

Uganda: Poverty Reduction Strategy Paper—Joint Staff Advisory Note

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Paper 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) to the Executive Boards of the two institutions. A JSAN evaluates the strengths and weaknesses of a country's poverty reduction objectives and strategies, and considers whether the PRSP 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.

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INTERNATIONAL DEVELOPMENT ASSOCIATION
AND
INTERNATIONAL MONETARY FUND

REPUBLIC OF UGANDA

**POVERTY ERADICATION ACTION PLAN
JOINT STAFF ADVISORY NOTE**

Prepared by the Staffs of the IMF and IDA

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I. OVERVIEW

- 1. In May 2005, the Government of Uganda formally launched its Revised Poverty Eradication Action Plan (PEAP) 2004/05-2007/08.**¹ This document, which represents the second revision of the 1997 PEAP, serves as Uganda's Poverty Reduction Strategy Paper (PRSP). The PEAP 2004 was prepared by the government through broad-based consultations with stakeholders and civil society, and builds on the PRSP Annual Progress Report presented to the Executive Boards of Directors of the International Development Association (IDA) and the International Monetary Fund (IMF) in September 2003, along with the Joint Staff Assessment (JSA).
- 2. The PEAP 2004 describes the participatory process underpinning the development of the PEAP strategy, provides a poverty diagnosis, and presents policy measures, sector plans, costing, and a results-oriented policy matrix for sustainable economic growth and poverty reduction over the 2004/05-2007/08 period.** This revision of the PEAP was based on extensive consultations over a two-year period involving three national stakeholder workshops to discuss the revision guidelines, the draft sector papers, and then the first draft of the PEAP. The PEAP consultations were carried out in tandem with the budget process and relied on a bottom-up approach of

¹ The final draft of the Revised PEAP 2004/05-2007/08 was presented to the Cabinet in November 2004. It is referred to as the PEAP (2004) in the remainder of the JSAN.

building from sector working group review papers and extensive comments from civil society.²

3. **The PEAP 2004 argues for a shift of the policy focus from recovery to sustainable growth and structural transformation and presents specific Government policies to accelerate poverty reduction.** It places emphasis on the importance of a stable and consistent macroeconomic framework, fiscal deficit reduction, conflict-resolution, good governance, increased production and productivity in the agricultural sector, and strengthened human development. The problem of high population growth and increasing income inequality are noted as major challenges in the fight for poverty reduction. The PEAP 2004 identifies various policies for accelerating growth and poverty reduction, and improving service delivery through five pillars: (i) economic management; (ii) enhancing production, competitiveness and incomes; (iii) ensuring security, conflict resolution and disaster preparedness; (iv) good governance; and (v) promoting human development.

4. **This Joint Staff Advisory Note (JSAN) provides staffs' analysis and advice on key priorities for strengthening the PEAP and for ensuring effective implementation.** It also highlights several critical areas where current policies do not match those articulated in the PEAP 2004.

II. STRENGTHENING UGANDA'S PEAP 2004

A. Poverty Diagnosis

5. **The poverty analysis, based on the Household Surveys, provide an adequate picture of Uganda's poverty profile, but additional research would facilitate the formulation of an effective poverty reduction strategy.** The PEAP points to possible reasons for the observed poverty trends in Uganda since 1992, but the analysis does not extend itself to searching for the factors that may have contributed to the recent slowdown in poverty reduction and the increasing inequality. Possible lines of query could include assessment of the impact on poverty of Uganda's rapid population growth, vulnerability to various commodity price shocks, lack of accumulated savings to venture into different cash-crop production, and general suppression of economic activity and service delivery due to insurgency. While the observed increase in poverty between 1999 and 2002 remains a cause for concern, the trends are inconsistent with other measures of well-being. Evidence from the Poverty Assessment being conducted by the World Bank suggests that overall, the value of household assets continued to increase and that the proportion of households owning specific assets such as a bicycle, radio, television, etc., increased between 1999 and 2002.

