LDPG Meeting with Ministry of Finance on Budget 20/21
Thursday 12 December 2019

Uganda is changing at pace. With the 2nd fastest population growth rate in Africa (equating to the population doubling every 19 years), and the fastest rate of urbanisation in Africa, Uganda's needs are changing and multiplying. So too is Uganda's potential, if the country can capitalise on this change. It is a major task for policy – including budget policy – to respond to this, and turn need into opportunity.

Figure 1: Uganda population projections to 2100

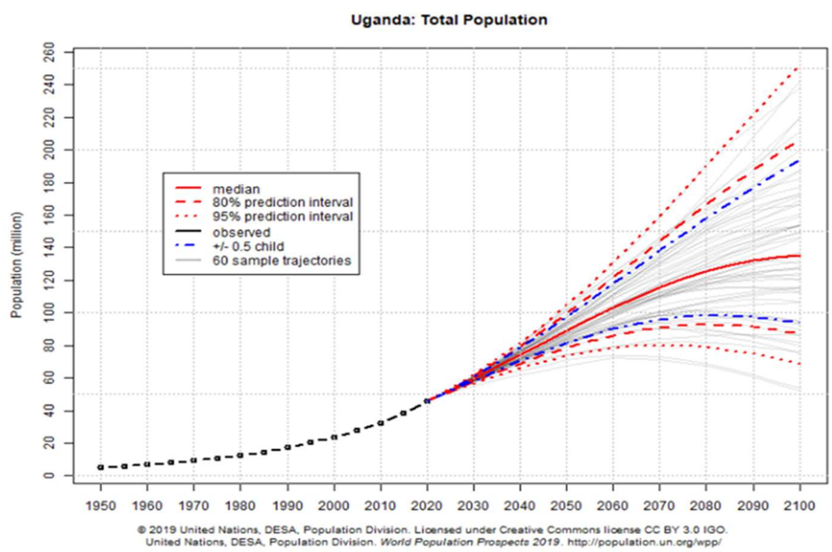
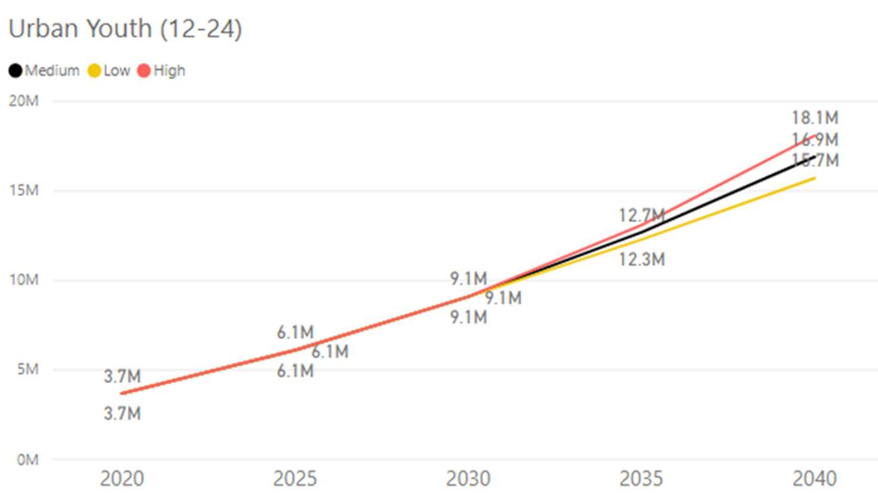


Figure 2: Urban youth projections to 2040, under low, medium and high fertility scenarios

