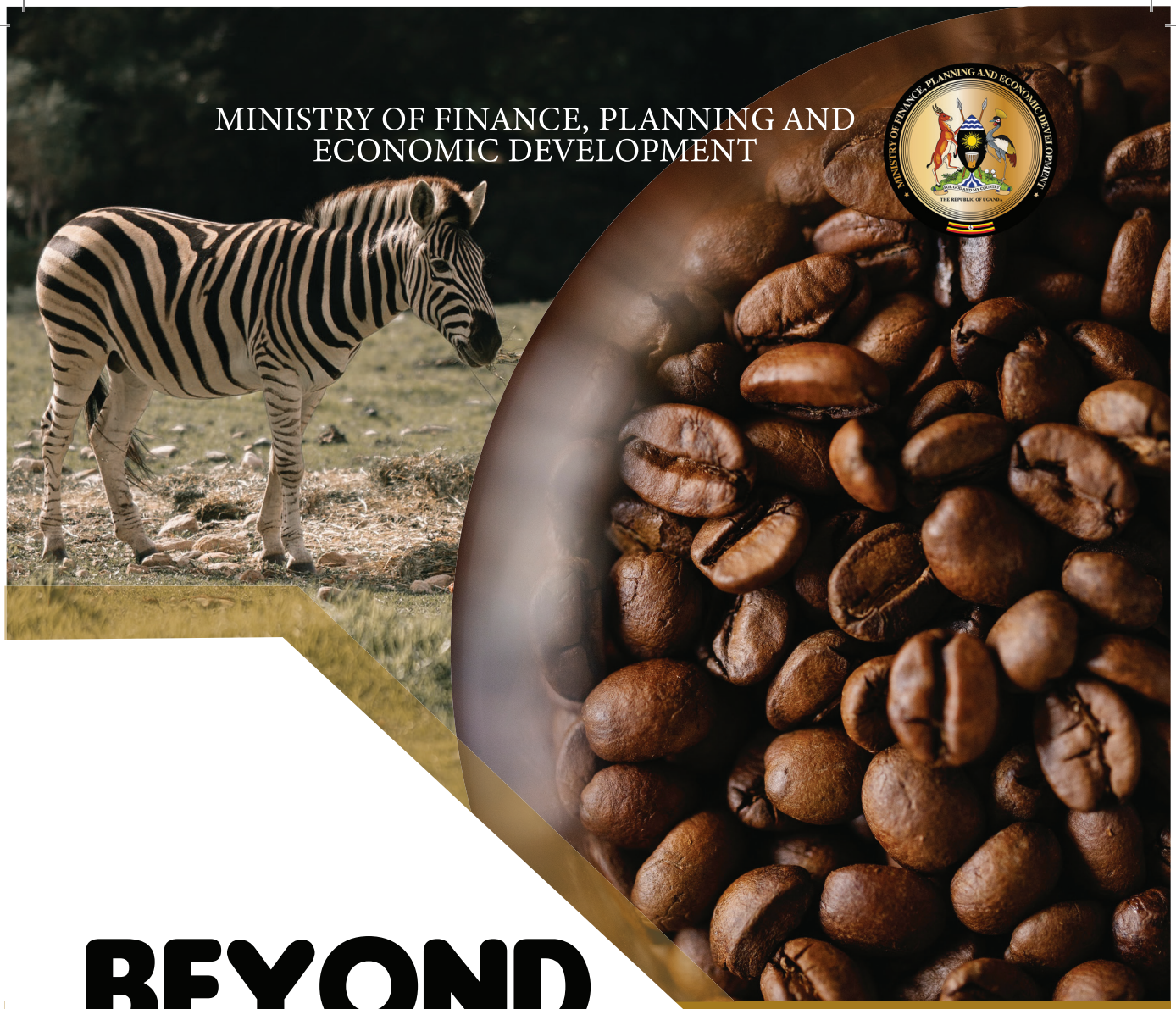

MINISTRY OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT

BEYOND RECOVERY 2021

POLICIES TOWARDS RESURGENT GROWTH IN UGANDA

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IGC

Beyond Recovery: Policies towards resurgent growth in Uganda

Content

ACRONYMS

ACET --African Centre for Economic Transformation
AfCTA --Africa Continental Free Trade Area
AfDB -- Africa Development Bank
ASSP -- Agriculture Sector Strategic Plan
BEC-- Broad Economic Classification
BRT -- Bus Rapid Transit
BUBU -- Buy Uganda, Build Uganda
CET -- Common External Tariff
COMESA -- Common Market for East & South Africa
COVID-19 -- disease caused by Corona virus
CSA-- Climate Smart Agriculture
CSCF -- Commodity Specific Commission Factor
DC -- District Commission
DRC -- Democratic Republic of Congo
DRMS -- Domestic Resource Mobilisation Strategy
EAC -- East African Community
ESI -- Environmental Social Impact
FDI --Foreign Direct Investment
FTA -- Free Trade Area
GDP -- Gross Domestic Product
GKMA -- Greater Kampala Metropolitan Area
GOU -- Government of Uganda
HCI -- Human Capital Index
ICOR -- Incremental Capital Output Ratio
ICT -- Information Communication Technology
IMF --International Monetary Fund
JICA-- Japan International Cooperation Agency
KCCA -- Kampala Capital City Authority
LIDC-- Lower Income Developing Countries
MDAs -- Ministries Departments & Agencies
MFPED -- Ministry of Finance Planning & Economic Development
MNC -- Multinational Companies
NDP -- National Development Plan
NDP III -- The third National Development Plan
NEMA -- National Environment Management Authority
NPA -- National Planning Authority
NRM -- National Resistance Movement

NTB -- Non-Tariff Barriers
NTM -- Non- Tariff Measures
OSBP -- One Stop Border Posts
PAU -- Petroleum Authority of Uganda
PFM -- Public Finance Management
PIM -- Public Investment Management
PIP -- Public Investment Plan
PLE-- Primary Leaving Examination
PPP -- Public Private Partnership
QENP -- Queen Elizabeth National Park
SADC -- Southern Africa Development Cooperation
SAPs-- Structural Adjustment Programs
SME -- Small & Medium Enterprises
SOPs -- Standard Operation Procedures
SSA-- Sub-Saharan Africa
TFP -- Total Factor Productivity
TPD -- Tax Policy Department
TSDP -- Tourism Sector Development Plan
UBoS -- Uganda Bureau of Statistics
UDB -- Uganda Development Bank
UDC -- Uganda Development Corporation
UNDP -- United Nations Development Program
UNMA -- Uganda National Meteorological Authority
URA -- Uganda Revenue Authority
UWA -- Uganda Wildlife Authority
VAT -- Value Added Tax
VFR -- Visitors, Friends & Relatives
VT -- Vocational Training
VTI -- Vocational Training Institutes
WTO -- World Trade Oganisation