6. **The PEAP highlights gender inequality as an impediment to poverty reduction and growth.** This reflects women's lack of access to and control of productive

² Uganda NGO Forum and Private Sector Foundation contributed to the process by sending their comments at each stage of PEAP revision and holding their own consultations. The Parliament held two separate workshops during the PEAP revision process.

resources—including limited land and property rights—lower labor participation, and higher prevalence of HIV/AIDS among women alongside greater burdens placed on them for the care of those affected and the orphans. The PEAP identifies some priority actions to enhance gender equality as part of the growth agenda, notably through the implementation of the revised National Gender Policy, strengthening of women's land rights, domestic relations and sexual offense laws, and by addressing gender and equity issues in planning and budgeting.

7. **Staff calculations based on the geographical poverty data from the 2002 Household Survey show that tackling poverty in the conflicted-affected North and East can yield significant reductions in the national average poverty rate.**³ For example, if poverty rates in the two regions were brought down to the national average, overall poverty would reduce by about 6 percentage points, while reducing poverty in these regions by half would yield over 10 percent decline in overall poverty. Therefore, a more tangible progress in securing peace in these regions is an urgent priority.

B. Macroeconomic Framework

8. **The medium-term growth objective under the PEAP 2004 has been set at 7 percent.** This is ambitious but realistic, assuming that policies are strengthened as envisaged in the plan. The PEAP would, however, benefit from a more developed analysis of the sources of growth that could help to explain why productivity growth has been relatively low in recent years, and in which sectors productivity is lagging. Many of the PEAP projects that focus on enhancing productivity could be further elaborated upon, including on how to achieve better results through the Program for Modernization of Agriculture (PMA), Medium-Term Competitiveness Strategy (MTCS), and Strategic Export Program (SEP). Equally, further discussion of the social challenges of how to deal with one of the highest population growth rates in the world would be useful.

9. **On fiscal policy, the PEAP 2004 commits to achieving gradual fiscal consolidation without jeopardizing poverty reduction.** The government plans to reduce the fiscal deficit, excluding grants, by 1 percentage point annually, from about 10 percent of GDP in 2004/05 to about 7 percent in 2007/08. The staffs welcome the clear discussion of the challenges of maintaining macroeconomic stability and strong private sector-led growth in an economy experiencing large donor inflows. The analysis could, however, be strengthened by a discussion of the challenges to manage potential scaled-up donor inflows in support of the Millennium Development Goals (MDGs) in a manner that maintains macroeconomic stability.

10. **Efforts to strengthen revenue mobilization will be critical in reducing the fiscal deficit.** Given the low tax-to-GDP ratio by regional standards, there is room for raising revenue through tax administration reform and a well-designed tax policy that

³ Due to insecurity at the time of the surveys, some districts of the North (Pader, Kitgum, and Gulu) were not included. This limited a fuller understanding of the poverty situation in the region, where approximately 1.6 million people are living in camps due to insurgency. The Uganda Bureau of Statistics has just completed a Northern Uganda Survey whose results could provide further insight into the poverty situation in the region.

includes a broadening of tax bases. In this respect, measures that would seriously erode the tax base, such as income tax holidays, should be avoided. While specific tax policy measures, including changing excise taxes and VAT, are being proposed, the ongoing restructuring of the Uganda Revenue Authority is an important step in strengthening revenue collection. The discussion of revenue mobilization could, however, be strengthened by being more specific on the tax measures envisaged for 2005/06 and 2006/07 and defining possible contingency measures in the case of revenue shortfalls.

