilities, and a significant jump in other pandemic-related spending on security and health; the latter including, for instance, transfers to referral hospitals. Interest payments on domestic debt also grew 0.2 percent of GDP in FY20 compared to the previous fiscal year, given financing shortfalls throughout the year as revenues significantly undershot budgeted amounts. Despite a sharp drop in externally financed development spending in FY20, compared to the previous fiscal year, total development expenditures rose to 8.7 percent of GDP in FY20 from 7.6 percent in FY19. This was driven by a sharp increase in domestically financed spending, with the majority of these funds going to the construction of roads, bridges and other structures, and on-going payments for the recently purchased planes for Uganda Airlines. Net lending, meanwhile, halved to 0.6 percent of GDP; most of which is related to the decline in financing of hydropower production, as Isimba dam is complete and Karuma dam will be finished by the end of 2020. In FY20, the government also recapitalized BoU by 0.1 percent of GDP.³⁸

39. Financing continues to be driven by external borrowing, although recourse to the domestic debt market has intensified in FY19 and FY20 (Table 4). Over the past few years, external project-related disbursements have largely been driving government borrowing. Domestic borrowing started playing a more prominent role again in FY19, when it doubled compared to FY18, and further expanded in FY20 to 2.8

percent of GDP. That said, by the end of FY20, International Financial Institution (IFI) financing and the syndicated loan from Stanbic and Trade Development Bank (totaling US\$670 million) significantly bolstered external financing through budget support. Once budget support from IFIs materialized, the government then made a net repayment of domestic debt in July 2020 of about 1 percent of GDP. One month later, however, the government's net borrowing in the domestic market totaled 1.5 percent of GDP.

40. The pre-COVID FY21 budget has not yet been reprioritized, and it seems adjustments will be made through supplementary schedules. The first supplementary schedule was released in July 2020. As a result, overall expenditures were raised by an estimated 0.3 percent of GDP, with a large share going to State House for classified expenditures. The allocation for domestic arrears was increased by 0.1 percent of GDP and directed to repaying arrears of coffee suppliers, suppliers of tea seedlings and for utility arrears – one of the GoU's COVID-19 support measures was a moratorium on disconnecting electricity and water services. Finally, a substantial transfer was made to UDB to support the manufacturing sector affected by the COVID-19 pandemic (Box 1).

41. Against the background of low tax revenues and elevated levels of both current and capital expenditures, Uganda's public debt has risen sharply to 41 percent of GDP in FY20 from 27 percent in 2015; and is set to exceed 50 percent of GDP within the next two years (Figure 24). Despite the significant rise in the public debt-to-GDP ratio, Uganda remains at low risk of debt distress based on the April 2020 joint World Bank-IMF debt sustainability analysis (DSA). The low risk rating is largely predicated on two broad factors: 1) relatively strong policies and institutions and

³⁸ Using FY20 GDP.



high foreign exchange reserves; and 2) highly concessional loans that dominate the portfolio and Uganda's restraint so far from issuing international bonds, which has led to a smooth repayment profile.³⁹

42. Despite the low risk of external debt distress rating, Uganda faces heightened liquidity vulnerabilities. This is most apparent when looking at the debt service-to-revenue ratio, which in Uganda totaled 40 percent in FY20 – interest payments alone accounted for 15 percent of total revenues. Given large expected gross financing needs in FY21 and FY22 – due in part to continued weak revenues from the economic impact of the pandemic – debt servicing is likely to exceed 50 percent of revenues going forward.

This is very concerning given that Uganda's debt service-to-revenue ratio already surpasses ratios seen in many countries, even those at high risk of debt distress. For instance, none of the countries at high risk of debt distress exceeded a 37 percent debt service-to-revenue ratio in 2019 (Figure 25). In addition to exposing the budget to vulnerabilities, the large interest payment bill of over 2 percent of GDP also consumes fiscal space that the government could instead use to address development priorities. In other words, central government interest payments on domestic debt alone exceeded spending on both education and health (excluding donor projects) in FY20. The size of total interest payments (domestic and external) in FY20 actually came very close to total spending on the road and works programs.

Figure 24: Total public debt (% GDP)

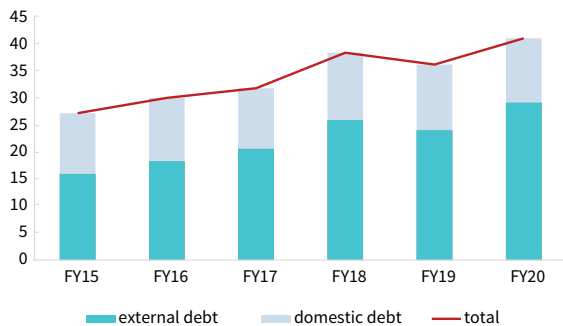
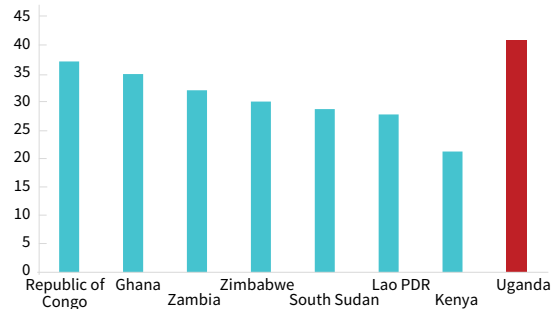


Figure 25: Debt service-to-revenue ratio (% 2019)



Source: BOU, UBOS and World Bank calculations

³⁹ About two-thirds (US\$8.5 billion) of outstanding public debt is owed to external creditors, largely for energy and infrastructure projects, and with a weighted average interest rate of about 2 percent. Domestic debt totaled US\$4.3 billion, with roughly three-fourths in Treasury Bonds with maturities from 2 to 15 years, while the rest is in short-term Treasury Bills.

2. ECONOMIC OUTLOOK AND RISKS

2.1. A slow and uncertain economic recovery is expected

43. The medium-term outlook for Uganda has worsened considerably due to the prolonged impact of COVID-19, the recent rise in infections and election uncertainty. Although the lockdown has been lifted and the international airport is now open, the acceleration in infections could keep the recovery muted in FY21. While the PMI seems to predict a mild recovery in economic activity, FY21 will experience the full-year effect of the shock from the pandemic, compared to only the last quarter in FY20. As a result, under the baseline scenario, instead of a “V” shaped recovery, only a gradual “U” recovery is expected for Uganda (Table 5 and Figure 26). Under this scenario, real GDP growth

in FY21 is projected at about 3.0 percent – a 0.7 percentage point decline compared to the July 2020 Uganda Economic Update projection. This is comparable to the government’s latest growth projection of 3.1 percent for FY21. An expected post-election rebound in growth to about 6.0 percent in FY22 is predicated on an acceleration in private consumption and investments, including FDI, and supported by higher growth in exports as the global economy stabilizes. The latter is assumed to benefit from the rollout of a COVID-19 vaccine in the first half of FY21. Unfortunately, even if the GDP growth rate rebounds strongly in FY22, the level of per capita GDP is likely to remain well below its pre-COVID trajectory (Figure 27).

Table 5: Baseline macroeconomic outlook (annual percent change unless indicated otherwise)

	FY20	FY21f	FY22f
Real GDP growth (baseline)	2.9	3.0	6.0
Private consumption	2.6	1.9	4.6
Government consumption	0.9	15.9	2.1
Gross fixed capital investment ⁴⁰	2.7	3.3	8.9
Exports (goods and services)	-7.5	6.2	14.6
Imports (goods and services)	-7.8	8.3	10.2
Agriculture	4.8	3.8	4.1
Industry	2.2	3.0	6.9
Services	2.9	2.5	6.2
Inflation (consumer price index)	2.9	5.5	4.5
Current account balance (percent of GDP)	-7.5	-7.8	-8.5
Net foreign direct investment (percent of GDP)	2.6	2.4	3.0
Fiscal balance (percent of GDP)	-7.2	-7.8	-5.5
Public debt (percent of GDP)	40.2	46.2	49.9

Source: UBOS, IMF and World Bank staff estimates

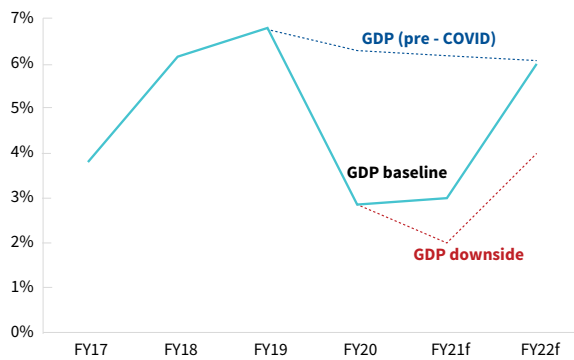
⁴⁰ Includes both public and private investments.



44. Although the services sector is expected to contract further, agriculture growth looks set to remain resilient, whilst there is likely to be an initial recovery in industry. Agriculture is projected to grow at almost 4.0 percent in FY21 supported by favorable weather, government’s commitment to keeping agriculture and rural-to-urban supply chains open and running effectively, robust growth in livestock, and an expected recovery in fish exports. A pick-up in manufacturing and construction output is expected to lift industrial growth in FY21, as access to global supply chains normalize and government continues to encourage domestic production and import substitution. Growth in services

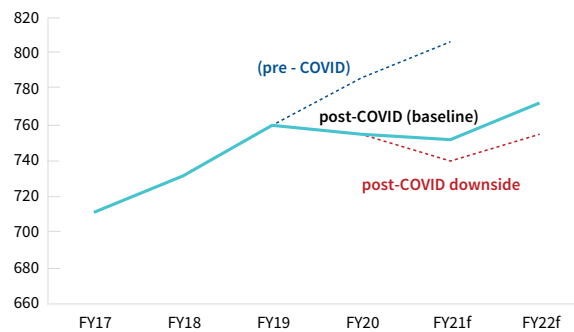
is expected to slow further in FY21 due to an expected contraction in wholesale and retail trade, transportation and storage, and accommodation and food services, all of which are sectors that will take time to recover from mobility restrictions and overall muted domestic demand fed by ongoing uncertainties. The situation is particularly dire for the tourism sector, which may lose more than US\$5 billion in revenues over the next five years.⁴¹ This will translate into significant job losses, with tourism jobs having tripled over the last decade to more than 600,000. Job losses in this sector will also have negative consequences for the resilience of Uganda’s recovery.

Figure 26: Real GDP growth rate (percent)



Source: UBOS and World Bank staff estimates

Figure 27: Real per capita GDP (USD)



Source: World Bank staff estimates

41 United Nations Uganda (2020)

Table 6: COVID-19 health and economic assumptions

Key variables	Baseline scenario	Downside scenario
Health		
Number of cases	Increasing through end-2020	Additional waves into late 2021
Widespread availability of vaccine	By mid-2021	By end-2021
Economic		
Lockdown and mobility restrictions	Fully lifted by end-2020	Ad-hoc restrictions until mid-2021
Support to firms and vulnerable h/holds	Continued in FY21 and FY22	Scaling back prematurely in FY21
Elections	Expected disruptions	More disruptive
Oil price, Brent (average US\$/bbl)	\$45 in FY21 and \$55 in FY22	<\$40 in FY21 and <\$50 in FY22
Key commodity prices (coffee and gold)	Moderate	Weak
Tourism rebound	In late 2021	In late 2022

Source: World Bank staff

45. The decline in growth in FY21 could be larger and the recovery over the medium term slower considering large global and domestic uncertainties. The level of uncertainty associated with COVID-19 exceeds that of any other crisis experienced since at least 1960 (Loayza et al, 2020). Therefore, under the downside scenario growth could decelerate to as low as 2 percent in FY21 and with a more muted recovery to 4 percent in FY22 (Figure 26). This poorer performance could materialize if Uganda experiences a combination of additional waves of infections in 2021, the COVID-19 vaccine is delayed until the end of 2021, ad-hoc mobility restrictions are introduced between now and mid-2021, government prematurely scales back support to vulnerable persons and businesses, election-related economic disruptions are more pronounced than expected, tourists only start traveling to Uganda in larger numbers in the second half of 2022 onwards, and/or average oil prices remain well below the break-even price of production in Uganda of US\$60/bbl and, therefore, postponing

the Final Investment Decision (FID) on domestic oil production.