Foreword from the Permanent Secretary/Secretary to the Treasury

The global pandemic has posed unprecedented challenges for Uganda. Although signs point to a continued recovery in 2022, COVID-19 put increasing strains on our health system, hurt households and businesses, and depressed the overall performance of the economy. At the same time, the pandemic pushed the world into its severest recession since the great depression - with an impact on Uganda's economy as severe as the disease itself. Contracting markets abroad cut into our exports. The tourism industry, caught between lockdowns and fear, was decimated. Uncertainty curtailed foreign investment. The Ugandan diaspora, exposed to new levels of unemployment abroad, has had to slow remittances. Meanwhile, although oil prices have rebounded in recent quarters, the collapse in prices in 2020 stalled momentum of the industries' development in Uganda.

Responding to these challenges to consolidate the emerging recovery requires decisive policy action. To set Uganda back onto a course towards middle income status, Government will put in place evidence-based policies that will enable citizens to reap new opportunities for growth in a rapidly changing global landscape.

This book – concerned with the question of how Uganda can re-launch high growth that will create new prosperity for all citizens – provides key elements for such comprehensive policy reform. The purpose of this collection of articles is to provide the general public with an overview of critical challenges and opportunities in selected topic areas, as well as strategic interventions that will be adopted by Government to support economic recovery.

The insights, ideas and recommendations presented in the various chapters benefitted from research and vibrant high-level exchange at four Economic Growth Forums held in Uganda between 2017 and 2020. The Economic Growth Forum is an annual conference hosted by the Ministry of Finance, Planning and Economic Development in collaboration with the International Growth Centre. The goal of the Forum is to bring together leaders from Government, stakeholders, the private sector, academia, and civil society to discuss actionable policy solutions to growth obstacles. The event serves as a starting point for Uganda's annual budget cycle, and provides a unique platform for constructive exchange on growth issues of the country, informed by cutting-edge economic analysis.

Inclusive economic growth in Uganda cannot be achieved by one policy or programme. Rather, Ugandan livelihoods will be improved through the successful interplay of several reforms, ranging from skilling Uganda's abundant and young labour force, to raising tax revenues to finance growth-stimulating investments in education, health, and infrastructure, to creating a business environment that can attract investment and foster the creation of globally competitive firms. This book covers a range of topics, all of which are central to our collective ambition to transform Uganda into a modern and prosperous country, as envisioned by His Excellency, the President in the Vision 2040.

It is my hope that the contents of this book will provide evidence for action, and inspire its readers to consider how best they can support this shared vision in their daily actions.

CHAPTER 1 :

Overview

Louis Kasekende and Richard Newfarmer

The Covid-19 pandemic and global recession of 2020 brought Uganda's previous four years of rapid growth to a sudden halt. The recessionary forces emanating from the global economy undercut Uganda's export growth, dried up tourism revenues, curtailed incoming foreign investment, and blew a hole in the nation's fiscal accounts. It also exposed underlying drags on Uganda's pre-Covid growth trajectory – inefficiencies in public expenditures, stagnating agricultural productivity, high costs of doing business and slow growth in globally competitive industries.

Even though the economy seems to be rebounding, the crisis has made Uganda's agenda of medium-term policy reform all the more urgent. While the country has managed the disease extraordinarily well to date -- with infection rates per 100,000 at about two percent of those in the UK and about five percent of those of South Africa[1] – the cost to achieve these results in the form of an emergency lockdown and border closings at the outset of the pandemic has been high, especially for Uganda's poor. According to a study by the International Growth Centre, the combined effects of initial domestic containment measures and the global recession in the first half of 2020 resulted in an increase of poverty by almost 8 percentage points, pushing up poverty rates to levels not seen in a decade (Younger et al, 2020).[2] Unemployment shot up. SMEs, especially female owned firms, were particularly hard hit, experiencing losses in demand, revenues and profits that are yet to recover. The reduction in SME performance also resulted in substantial losses in terms of workers' wages, which are still well below pre-pandemic levels (Gulesci et al. 2020; Alfonsi et al., forthcoming a; Alfonsi et al., forthcoming b). In the aggregate, Musisi in this book estimates that the cumulative forces of the global recession cut 3 percentage points off Uganda's trend growth projections.

As a result of the global recession, Uganda faces a much-changed international environment. The crash of the global economy intensified structural changes already evident in the pre-pandemic world: the accelerated pace of technological diffusion through new channels of communication, the heightened importance of service sectors as a source of jobs and growth, and secular trends towards worsening income inequality within many nations. At the same time, Uganda has to confront a changed international market. China and East Asia, recovering more rapidly than Europe and the US, are consolidating their position as new centres of global demand. India and the Middle Eastern countries will likely be of growing importance as customers to agriculturally rich Uganda. Because East Africa is growing more rapidly than other areas, regional trade will continue to be of great importance. Moreover, access to global savings will likely become more constrained and probably take new forms – while FDI flows into developing countries are likely to recover from a Covid 19 trough, the rebound is unlikely to be substantial , meaning that access to FDI will remain competitive.[3]

This book analyses both obstacles and opportunities for Uganda in this new post-pandemic world

1 Hannah Ritchie, Edouard Mathieu, Lucas Rodés-Guirao, Cameron Appel, Charlie Giattino, Esteban Ortiz-Ospina, Joe Hasell, Bobbie Macdonald, Diana Beltekian and Max Roser (2020)- "Coronavirus Pandemic (COVID-19)". Published online at OurWorldInData.org. Retrieved from: 'https://ourworldindata.org/coronavirus

2 Younger et al (2020) "Estimating income losses and consequences of the COVID-19 crisis in Uganda".

3 UNCTAD (2021) reports that global FDI flows fell by 42 percent in 2020. It should be noted, however, that in Africa this reduction has been at least somewhat moderate, with a recorded fall of 18 percent. https://unctad.org/system/files/official-document/diaeiainf2021d1_en.pd

for the country to move from deep slowdown to sustained and inclusive growth. Collectively, the chapters in this book speak to four interrelated challenges that Uganda confronts.