11. Expenditure prioritization and value for money will need increased attention, given the strategy of restrained overall expenditure growth. The staffs welcome the detailed discussion of public expenditure policies in Chapter 8. However, a stronger emphasis is needed on public administration and pay reform, which have stalled in recent years, and where policies are not well articulated in the PEAP. A key concern, in this regard, is that recurrent spending has grown in recent years, at the expense of domestic public investment (PEAP 2004, Table 8.1). A rationalization of low priority recurrent spending—especially in public administration—is needed to create fiscal space for much-needed infrastructure investments and to avoid dependency on donor inflows for funding wage and other recurrent expenditures. In addition, strengthened public expenditure management is needed, including achieving improvements in the (i) integration of donor-supported projects into the budget; (ii) monitoring and control of domestic arrears; and (iii) budgeting, expenditure execution, and reporting at the local government level.⁴ In this context, the staffs urge the authorities to continue strengthening expenditure management and fiscal reporting to ensure the success of the decentralization strategy.

12. Finance and trade are cornerstones for stronger growth and mitigation of exogenous shocks. The PEAP 2004 assigns an important role for financial deepening, but its analysis and coverage is weak and only few policy actions related to micro finance institutions and pension reform are identified.⁵ Policies to foster financial intermediation and long-term financing, including a carefully structured reform of the pension system will be critical. The staffs support the PEAP's strategy of openness and regional integration to strengthen competitiveness. However, given the political commitment to developing the East African Community (EAC) as a single trading market, it would be important to present a more considered analysis of the potential benefits that the EAC presents for Uganda's poverty reduction strategy. In introducing export-processing zones (EPZs), it will be important to ensure that the legal, regulatory and taxation frameworks are consistent with best practices and Uganda's implementation capacity. In this respect, the staffs note that the authorities should avoid introducing tax holidays, given Uganda's relative low tax revenue ratio.

⁴ Further strengthening of the public financial management systems at the local government level is crucial, given the large scale of decentralization that has taken place in Uganda. To date, nearly 40 percent of total expenditures and about 60-70 percent of spending under the PAF are executed by the subnational authorities. Initiatives in this area are coordinated under Uganda's Fiscal Decentralization Strategy (FDS), which is entrenched in the PEAP.

⁵ The recent Financial Sector Assessment Program (FSAP) update presents a thorough analysis of the weaknesses in the financial sector as well as possible policy actions.

13. **Debt Sustainability and Vulnerabilities:** Government's commitment to gradually reduce reliance on external borrowing, together with the intention of major creditors, including IDA, to provide increasing proportions of their financial support in the form of grants, will contribute to a further decline in Uganda's debt sustainability indicators. Indeed, the external debt service burden has remained at broadly similar ranges as a share of GDP at HIPC completion point. An external debt sustainability assessment undertaken by Fund Staff earlier this year, however, shows that the debt burden is highly sensitive to export shocks, such as a decline in the terms of trade. Past output growth trends show that the Ugandan economy is also vulnerable to the impact of adverse weather conditions. The PEAP provides only limited discussion of the potential vulnerability of macroeconomic performance and poverty reduction to exogenous shocks, such as adverse developments in the terms of trade, donor support, security, and weather conditions. The stock of domestic debt is growing and the associated debt servicing cost now exceeds that for external debt.

C. Promoting Growth for Poverty Reduction

14. **The PEAP rightly focuses on the challenge of moving from economic recovery to sustained growth and structural transformation.** The growth objective will require substantial investments in infrastructure and strengthening of policies. The PEAP notes that higher levels of private investment will be needed to meet the required investments, and that this may involve exploring international market opportunities. The PEAP also emphasizes the tension between the resource requirement for investments and the expectation of improved access and quality of services. This tension is exacerbated by the fact that over 50 percent of the population is now in the dependent age groups with the young requiring primary and secondary education and the old seeking health care. Hence, a longer-term vision on the best way to promote key social services on a sustainable basis is long overdue, as is the debate on the need to reduce the average fertility rate currently standing at just below 7 children per woman.

15. **Policies geared to support agricultural growth require special priority.** The PEAP 2004 notes that 86 percent of Ugandans live in rural areas, and that 77 percent of active rural labor is employed in agriculture. Slow progress in the implementation of the 7 pillars of Plan for Modernization of Agriculture (PMA) and their rollout to all districts has been a major handicap to agricultural development. It will be critical for the government to address the institutional and resource constraints that have limited implementation of the PMA to only 2 (extension and research) out of the 7 pillars and to only a limited number of districts. Farmers in Uganda also face high transactions costs in accessing inputs and in getting their crops to market. They also lack access to affordable credit. Recent studies indicate that access to infrastructure and agricultural services by the rural poor has not kept pace with growth in access to social services since 1992. The government is therefore encouraged to place special emphasis on rural transportation, rural energy, and agricultural services in future budget and policy decisions.

