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Uganda: Joint Staff Assessment of the Poverty Reduction Strategy Paper Annual Progress Report

The attached Joint Staff Assessment (JSA) of the Poverty Reduction Strategy Paper Progress Report for **Uganda**, prepared by the staffs of both the World Bank and IMF, was submitted with the member country's Poverty Reduction Strategy Paper (PRSP) Annual Progress Report to the Executive Boards of the two institutions. A JSA evaluates the strengths and weaknesses of a country's poverty reduction objectives and strategies, and considers whether the PRSP or IPRSP provides a sound basis for concessional assistance from the Bank and Fund, as well as for debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Debt Initiative. The Boards then decide whether the poverty reduction strategy merits such support.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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REPUBLIC OF UGANDA

Joint Staff Assessment of the Poverty Reduction Strategy Paper Annual Progress Report

Prepared by the Staff of the IMF and IDA

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I. OVERVIEW

1. **The Uganda Poverty Status Report 2003 (hereafter referred to as the Report) reviews Government's progress in implementing the Uganda Poverty Eradication Action Plan (PEAP) and serves as Uganda's third annual Poverty Reduction Strategy Paper (PRSP) progress report.**[1] The Report was submitted to Parliament in April 2003 as a background document to the proposed 2003/04 budget and mainly covers developments through fiscal year 2001/02 (July–June).[2] Since new poverty headcount figures based on the 2002/03 household survey will be available only in the Fall 2003, the Report used qualitative data, especially the Second Uganda Participatory Poverty Assessment Process (UPPAP2) and the Village Census, both of which provide a perspective of the poor on poverty and public service delivery. Together with an update of the poverty situation, the Report will serve as background for the forthcoming revision of the PEAP, which is expected to be completed by early 2004.

2. **The implementation of the PEAP faced a number of challenges in the period covered by the Report, including shortfalls in economic growth and persistent insecurity in the northern parts of the country.** Although progress was made in implementing the PEAP program, annual real GDP growth has fallen short of the 7 percent target in the past couple of years, owing in part to a difficult external environment and slippages in key investments. The macroeconomic effects of a widening fiscal deficit funded through increased donor assistance and the mopping up of the corresponding injections of liquidity in shallow domestic financial and foreign exchange

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[1] A summary of the PEAP serves as Uganda's PRSP. The Poverty Status Report documents the progress under each of the four pillars of the PEAP/PRSP: (i) creating a framework for economic growth and structural transformation; (ii) strengthening good governance and security; (iii) increasing the ability of the poor to raise their incomes; and (iv) improving the quality of life of the poor.

[2] The Report also discusses some developments during the first half of 2002/03, such as budget execution.

markets have also emerged as concerns, as has the efficiency of rapid increases in public expenditures.

II. OVERALL ASSESSMENT OF THE REPORT

3. **The Report was prepared through a consultative process, involving line ministries, research institutions, civil society organizations, and development partners.**[3] Staff commend the authorities for having deepened participation in this process and welcome steps to further enhance participation in the preparation of the forthcoming revision of the PEAP. The Report is well structured, contains sensible diagnoses of many of the main problems, and attempts to prioritize policy actions, taking into account the complexity and multi-dimensional aspects of the issues. Moreover, the Report is well-timed, as many of its conclusions can be utilized in the revision of the PEAP. Staff also welcome the way the results of UPPAP2 have been used in reviewing progress in poverty reduction and service delivery.

4. **The Report indicates that the Government has made satisfactory progress in implementing the PEAP, with improvements in access to education, health, and water and sanitation, and in the quality of some services.** However, relatively high levels of poverty persist in some regions and among some groups, and mortality and HIV/AIDS indicators have not improved as expected. The Report recognizes that advances have been made with reforms aimed at stemming corruption and strengthening economic governance, but progress in the area of political governance has been slow.

5. **The Report reconfirms the Government's commitment to macroeconomic stability and a private sector, export-led growth strategy**. It provides a balanced overview of macroeconomic developments in the past few years and the factors that have constrained growth and the transformation of the economy. In this connection, the Report notes the Government's concerns over the size of the fiscal deficit and the sustainability of Uganda's external debt. Staff welcome, in particular, the Report's focus on the need to raise revenues and reduce the growth of expenditures in areas that do not have a strong link to poverty reduction, such as Public Administration, and enhancing the efficiency in the use of public resources.

6. **The Report is candid about the weaknesses in implementing the PEAP, particularly at the sectoral level.** However, staff note that despite the forthright assessment of these problems, the Report fails to link them to the overall PEAP strategy and does not identify the adjustments needed to address them. Staff recommend that the Government use the sector policy assessments to guide the revision of the PEAP.