- First, *Uganda must manage the complex transition from a growth recession in 2020 to a robust recovery in 2021/22 and 2022/23.* It begins this task rebuilding from the ashes of 2020 that bankrupted some businesses, including SMEs, increased poverty, and likely greater wealth concentration than before the pandemic.[4] This policy agenda has several facets: establishing a macroeconomic framework that entails effectively managing and then phasing out support programs, reversing pandemic-driven revenue shortfalls, and increasing the equity and efficiency of revenue mobilization, while at the same time increasing the productivity of public investment.
- Second, to sustain growth momentum, *Uganda will have to raise the productivity of both labour and capital.* This too has several dimensions: managing the long-term demographics to take advantage of near-term rapid increases in the labour force, increasing the amount of capital per worker through increases in investment, lifting educational outcomes as well as ensuring that Uganda's rapid urbanization works as a source of productivity gains rather than as a drag on growth.
- A third challenge is to *accelerate export growth and leverage regional and global integration to develop new sources of growth.* This entails balancing the potential for pro-competitive import substitution policies in Uganda along with trade and regional integration opportunities that allow Ugandan firms to overcome their small domestic market, realize economies of scale and grow.
- *A final imperative is to speed up the structural transformation process by actively supporting growth of high-productivity sectors.* Here the book explores the possibilities and challenges for Uganda to take advantage of the potential of key strategic sectors identified by the government that could provide high productivity jobs, namely high value-added agriculture, tourism, industry, and the hydro-carbons sector.

The four sections that follow present selected highlights and policy recommendations from the 13 papers included in this book. The analyses and suggested policies in this volume are not intended to be comprehensive – indeed other policy domains, such as innovation, electronic commerce, labour markets, social protection, and health, to name a few, merit their own analysis. Nonetheless, while this collection does not purport to be fully comprehensive, it does speak to topics central to *Uganda's Vision 2040* – and thereby provides guidance in responding to key challenges facing Uganda in a post-pandemic world.

4 Qureshi (2020) points out that the effects of the pandemic recession have driven up inequality around the world because many smaller businesses without the cushion of abundant resources have been destroyed and workers with fewer skills, particularly in services industries, have been more adversely affected.

Challenge 1: Managing the transition from deep slowdown to sustained economic recovery

Rekindling growth momentum is the government's main task for the coming years. In his contribution, ***"Accelerating and sustaining Uganda's growth momentum",*** Dr. Albert Musisi observes that following decades of impressive growth, Uganda's economic growth has slowed over the last ten years. Several reasons account for this: weak external demand, declining productivity (especially in the agricultural sector) and the negative impact of rapid urbanization on productivity and growth. The Covid-19 recession exacerbated these problems. The crisis and associated lock-down measures especially affected SMEs – which had no choice but to cut salaries and lay off many mostly unskilled workers. In some extreme cases, the SMEs ceased business operations. At the same time, the worldwide recession resulted in a stark decline of FDI inflows, remittances, exports, and tourism receipts. Combined, these developments resulted in economic growth much lower than projected prior to the pandemic and led to a substantial increase in poverty rates to a level last seen in Uganda about a decade ago.

The impact on public finance was no less severe. Recession simultaneously depressed revenues and mandated increases in social protection expenditures. Deficits rose. Public sector debt has increased. Uganda enters the recovery in a highly constrained fiscal environment.

To reignite economic growth, Dr. Musisi suggests that Uganda needs to treat constraints to economic growth that were already existent prior to the crisis with even greater attention. To increase production and productivity, Uganda will have to raise the efficiency of public investments, enhance productivity of private investment, create supportive conditions for SMEs, foster urban productivity, and enhance regional integration to overcome a small domestic market. A second set of policies must be concerned with raising resilience to future shocks through the diversification of the export basket, strengthening of the fiscal policy space and investing in climate resilient public infrastructure. The role of the government to support these goals through well-designed and rigorously implemented economic policies will be crucial.[5]

The chapter by Adrienne Lees and Carol Namukwaya, ***"Enhancing Domestic Revenue Mobilization in Uganda",*** focuses on improving tax policy and administration. They note that in the run up to eve of the pandemic recession, Uganda had experienced a widening gap between expenditures and revenue collection. With a revenue-to-GDP ratio of only 13.3 percent in fiscal year 2020/21, Uganda lags both its regional peers (for example, the revenue-to-GDP ratio in Rwanda was 18.7 percent in FY 2018/19) and behind the country's own revenue potential estimated at 22-26 percent of GDP. Improving tax policy is a priority. Statutory rates provide potential revenues much higher than actual collections because the government grants generous exemptions to foreign and domestic

5 In addition to its role in policy formulation, discussed throughout, the role of government in shaping an inclusive growth path is critical. John Jellema et al (2016) in their IGC study of its revenue and expenditure patterns found that the incidence of government was moderately progressive, but that the relatively small size of government in Uganda when compared to other countries of its per capita income reduced the otherwise positive effects of the public sector in Uganda.

investors. Eissa et al (2020) estimate that income tax and customs exemptions cost the government around 1 percent of GDP in revenues, roughly equivalent to half of what the country spends on its health system. International evidence suggests tax incentives have negligible effects on firm productivity and growth. Their overall cost and effectiveness in Uganda could likely be improved with more strategic administration, establishing sunset provisions so they expire, and careful monitoring to ensure that company commitments made in exchange for tax relief are fulfilled. Moreover, VAT collections constitute about one-third of revenues but are limited by exempted activities, most notably in the agricultural sector. At the same time, efforts to provide targeted business support to SMEs may be crucial to eventually incorporating much of Uganda's large informal sector into the formal tax net. Finally, the personal income tax that today collects only about 2.2 percent of GDP, could be recalibrated to be more progressive and provide greater revenues, among others by adequately taxing high net worth individuals.

Beyond reform to tax policy there is significant scope for Uganda to enhance its revenue collection through improvements in tax administration. The introduction of the Electronic Fiscal Receipting and Invoicing System (EFRIS) offers considerable scope to improve VAT and excise duty collections. Maintaining an adequate registry of taxpayers and enhancing the adoption of data-based techniques to identify firms at risk of evasion could plug holes in the tax net - for example, through systematic cross-checks of VAT taxable transactions between domestic firms and surveys of retail establishments. At the same time, policy makers should resist the temptation to "expand the tax base" by introducing new, poorly designed tax handles in response to short-term revenue pressures. Instead, when designing revenue-raising proposals, the government should consider measures that will contribute to the recovery from the COVID-19 pandemic and that are aligned with other government objectives, such as curbing environmental pollution through adequate taxation of harmful activities.