46. The sharp decline in world oil prices resulting from the COVID-19 crisis could delay oil sector investments in the medium term and oil production and exports beyond 2025. The oil sector FID was expected in 2020, which would have encouraged large private and public sector investments into the oil sector, some of which could be tapped by local suppliers – as per the country's local content policy – and local communities. However, the precipitous fall in oil prices and projection that they will remain well below the estimated breakeven price for Ugandan production over the next few years could postpone investment decisions in the oil sector.⁴² This may further delay the timing of oil production and foreign exchange inflows from oil exports. Past episodes of large oil price reductions due to global recessions also suggest a large degree of persistence in low prices,⁴³ which poses additional uncertainty and hence difficulty for Uganda's oil

⁴² World Bank Commodities Price Forecast (October 2020)

⁴³ Wheler et al. (2020)



production plans. Nevertheless, the private sector still seems to see the oil production outlook in Uganda as positive, given Total's purchase in April 2020 of Tullow's entire interests in Uganda's Lake Albert development project for US\$575 million.⁴⁴ Furthermore, in mid-September 2020, Uganda signed Host Government Agreements (HGAs) with Tanzania and Total for the development of the East Africa Crude Oil Pipeline (EACOP) project. The HGA will regulate the construction and operation of the pipeline from the oilfields in Uganda to Tanzania's coast and is one of the key agreements for reaching the FID. The start of oil production may also be impacted by lending decisions of China's EXIM Bank, which already has significant exposure to Uganda's infrastructure investments. In sum, if the FID is taken in 2021, oil production could still start in 2024/25. That said, Uganda's reserves are of lower quality and will trade at a discount, which will likely reduce future oil export receipts.

47. Inflation is expected to reach 6 percent by early 2021 – exceeding the inflation target of 5 percent – but decelerate thereafter to within the target. Low oil prices should help limit non-food inflationary pressures, whereas food price inflation is assumed to remain muted as any supply interruptions caused by the pandemic ease over the medium term. Against this relatively low inflation outlook, the BoU is expected to maintain the policy rate at around 7 percent over the short to medium term, the lowest policy rate since inflation targeting was instituted. This should provide some support to the economy in alleviating the demand and supply shocks brought about by the pandemic.

48. As supply chains stabilize and the economy recovers, imports are expected to climb, which, together with a rise in oil prices, will lead to a widening current account deficit. After a narrowing of the external shortfall in FY20 to 5.9 percent of GDP, the current account deficit is projected to widen to about 8 percent of GDP in FY21-22, under the baseline. Although merchandise exports are expected to recover as the global economy rebounds in 2021, there is great uncertainty regarding the speed of recovery in remittances and an expectation that tourism revenues will remain flat for some time. The rebound in exports looks set to increase given the positive price outlook for Robusta coffee, maize, cotton and tobacco over the next three to five years.⁴⁵ Remittances, meanwhile, are projected to remain below FY20 outcomes as the recovery is gradual and the impact of COVID-19 affects the entire FY21 fiscal year. Considering the significant uncertainty about travel habits in a post-COVID world, corresponding tourism inflows to Uganda are assumed to only recover gradually and remain well below the net inflow of 2.3 percent of GDP in FY20.

49. The external financing requirement is expected to be largely met by concessional and commercial government borrowing in FY21 as a slow recovery in FDI inflows is expected. Net FDI inflows are set to further decelerate in FY21 in light of the full-year effect on the balance of payments, and with a sluggish recovery thereafter. This will likely create an external financing gap, which in part will be met by excess financing in late FY20 and early FY21 that has led to a surge in foreign exchange reserves to 5.1 months of imports in August 2020 – the highest level over the past three

⁴⁴ Under the terms of the deal, Total will acquire all of Tullow's existing 33.3 percent stake in each of the Lake Albert project licenses EA1, EA1A, EA2 and EA3A, and the proposed East African Crude Oil Pipeline System. In addition, conditional payments will be made to Tullow linked to production and the oil price, which will be triggered when Brent prices are above US\$62/bbl.

⁴⁵ World Bank Commodities Price Forecast (October 2020)

years. The accumulated reserves are expected to be drawn down in FY21, despite disbursements from multilateral creditors.

50. The fiscal deficit will increase in FY21 given elevated current spending to respond to the pandemic and a large shortfall in revenues due to lower levels of economic activity. The initial intention of government to actively reprioritize away from non-priority infrastructure projects has not materialized in FY21 and may only take place in FY22. As a result, government projects the deficit to expand to 8.8 percent of GDP in FY21, followed by a contraction to 5.5 percent in FY22 (Table 7). Currently, however, a large share of the proposed FY21 deficit remains unfunded. Furthermore, it is likely that the rise in current spending will in

part be offset by lower than expected externally financed capital spending, given the historical under execution of capital spending. As a result, a deficit of 8.8 percent of GDP in FY21 is therefore unlikely due to both financing limitations and the ultimately lower capital spending. A more realistic fiscal shortfall of around 7-8 percent of GDP is expected. In FY22, a rebalancing between current and capital spending is likely to happen. As the impact of COVID-19 eases and elections are concluded, current spending is set to decline, while public capital expenditures will increase to meet investment demands of oil-related roads, the Kampala-Hoima corridor, EACOP, and power transmission and distribution networks to special economic zones and rural growth centers.

Table 7: Fiscal outlook (percent of GDP)

	Actual FY19/20	Budget (pre-COVID) FY20/21	Budget (post-COVID) FY20/21
Total revenue and grants	13.3	15.4	13.8
Total revenue	12.5	14.3	12.7
Grants	0.8	1.1	1.1
Expenditure	20.5	24.0	22.6
Current expenditure	10.9	11.9	11.8
Development expenditure	8.7	12.1	10.8
Primary balance	-5.1	-5.9	-6.1
Overall balance	-7.2	-8.6	-8.8

Source: MoFPED

51. With sustained fiscal deficits, total public debt is projected to surpass 50 percent of GDP by FY23-24. This exceeds the government's commitment in recent years to maintain public debt below 50 percent of GDP in nominal terms. However, despite this steep trajectory, in present value terms external public debt is projected to peak at 25 percent of GDP in FY24 because of the

greater weight of concessional loans in the debt portfolio, which suggests a lower burden on the economy. Nevertheless, despite the high share of concessional external debt in the portfolio, the government's sizable domestic borrowing is projected to raise the gross financing need in FY21 to almost 14 percent of GDP, and above 15 percent of GDP by FY24.

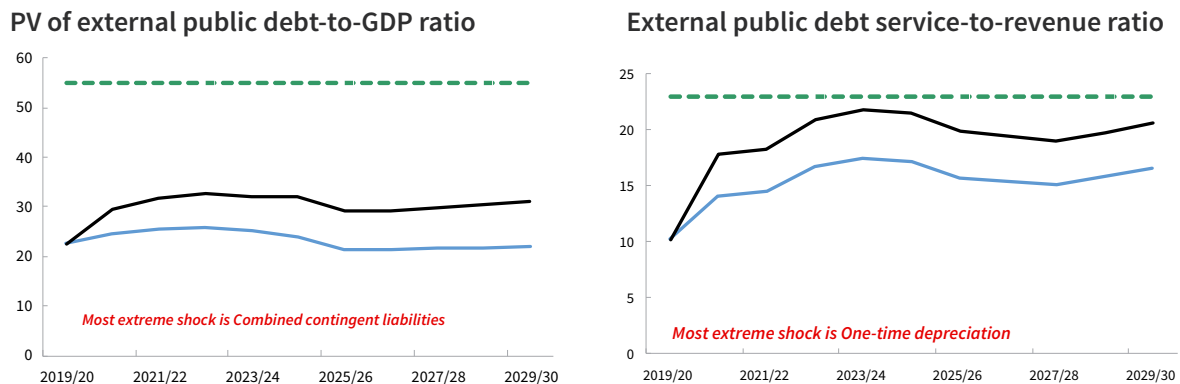


52. The joint World Bank-IMF DSA undertaken in April 2020 concludes that Uganda remains at low risk of external debt distress.⁴⁶ Despite higher debt burden trajectories relative to the May 2019 DSA, all external debt and total public debt burden trajectories in the April 2020 DSA remain below their respective indicative thresholds⁴⁷ under the baseline and stress test scenarios. The updated baseline scenario includes additional non-concessional borrowing and COVID-19 related financing from IFIs. The two most extreme stress tests (lines in black in Figure 28) represent the contingent liability scenario, which reflects a shock of about 17 percent of GDP, and a one-time 30 percent exchange rate depreciation shock.

53. Nevertheless, liquidity pressures on the budget will persist. While the government has not issued international bonds, and therefore does not face external debt principal repayment

spikes, total public debt service (interest and principal due) is expected to average around 60 percent of government revenues over the next four years.⁴⁸ This is due to heavy reliance on domestic borrowing in an environment of high interest rates. As discussed in Section 1.7, Uganda has a total debt service-to-revenue ratio at levels that correspond to countries at high risk of debt distress. This exposes the government to liquidity risks and underscores the importance of raising tax revenues by aggressively reducing tax expenditures some time after the elections in early 2021, and when economic conditions allow, to ensure fiscal sustainability over the medium term. Furthermore, fiscal restraint will be required to reduce debt vulnerabilities and lower the liquidity pressures on the budget, in addition to reforms that help attract external concessional financing from bilateral creditors.

Figure 28: Uganda remains at low risk of external debt distress



Source: IMF/World Bank joint DSA May 2020

Note: the green dotted line represents the indicative threshold; the black line depicts the most extreme shock described at the bottom of the chart, and the blue line is the baseline scenario

⁴⁶ Its debt-carrying capacity is assessed at 'strong' in the revised Low-Income Country Debt Sustainability Framework (LIC DSF).

⁴⁷ The thresholds represent a level of debt burden that if exceeded results in a higher risk assessment.

⁴⁸ The total debt service-to-revenue debt burden indicator does not have an indicative threshold in the DSA. This ratio averages 60 percent because of the large share of domestic debt that has short maturities and very high interest rates (13-14 percent). However, the external debt service-to-revenue ratio remains well below the indicative threshold under the baseline, which reflects the government's prudent borrowing strategy to largely borrow on concessional terms and not tap the international bond market. The latter results in a relatively smooth debt service trajectory, without any maturity concentrations.

2.2. Risks remain tilted heavily to the downside

54. The macroeconomic outlook faces significant downside risks, mostly from COVID-19. If the impacts of COVID-19 last longer globally, or spread more widely in Uganda, they could deter the recovery in Uganda's exports, adversely impact a rebound in FDI, tourism and remittances, and further depress domestic economic recovery. This could lead to a more severe impact on society and the economy, including on health, incomes, livelihoods, and external and fiscal balances. Furthermore, while lower oil prices are beneficial to Uganda's trade balance and real growth outcomes, significantly lower oil prices would also increase risks to investment plans in the Ugandan oil sector.

55. Global factors could increasingly undermine Uganda's economic recovery. As discussed in Loayza et al., the global response to the pandemic is likely to continue being chaotic, with cycles of outbreaks and lockdowns, until a vaccine or effective treatment is made available. For this reason, it is likely that international borders will remain restricted and global economic activity will be volatile. This implies that negative external shocks will continue to arise, which may also affect countries that are able to reduce the public health risk posed by COVID-19. Furthermore, even when a vaccine is available, the challenges of rolling it out globally could further delay the global recovery. This overall adverse external situation is also being aggravated by the worsening trade and technological disputes between China and the United States.

56. Heightened uncertainty around the 2021 elections could undermine investments and the economic recovery, as well as lead to higher fiscal deficits. While factored into the outlook for FY21, political risks could be more pronounced

– for example, there have been instances of civil unrest during recent election periods. If such unrest were to happen again leading into the 2021 elections, this may increase uncertainty and potentially result in a deterioration in longer-term investor sentiment (both domestic and international). This may also slow oil investments and deter a recovery in the tourism sector.

57. Spending pressures and adjustments to government's debt profile could jeopardize Uganda's hard-earned macroeconomic stability. Whereas Uganda's spending boom has been mainly related to investments, additional pressures may arise from excessive spending in the run-up to the 2021 elections and unexpectedly high subsidies to sustain the revived Uganda Airlines. Furthermore, new ad-hoc tax exemptions ahead of the elections and weak implementation of new tax-enhancing measures and reforms may strain the government's ability to raise additional revenue to offset higher expenditures. A significant shift in debt towards more non-concessional borrowing and/or the issuance of a Eurobond would disrupt the smooth repayment profile Uganda currently enjoys and raise debt burden trajectories and further increase debt vulnerabilities.