16. **The staffs concur with the PEAP 2004's finding that further infrastructure improvements are needed.** Reliable and more accessible electricity supply is needed for structural transformation into industry, in particular to increase the value-added

component in agricultural exports through agro-processing. Better roads, rail, and air freight links are needed to reduce the extraordinarily high transactions costs which Uganda faces from being landlocked. The PEAP identifies nearly all of the broad areas of infrastructure as being important, but also notes that, in recent years, public infrastructure investment as a share of GDP has been falling. This is a worrying trend, suggesting that additions to Uganda's infrastructure are failing to keep pace with the rate of depreciation of the existing infrastructure and would not be able to accommodate the needs of a growing economy and population.

17. **The staffs also note that the focus on security, conflict resolution and disaster management needs to be translated into tangible progress.** The PEAP 2004 lacks a comprehensive and strategic plan that addresses both the security and poverty reduction objectives. The poverty rates in the North and the East stand at 64 percent and 46 percent, respectively, compared to the 22 percent in the Central and 31 percent in the Western regions. The PEAP 2004 reports that in the nine districts most affected by insecurity and distress migration (PEAP Table 5.2), an average of about half of the population is classified as internally displaced persons, most living under extreme hardship conditions as well as under perennial fear of insurgency attacks. Progress toward peace and reintegration in the conflict-affected areas will not only heal the two decades of human suffering, but is also likely to provide a substantial peace premium in the form of growth and poverty reduction coming from restoration of economic activity in the North and the East.

D. Human Development and the MDGs

18. **The PEAP reports that access to essential services improved steadily over the past decade, especially in education, health care, and water and sanitation.**

Compared to 1992 when only about 65 percent of primary school age children actually attended school, the net primary school enrolment in 2003 stood at about 85 percent owing in large part to the government's provision of Universal Primary Education (UPE). In the health sector, abolition of user fees in the public health care centers in 2001 may have contributed to the dramatic increases in the number of patients seeking outpatient facilities, rising from 9.3 million new cases in FY1999/2000 to 17.7 million in FY2002/03, equivalent to an increase from 0.4 to 0.7 visits per person per year. Access to safe drinking water in 2004 stood at about 62 percent, with access in rural areas having increased from 20 percent in 1991 to 55 percent in 2002.

19. **The PEAP also notes steady improvements in the quality of these services, although more can be done to improve the poor outcomes in learning achievement, life expectancy, child and maternal mortality, and high incidence of stunting among children under five.**⁶ Possible reasons for the lack of faster progress in these outcome indicators may be attributed to: (i) the poor quality of key service delivery elements such as drug shortages, poor water chain management, poor sanitation and hygienic practices

⁶ In the health sector, DPT3 coverage also increased from 41 percent to 85 percent and drug supplies and availability have improved. In terms of resource outputs, proportion of trained health care workers increased from 33 percent to 68 percent.

in spite of increased access; (ii) the high population growth rates causing the demand for social services to outstrip the growth in supply; and (iii) insufficient attention to cross-cutting sectoral interventions that can influence these outcome indicators. The PEAP recognizes, therefore, the need to renew the focus on improving the quality of social services by ensuring better value-for-money and strategic investments in the enhancement of service provider capacity and promoting access to family planning services. The Staffs suggest that a stronger consideration be given to issues of efficiency, sustainability and strategic orientation of sector budgets.

20. **The Staffs welcome the fact that most of the PEAP targets are consistent with the MDGs, and that Uganda is committed to achieving them.** Recent studies indicate that Uganda is likely to meet half of the MDG targets, but faces significant challenges in meeting other targets such as maternal and under-5 mortality, gender equality, and environmental sustainability. Additional technical and financial support is necessary to put back on track Uganda's progress in meeting these MDG targets.