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[3] In the Introduction of the Report, there is a description of this process.

7. **The Report does not present an updated macroeconomic framework nor does it identify and cost policy priorities for the near term.**[4] Looking ahead, staff urge the authorities to include such information and analysis in the revision of the PEAP.

III. SUSTAINED GROWTH AND STRUCTURAL TRANSFORMATION

8. **The economic growth performance in recent years points to the need to reassess the growth strategy and targets, and intensify efforts to remove the remaining constraints to private investment.** Since the late 1990s, real GDP growth has moderated to 5-6 percent a year. This performance, though solid, has been lower than the PEAP target of real GDP growth of 7 percent. Staff welcome the analysis of economic growth, investment, and export promotion issues contained in the Report, but encourage the Government to develop—and incorporate in the revised PEAP—a clear vision of the structural transformations necessary to underpin sustained higher growth. Despite progress made in implementing key programs to support economic growth such as the Plan for Modernization of Agriculture (PMA), the Strategic Exports Program (SEP), and the Medium Term Competitiveness Strategy (MTCS), the Report candidly discusses the weaknesses in the initial design of the SEP and the lack of transparency in the program's incentive structure. The Government intends to replace the ad hoc incentive structure with a generalized system of incentives that are harmonized among the East African Community (EAC) countries. Staff welcome this proposal, but urge the Government to assess the costs and benefits of the existing and proposed incentives, including a recent initiative to establish export processing zones, and to intensify its efforts to overcome the impediments to private sector activity by strengthening governance, improving infrastructure, and further developing financial markets.

9. **The Report expresses concern about the widening fiscal deficit and increased donor dependence.** Public expenditure as a share of GDP increased from 16.4 percent in 1997/98 to 24.9 percent in 2001/02. Since the rise in domestic revenues did not keep pace, the overall fiscal deficit excluding grants widened from 5.8 percent to 12.7 percent of GDP over the same period. Including grants, the fiscal deficit rose from 1.1 percent of GDP in 1997/98 to 5.6 percent in 2001/02. (In 2002/03 the deficit narrowed to 11.4 percent of GDP, excluding grants, and 4.1 percent of GDP, including grants.) Although the larger deficits have been covered by increased donor support, they have resulted in increased injections of liquidity that needed to be mopped up to contain inflation. The Report notes that these sterilization operations have exerted pressure on real interest rates and/or the exchange rate, raising concerns about the crowding out of private sector activities and adversely affecting export growth. To address the situation, the Government intends to reduce the fiscal deficit over the medium term through a gradual fiscal consolidation, mainly by increasing revenues, without jeopardizing poverty reduction and key economic programs.

[4] Staff note that for several sectors (e.g., health, education, and water and sanitation) the cost of achieving specific sector outputs is routinely included in the development of the Medium Term Expenditure Framework (MTEF).

10. **The revenue-to-GDP ratio increased to 12.2 percent in 2001/02 (and to 12.3 percent in 2002/03), but it remains low by the standards of many other Sub-Saharan African countries, which collect, on average, about 23 percent of GDP in revenues.** The Government is aiming to increase revenues through reform of tax administration, including computerization and the removal of corrupt staff from the Uganda Revenue Authority (URA). These measures are expected to yield increasing gains in the medium term. However, in the view of staff, additional tax policy measures may be needed to significantly raise revenues over time. Staff suggest that in the forthcoming revision of the PEAP, the authorities outline a medium-term plan to enhance revenue mobilization which would be consistently applied, emphasizing broad-based taxes and minimizing the burden on the poor. An agenda for strengthening tax administration could also be usefully set out in the PEAP revision.

11. **Enhancing the effectiveness of government expenditure and expenditure management are critical for achieving poverty reduction objectives.** The Budget Act of 2001, by clearly outlining the budget process timetable, has provided new tools to strengthen budget management and has involved Parliament in the budget preparation process. The new Public Finance and Accountability Act, in turn, constrains supplementaries, and strengthens Parliamentary oversight and transparency of the budget. To improve monitoring and budget efficiency, the Government has steadily expanded the output and outcome-orientation of sectoral programs, but further work is needed to extend this to all areas of the budget. In this context, it is critical to strengthen monitoring and evaluation, reporting, and accountability systems, both at the national and local level. The Report calls for improved prioritization of the budget and for streamlining public administration expenditure. Staff welcome the proposed rationalization of spending on public administration and stress the need to implement expeditiously the proposed medium-term measures.