58. Businesses continue to face critical constraints such as access to finance, skills and electricity, and an uncertain regulatory environment. The cost of finance is already high in Uganda, so very few Ugandan firms have a bank loan or line of credit, and the ones who do face high costs and large collateral requirements. Given the likelihood of a further sharp deterioration in the asset quality of the banking sector, access to finance may become even more limited for firms in the next few years. Despite the heavy infrastructure investments by government, infrastructure services remain a key binding constraint to many firm operations. For example, only 58 percent of the urban population currently

has access to electricity compared to 89 and 84 percent in Rwanda and Kenya respectively.⁴⁹ This has resulted in one of the lowest electricity consumption rates per capita in the world. Such circumstances inhibit productivity and private sector development. Although Uganda has improved across several measures of business environment performance in recent years, significant challenges remain. These include cumbersome processes to obtain an investment license and difficulties with the regulatory environment and contract enforcement. All of these issues will likely frustrate the post-COVID rebound in private sector activity.

59. Uganda continues to be amongst the world's most vulnerable and simultaneously least adapted countries to climate change.

The increasing frequency of climatic shocks (e.g. drought and floods) pose a heavy burden on the economy, export earnings and rural livelihoods. Most Ugandan households lack adaptive capacity to natural disasters and climatic stressors. This is further exacerbated by generally low technology adoption rates and limited access to alternative off-farm income streams. The country also lags its East African peers in water management, storage and irrigation, which is key to building resilience of the agriculture sector.⁵⁰ However, even with these improvements, poorer Ugandans, particularly in rural areas, will still face increasing climatic risks to their livelihoods. Any weather-related shock in FY21 or FY22 would certainly impede the post-COVID recovery.

2.3. Policy actions for a resilient and inclusive recovery

60. The COVID-19 crisis poses significant risks to Uganda's socioeconomic stability that need to be carefully managed. The livelihood of many Ugandans has been severely disrupted, and poverty is set to increase. COVID-19 has also altered Uganda's development options and priorities. The government is going to have to respond with fewer resources due to dwindling revenues and also to ensure fiscal sustainability by limiting public debt vulnerabilities. Policy actions in three key areas are required to manage these risks and promote more inclusive growth:

a) Preserve and strengthen human capital

- To avoid lasting damage to household incomes and human capital, it is imperative to develop and implement shock-responsive social protection programs. These programs can be an effective means to protect households exposed to shocks and put them in a better position to recover after a shock. When deployed quickly after an emergency, like COVID-19, they are also cost-effective as they prevent households from falling into destitution and prevent long-term and often irreversible damages to both physical assets and human capital. Safety net programs such as the Northern Uganda Social Action Fund (NUSAF) and Senior Citizens Grant (SCG) are currently key mechanisms for risk mitigation and responding to shocks. Government's planned short-term labor intensive public works program, financed through the Road Fund, is another such



⁴⁹ World Bank Development Indicators, 2018

⁵⁰ See World Bank (2018). Currently only about 7,000 ha of cultivated land is under formal irrigation, about 1.2 percent of an estimated irrigation potential of 600,000 ha.

mechanism. Nevertheless, the coverage and design of these three programs will be insufficient to meaningfully address the scope of the economic and health shock that has hit Uganda. Social safety nets should, therefore, be expanded or new time-bound mechanisms introduced in response to shocks to provide support to vulnerable households.

- Children's and young adults' education and health must become a policy priority throughout and after the crisis. Human capital loss from school closures needs to be minimized in an environment where digital options are very limited for poorer and rural households. Government needs to develop a strategy to ensure children return to school, including proactively re-enrolling children, even those who may have married or became pregnant during the prolonged closure of schools.⁵¹ In addition to the loan facility that has been made available to teachers in private schools, greater support also needs to be given to private providers of education.⁵² The inability of these providers to reopen would greatly affect the education sector in the long run (see Part 2). Going forward, a greater focus will also be required on learning outcomes to ensure students catch up for the lost school days in 2020. Furthermore, a robust digital agenda for education and improving digital skills needs to be developed. However, before even considering access for the learners, the focus must be on digital skills for teachers, many of whom currently have limited abilities in these areas.

- The COVID-19 pandemic threatens Uganda's progress in key health and related human capital development outcomes, with growing evidence of a declining uptake of essential health services (see Section 1.4).⁵³ Unfortunately, the ability of the health system to concurrently respond to COVID-19 and other health conditions is severely curtailed by resource constraints and limited capabilities at national, sub-national and health facility levels. These service delivery constraints are then compounded by demand side challenges, including the high burden of out-of-pocket payments for healthcare. With the expected increase in poverty, this will further limit access to health services. Therefore, greater and smarter investments are required in the health sector to deal with the direct effects of COVID-19 and ensure continuity of non-pandemic essential services. This needs to be complemented by key reforms including deepening results-based financing in the sector, introducing a prepayment mechanism through operationalization of the national health insurance scheme, and digitalization of healthcare.⁵⁴

b) Support and revive small businesses and jobs



- Relief measures implemented by the government, especially extension of loans, tax payment deferrals and reduction of financing costs were seen by firms as the most effective support measures. The suspension of payments to

51 This could include 'back to school campaigns', advocacy with parents and communities, and requesting district education teams to mobilize children at that level.

52 This is particularly important for secondary education where private schools account for over 50 percent of secondary school going children.

53 Covid-19 has already put a huge burden on a weak health system that is already grappling with a backlog of common infections; maternal, child health and undernutrition complications; increasing prevalence of non-communicable diseases; and frequent public health emergencies, including viral hemorrhagic fevers.

54 See World Bank, (2020, July) for some suggested digital solutions in the health sector.

utilities and stabilizing the exchange rate were also seen as useful. Where fiscally feasible, the government could consider both extending these measures and mitigating the shortfall in sales by accelerating the repayment of domestic arrears and developing a culture of on-time payment of invoices to reduce liquidity constraints in firms.

- Rebuilding a more competitive and resilient economy will also require addressing the structural and policy issues that lead to higher financing costs. Government borrowing, which increases benchmark costs for lending in the market, should be limited through better liquidity management and less borrowing. In addition, policy actions to further reduce lending rates could include encouraging the consolidation of smaller banks, sharing of infrastructure, increasing competition, improving banking supervision and risk management, and encouraging savings.⁵⁵ In the longer term, promoting regional financial integration across the East African Community would also help.
- Government must also continue to encourage the adoption of digital technologies by shifting government services to digital platforms, strengthening the legal and regulatory environment for the use of digital platforms, and boosting the digital entrepreneurship ecosystem. Digital solutions can support delivery of essential services for firms (e.g. utility and tax payments, access to markets via digital platforms and e-commerce, and digital SME finance), consumers (e.g. mobile money, remittances and e-commerce) and the most vulnerable (e.g. expanded and new short-term social safety nets).

c) Prudent and transparent fiscal management



- Raising tax revenues is inevitable over the medium term if Uganda wants to avoid significant liquidity pressures. Improved revenue mobilization could also form part of a strategy to reduce interest rates in the domestic debt market, if it results in reduced domestic borrowing. A key first step is to remove tax exemptions as soon as possible and when economic conditions allow, which would help increase tax revenues and by doing so put the budget back on a sustainable path. Over the medium-term, government needs to fully implement the new Domestic Revenue Mobilization Strategy (2019/20-2023/24) to close gaps in tax policy, improve the productivity of tax instruments, and increase the efficiency of the tax administration.
- Enhanced revenue mobilization can be accompanied by careful debt management that would rely less on expensive domestic financing and would instead maximize external concessional borrowing. Such an approach would also reduce the crowding out of the private sector, with positive spillover effects for economic growth. To be able to improve access to concessional financing, particularly from bilateral creditors, government will need to take a more balanced approach with respect to investments in the infrastructure and social sectors. This may mean a gradual reprioritization of the budget toward spending more on human capital development.
- Spending controls represent an additional tool to place the budget on a sustainable path and encourage broader financing participation by development partners. There have

55 Jefferis et al. (2020)

already been alleged instances of resource mismanagement in the government's response to COVID-19.⁵⁶ This does not bode well for government's credibility in managing the crisis and discourages development partners wanting to support the response. Enhanced public debt transparency and transparency of resources spent on COVID-19 activities would also increase donor confidence and may help bring bilateral creditors back to the table to discuss budget support. Debt transparency has moved to the forefront of the policy agenda

for multilateral, bilateral and private sector creditors, and is an important steppingstone for Uganda to improve donor and investor relations.

- Raising revenues, maximizing concessional financing and better spending controls are also important for creating the fiscal space to finance the other policy actions discussed in this section, as well as some of the measures outlined in Part 2.



⁵⁶ Four officials in the Office of the Prime Minister (OPM), including the Permanent Secretary, have been accused of fraudulent procurement of relief food for people affected by the COVID-19 lockdown and are being charged before the Anti-Corruption Court. See also Otage (2020).



PART 2

INVESTING IN UGANDA'S YOUTH

3. INTRODUCTION

61. Uganda is entering a pivotal stage of its development path. The population is currently estimated at 46 million and will most likely rise to around 104 million by 2060. Close to 70 percent of that population will be of working age, and about half of the population will reside in urban centers, which is a doubling in the proportion of the urban population observed today. This presents an enormous opportunity to invest in education and health so that the soon-to-be working age population will have the skills and health necessary to be fully productive and contribute to the country's economic growth. At the same time, this sharp increase in the size of the population will aggravate the country's many ongoing challenges in the delivery of basic education and health services, while at the same time trying to manage public investments and improve current access levels in these sectors. In sum, for Uganda to benefit from the demographic dividend (see Box 3) the country will require not only substantial resources to serve a larger population and achieve significant improvements in quality, but even greater resources if the current low access rates and quality are to be elevated. If investments in health and education are not shifted to a higher trajectory in the short term, the access and quality gap will keep increasing over time and catching up at a much later stage will prove extremely difficult.

62. Investments in youth over the next five years will significantly impact the future path of the country's prosperity, especially in light of the COVID-19 crisis. With its decreasing mortality rate and an increasing share of working-age individuals, Uganda is entering the early stage of its demographic transition. Since 2013, when Uganda's Vision 2040 was launched, the country has moved from the pre-transition stage (high mortality, high fertility) to the early transition stage,

with dropping child mortality rates and modestly decreasing, but still relatively high, fertility rates—thus, resulting in a country today with a very young age structure. The right set of policies and conditions could provide the opportunity to capitalize on the resulting demographic dividend. Unfortunately, the COVID-19 crisis has reversed progress on key human capital development indicators, with negative repercussions on the education and health sectors (see Section 1.4). The post-COVID recovery will, therefore, require that Uganda gets back on track quickly to ensure that its young people have access to the critical basic services they need to make the most of their potential, and that short and longer-term productivity is sustained and enhanced.

63. The main objective of this special topic is to inform policymakers, stakeholders and the broad public about Uganda's demographic trends and their implications as the government formulates medium term investment plans and policy actions for human capital development. The analysis quantifies both the effort required to continue providing the growing population with education and health services in the coming years, as well as the considerable resources that will be needed to increase the level of access and quality of these services in line with SDGs. The special topic also presents policy recommendations in these sectors for making the attainment of the SDGs more feasible and sustainable. It is clear that an expansion of the services at scale will not be possible without significant reforms in each sector to improve the efficiency of service delivery. The latter will also necessitate an overall shift in the management of public investments and an increased role for the private sector in these sectors.



Box 3: Demographic dividend – the great potential for demographic transitions

The *demographic dividend* is the accelerated economic growth and prosperity that may result from a decline in a country's birth and death rates and the subsequent change in the age structure of the population.⁵⁷ Given the continuous nature of demographic transitions, the demographic dividend is usually broken down into two parts called the *first* and *second* demographic dividend.

The **first demographic dividend, characterized by increased labor supply in the economy, is brought on by a lower child dependency ratio resulting from a decreasing fertility rate.** Higher survival rates in a given population cohort, followed by fewer children in the next, produces a population bulge that translates into a higher labor supply and a lower dependency ratio (Schneidman et al., 2016). The effect is magnified when lower fertility allows more women to enter the formal labor force. Those who enter can produce for their households and themselves while having fewer children than previous cohorts. This allows society – both households and the government – to spread its investment in education and health resources over fewer children,⁵⁸ which significantly increases human capital for the members of this cohort.⁵⁹ As these groups then move into productive jobs, the gains in terms of household and national income are materialized.