The expenditure side of the public ledger will also be important in the recovery process as Justine Ayebare outlines in her chapter, ***"Public Investment Management as a Driver for Growth".*** The chapter focuses on ways through which targeted investments in public goods such as education and health, as well as physical infrastructure like roads, airports and dams can propel inclusive growth. Over the past decade Uganda has more than doubled its spending on public investment projects from USD 1.2 billion in 2010/11 to USD 4.4billion in 2020/21 . While this growth is impressive, as a share of the country's GDP, public investment is still low, increasing only from about 4.6 percent to 7.8 percent over this period. At the same time, low levels of social spending imply that fiscal policy in Uganda has limited redistributive effects and lags behind its potential to combat poverty and inequality (Jellema et al., 2016).

Not only is public investment relatively low in Uganda - it also exhibits extremely low levels of efficiency. Over the decade to 2014, Ayebare cites data showing that Ugandan investment was half as productive as in developing countries on average. Because of inefficiencies in Uganda's public investment management, every dollar invested in the development of public capital stock between 2004 and 2014 generated only 0.8 USD worth of economic activity. To put this into perspective, in the United States, every

dollar invested in the development of the interstate highway network over the period 1954 to 2001, is estimated to have generated about 6 USD of economic activity. Several reasons account for this underperformance: a proliferation of projects that lack strategic focus on structural transformation, inadequate funding that falls short of ambitious plans and creates an inventory of half-finished projects, over-reliance on donor funding that sometimes hits political or administrative tripwires, and insufficient provision for recurrent expenditures necessary for adequate operation and maintenance of existing investments.

Ayebare makes the case for Uganda to increase the efficiency of its public spending through a more efficient Public Investment Management System and discusses a range of possible policy and institutional reforms to facilitate this goal. These include establishing an integrated databank of projects to align project information and create a reliable source of data for decision making, linking major infrastructure corridors to the investment promotion program and production/marketing centres, as well as better co-ordination with development partners to avoid distortionary off-budget support and supply-driven projects that do not match actual priorities. Finally, undertaking more systematic cost-benefit analysis of projects (including necessary operation and maintenance costs) when ranking possible investments could raise investment productivity substantially.

Challenge 2: Increasing the productivity of labour and capital

Uganda's second medium-term challenge is to raise the productivity of its labour force and capital stock – and the way they are combined in enterprises to drive growth in total factor productivity. Demographics are a key driver of underlying opportunities. The country is young, even by African standards: some three quarters of Uganda's population is under the age of thirty. Moreover, the population is growing rapidly at about three percent per year, and the dependency ratio (that is, children and retired people to labour force) is declining. Besides the growth in the labour force, this demographic transition could augur a natural increase in labour's contribution to GDP. Whether Uganda can take advantage of this opportunity depends, among other things, on its capacity to educate the labour force and its capacity to increase its productive investment, especially in cities. Four papers in this book analyse these forces shaping Uganda's response to the productivity challenge: demographic trends, issues in education, obstacles to investment, and the role of urbanization.

Sam Mugume, Susan Kavuma and John Okiira in their chapter "***Reaping the demographic dividend: Uganda's case"*** examine the latent potential of Uganda's young population and the opportunities that exist to convert it into a demographic dividend and spur economic development. Drawing from the literature ranging from Malthus to the Solow growth model, they point out that Uganda started its demographic transition after 1991. Death rates dropped sharply with significant reductions in maternal and infant mortality while fertility rates remained high because of limited access to family planning methods, early marriages, high school dropout rates of girls, and cultural preferences for large families. Population growth was most dramatic in the rural sector. For example, the

share of labour in agriculture rose to 73 percent in 2017, up from 69 percent in 2002.[6] The ratio of available arable land to labour has fallen correspondingly, undermining labour productivity.

Capitalizing on these natural forces for productivity gains requires several policies, including the provision of accessible medical facilities and offering affordable family planning services. Realizing the potential productivity gains requires moving labour from subsistence agriculture to more productive jobs, both within the agricultural sector and out of it into manufacturing and services.[7] Tapping into the potential for increasing national savings underscores the importance of incorporating low-income workers in the financial system and expanding financial services to the rural population.

Arguably the most important tool available to government to raise labour productivity is education policy, the subject of Nicole Ntungire's chapter on ***"Education and skills for growth"***. Providing skills for the country's rapidly growing workforce -- with about 500,000 new entrants per year -- is increasingly critical for the country's long term growth trajectory. However, the educational system falls short of responding to this challenge. Completion and retention rates are low, with completion rates for Grade 9 as low as 30 percent. Teacher absenteeism is unforgivably high - on any given day 28 percent of the teachers on a school's pay roll will be absent. With inadequate instructional materials and pedagogy on top of these shortcomings, educational outcomes are predictably low.

A related problem is that school curricula do not provide graduates with the skills demanded by Ugandan firms. The chapter highlights the mismatch between labour demand and supply in Uganda, resulting in a high number of unemployed, mostly young Ugandans on the labour market.

Among Ntungire's proposed recommendations are to develop a continuous measure of assessment for the basic primary level (P1 to P7) so as to mitigate the risk of educational triage and distorted educator incentives created by the dependence on a single performance metric (i.e., the Primary Leaving Exam). On teacher absenteeism, evidence shows that 'smart' accountability contracts -- in the form of well-designed local monitoring programs that involve parents and head teachers and use digital technologies (such as SMS reporting platforms) -- can deliver substantial low-cost improvements in teacher attendance. Such measures will be critical in allowing students to catch up on months of schooling lost to the pandemic. Expanding and revamping the vocational training system to make it more market responsive, for example through certified training programs and through opportunities for workers trained informally on the job to acquire formal certification of their skills, would also afford opportunities to school dropouts that would otherwise have no opportunity to gain relevant skills and demonstrate them to employers.

Increasing the rate of capital accumulation and its quality are no less important in response to the productivity challenge. Priya Manwaring of the International Growth Centre takes up that issue in her chapter, "***Unlocking investment for growth: policy considerations for Uganda".*** Investment rates, while comparable to other countries in the region, are

6 See: https://data.worldbank.org/indicator/SL.AGR.EMPL.ZS?locations=UG

7 See Guloba et al (2020) for a discussion of structural transformation and labor productivity in the context of Uganda.

well short of the rates that contributed to accelerate growth in East Asia. Investment as a share of GDP was about 26% in 2019, prior to the pandemic.[8] Of this, about three quarters was private investment, with nearly 15% undertaken by foreign firms.