12. **Financial sector reforms and improved banking supervision have strengthened the banking system.** The new Financial Institutions Bill and the Micro-finance Deposit-Taking Act provide for improved regulation and supervision of the banking system and micro-finance industry. It is important that the authorities expeditiously enforce the new legislation and ensure compliance by all banks, especially with regard to the regulations pertaining to and reporting of capital adequacy, large loan exposures, and insider lending. Enforcement of sound banking practices, as well as promoting the insurance and leasing sectors, could lead to a greater extension of financial services to small and medium enterprises. Staff welcome the Government's intention to expedite social security reforms, including the restructuring of the National Social Security Fund (NSSF), and suggest that prompt action be taken also to divest the Uganda Development Bank.

IV. GOOD GOVERNANCE AND SECURITY

13. **The Report notes with concern the consequences of Government's inability to end the hostilities and general insecurity in some parts of the country.** The Report highlights the increased poverty due to the loss of livelihoods, reduced access to public services, overcrowding in areas of refuge—with resulting environmental degradation—

and human rights violations in the areas of conflict. Staff agree that the conflict needs to be addressed more effectively, particularly its humanitarian aspects. The revision of the PEAP will provide an opportunity to articulate the development needs of the areas affected by conflict as well as to define a comprehensive development plan for the way forward. In addition, more attention needs to be paid to the identification of specific points of social tension (for example, over land) and appropriate remedial measures should be devised.

14. **The Report is candid about the slow progress in implementing reforms in the area of governance.** While the recent National Integrity Survey shows some perceived improvement in combating corruption, it continues to highlight corruption as a serious problem. In this regard, aggressive implementation of the new Leadership Code will be essential for restoring confidence in public institutions. Also, a concerted effort to follow-up on the recommendations of the Judicial Commission of Inquiry into the Uganda Revenue Authority is important. Staff note the need to address weaknesses in the justice, law, and order sector to ensure predictability of court judgments.

15. **The issues of public sector reform and pay reform are highlighted in the Report, although no action plans are articulated.** The Government recognizes the problem of inadequate human capacity as a major constraint for improved service delivery. In this context, improvement of pay for key public service professionals has been an important issue on the agenda. In March 2002, a pay reform strategy with a 10-year timeframe was adopted by the Government as a basis for moving forward with a transparent and equitable pay structure, and since then implementation of the strategy has commenced. There have also been sustained improvements in payroll management. For instance, with the decentralization of the teachers' payroll, new teachers are now accessing the payroll within a month from the date of their assumption of duty. However, problems remain in reconciling the need for increased capacity with ensuring that the wage bill remains consistent with medium-term fiscal prospects. Staff welcome the efforts by the Government to undertake a study on the cost effectiveness of social sector employment and look forward to discussing its results with the Government.

V. INCREASING THE INCOMES OF THE POOR

16. **The Report provides further analysis of the incidence of poverty in Uganda based on past data.** This analysis indicates that poverty reduction programs have not necessarily translated into welfare improvements for the poor and a more equal distribution of income. The Report indicates that significant disparities in income and socio-economic welfare still exist among certain households, age and gender groups, and geographical areas. The disparities are particularly marked between the rural and urban areas, and the Northern region and the rest of the country. In the view of staff, this analysis needs to be complemented with recommendations on specific actions that should be taken to address prevailing income inequalities. In this regard, particular attention should be paid to understanding the poverty reduction effects of different growth scenarios, as poverty elasticity can vary significantly across sectors and regions. Staff encourage the Government to evaluate the poverty reduction impact of alternate growth scenarios in the revised PEAP.

17. **The Report notes that in addition to enhancing growth prospects, key economic programs (PMA, SEP, and MTCS) have been formulated to increase directly the incomes of the poor.** For example, the program to distribute coffee seedlings under the SEP benefits primarily small farmers. However, there are important issues to be addressed with regard to the implementation and consistency of these programs. The SEP takes a supply chain approach, focusing on the promotion of particular crops and proposing specific interventions for extension, research, financing, land tenure, and marketing. The PMA, however, takes a broader approach focusing on advisory services, technology, rural finance, infrastructure, natural resource management (land tenure, environment), agricultural education, and agro-processing and marketing for the sector as a whole, without a specific crop focus. As both programs target the agricultural sector, it is important in the staff's view that the links between the PMA and SEP be clarified to ensure coherence between the two programs. There is a significant risk that the SEP could create additional parallel approaches to the PMA, and divert funds away from PMA activities. In this regard, staff encourage the Government to focus on implementation of the PMA and to assess its impact on improving income prospects in rural areas.