The **second demographic dividend takes place as this cohort, which experienced significant human capital investments, moves through the economic life cycle and saves.** These individuals are more productive than previous generations and, with higher earnings and more disposable income, savings go up considerably. If these savings are then translated into productive investments in key sectors, there is a second boost to economic growth and national income, which in turn results in higher living standards for the entire population (Schneidman et al., 2016), as observed in some countries in East Asia (UNICEF, 2020). The bulged cohort will also have accumulated enough assets so that they do not need to be cared for in older age by the incoming younger cohorts, who themselves can then be more productive and invest etc. (Canning et al. 2015).

Policies and planning can make a critical difference in how demographic change affects progress toward development and economic growth (Global Monitoring Report, 2015/2016). The demographic dividend is not automatic, and will only materialize if certain necessary conditions are met for the country. Most critically, sustained investments in education and health are necessary as the young population expands, ensuring not only widespread access, but also the delivery of high-quality services that guarantee human capital accumulation. This will lay the foundation for the growing working-age population to generate and access high-productivity jobs and contribute to the country's accelerated economic growth. Recent evidence suggests that countries are running out of industrialization opportunities sooner and at much lower levels of income compared to the experiences of early industrializers. The latter means that unskilled manufacturing jobs are unlikely to arrive at the same pace as the increase in the labor force (Rodrik, 2016). Therefore, investing in a skilled labor force will be especially important for Uganda's development path.

57 Often referred to as the economic dividend: a period of sustained economic growth and improvement of the human development indicators. The textbook examples of countries that were able to reap the economic dividend are the East Asian countries such as Thailand, Vietnam and South Korea.

58 Kalemli-Ozcan et al. (2000)

59 A model by Karra et al. (2017) suggests that, as Uganda is at such low levels of income, a decrease in fertility will not see a large increase in physical savings as was the case in East Asia. Instead, households will use the additional income to improve schooling or to take foregone healthcare interventions. Therefore, the human capital channel is likely to be stronger in low-income settings than in East Asia.

64. The next sections of this report will examine the investments required in education and health for Uganda to get on track to meet the SDGs. This includes assessing Uganda's current demographic transition, presenting population projections for the period 2020-2060 at the national level and disaggregated by specific age groups and for urban and rural areas, and describing the implications of these projections in terms of service delivery and infrastructure investments in the education and health sectors. Importantly, the report also examines two different scenarios for service delivery and highlights the required quality improvements needed. The first scenario, termed 'Business as Usual' or BaU, is the most likely scenario going forward, which models the implications of population growth under the assumption that the current access and quality of service delivery remains broadly *constant over time* (Table 8). The second scenario, termed 'Achieving the SDGs' or SDG, simulates the implications of population growth under the additional assumption of gradual improvements in key sector parameters related to access and quality that would allow the country to meet the SDGs in the education and health sectors. To

provide context, the report first gives a broader overview of the longer-term implications for the health and education sectors over the 2020-2060 time period. The report then focuses on the inputs and fiscal effort that are likely to be needed over the period 2020-2025 to provide the projected population with basic education and health for both the BaU and SDG scenarios, and ideally put Uganda on track for a more prosperous future.

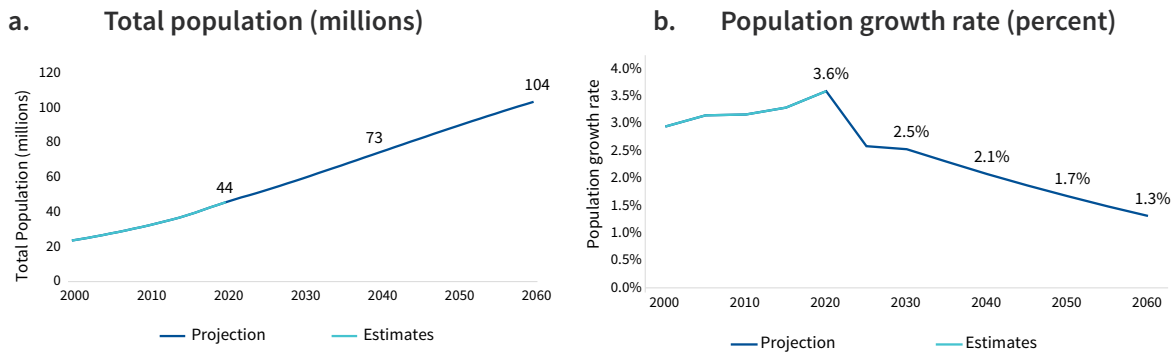
3.1. Population Projections for Uganda: 2020 – 2060

65. The population of Uganda is expected to increase from around 46 million in 2020 to 74 million by 2040 and more than double to 104 million by 2060.⁶⁰ The projections assume that population growth rates will slow significantly over the next few years. More specifically, population growth is estimated to reach its peak at around 3.6 percent in 2020, and decline subsequently to 2.1 percent in 2040 and 1.3 percent in 2060 (Figure 29b). Since 2000, the population growth rate has averaged more than 3 percent.

60 These estimates are based on the UN Population projections for the period 2020-2060. The population projections that are used to quantify the challenge in terms of service delivery and fiscal effort that Uganda faces over the next 40 years are based on the World Population Prospects 2019. These projections are constructed using all available sources of data on population size and levels of fertility, mortality and international migration for Uganda. Of particular note is the large refugee flow from the DRC and South Sudan, which have contributed to the population growth in Uganda, with 1.2 million refugees residing in Uganda as of 2019. The projections also consider the trajectory of access to and use of family planning and reproductive health services observed in Uganda in recent years, as well as that of countries with similar conditions. The World Population Prospects 2019 was produced by the UN Department of Economic and Social Affairs, Population Dynamics. The information is publicly available at <https://population.un.org/wpp/>. The projections differ from those of UBOS due to different methods used - <https://www.ubos.org/explore-statistics/20/>.



Figure 29: Total population trajectory

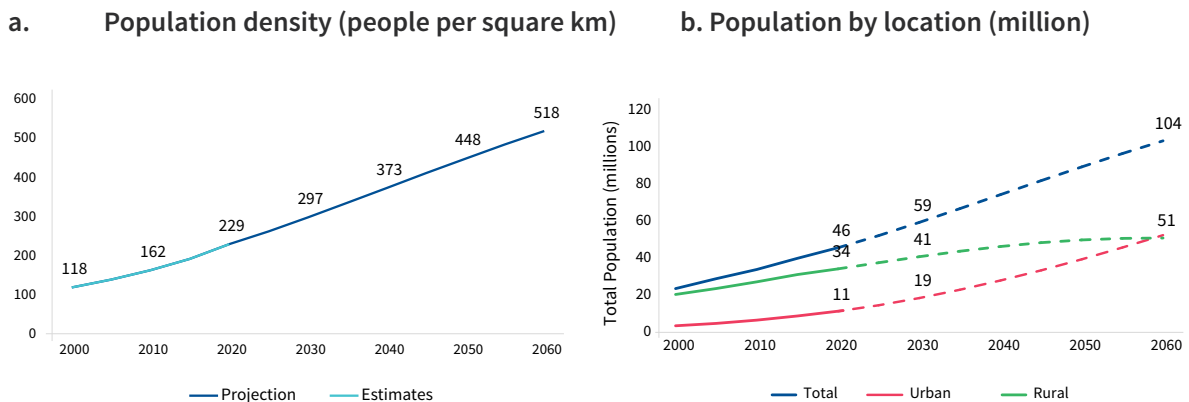


Source: UN population Division, World Population Prospects 2019 Revision.

66. The high population growth will result in increased population density, and by 2060 more than half of the population will reside in urban centers. While the population density of Uganda is currently comparable to that of Italy, by 2055 it will surpass India's current population density of 455 people per square kilometer, and by 2060 it will be about on par with South Korea's current population density of 529 people per square kilometer. In 2020, about 34 million people are

estimated to be living in rural areas of the country, while urban centers hold approximately 11 million people, close to 25 percent of the population. According to the projections, however, by 2060 Uganda's urban population will surpass its rural population, with estimates of 53 million people living in urban areas and 51 million people living in rural areas (Figure 30b).

Figure 30: Population density and urbanization

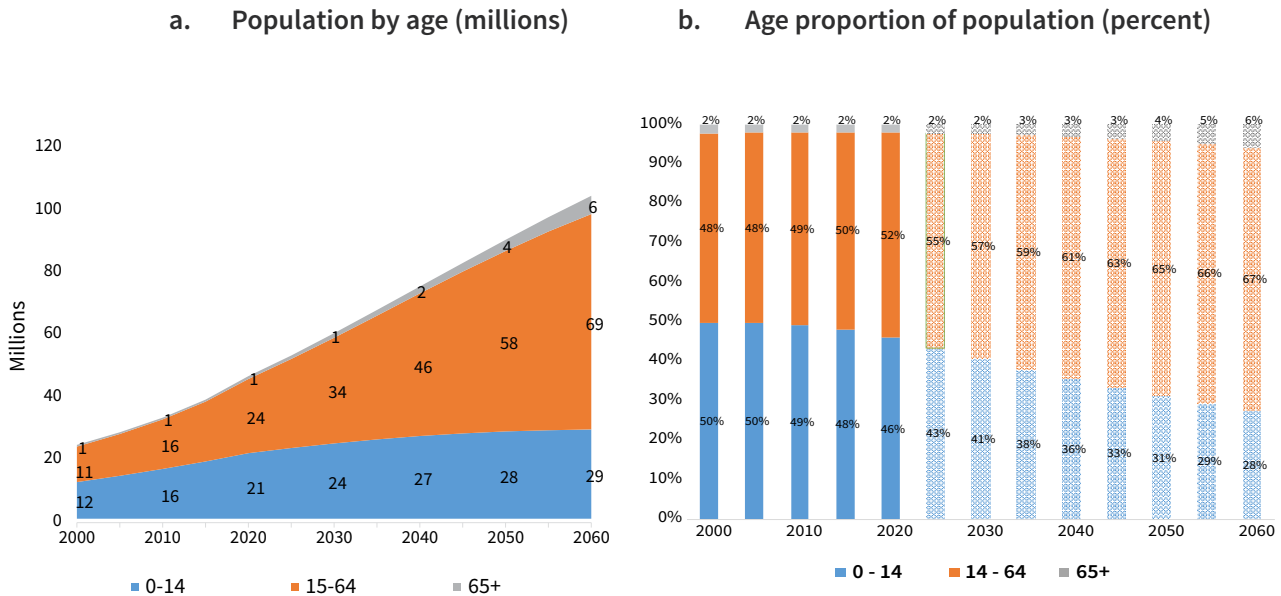


Source: UN population Division, World Population Prospects 2019 Revision

67. The increase in the working-age population will have implications for economic development. The age structure of the country will change dramatically over the next 40 years. The young population (ages 0 to 14 years) is projected to grow from 21 million in 2020 to approximately 27 million by 2040 and 29 million by 2060. At the same time, the working-age population is set to increase from 24 million in 2020, to 46 million in 2040 and 69 million by 2060. However, while more people will be entering the labor force, this does not mean that they will automatically be employed as agglomeration effects of population growth do not necessarily bring about new jobs. In fact, under current conditions, including low levels of human capital, the employment gap (defined as the difference between the number of people

in the labor force⁶¹ and the number of people employed)⁶² will grow at a steady pace of 350,000 jobs per year or at an average annual rate of 3 percent throughout 2020-2040. This means that by 2025, the employment gap will have already reached 9.1 million people (Figure 31c) – up from 7.8 million today. Building human capital is a key action to ensure that Uganda’s youth have the skills to both access and create jobs and, thereby, help prevent unemployment from spiraling out of control. The senior population, meanwhile, is set to increase more than six fold between 2020 and 2060 (Figure 31a). While absolute numbers will remain low in 2060, at about six million seniors, this could strain the health care system in Uganda as seniors often have higher health care needs (Global Monitoring Report 2015/2016).