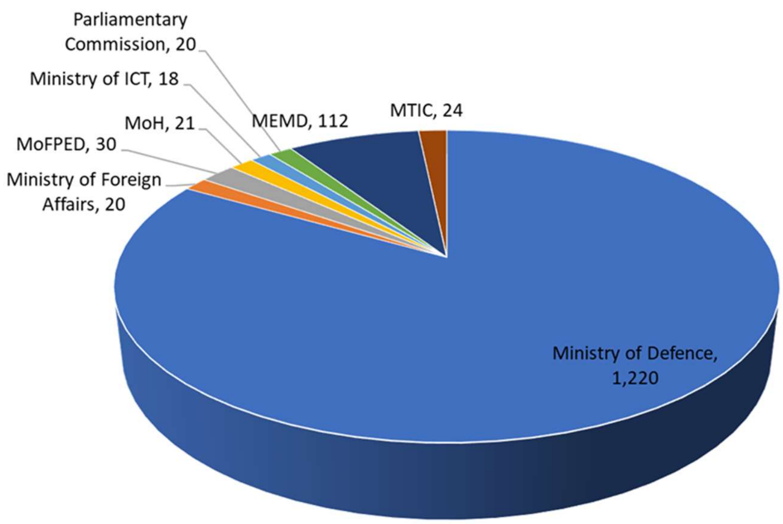


This short issues paper identifies a number of budget issues – on process, prioritisation and financing - that LDPG see as critical and want to flag to the Government of Uganda, in this time of huge and demanding change. Within these areas we see potential for collaboration, where we'd like to work with you to strengthen budget outcomes. But we also want to flag concerns. A number of aspects of the proposals for FY 20/21; and the agreement and execution of FY19/20, seem to undermine the budget's developmental potential.

1. **<u>Budget process</u>**

We are concerned both about the unprecedented passing of the 19/20 budget without Parliamentary debate, restricting scrutiny; as well as the use of supplementaries. Supplementary budgets undermine budget credibility and skew resources towards particular sectors – as shown below.

Figure 3: Supplementary budget expenditure in FY 19/20 to date



What do you anticipate taking place with the FY 20/21 budget? How do you plan to limit processes which undermine budget credibility?

2. **<u>Budget prioritisation</u>**

LDPG has identified three focal areas for budget engagement: human capital (health and education), agriculture, and infrastructure (energy and works and transport). In this meeting we would like to explore key aspects of financing these sectors, and for each ask two questions:

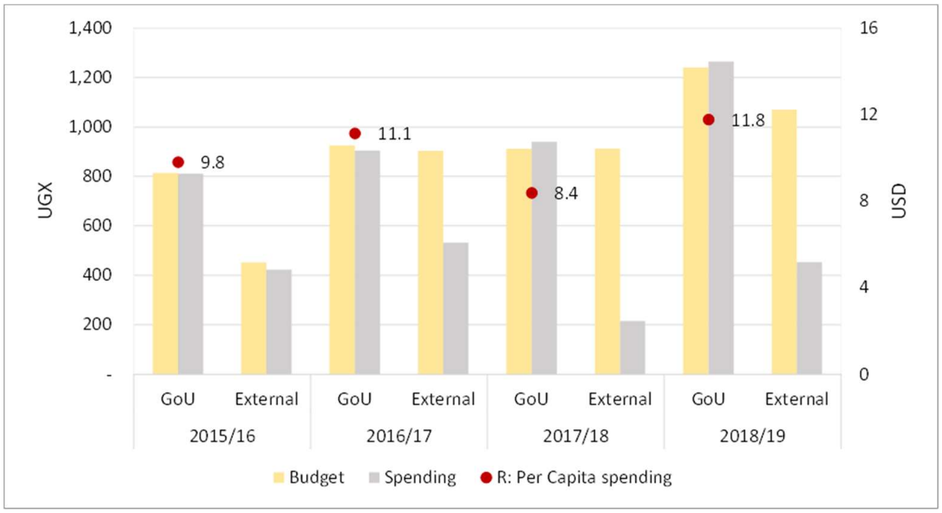
- What you see as the major technical and political economy challenges associated with making budgetary decisions which effectively serve Uganda's needs in these sectors?
- Are there ways we can work together to address these, and promote better outcomes for this budget?

<u>Human capital</u>
Demographic change means need is rising fast. Spend on health alone will need to increase by almost 1.5 bn USD by 2040 just to maintain current per capita expenditure levels. That represents a close to doubling of the 1.9bn USD current budget for health.