Raising these rates will require raising domestic savings – some of which may be endogenous to the demographic and growth process -- and intermediating them successfully into productive investment. Several factors directly impede high quality investment. Macroeconomic volatility in the form of periodic fluctuations in exchange rates, inflation, and persistently high real interest rates, a set of issues treated amply in the chapter of Musisi. Beyond this, infrastructure also remains a constraint, particularly high cost of electricity and lack of reliability. Moreover, often prospective investors have difficulty in accessing land, particularly in urban areas. Finally, skill gaps in the local labour force continue to present a long-term barrier to investment.

This rendition of impediments to accelerating investment suggest its own list of policy actions. This includes improvements to electricity access, reducing costs of finance, enhanced trade facilitation, reducing unnecessary bureaucratic "red tape", and enhancing the protection of land and property rights. Special Economic Zones can play an important role in providing a testing ground for new policies and programs in a way that is fiscally sustainable and monitorable. However, at present, plans for these Zones appear to be excessively ambitious rather than focused and implementable. Scaling down the number of anticipated zones and increasing the resources devoted to a few productive ones may have a high pay-off. Finally, the chapter considers further enabling conditions to make the most of investment in Uganda. This includes effective systems for monitoring and evaluation of investment promotion policies, clear conditions on support provided to firms, and concerted efforts to plan for spill overs from larger investments on the wider domestic economy. Creating a program to help overcome information asymmetries between large investors and local suppliers and help to build local supplier capacities has the potential to spur upstream investment. Enlisting the support of foreign enterprises in these types of supplier development programs have been quite successful, especially for developing SMEs (see Arraiz, et al (2012) and Manwaring and Rauschendorfer (2020)).

Cities are a crucial site for, and catalyst to, productivity increases. The Haas-Nyakahuma chapter on "***Proactive urban policy: A recipe for productive and liveable cities"*** emphasizes that cities can be engines for economic growth -- they bring people together in ways that provide fertile grounds for the exchange of ideas that lead to innovation; they provide for economies of scale, particularly in productivity-inducing services; and they lead to agglomeration economies. But this process is not automatic - if poorly governed, cities can be sites of overcrowding, congestion, pollution, and contagion and become a drag on growth. In most countries in Europe, North America and Asia, urbanization has been positively associated with economic development, but this relationship appears to be more problematic in some sub-Saharan African countries, including Uganda. Urbanization in Africa is occurring at much lower levels of per capita incomes than in other regions. While agglomeration can allow firms to specialize, attain efficient production scale, and raise productivity, urbanization driven instead by commodity booms, policies that

8 World Bank Development Indicators on gross capital formation (% of GDP)

create an urban bias in terms of trade, and weak creation of productive jobs cannot fuel growth and rising living standards.

Two major constraints impede growth in Ugandan cities: weak property rights and lack of connectivity in cities. Complex land tenure systems and poor systems of land administration impede the ability of government and the private sector to invest in and transact urban land to its full potential. At the same time, the lack of a public transport system as well as infrastructure investments that lag well behind what is needed for rapidly growing populations limit the connectivity between citizens that drives productivity gains. Central to the task of making Ugandan cities a driver of growth is strengthening property rights through incremental land reform, land zoning and pro-active city planning, and coordinated investments in high-capacity mass public transport, notably in Kampala. Particularly as Uganda embarks upon the establishment of fifteen new cities, implementation of these type of reforms will require governance structures and financing that allows for effective and empowered urban institutions across the country.

Challenge 3: Growing exports and expanding access to markets

The global pandemic recession has served to depress Uganda's exports and plunge the current account into a significant deficit. This underscores the long-term structural challenges facing its external sector. Uganda, much like other countries in East Africa, entered the crisis with an export-to-GDP ratio of around 17 percent, more than 8 percentage points below the Sub-Saharan average.[9] To realize its future growth prospects, Uganda will have to accelerate the pace of its export growth. It will also have to begin to reduce its reliance on development assistance while attracting more foreign investment to finance its external deficit.

Rauschendorfer, in the chapter ***"How can Uganda harness trade and regional integration for economic growth?",*** underscores the importance of trade agreements in this process. He begins by noting that international trade is critical for Uganda by facilitating better access to high-quality inputs for production, by increasing competition in final goods markets, and by enabling Ugandan firms to overcome the limits of small domestic markets to attain economies of scale. His review of Uganda's trade performance over the last twenty years finds that, even though Uganda exports less than average for other countries at its per capita income, export growth has been relatively rapid and with considerable diversification. Regional markets have been central to both of these outcomes, especially for Uganda's manufactured goods.

The customs union of the East African Community (EAC) which Uganda founded together with Kenya and Tanzania in 2005 has been a prime driver of export growth. The bloc now comprises of Kenya, Rwanda, Tanzania, Burundi, South Sudan and Uganda, and serves as destination for about one third of Uganda's merchandise exports. No less important, it also accounts for a disproportionate share of Uganda's non-traditional manufactured

9 See "Exports of goods and services (% of GDP)": https://data.worldbank.org/indicator/NE.EXP.GNFS.ZS

goods with the implication that it is a driver of structural transformation. Though not a member of the EAC, trade with its regional neighbour to the west, the DRC, is also growing rapidly, and is the destination of a rising share of Ugandan exports, especially agro-based manufactures.

While the EAC is essential for Uganda's future export performance, the customs union is exposed to several threats. The Common External Tariff now under review may raise tariffs on key Ugandan inputs that could undermine its competitiveness. Countries have too frequently pursued self-sufficiency policies in response to Covid 19. For example, Kenyan restrictions on Ugandan maize has hampered exports. New trade agreements, including the African Continental Free Trade Agreement, the proposed Kenyan FTA with the US as well as the long-gestating Economic Partnership Arrangements with the EU, may well introduce new stresses to the policy architecture. Finally, ever-present political tensions militate against trade expansion, notably the sporadic border closings with Rwanda.

Nonetheless, Rauschendorfer emphasizes that the most important constraint may reside less in access to foreign markets than on supply side constraints that hinder Ugandan exporters from fully reaping regional and global opportunities. These constraints include issues such as high transport costs for both exporting and importing, pervasive "red tape" and non-tariff measures (NTMs). The lack of testing facilitates that would allow exporters to certify that products are safe and ready for human consumption is a further impediment, constraining access to high-value markets in the north.

To spur export growth, the paper enumerates several recommendations targeted at reducing obstacles to increased trade. These include a successful conclusion to the comprehensive review of the Common External Tariff in a way that avoids undercutting competitiveness, reducing the cost of trading, sensitizing firms regarding export procedures, standards and regulations, and ensuring that policies postulated in strategic documents like the National Export Development Strategy are also implemented.