Figure 31: Population projections by age

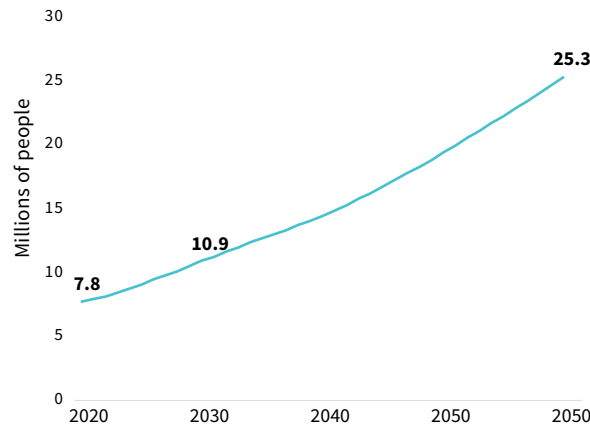


61 For the analysis throughout this section, the labor force is defined to include all the population aged 15 and above.

62 Following ILO standards, employment is defined as work performed in return for pay or profit. This definition, adopted by ILO since 2013, is suitably narrower than the scope of the previous definition which included some unpaid activities such as subsistence work (ILO, 2013).



c. Gap between the labor force and employment



Source: UN population Division, World Population Prospects 2019 Revision

3.2. Setting the Stage: Investing in Uganda’s Demographic Transition 2020-2060

68. Over the past three years, the GoU has begun improving the adequacy of financing for education and health. Wage, non-wage recurrent and development grants have shown a steady increase both in education and health from FY2017/18 to FY2019/20. Specifically, reversing over a decade of decline, operational non-wage recurrent grants for both education and health have increased in the double digits, in nominal terms. Non-wage recurrent grants for education have increased by 41 percent in the budget from FY2018/19 to FY2019/20, and similarly non-wage recurrent grants for health have increased by 42 percent. This has had a direct impact on school and health facility level operational funding. More precisely, budgeted and released operational funding for primary schools increased 50 percent,

and for health facilities the increase amounted to 43 percent since FY2017/18. A similar pattern was observed for development spending in the education and health sectors.

69. An equivalent of US\$200 million was allocated to development grants to upgrade and construct health and education facilities.⁶³ The GoU upgraded existing Health Center (HC) IIs to HC IIIs and built secondary schools in sub-counties, where these facilities do not exist in line with policy commitments. The upgrading of 331 HC IIs to HC III and 232 new secondary schools for construction are under implementation. By the end of March 2020, contracts for 113 schools had been issued – of these three schools had been completed and roofing had commenced in 34 sites. Contracts for upgrading of 129 health facilities had been issued – of these five had been fully constructed and 21 general wards, 27 four stance latrines and four outpatient departments

63 This was part of the World Bank supported Uganda Intergovernmental Fiscal Transfers Programme (UgIFT), which was approved in June 2017 and became effective in May 2019.

had been completed. Unfortunately, costs in both sectors were significantly higher than originally projected, and construction of these facilities has brought focus and sparked action to strengthen contract management and environmental and social safeguards implementation.

70. While this progress is promising, further efforts are required for Uganda to reach the goals the government has set for itself and which are themselves aligned to the SDGs. This should then move the country beyond the *status quo* levels of service delivery in the education and health sectors (Table 8); a shift which is essential for the country's young population to accumulate the human capital required to reach its full productive potential.

71. In particular, further efforts need to address the gaps in quality and distribution of education services across the country. While the expansion of universal primary education has been pro-poor, and therefore equity of access has significantly improved, dropout rates tend to be higher amongst the underserved populations and in rural areas. The disparities in access to secondary education are more pronounced and cut across regional, location, wealth, and gender dimensions. For instance, enrollment rates in urban areas of the Central region are dramatically higher than those in rural and underserved areas in the North: in 2015, the Gross Enrollment Ratio (GER) in the capital city of Kampala was over 50 percent, while in rural Kaabong (Karamoja district) it was only 5 percent. Variations by welfare quintiles reveal that secondary school enrollment drops with decreasing welfare. It is the lowest for persons in the lowest quintile (7 percent) and highest

in the fifth quintile (41 percent).⁶⁴ Disparities in completion⁶⁵ rates are also evident between rural areas, at 6.5 percent, and urban, at just over 14 percent. Meanwhile, large variations in secondary completion rates persist across the country with Kampala (Central) having the highest completion rate of over 17 percent, while Karamoja (North) has the lowest at just over 4 percent. Inequities also persist in terms of access to *quality* education services. Results of the National Assessment of Progress in Education (NAPE) show that student learning is on a declining trend and that differentials persist across gender, especially in biology and math, and across urban and rural schools.

72. Similarly, addressing quality and equity concerns in the health sector will be essential to improve health outcomes. Sick people in poorer areas of Uganda, such as the Northern region, are more likely to face overcrowding and long queues while visiting their health centers, indicating a shortage of resources in these areas. The poorest localities (particularly the Northern and Eastern regions) are also those with very limited availability of basic infrastructure and equipment in health facilities. For example, maternity waiting centers are available in only 24 percent of health centers, contributing to the low proportion of pregnant women delivering in formal health facilities, despite the high rate of attendance for Antenatal Care (ANC) and the mama kit program. Furthermore, it is estimated that nationwide the rate of absenteeism of health workers is high at 42 percent – highlighting a major inefficiency in the use of medical personnel.⁶⁶ Addressing these gaps are a key component to providing quality health services to Uganda's growing population.

64 National Household Survey 2012/13. Data on wealth and enrollment disparities were not included in the 2016 National Household Survey.

65 Completion rate here is defined as children completing primary seven as a proportion of children entering primary one.

66 World Bank (2016)



73. Under a BaU scenario, which maintains current access levels to public services, the physical inputs and fiscal effort will still be considerable to provide services for Uganda's growing population. Currently, only one-third of Ugandan students complete the 7-year primary cycle and gross enrollment rates in secondary schools have stagnated at around 30 percent for decades (Table 8). In order to just maintain these current rates for the growing population, the total cost of providing education services (primary and secondary) will increase from US\$834 million to about US\$1,001 million between 2020 and 2060.⁶⁷ Similarly, the expenditure needed to provide basic health services in line with the current 44 percent coverage rate to the growing population will more than double from US\$703 million to US\$1,592 million between 2020 and 2060.

74. Under the SDG scenario, where access levels are enhanced, even greater fiscal efforts are required. More specifically, to provide universal access to primary and secondary education and improve the quality of these services – in line with the Education and Sports Sector Strategic Plan targets – it will cost around US\$1 billion in FY20/21 and over US\$2.2 billion in 2060. As a comparison, the FY21 budget allocated half of the required amount or US\$476 million for primary and secondary education.⁶⁸ At the same time, the cost of providing universal health coverage (starting in 2020) rises from US\$1.4 billion to US\$3.2 billion between 2020 and 2060. This compares to an allocation of US\$742 million in the FY21 budget.

Table 8: Current access rates for public services

		BaU scenario access rate
Education	Primary	100% gross enrollment, but 30% completion
	Secondary	30% gross enrollment
Health services		44% coverage

Table 9: Annual fiscal expenditure estimates by 2060

Sector	BaU scenario	SDG scenario
Education	US\$1,001 million	US\$2,224 million
Health	US\$1,592 million	US\$3,184 million

75. To avoid such a widening gap, Uganda cannot afford to maintain the status quo (BaU scenario) for much longer, without starting the shift to the SDG scenario. As a result, the next sections will discuss in more detail the increases in inputs and fiscal effort required in the education and health sectors to both maintain the *status quo* and ideally start the shift to the SDG scenario. In particular, the focus will be on what needs to be done in the short-term, between now and 2025, for Uganda to get on track to meet its goals and make the necessary investments to realize the demographic dividend.

⁶⁷ The fiscal implications for both the BaU and SDG scenarios are expressed in 2019/20 prices.

⁶⁸ National Budget Framework Paper FY20/21. Source: https://budget.go.ug/sites/default/files/National%20Budget%20docs/National%20Budget%20Framework%20Paper%20FY%202020-21_0.pdf

4. INVESTING IN EDUCATION

76. This section examines how the population projections affect the provision of education services. Specifically, it focuses on the implications of enhancing access and quality of service in line with the GoU medium-term goals of ensuring

universal access, as specified under the education SDGs. The analysis focuses on the primary and secondary education sub-sectors, as they account for most of the annual education budget.

Box 4: 'Business as Usual' versus 'Achieving the SDGs' scenarios in education

The BaU scenario looks at how much it will cost the GoU to finance the education sector without any significant improvements in performance and quality between 2020 to 2025. For example, this assumes that the current teacher to pupil ratio is maintained, the current low levels of enrollment in secondary school remain constant, and the quality of teaching is not improved, among others.⁶⁹

In contrast, the SDG scenario simulates the implications of gradual improvements in key parameters related to expanding access and improving the quality of education. Under this scenario, the assumption is that the first set of improvements will be realized by 2025 – this is when the Education Sector Strategic Plan (ESSP) for the 2020-2025 period targets are set to be achieved.⁷⁰ The second set of improvements are modelled to be introduced gradually until 2040 and then sustained until 2060.⁷¹ Improvements are aimed at bringing universal primary and secondary education access by the year 2030, as well as significant and concurrent improvements in quality, which are also in line with the SDG targets for education. The SDG scenario is expected to improve 'Learning Adjusted Years of School' (LAYS) from 4.5 years to 7.5 years in the medium term (Kenya currently scores 7.8).⁷² While on average a child in Uganda completes 7 years of school by the age of 18, this declines to only 4.5 years if quality of learning outcomes is factored in (2.5 years are considered 'lost' due to poor quality of education). In this scenario, primary enrollment (Figure 32) will not change significantly between 2020-2025, as a result of implementing measures to reduce the number of over and under-aged pupils in the system and thus create space for more pupils of the correct age to enter the system.⁷³ This will comprise considerable efficiency gains for the sector, as resources will be spent across a larger number of new pupils, instead of 'reinvesting' in a smaller number of students who repeat several years in the system or spent unproductively on primary school drop-outs.

69 These assumptions include the following parameters that are to be maintained for public education at the 2019 level: 1) Gross Enrollment Ratio (GER): 132% for primary, 32% for secondary; 2) pupil to teacher ratio: 52 for primary, for secondary; 3) pupil to textbook ratio: 4 for primary, 7 for secondary; 4) pupil to classroom ratio: 71 for primary, 65 for secondary; 5) schools per inspector ratio: 80 for primary, 90 for secondary.

70 The targets for 2020-2025 are the following. For primary: GER – 123%; pupil to teacher ratio – 48; pupil to textbook ratio – 2; pupil to classroom ratio – 65; schools per inspector ratio – 60; public share of enrollment – 66%. For secondary: GER – 45%; pupil to teacher ratio – 18; pupil to textbook ratio – 5; pupil to classroom ratio – 58; schools per inspector ratio – 60; public share of enrollment – 50%.

71 The second set of targets, to be achieved by 2040 are the following. For primary: GER – 100%; pupil to teacher ratio – 35; pupil to textbook ratio – 1; pupil to classroom ratio – 40; schools per inspector ratio – 40; public share of enrollment 63%. For secondary: GER – 70%; pupil to teacher ratio – 12; pupil to textbook ratio – 2; pupil to classroom ratio – 40; schools per inspector ratio – 40; public share of enrollment – 62%.

72 The learning adjusted years of schooling (LAYS) is a macro-level concept introduced by the World Bank that combines quantity and quality of schooling into a single easy-to-understand metric of progress. LAYS are calculated by multiplying the expected years of schooling by the ratio of the most recent harmonized test scores to 625, where 625 corresponds to advanced attainment of TIMSS test.

73 These measures include strengthening early childhood education and age-appropriate enrollment of pupils in primary school.



4.1. Input requirements

77. Under the BaU scenario, considerable funding and inputs like teachers (along with reducing absenteeism) and classrooms are needed to maintain key access and quality indicators. With national enrollment in primary school increasing by over 200,000 students per year between 2020 and 2025, the total number of primary school teachers hired by the government will need to increase from 162,417 in 2020 to 177,919 by 2025 – or an additional 15,502 teachers. This assumes a constant teacher-to-student ratio of 52. Similarly, with enrollment at the secondary level increasing by over 62,000 students per year between 2020 and 2025, the number of lower and upper secondary teachers will need to increase from 44,581 in 2020 to 51,155 in 2025 – or an additional 6,574 teachers. This means that over 3,000 new primary level teachers⁷⁴ and over 1,300 new secondary level teachers⁷⁵ will need to be added to the government payroll each year between now and 2025. At the same time, supervision efforts and other measures will need to be enhanced to reduce absenteeism among existing teachers. Furthermore, to maintain the same pupil to classroom and pupil to textbook ratios, the GoU will need to construct 11,000 additional primary level classrooms (or 2,200 per year) and 2,000 additional secondary level classrooms (or 400 per year) over the next five years.⁷⁶ By comparison, between 2002 and 2016 the government constructed on average 2,320 classrooms per year at the primary level.⁷⁷ Assuming no improvements in the pupil to textbook ratio, the requirement

for textbooks⁷⁸ will be on average 300,000 and 200,000 every year for primary and secondary students, respectively, between now and 2025.