E. Governance Reforms

21. **Overall progress in governance has continued to be slow, despite some marked progress in a few areas.** Recent reports on corruption show that Uganda has slightly improved its rating globally, but still remains at the low end of the scale in country rankings. The set back in implementation of the Leadership Code arising from the High Court challenge of some of its provisions is regrettable and a cause for concern. The progress in implementing the recommendations of various Commissions of Inquiry has been very slow and warrants specific actions. Staffs stress the need for a clear demonstration of Government's commitment on governance reforms and a strengthening of the specific implementation details currently lacking in the PEAP 2004. The Government is currently engaging the stakeholders in defining measures that could contribute to improved governance in the annual PEAP policy and results matrix, but concerns remain on the speed of implementation as well as the effectiveness of some proposed measures in reducing corruption.

22. **The PEAP 2004 defines "transparent, efficient, accessible and affordable Government" as one of the elements for good governance.** The donor community, however, has often expressed concerns over a number of recent government interventions in favor of individual investors or businessmen where there may be a perceived or real conflict of interest. As many of these interventions have distorted, or placed a burden on, the approved budget, the Staffs recommend that such interventions be strictly avoided.

23. **The Staffs welcome the PEAP 2004's attention to political governance institutions which absorb a significant amount of resources.** It notes that large and unpredictable claims on resources by these institutions have been a problem, requiring frequent supplemental expenditures in the past. The PEAP 2004 alludes to efforts underway in developing a coordinated strategy to deal with over-expenditures, mostly in the public administration sector, but this will need decisive political backing to be meaningful.

F. Monitoring and Evaluations

24. **The PEAP 2004 provides an innovative results matrix which links areas for policy action with intended results and annual indicators for monitoring the results.** After the finalization of the PEAP, the Government has developed a substantially more detailed results matrix which ties specific policy actions to monitorable annual output/outcome indicators. Once finalized, this matrix will allow, at the same time, the consolidation of multiple Monitoring and Evaluation processes used by the Government and the donors. The Bank is supporting these efforts through assistance on the implementation of the National Integrated Monitoring and Evaluation Strategy (NIMES), and by helping to strengthen the collection of relevant data through the Statistical Capacity-building program. The cost of implementing the NIMES needs to be firmly established and incorporated into the medium-term expenditure framework.

III. CONCLUSIONS AND ISSUES FOR DISCUSSION

25. **Bank and Fund Staffs believe that the PEAP 2004 constitutes a comprehensive and well-balanced strategy to achieve accelerated growth and poverty reduction.** The report builds on the experience of implementing two earlier programs, benefits from more extensive consultations with stakeholders and, thus, provides a clear and coherent framework for poverty reduction in Uganda. The macroeconomic performance remains sound, harnessed by prudent fiscal and monetary policies, as well as by continued broad-ranging structural reforms.

26. **However, major challenges remain and risks persist.** The number of people living in poverty and inequality of income distribution are high, the quality of life indicators are still generally poor, and the economy will continue to be prone to exogenous shocks. Corruption, perceived or real, needs to be tackled resolutely. The PEAP 2004 candidly recognizes these challenges.

27. **Do Directors support the staffs' view that the PEAP 2004 provides a credible strategy for achieving poverty reduction?** Do Directors agree with the staffs' recommendation that special attention needs to be given during implementation of the PEAP 2004 to the following priorities?: (i) maintenance of a stable macroeconomic environment and a gradual fiscal consolidation; (ii) efforts to achieve savings in nonpriority spending that can be reallocated to infrastructure and other priorities; (iii) dealing with the current high population growth and fertility rates; (iv) innovative ways to bring about increased agricultural production, productivity and increased incomes; (v) energy supply and infrastructure development; (vi) decisive measures to deal with corruption at all levels; and (vii) improvement in the security situation in the country.