A different approach on how to harness trade for growth is to consider ways to channel domestic demand away from imported goods and towards products made locally instead. Davis Vuningoma in his chapter ***"Import substitution and export promotion for sustainable economic growth"*** explores ways in which Uganda can substitute imports efficiently without undermining access to crucial inputs for domestic firms or undermining competition as a key driver of growth and innovation, eventually leading to impediments on the country's exports. To this end, the paper begins with a critical review of a concept that is often assumed to be a sensible indicator for the economic health of an economy, the "trade deficit". As with other countries, the growth of the trade deficit in Uganda is not correlated with -- or a good predictor of -- economic growth. To a large extent, Uganda's import basket consists of inputs into productive activities (e.g., machinery, fuel, or packaging materials). Underscoring the importance of imports for economic growth, the paper then proceeds to suggest a sub-set of mainly consumer goods that are currently imported but could potentially be replaced with local products. The author then discusses tools to implement import substitution in practice and analyses various instruments based on the experience of other countries, including tariff increases,

mandatory local content, or supplier development programs. Many of these policies, however, were found to be ineffective in other countries, and indeed if adopted in Uganda, would contravene regional integration objectives and protocols. Based on the existing literature, he postulates that policy tools that are targeted at helping domestic firms overcome information constraints and that encourage entry and competition are more likely to lead to success than those that restrict competition. For example, Vuningoma finds that supplier development programs are more likely to succeed in building strong companies that are eventually able to compete with imported products than government procurement reservations, local content requirements or tariffs.

After linking these tools to various Ugandan strategies and official policy documents, the paper concludes with several policy recommendations, advocating for a "strategy mix" between pro-competition import substitution policy and export promotion. Among the key guidelines to implement such a strategy mix, the paper suggests that protectionist policies (e.g., import tariffs) should only be pursued hand in hand with credible time limits and under full consideration of the economic and social ramifications. On the whole, programs should emphasize policies that enhance (rather than decrease) competition and encourage entry.

Challenge 4: Increasing the pace of structural transformation and job creation in key sectors

With a young and fast-growing population, Uganda has an opportunity to harness the power of its growing labour force to the cause of accelerated and inclusive growth. This requires creating new jobs in high productivity activities and moving labour progressively out of low-productivity employment and into higher productivity jobs. In this process of structural transformation, Dani Rodrik (2014) emphasized the importance of moving workers out of low productivity agriculture and creating manufacturing jobs, without which Africa's growth prospects would be dim. Since then, a more recent literature has highlighted other high-productivity economic activities that could complement manufacturing in the process of structural transformation, such as commercialized and export-oriented agriculture (e.g., cut flowers or fresh fruits and vegetables), agro-processing, tourism, business services, and ICT. These activities are called "industries without smokestacks"[10] – that is, activities that share many of the desirable growth-producing characteristics of manufacturing such as being tradable, offering opportunities for technological change, innovation and productivity growth and the potential to benefit from agglomeration externalities. In Uganda, moving labour to high-productivity jobs within broadly defined sectors (for example, from subsistence agriculture to coffee farming or from informal services trade to a high-productivity sector such as tourism) may be as important to the growth process as moving workers between sectors. In either case, policymakers have to accelerate growth and job creation in high productivity activities. Four sectors in Uganda are crucial to this task and have been identified by the government as key

10 This is the term used by Newfarmer, Page and Tarp (2018) in their book ***Industries without Smokestacks: Industrialization in Africa Reconsidered***. Oxford: University Press.

strategic sectors: agriculture, industry, tourism and Uganda's currently nascent oil and gas sector.

In their chapter ***"Agricultural transformation and Agro-industrialization in Uganda",*** Florence Nakalanzi and Yasin Mayanja point out the centrality of agriculture to Uganda's economy and the structural transformation process in the country. About 70 percent of the Uganda's labour force derive some form of employment from agriculture and agriculture-related activities, and the sector contributes around 50 percent to Uganda's total export earnings. However, agricultural productivity remains low, and more than 40 percent of the Ugandan labour-force is engaged in low-productivity subsistence farming. Indicative of its low productivity, the sector only contributes about a quarter to Uganda's GDP.

The chapter explores potential pathways and strategies to harness the agricultural sector for higher economic growth. The authors suggest that "agro-industrialization", i.e., adding value to the country's sizeable agricultural output, has the potential to boost inclusive growth, drive the structural transformation process and create productive employment across the country. However, doing so requires raising agricultural productivity by accelerating the adoption of better agricultural technologies (such as hybrid seeds and fertilizers), laying a policy focus on facilitating the commercialization of agriculture, securing land tenure for farmers, and supporting new ways of conducting business in the sector, particularly contract farming.

Policies to realize the potential of agriculture and agro-industrialization in Uganda first and foremost include the enforcement of quality standards along the supply chain for agricultural inputs to build trust among end-users and overcome obstacles to the adoption of modern agricultural technologies, key drivers of agricultural productivity.[11] Similarly, leveraging modern technologies to educate farmers about the benefits of these new inputs has been shown to be crucial in driving adoption. Finally, the government will have to play a key role in helping farmers respond to the challenges of climate change in the country and help establishing concrete options for better agricultural markers. These include out-grower contracts, insurance contracts with premiums charged at harvest or exploiting the vast potential of digital trading platforms. Enhancing the statistical base from which to make decisions and monitor outcomes in the agricultural sector will be critical to future productivity gains.

Flavia Nasobora adds to this book a review of Uganda's industrial sector in her paper, ***"Industrialization: A driver of growth in Uganda".*** Beginning with the observation that the manufacturing sector in the country is still nascent and constituted about 16.4% of the country's GDP in FY 2020/21, she focuses on ways to create globally competitive firms due to their pivotal importance for long term development in Uganda.

Given the promise of food processing and other "Industries without Smokestacks",

11 For example, Bold et al (2015) study the market for agricultural inputs in Uganda and find that fertilizers miss up to 30 percent of nutrients, while modern hybrid maize seeds contain less than 50 percent of authentic seeds. The authors postulate that smallholder farmers do not adopt modern technologies due to the low quality of these products, presumably stemming from adulteration.

the chapter then considers three policy areas to promote industrialization in Uganda. The first is reforms targeted at creating an attractive business environment, including investments in infrastructure such as transport and electricity, providing the labour force with necessary skills, and access to affordable finance for investment. The second is policies to promote access to foreign direct investment and exporting activities that can themselves raise firm productivity, including targeted supplier development programs and reductions in non-tariff barriers. The third area considered is active industrial policy to promote agglomeration through Special Economic Zones that allow firms to share markets, inputs and ideas that can raise productivity. Finally, the chapter considers regional and global policies that would be conducive to industrialization in Uganda. This includes strategic reform of tariffs in line with regional priorities, investments in cross-national infrastructure, and efforts to better integrate services across the region.