Alongside this, the recent IMF article 4 mission reiterated the importance of human capital investment to complement investments in physical infrastructure. IMF modelling suggest that long-term growth will best be promoted by allocating approximately 70% of resources to human capital sectors – as opposed to the approximate 30% allocation at present.

The figure below demonstrates that the budget for health has slightly grown in per capita terms over the last few years.

Figure 4: Budget allocations and expenditure in health: total and per capita – 15/16 – 18/19



However, this year's allocation to health dips dramatically - with Government of Uganda's contribution to the sector declining 11% year on year. This fails to hold steady progress to date, and represents a backwards step in terms of making the shift towards sustained higher levels of human capital investment that appear necessary to maximise long term growth.

Can GoU reverse the proposed cuts to its own financing of the health sector in 20/21? And can we make decisions together this year to put human capital sectors on a sounder long-term footing? This is particularly critical given that development partner funding to health looks likely to experience a sustained decline over the medium term.

Agriculture

The budget theme emphasises the importance of agro-industrialisation as a driver of job creation and shared prosperity. There are questions about whether the underlying agriculture sector in a position to underpin a drive to ag-processing, ag-trade and commercial agriculture at scale. In that light the proposed 25% increase in GoU funding to the agriculture sector in the FY 20/21 budget is welcome.

There are critical questions however, about allocations within the sector. More than a quarter of the allocation to Agriculture is earmarked for planting materials, implements and stocking materials under National Agricultural Advisory Services (NAADS) and coffee seedlings under Uganda Coffee Development Authority (UCDA). Yet, there have been persistent reports of problems when it comes to the free distribution of agricultural inputs, including crowding out of the private sector and the distribution of incorrect and/or poor-quality inputs. What can we do to shift allocations of finance towards expenditures with greater likelihood of strengthening sector performance?

Works and Transport

Roads maintenance stands at less than 12% of the sector budget. As a result, it only meets about 26 percent of the need, presenting a precarious situation for the sustainability of the roads asset base (which degrades further - with higher replacement costs - the longer that maintenance is lacking). It has been recommended that 24% of the roads budget is allocated towards maintenance. Does this recommendation make sense to the Ministry of Finance? What would it take to move in this direction?

Prioritised projects

The budget call circular lists 6 'prioritised projects':
(a) General elections
(b) Defense classified expenditure
(c) The national airline
(d) Salary enhancements
(e) Counterpart funding for projects, and
(f) Funding to 10 newly created cities.

There are of significant concern to us, as there seems to be limited linkage between these priority projects and the budget theme; or a strong evidence base linking a number of them with development impact. How do you view these 'priority projects'? How do you anticipate they will play out as the budget is finalised?

Development partner aid reporting
We are aware of the importance of development partners reporting their spending commitments in order to enable GoU to make good budget allocation decisions (and then executing that spending as planned). How has the aid reporting exercise gone this year? Where do we need to step up our performance?

3. Budget financing

While Uganda remains at low risk of debt distress, containing debt will continue to be a critical priority. An unexpected downturn in GDP growth or increased reliance on non-concessional/commercial borrowing would create additional vulnerabilities, as IMF modelling has shown. Final Investment Decision in the oil sector are also concerning, given that the heavy borrowing for oil sector-related infrastructure is relying on enhanced repayment capacity from oil exports, which looks set to be deferred. Debt to GDP having increased by approximately 2% every year over the past 5 years. It will take a conscious effort by Government to rein in this trend.

We welcome Government efforts to enhance domestic revenue mobilisation, and see tax exemptions as a critical area of potential. World Bank estimates suggest that revenue forgone across all tax sources due to tax exemptions were in the range of 4½ to 5 percent of GDP in in FY16/17; while evidence presented at the National Growth Forum in August 2019 suggested there is very little evidence that these exemptions encourage greater investment, with investment decisions made based on business environment fundamentals.

What challenges do you face associated with making budgetary financing decisions which meet Uganda's needs, including maintaining macroeconomic stability? And are there further ways we can work together to enhance the sustainability of budget financing – for example via helping to construct a framework for assessing tax exemptions?