78. At the primary level, the SDG scenario results in lower input demands compared to the BaU scenario, due to the already near universal enrollment and projected efficiency gains brought about by measures to reduce grade repetition. Under this scenario, the projected increase in primary-level students is 200,000 over the five-year period from 2020 to 2025, or 40,000 per year – one-fifth of the projected primary-level enrollment under the BaU scenario. Therefore, between 2020 and 2025, the number of primary school teachers, hired by the government, will need to increase from 162,417 in 2020 to 173,676 by 2025, or an additional 11,259 teachers – a slightly lower number relative to the BaU scenario due to reforms that bring down the number of over and under-aged pupils at the primary school level. Similarly, the GoU will need to construct only 9,600 additional primary level classrooms as opposed to 11,000 under the BaU scenario, and the primary-level textbook requirement will fall by about 500,000 from 2020 to 2025.

79. In secondary education, considerable additional inputs beyond the BaU scenario will be necessary to accompany the swelling secondary-level student population. Under the SDG scenario, enrollment at the secondary level will increase by more than 68,000 students per year between 2020-2025 (Figure 32a). In order to provide for this growth in enrollment and enhance

74 By comparison, on average 1,213 of new teachers were added to the government payroll annually between 2002 and 2016 (Education Fact Sheet 2016, Ministry of Education and Sports (MoES).

75 Number of teachers required for the current staffing norms. This assumes that the non-public providers will continue to pay wages for teachers employed in non-government schools, who currently constitute 63 percent of the teachers in the country.

76 In the case of the secondary level, the construction burden for government is lower, given that the participation of the private sector is larger.

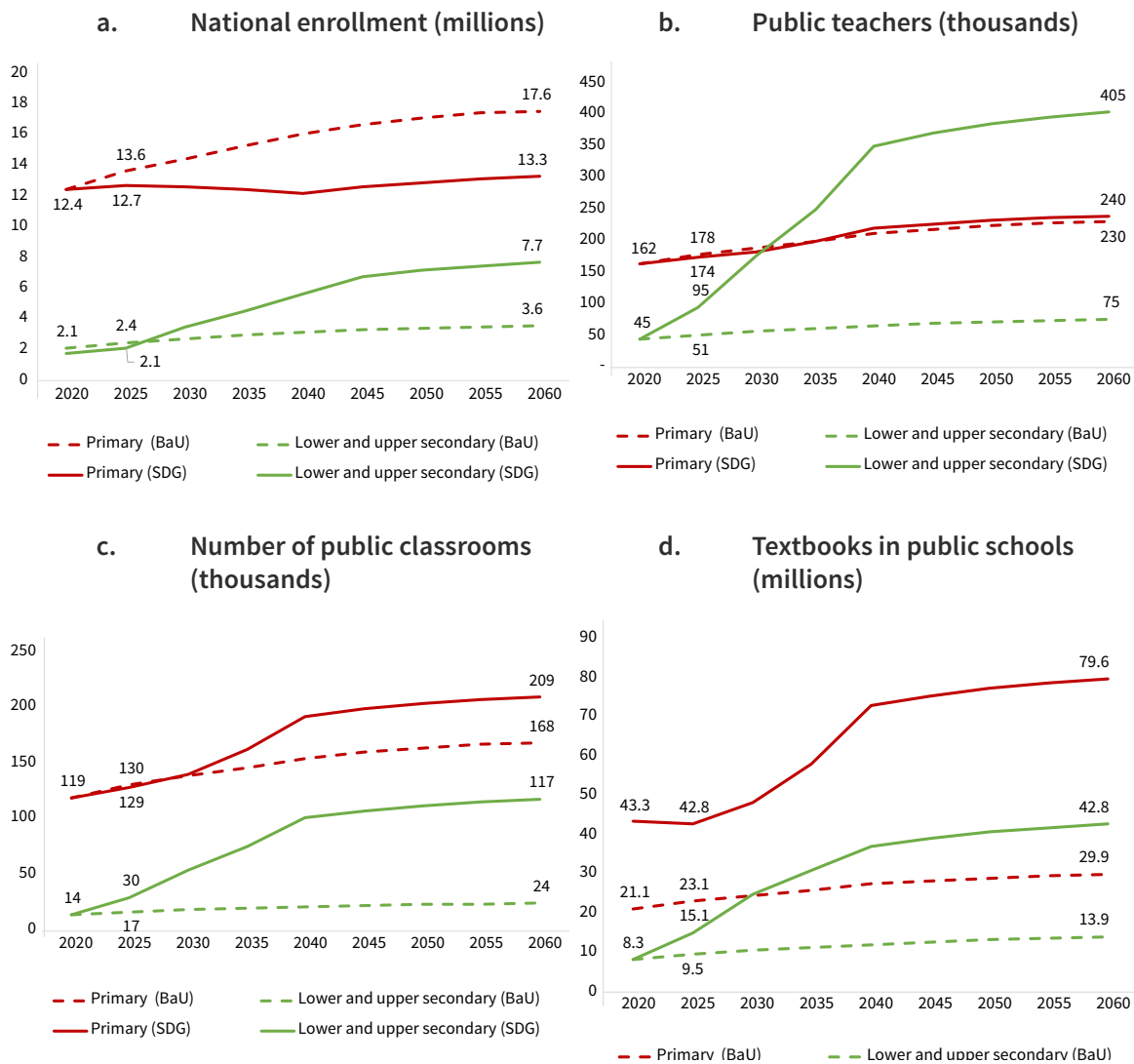
77 Education Fact Sheet 2016, MoES.

78 Fiscal implications for textbooks consider the rate at which textbooks are recycled between cohorts.

quality, the number of lower and upper secondary teachers will need to increase from 44,581 in 2020 to 95,317 in 2025, or more than 10,000 additional secondary level teachers per year—a sizable jump from the BaU scenario (Figure 32b). Similarly, the GoU will need to more than double the number of secondary level classrooms over the next

five years, from 14,400 in 2020 to 29,800 by 2025 (Figure 32c). This translates to an average of more than 2,500 additional secondary level classrooms per year between 2020 and 2025 – more than the entire five-year period combined under the BaU scenario.

Figure 32: Projected educational inputs under the BaU and SDG scenarios (2020-2060)



Source: Author's calculations



4.2. Fiscal implications

80. A significant increase in public resources will be required to cover the input requirements even under the BaU scenario. The combined primary and secondary budgets will need to almost double over the next five years to keep pace with the growing school-age population; increasing from US\$480 million in 2019 to an annual average of US\$833 million in the period 2020-2025 (Figure 33a).⁷⁹ In GDP terms, the funds required for this scenario (i.e. just for the input requirements) will equal about 2 percent of GDP annually for the period 2020-25, and 8 percent of the projected national budget for the fiscal year 2024/25. As a reference, between 2015-2019 the combined primary and secondary sub-sector budget averaged between 1.6-1.8 percent of GDP; for FY20/21, the GoU budget framework for education was 9 percent of the national budget. While the main cost driver for both primary and secondary education will be teacher wages, infrastructure investments will also take up a considerable portion of the budget over the next

five years. Lower overall costs for secondary education are due to the current private sector share of enrollment.

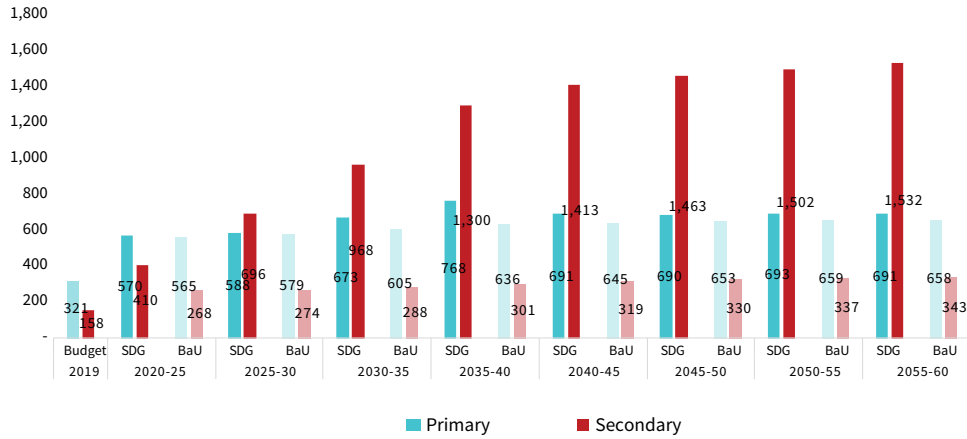
81. The fiscal effort for the SDG scenario is substantial. For this scenario, the combined (primary and secondary level) average annual budget will need to more than double from US\$480 million in 2019 to US\$979 million in the period 2020-25 (Figure 33a). This scenario will push the education budget to around 5 percent of GDP and about 20 percent of the projected national budget in the 2020-2025 period (Figure 33b). This would then put Uganda on par with higher-performing peers such as Kenya, where education spending accounted for 5.2 percent of GDP and 21.0 percent of government expenditure in 2017/18.⁸⁰ Thus, efforts to increase access and improve quality will require a significant increase in public resources, which may be difficult to fully mobilize under current circumstances. The next section discusses options to manage the education budget more effectively, including sharing the burden with other stakeholders.

⁷⁹ A jump in the overall costs between 2019 and 2020-25 for the BaU scenario is explained by a steep growth in the school age population in the period 2020-25, as well as the following: more investment into teacher training being taken up by GoU (currently a large portion is funded by the Global Partnership for Education); and increase in capitation grants through the Uganda Intergovernmental Fiscal Transfers Program.

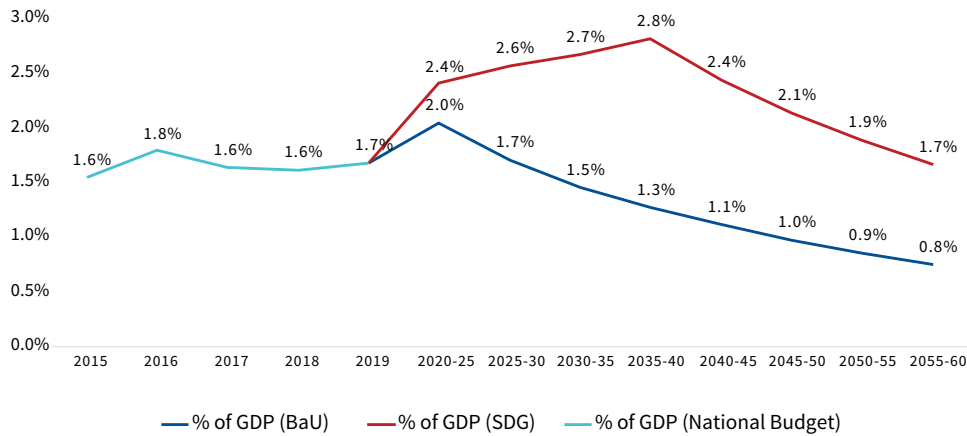
⁸⁰ UNICEF (2018)

Figure 33. Fiscal implications under the BaU and SDG scenarios (5-year average), 2020-2060

a. Average annual cost of primary and secondary education (millions of USD)⁸¹



b. Average annual cost of primary and secondary education, relative to recent government budget for primary and secondary education (% of GDP)



Source: Author's calculations, Uganda Budget Data Portal (<http://budget.go.ug/dataportal>)

⁸¹ Costs based on the input requirements used for the projections. These input requirements are modelled in a way to reflect approximate budgetary requirements for the primary and secondary sub-sector.



4.3. Managing the education budget more effectively

82. Investing in education is crucial to fully capitalize on the benefits of the demographic transition. As the BaU scenario demonstrates, the GoU will have to invest heavily just to be able to absorb the growing number of students (even under the assumption that there are no improvements to access or quality). Although more substantial and strategic investments in the sector are required to reach the SDG scenario, these will also generate substantial efficiency gains in the long term. However, given the impact of COVID-19, the GoU will find it increasingly difficult to raise the necessary resources and close the widening gap. This section provides policy recommendations for how GoU can manage the education budget more effectively, reduce some of the costs and share the financing burden with non-state stakeholders.