Arguably Uganda's most important "industry without smokestacks" is tourism. In ***"Supporting tourism development in Uganda"***, Wilber Ahebwa and Rosette Nakavuma begin with highlighting the enormous importance as well as the potential of tourism as a source of export earnings and decent jobs globally. Following a review of both Uganda's tourism assets as well as the government's plans to bring them to bear for higher growth and employment creation, the paper then provides a review of Uganda's tourism performance pre-COVID-19, documenting substantial increases in international tourist arrivals over the last 15 years resulting in a sizeable contribution to the country's export earnings (ca. 25 percent in 2018).

From this starting point the paper provides an assessment of the demand- and supply-side competitiveness of Uganda's tourism sector as well as an assessment of the impact of COVID-19 on the sector so far. Due to the dependence of the sector on the feasibility of international travel, tourism is by far the hardest hit sector in Uganda, with estimates postulating an aggregate loss of 5 billion USD by 2025. Consequently, the paper's six concluding priorities and accompanying policy recommendations are divided broadly into immediate responses to the crisis, for example the need to rapidly develop a crisis response strategy and providing liquidity for struggling businesses, while at the same time ensuring that the country adequately prepares for the return of international tourists, assumed to commence in late 2022. These priorities include the conservation of tourism resources (i.e., wildlife and heritage resources), developing more and better tourism products, creating systems of quality assurance (e.g., staring systems for hotels), developing an adequately skilled labour force capable of interacting with demanding international tourists as well as strengthening Uganda's brand as a destination through increased marketing and promotion efforts.

Finally, in ***"Implementing local content in Uganda's oil and gas sector: Challenges and opportunities"***, Moses Kabanda explores the potential of boosting private sector development in the country by increasing local content in the Uganda's nascent oil and gas sector. The author begins by recapping the potential benefits of commercially exploiting Uganda's oil reserves, noting that the recoverable oil reserves could support the production of up-to 260,000 barrels of oil production per day for 15 years, translating in per capita gains of about 46 barrels per each Ugandan citizen over this period.

However, the potential benefits of commercial oil exploitation in Uganda go far beyond direct revenue effects. Incoming multinational oil companies will have to purchase sizeable volumes of goods and services in order to operate in the country, creating an important opportunity for Ugandan firms and workers to benefit from surging demand in sectors that supply to oil companies. The author then provides a review on how Uganda has thus far worked towards encouraging local content in the sector, what progress has been made and what constraints remain to be solved in order to foster increased usage of Ugandan goods and services in the nascent oil and gas sector. Among the most important policy recommendations brought forward by the author are to extend the *National Suppliers Database* which should also include information on individual domestic firm capabilities (firm performance, markets served, transaction history) in areas relating to the oil industry to better guide multinationals' decisions, to implement targeted *Supplier Development Programs*, that would allow local suppliers to learn from MNCs with respect to best practices and technology and to work towards overcoming critical supply side constraints that prevent would-be suppliers from realizing existing opportunities (for example lack of access to finance or inability to showcase quality due to missing opportunities for testing and standards certification).

The Way Forward

Government policy in response to the challenges and opportunities described in this book will either form a coherent and effective program that spurs a return to high and inclusive growth, or produce indecisive interventions that can only generate a lingering scenario of stagnant incomes, obstinate poverty, and an exacerbation of inequality. Evidence, analysis, and assiduous implementation are the ingredients of high growth policies. The topics covered in this volume inform central elements of a post-recession reform agenda in managing the recovery and public investment, in promoting productivity of labour and capital, in developing exports, and in structural transformation. As policies are incorporated into national planning, a final requirement – unelaborated here but well known in the Ugandan context – is to move from the formulation of sound economic policy to implementation. If Uganda can develop and implement policies to respond to current challenges, the prospect of a return to rapid and inclusive growth in the coming decade is bright indeed.

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Chapter 2 :

Accelerating and sustaining Uganda's economic growth

By Dr. Albert Musisi (Ministry of Finance, Planning and Economic Development, Macro-Economic Policy Department)

1. Introduction

Uganda's economic growth trajectory over the past four decades has been one of both highs and lows. Like in many other African countries, growth rates were volatile particularly at short to medium term horizons (see Figure 1). Nevertheless, during the period between1987/88 to 2010/11, economic growth soared achieving an average growth rate of over 7 percent per annum. This good performance was underpinned by a range of factors including post war recovery, a favourable domestic and external macroeconomic environment for most of the period as well as strategic economic, social and structural reforms which resulted in improvements in production and productivity.

Uganda's recent GDP growth performance (2011/12 - 2019/20) averaged at 4.6 percent, which is significantly lower than the impressive growth achieved in the previous two decades. During this period, economic growth performance was also lower than most of its peers in the relatively better performing East African Community (EAC) region, for example, Kenya, Tanzania, and Rwanda as well as other countries in Sub-Saharan Africa (SSA) like Ethiopia. Growth in per capita income (constant 2016/17 prices) declined to an average of 0.5 percent, compared to an average of over 4.9 percent in the previous period, frustrating the country's middle income status aspirations. The country's economic growth episode during this period was characterised by low and volatile economic growth and a significant decline in the contribution of physical capital accumulation and total factor productivity to overall growth. Among the key causal factors are the more frequent external and domestic shocks that affected the economy including the most recent corona virus (Covid-19) pandemic.