18. **Many of the PMA programs are in the early stages of implementation and scaling up will require additional resources, as well as greater intra-sector and cross-sector prioritization.** In many of the areas under the PMA, there has been slow progress due to lack of clarity about institutional relationships and the resources needed for carrying out identified priorities. Thus, there is a need for improved prioritization of intra-sector resources to ensure alignment with PMA priorities. The National Agricultural Advisory Services program, for example, currently reaches about 30-35 percent of the districts (although it is not yet operating in all sub-counties of these districts). This program, which is a central component of PMA implementation, requires additional resources if it is to reach the remaining districts. Staff also welcome the attention in the Report to efforts for enhancing land tenure rights in order to facilitate the transformation of agriculture and increase incomes of the poor. In this regard, staff are pleased that the Government has indicated that implementation of the Land Act will be the subject of a future Poverty and Social Impact Analysis.

VI. IMPROVING THE QUALITY OF LIFE OF THE POOR

19. **The Report highlights the ongoing problem with stagnant infant, child and maternal mortality indicators, in addition to high fertility rates**. The Report also stresses the Government's commitment to improving this situation. In response to stagnant mortality indicators, in 2002, the Government set up an inter-ministerial committee led by the Ministry of Finance, Planning and Economic Development which has focused on developing an inter-sectoral strategy for interventions in health, water and sanitation, and education sectors. In the view of staff, the challenge is to effectively implement this inter-sectoral strategy through the budget process. An additional area of concern is recent evidence of stagnation of HIV/AIDS prevalence rates after a decade-long downward trend.

20. **Although the Report does not explicitly address MDGs, the PEAP goals are in many respects compatible with, or more ambitious, than the MDG goals.** Given the formidable demands on the social sectors in the attainment of PEAP targets, increased resources have been directed toward the provision of health facilities, primary education, and clean water and sanitation. The cost of these activities on the Government budget has been high and is expected to remain so in the future. However, in the view of staff, it is also evident that scarce financial resources are not the only constraint to expanded service provision: there remain serious supply constraints to the recruitment of qualified personnel, which money alone cannot alleviate. In addition, rapid expansion of social sector employment will inevitably lead to the recruitment of sub-standard staff and thereby reduce the quality of service provision. The competition for scarce resources, given the limited size of the overall resource envelope, has led to an increased focus on efficiency of resource utilization. In the view of staff, continued attention to improving cost efficiency will be essential if PEAP and MDG targets are to be achieved. The PEAP revision offers an opportunity to address this issue.

21. **The Report touches on the need to improve service delivery through increasing the efficiency and impact of sectoral expenditures, but fails to identify specific actions to this end**. The recent survey results indicate that while access to education, health, and water and sanitation has improved, the quality of services, in addition to cost effectiveness, remains an issue. In the view of staff, the results of surveys and studies can be effectively used to develop specific corrective actions in the sectors concerned. Staff encourage the Government to address this in the forthcoming PEAP revision.

VII. CONCLUSION

22. **The Government has made satisfactory progress in PEAP implementation**. Macroeconomic stability has been maintained and growth has remained robust, even if less buoyant than in earlier years. Access to education, health, and water and sanitation has continued to improve, though the quality of services remains a problem and needs further attention. The second National Integrity Survey, conducted in 2002, indicates that there has been some reduction in the reported incidence of bribery since 1998, but the level of corruption remains high. Further efforts to combat corruption are needed.

23. **The Report yields several implications for the forthcoming revision of the PEAP**. In the view of staff, the following are particularly pertinent. First, given the moderation in economic growth, it is critical that the revised PEAP address the factors contributing to growth and structural transformation, and outline an updated strategy to promote economic growth. In staff's view, the PEAP needs to pay special attention to growth in rural areas, where poverty is most prevalent. Second, staff consider the PEAP revision to be an opportunity to make the strategy increasingly results-oriented by introducing quantitative monitoring indicators (input, output, outcome) to all sectors. For monitoring purposes, in addition to long-term targets, staff recommend that the Government includes interim targets for indicators in the revised strategy and links them explicitly to the MDGs. Third, a detailed costing of proposed reforms, which could be linked to future budgets, should be incorporated in the strategy. Fourth, staff recommend

that the Government spells out in the revised PEAP its strategy to address the stagnant infant and maternal mortality rates. Fifth, the PEAP revision process should include an updated debt sustainability analysis and plans for poverty and social impact analyses for selected structural/sectoral policies. Sixth, the PEAP revision provides an opportunity to further integrate gender and environmental concerns in Government programs. And seventh, the PEAP revision process should also detail actions needed to improve governance, including specific benchmarks.

24. In conclusion, the staffs of the Bank and Fund consider that, based on the PRSP annual progress report, Uganda's efforts toward implementation of the poverty reduction strategy provide adequate evidence of its continued commitment to poverty reduction, and therefore the strategy remains a sound basis for Bank and Fund concessional assistance. The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.