83. To address quality and equity concerns, Uganda must invest in the quality of education services. This entails addressing the drivers of learning, such as the establishment of school performance improvement frameworks, as well as quality of teaching, and teachers' distribution and motivation, among others. At the same time, focusing on raising education standards in lagging regions and underserved populations will address equity concerns in the distribution of public education services. The current medium-term plan envisages the financing for approximately 14,000 primary and 1,400 secondary school teachers provided to the least staffed LGs and new secondary schools.⁸² The latter will enable LGs to meet basic minimum school staffing levels. While the number of primary teachers meets the requirements of the growing population,

there is likely to be a significant shortage of secondary school teachers, of about 40,000 by 2025. Because hiring teachers alone will not solve Uganda's lackluster LAYS performance, additional inspectors will need to be recruited to meet a ratio of one inspector to 40 schools. Capitation grants for primary and secondary schools will have to continue to increase, enabling schools to make instructional materials and equipment available to teachers and maintain facilities. In addition, financial incentives linked to school performance will need to be tested and phased in. The construction, equipping and staffing of at least 259 new secondary schools is planned to be completed over the medium term, which is insufficient to address the requirement of 17,000 new classrooms that preserves the status quo.⁸³ In addition, to ensure adequate maintenance of operational facilities, a formula-based component of the development grant will fund the rehabilitation, expansion and equipping of existing schools to enable them to meet agreed basic standards. This will allow for the construction of 284 laboratories in existing secondary schools and investments of US\$ 30,000 in 1,000 existing primary schools.

84. In light of the shortages of primary and secondary schools, implementation of a cost-effective and demand-driven school construction strategy is paramount. Expanding at such a large scale and rapid pace requires more cost-effective and sustainable school infrastructure investments, including better utilization of existing infrastructure, reduction in construction costs where possible, larger schools to achieve economies of scale, and the creation of multi-purpose spaces. Such an approach would also benefit from a much closer collaboration

⁸² World Bank (2020a, September)

⁸³ GoU is also financing the construction of about 116 new lower secondary schools across the country and improving infrastructure in about 61 existing schools under the WB Uganda Secondary Education Expansion Project (USEEP) between 2021 and 2026.

between central and local governments, and improved oversight of construction works. In addition, the policy of double shifts to ensure effective classroom space utilization may also be beneficial.

85. The revision of teacher utilization and deployment policies and practices, especially under the new lower secondary education curriculum, are required to enable school managers to distribute work more efficiently.

The latter goes hand in hand with strengthening teacher supervision to minimize absenteeism and improve the quality of teaching. Furthermore, the official teaching load in Uganda in lower secondary education should be in line with the regional standard of 20 hours per week, allowing school managers to distribute work more efficiently. In addition, the allocation of teachers to schools should be needs-based, and more uniformly implemented.⁸⁴

86. The introduction of strategic and systemic reforms and investments will facilitate better resource allocation and substantial savings.

The biggest efficiency gains will come from improved deployment of teachers, investing in the drivers of learning and putting in place incentives to strengthen learning. In particular, this entails focusing on improving teacher quality and motivation, and increasing the support for school supervision. Shortages in teachers and schools can also be addressed by diversifying low-cost service delivery platforms through investment in remote learning, including distance education and online learning at the secondary level.

87. Finally, increasing education sector funding is an urgent priority necessary to address chronic underfunding and manage the demographic pressures.

Public education expenditure as a share of total public expenditures has decreased from 15 percent in FY12/13 to 10 percent in FY19/20. This suggests that education has a lower national priority than seven years ago, despite the improvements that started three years ago (see Section 3.2). The government needs to gradually increase its public expenditure on education as a share of the national budget to re-align it with the regional average and international norms, and ensure the accumulation of requisite human capital by the growing young population. Furthermore, given the tightening fiscal space as a result of COVID-19, better leveraging of non-state resources is even more critical. Allowing more private sector participation, especially at the secondary level, could alleviate the fiscal burden currently placed on the public sector. At present, more than half of national expenditure is paid by households and the non-state sector. The development of a policy framework for governing and regulating non-state actors is a necessary first step in developing a strategy that includes private partners in an effective way.

⁸⁴ Previous analyses show that the allocation of teachers to schools doesn't follow a clear pattern or is aligned with actual needs. Poor deployment practices, therefore, result in further additional costs to the government (World Bank 2019, May).



5. INVESTING IN HEALTH

88. This section examines how the population projections affect the provision of health services. It focuses on the implications of enhancing health

coverage in line with the government's medium-term goals of achieving universal coverage, as specified under the health SDGs.

Box 5: 'Business as Usual' versus 'Achieving the SDGs' scenarios in health

The BaU scenario for the health sector is based on the current service level, which covers 44 percent of the population;⁸⁵ whereas under the SDG scenario, Uganda will reach a service coverage index of 90 percent by 2030. This analysis encompasses public spending on the national minimum healthcare package or General Government Expenditure on Health (GGHE).⁸⁶ The fiscal effort for the BaU scenario is based on the GGHE in FY19/20, which was US\$703 million – 6.4 percent of the national budget and about 1.9 percent of GDP.⁸⁷ This level of government funding maintains the current BaU level of access, and the following core sector resource levels: 15 medical staff per 10,000 people (NPA Policy Brief, 2018/19) and 11 hospital beds per 10,000 people (Ministry of Health, 2019). However, the level of GGHE needs to more than double, as does the other sources of health financing, to achieve the SDG service coverage scenario and the associated volume of core resources: 44.5 medical doctors, nurses and midwives per 10,000 people (WHO, 2016) and 18 hospital beds per 10,000 people (UN, 2020) – a significant increase in the ratio of health personnel and inputs relative to the population.

5.1. Input requirements

89. The physical inputs required under the BaU

health scenario for the growing population will increase in tandem with the growing population over the next five years. Under this scenario, by

85 The UHC service coverage index measures progress towards SDG 3.8.1 and its component tracer indicators, based on the most recently available data and agreed upon methods. (SDG 3.8.1 is: *Coverage of essential health services, defined as the average coverage of essential services based on tracer interventions that include reproductive, maternal, newborn and child health, infectious diseases, non-communicable diseases and service capacity and access, among the general and the most disadvantaged population*) The 14 UHC service coverage index (SCI) tracer indicators span essential health service domains from reproductive and child health to non-communicable diseases (NCDs) and service capacity. The 14 tracer indicators are separated into four broad groups: A) RMNCAH (reproductive, maternal, newborn, child and adolescent health) - Family planning, 4+ visits ANC, Child immunization (DTP3), Care seeking for suspected pneumonia; B) Infectious disease control - TB treatment, HIV treatment (ART), Insecticide-treated nets (ITN), and Basic sanitation; C) Non-Communicable Diseases - Normal blood pressure, Mean fasting plasma glucose and Tobacco nonsmoking; and D) Service capacity and access - hospital bed density, health worker density, IHR (international health regulations) core capacity index.

86 This encompasses all (investment and ongoing) expenditures for delivery of essential health services, including for reproductive, maternal, newborn and child health, infectious diseases, and non-communicable diseases – be it promotive, preventive, curative, rehabilitative or palliative.

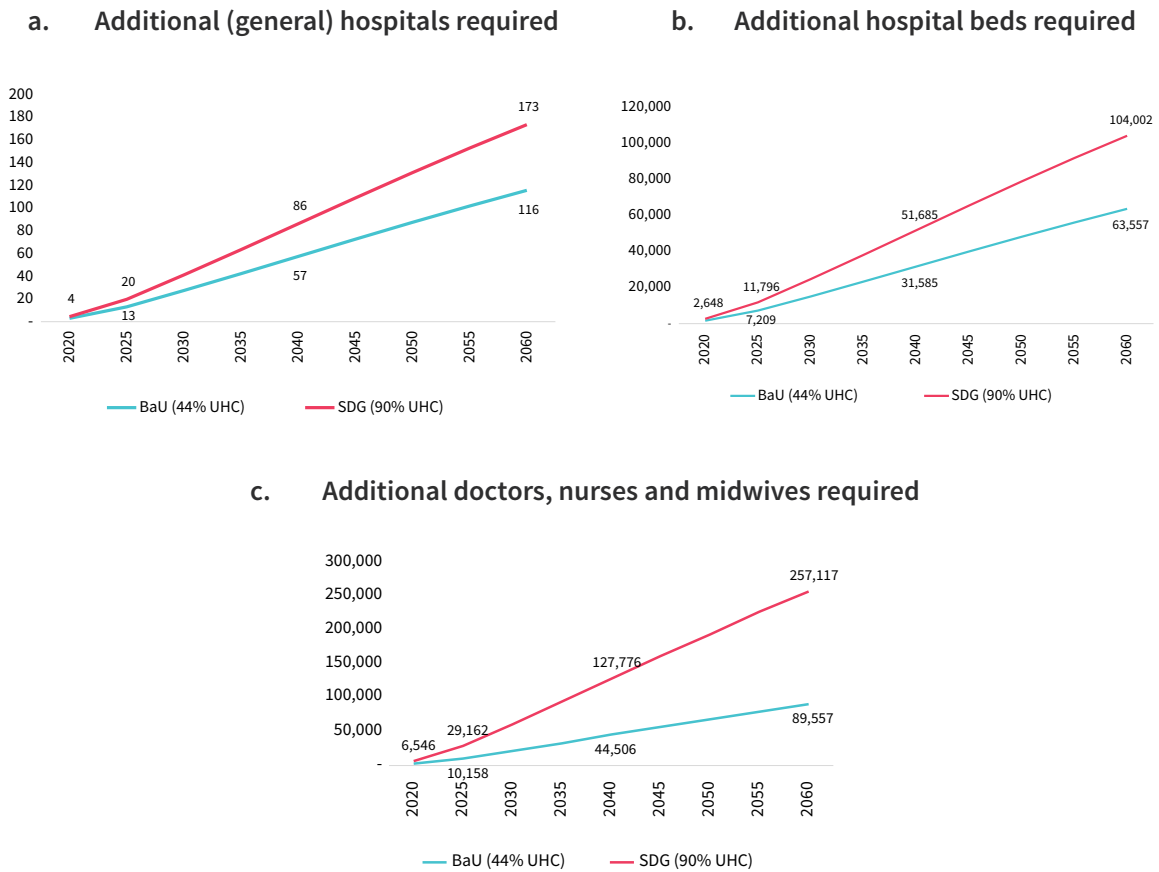
87 This amount was then converted into a per capita expenditure, which is the basis to estimate the costs under the two different access scenarios (Ministry of Finance Planning and Economic Development). Data for the projections of the physical resources or inputs, namely number of health facilities, hospital beds, health workers and other relevant standards, were obtained from various government documents, including the Annual Health Sector Performance Report for FY18/19 (Ministry of Health, 2018/2019) and the NPA Policy Brief (2018/2019). Cost estimates are presented in 2019/20 prices and it was assumed that there would be no changes in the model of service delivery, and disease patterns and social transitions.

2025, Uganda will need 13 additional general hospitals – an increase of 8 percent from the current 163 general hospitals country-wide – 7,209 additional hospital beds and 10,158 additional skilled healthcare workers (medical doctors, nurses and midwives) (Figure 34a & b).

on track to reach the UHC goals outlined in the SDGs by 2030, between now and 2025, the country will need 20 additional general hospitals, around 11,796 additional hospital beds (4,587 more than the BaU scenario), and a total of 29,162 additional skilled healthcare workers (19,005 more than the BaU scenario) to reach the 44.5 skilled healthcare workers per 10,000 population target (Figure 34c).

90. The input requirements for the SDG health scenario are significantly larger. In order to be

Figure 34: Additional inputs required to reach the BaU (44% UHC) and SDG (90% UHC) scenarios (2020-2060) on top of the 2019 baseline level



Source: Author's calculations based on the approved FY 2019/20 Budget (MoFPED) and the National Planning Authority (NPA) reported UHC service coverage index as of 2019 (NPA Policy Brief, 2018/19).



5.2. Fiscal implications

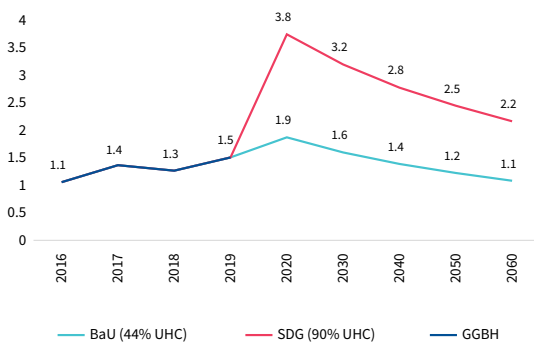
91. Under the BaU scenario, the fiscal effort is considerable, rising from US\$703 million in 2020 to US\$914 million in 2030. However, due to expected economic growth, the projected GGHE as a percentage of GDP is expected to drop from 1.9 percent in 2020 to 1.6 percent by 2030, comparable to the General Government Budget on Health (GGBH) for the last five years.

92. Realizing the SDG scenario and increasing the service coverage index to 90 percent requires more than doubling the projected annual GGHE budget. While the projected GGHE as a percentage of GDP is expected to drop from

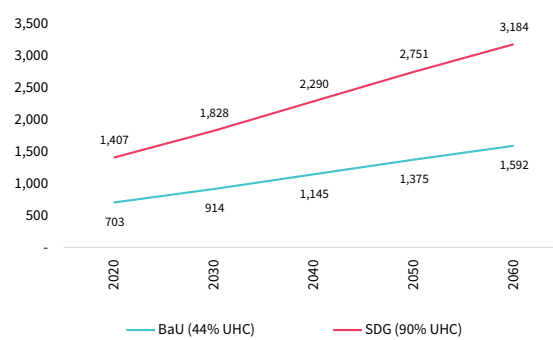
3.8 percent in 2020 to 3.2 percent by 2030 under the SDG scenario's assumptions, this would imply significant additional resources compared to the BaU scenario (Figure 35a). Specifically, Uganda will need to spend 1.6 percentage points of GDP (US\$914 million) more by 2030 to achieve the SDG of universal health coverage instead of simply maintaining the BaU scenario (Figure 35a & b). Thus, efforts to increase access and improve quality of health care will require a significant increase in public resources, which may be difficult to fully mobilize under current circumstances. The next section discusses options to manage the health budget more effectively, including sharing the burden with other stakeholders.

Figure 35: Projected GGHE for the BaU (44% UHC) and SDG (90% UHC) scenarios (2020-2060)

a. Projected GGHE, relative to recent GGBH trends (% of GDP)



b. GGHE projections (millions of USD)



Source: Author's calculations based on the approved FY 2019/20 Budget (MoFPED) and the NPA reported UHC service coverage index as of 2019 (NPA Policy Brief, 2018/19)

5.3. Managing the health budget more effectively

93. Providing the growing population with basic health services will be essential to guarantee their productive potential, and will help Uganda benefit from the demographic transition. For this

to happen, the national policy of expanding access in line with the SDG goals needs to be supported by robust efforts to: a) increase the level and improve the organization of resources directed to the health sector; and b) improve allocative and technical efficiencies in the health sector.

94. To meet the needs of the rapidly growing population, health financing must increase as a share of total government spending.

The resource requirements are high to achieve universal access to basic health services for the growing population over the next 40 years. While it may be difficult to reach the Abuja Target of increasing the general government expenditure on health as a proportion of the general government expenditure to 15 percent, the FY2019/20 level of health sector funding of 6.4 percent is too low and needs to be gradually enhanced over the coming years. Beyond donor contributions, adequate core public funding of health not only increases coverage, it also enhances the government's stewardship and oversight of interventions in the sector.

95. Enhancing private sector participation and contributions to leverage additional resources for the health sector.

The government alone cannot effectively address health needs especially considering the low tax-to-GDP ratio. However, private financing of health, especially out of pocket (OOP) financing, already accounts for about 37 percent of the total health expenditure in Uganda. This OOP financing is associated with negative effects on the welfare of households and should be considered with caution. Thus, raising additional funds from innovative health financing sources needs to be considered, including third party multivehicle insurance and expanding both mandatory and/or voluntary contributory insurance schemes. At the same time, government's formulation of the PPPH policy was a bold step for enhancing private sector participation and contributions to the health sector. It would be beneficial, however, to further strengthen the PPPH, especially in areas where government investment is low.

96. Increasing the efficient deployment and use of resources is also critical to generate savings in the health budget and create a more sustainable

system. Based on historical experience, inefficiencies account for losses of between 20 and 40 percent of healthcare resources in most developing countries (World Health Report, 2010) and, therefore, the importance of enhancing the efficiency of the health sector is paramount. Deepening the implementation of RBF and other purchasing arrangements in the health sector could improve efficiency. Simultaneously, it is important to regularly monitor the effectiveness of the deployed resources (including finances, human resources, infrastructure, equipment and medicine) and implement corrective measures in real-time if necessary. Improving management, maintenance and repair of equipment and enhancing staff time at task are two critical efficiency areas that need to be pursued further. Scaling up the digitalization of business processes in health service delivery, management of healthcare resources, training of personnel and procurement can also help to enhance efficiency. This will be particularly important for higher-level facilities, for which business processes can be streamlined, automated and digitalized.

97. Investing more in the quality of healthcare and making quality a central theme for health policy, financing and programmatic interventions is required to accelerate the achievement of health goals.

The GoU has several tools that can be used to strengthen the quality of healthcare, including regulation, information, financing and administrative actions. Areas to focus on include quality assessment processes and tools, better enforcement of the existing standards and regulations for key sector resources (namely human resources, medicine, equipment, infrastructure and health information), deepening quality of care as part of the results based financing and intergovernmental fiscal transfer reforms, and communicating quality as a key objective of the health sector at all levels. These efforts will only work well if the established standards, processes and procedures are backed by strong quality-

focused performance measurement, monitoring and informed investments.

98. Strengthening health promotion and disease prevention through a multi-sectoral collaboration. Since over 70 percent of the disease burden in Uganda is preventable and prevention measures are far cheaper than treatment on per capita terms, investing in this area can produce significant financial savings and health gains. Furthermore, the benefits of multi-sectoral collaboration was demonstrated in a recent GoU publication on harnessing the demographic dividend in Uganda, which showed that the maximum likely demographic dividend (in terms of a GDP per capita of US\$6,925 by

2065) can be attained by increasing key sectoral expenditures as a share of GDP, as well as by designing and implementing cross-sectoral policies in education, health, agriculture, social development, water, and the environment.⁸⁸ Yet, multi-sectoral collaboration is currently sub-optimal. Thus, efforts to change the current sector-based planning, budgeting, monitoring and learning approaches with program-based budgeting, as proposed in the Third National Development Plan, are important. MoFPED and the OPM should therefore fast track progress towards more optimal levels of multi-sectoral actions for health, which are also underpinned by the necessary resource allocations.



88 UNICEF (2020)

6. CONCLUSIONS AND RECOMMENDATIONS

99. The gains from demographic transitions are not automatic and will only materialize if certain conditions are met and deliberate policy actions taken. An increasing work force presents large opportunities, provided the relative size of the out-of-the-labor-force population (dependency ratio) declines and workers enter the labor market skilled and healthy. However, if not adequately supported, the demographic transition can cause increasing social frictions as the share of unemployed youth rises. To facilitate the payoff from the first economic dividend, there needs to be an overall increase in productivity, economic opportunities and jobs. This can be driven by sustained investments in education and health as the young population expands; ensuring not only widespread access, but also the delivery of high-quality services that guarantee substantial human capital accumulation.

100. If Uganda wants to develop human capital, it must improve the quality and expand access to basic education and health services for the general population. The current *status quo* in terms of quality and access is limiting the human capital accumulation of young Ugandans, constraining their income-generating ability and curbing their future productivity. Currently, a child born in Uganda will only be 38 percent as productive when she grows up as she could be if she enjoyed complete education and full health, according to the HCI (Human Capital Index) – one of the lowest levels in the world.⁸⁹ If education and health investments per capita do not keep up with population growth, the situation will become even more dire. Expanding access and improving the quality of basic education and health services

will be crucial if Uganda wants to move to a development path that ensures higher shared prosperity.

101. Government needs to mobilize additional resources for investing in human capital development and use existing resources more efficiently. As discussed in Part 1, raising tax revenues is inevitable over the medium term if Uganda wants to be able to properly invest in its own development. However, other than generating new funding, increasing the efficient use of existing financial and human resources and infrastructure and equipment is critical. The GoU also needs to maximize the use of concessional resources and grants. Furthermore, the overall efficiency of public spending can be improved, including enhancing the effectiveness of Public Investment Management (PIM), strengthening oversight at the facility level, and more broadly bringing closer the central and local governments in the common pursuit of raising human development outcomes. Greater emphasis on central level oversight, processes and systems strengthening means that management and monitoring tools needed to be put in place to ensure these activities are well coordinated across sectors.

102. Public resources also need to leverage private sector investments and financing. It is very unlikely that the public sector alone will be able to bear the fiscal implications of tackling the demographic challenge in Uganda in the medium term. Thus, the government must continue to develop a strong policy framework for private participation in all sectors to close financing gaps and achieve higher levels of spending efficiency.

⁸⁹ The HCI looks across health, education, nutrition and skills and is calculated based on five indicators: probability of survival to age 5; children's expected years of schooling; quality of learning; adult survival rate, and the proportion of children who are stunted.



PPPs could be an option that would allow upfront private financing for capital investment and crowd-in additional sources where user charges can be levied.

A final word: there is also another way

103. This report considers the population projections, and implications of these projections, without any fertility adjustments. When fertility adjustments are considered⁹⁰ this reduces the fiscal costs of both the BaU and SDG scenarios; quite substantially when trying to achieve the SDG scenario. Key to any fertility adjustment, however, is enhancing the agency of girls and women.



104. **Educating girls, empowering women, enhancing access to reproductive health services and employing women are central to harnessing the potential benefits of the demographic transition.** Of all four, however, educating girls is most important, with clear and large demonstrated positive spillovers worldwide.

105. **Improving the educational attainment of girls is essential for Uganda's future.** Enhancing the educational opportunities for adolescent girls boosts their productive and economic prospects in the future. Higher educational attainment among young women also delays childbearing, lowers the chances of early marriage, and empowers them as women, which in turn lowers fertility over time. Finally, improvements in the level of women's education enhances child health outcomes – more educated mothers are increasingly likely to use prenatal and child health services – which, ultimately, has positive consequences for human capital development and the demographic transition.

⁹⁰ For further information, see the full report: World Bank (2020b, October).

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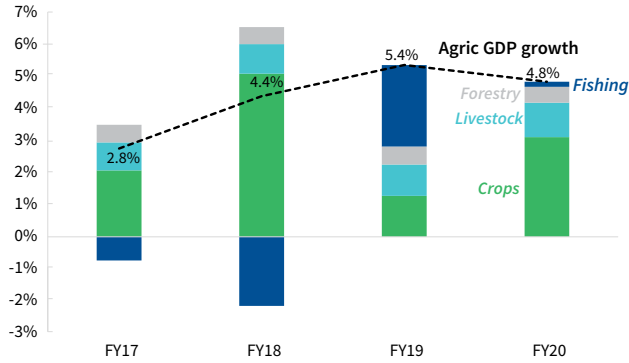
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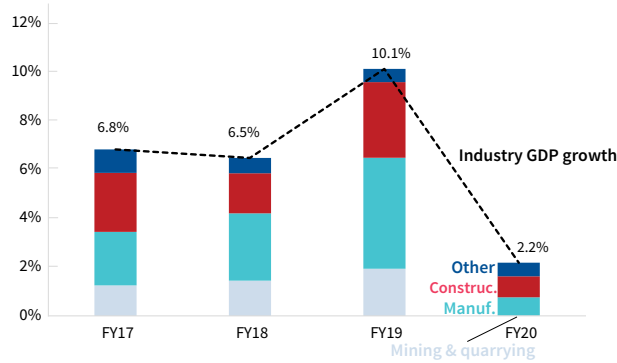
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ANNEX 1: SECTORAL GROWTH

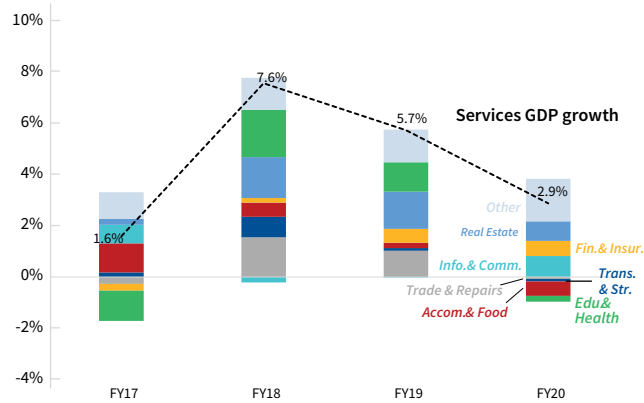
Agriculture – crops growth remained robust
(sectoral growth rate, contribution to sectoral growth, percent y/y)



Industry – a significant slowdown
(sectoral growth rate, contribution to sectoral growth, percent y/y)



Services – COVID-19 gave a boost to information and communications
(sectoral growth rate, contribution to sectoral growth, percent y/y)



Source for Figures 7-9: UBOS

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