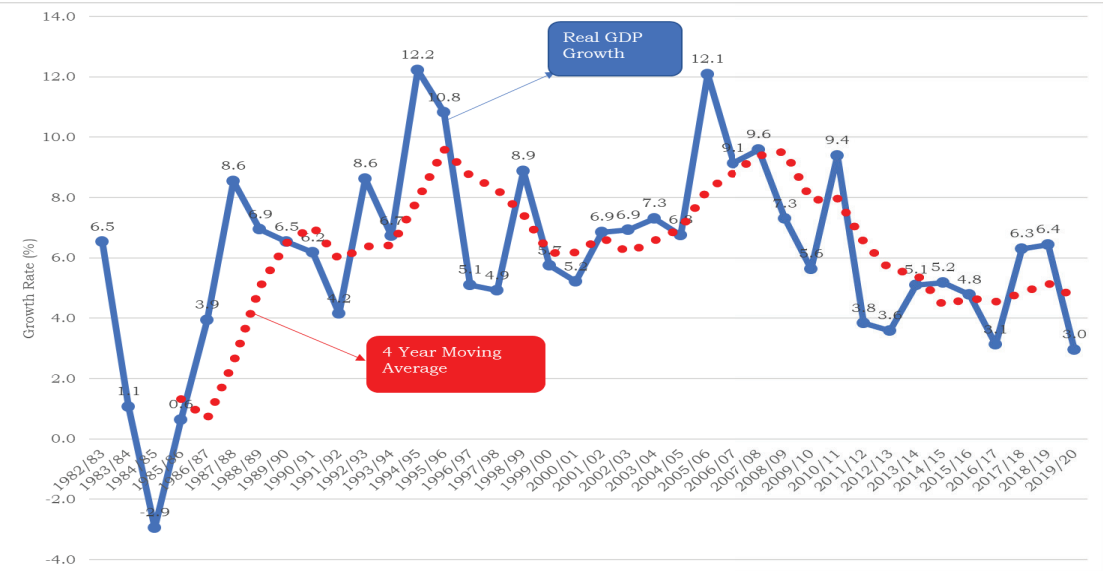
Although the economy has shown signs of recovery, economic growth has remained below potential growth. This chapter focuses on how Uganda can accelerate and sustain high economic growth rates. Section 2 of this chapter tracks Uganda economic growth trajectory from the financial year 1987/88 onwards and explores the factors that led to the slowdown in growth in the recent period 2011/12 to 2019/20, examines the key barriers or challenges to achieving faster economic growth, and identifies key strategies to accelerate and sustain Uganda's economic growth momentum. Conclusions are made in Section 3.

2. Evaluating Uganda's Economic Growth Performance: 1987/88 – 2019/20

Uganda's economic growth performance during the period 1987/88 to 2010/11 was impressive with growth averaging 7.6 percent per year for the 24-year period. This was a result of persistent implementation of key economic and structural reforms, improvement in macroeconomic management, liberalizing markets and trade, and providing the enabling environment for the private sector to play its important role in the growth process.

However, the period 2011/12- 2016/17 has been characterised by a slowdown in economic growth. On average, GDP growth was 4.3 percent during this period due to frequent shocks, e.g., the lagged effect of the global financial crisis, unfavourable weather conditions due to climate change, delays and poor implementation of some important policy and structural reforms. There was a growth rebound in 2017/18 and 2018/19 with growth averaging over 6 percent in the two financial years, but it was short lived due to the outbreak of the novel Corona virus. The outbreak of the corona virus (covid-19) negatively impacted the economy with growth declining to 3.0 percent in 2019/20 (see Figure 1 below). This was due to the lockdown restrictive measures on people movement across borders, closure of non-essential businesses and supply chain disruptions which affected supply of inputs to the productive sectors of the economy particularly the manufacturing sector.

Figure 1: Real GDP Growth Rates, 1982/83 – 2019/20.



Source: Author's calculations using National Accounts data (2016/17 constant prices) from the Uganda Bureau of Statistics (UBOS).

2.1. Growth performance before the delayed effects of the global financial crisis of 2007/08

The National Resistance Movement (NRM) government on assuming power in 1986 pursued a "control model" of economic management and attempted to bring down prices by taking administrative control over imbalances and re-valuing the shilling to make imported goods less expensive (Tumusiime-Mutebile, 1990). These policies resulted in undesirable economic outcomes characterised by macroeconomic instability, e.g., high inflation and an overvalued exchange rate which affected economic growth.

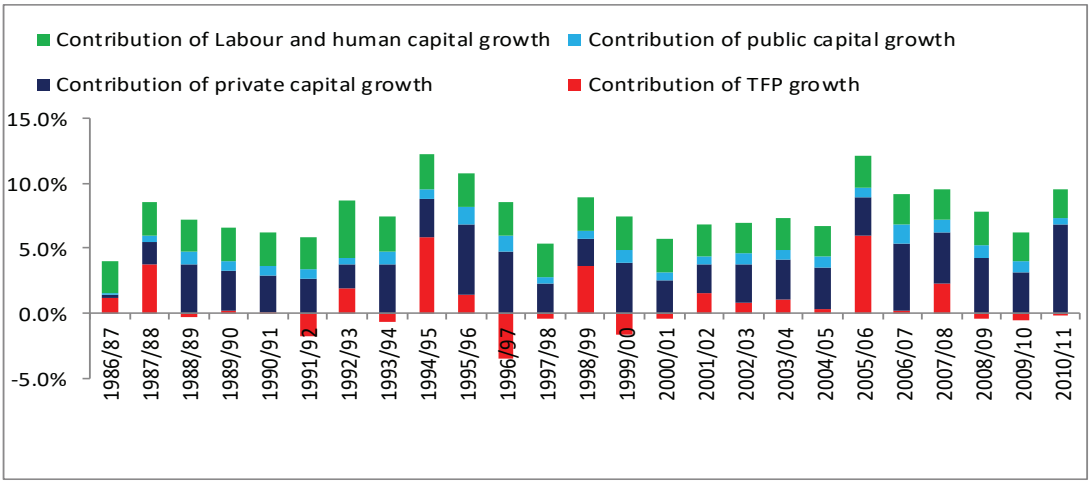
The government reversed its economic policies in 1987 and has implemented IMF/World

Bank type policies since then, even though there were slippages between 1987 and 1989. A number of economic and structural reforms were carried out under the Macroeconomic Stabilisation and Structural Adjustment Programmes (SAPs) especially in the early 1990s. These policies and reforms, together with positive economic shocks especially the favourable terms of trade related to the coffee boom of 1994/95 and political and social stability during this period resulted into positive economic outcomes. Market distortions were reduced or eliminated in the various sectors of the economy; there was large improvement in financial sector development, increased investor confidence resulting into increased private investment, improvement in capacity utilization in the industrial sector and a return of both human and financial capital from abroad.

Overall, the policies Uganda implemented especially from 1992 resulted in macroeconomic stability and significant achievements in growth and poverty reduction. As pointed out earlier, growth averaged 7.6 percent per year for the 24-year period between 1987/88 to 2010/11, and Uganda managed to more than halve the poverty rate from 56.4 percent in 1993 to 24.5 percent in 2009/10.

A growth accounting analysis undertaken as part of this study, shows that the key growth driver during this period was increase in capital accumulation due to increase in investment rates particularly by the private sector. Private investment as a percentage of GDP increased from 7.4 percent in 1996/97 to 20 percent in 2010/11, while public investment increased from 3.4 percent to 4.2 percent during the same period (see Figure 3 below). However, the contribution of total factor productivity (TFP) was extremely low on average (see Figure 2 below).[12]

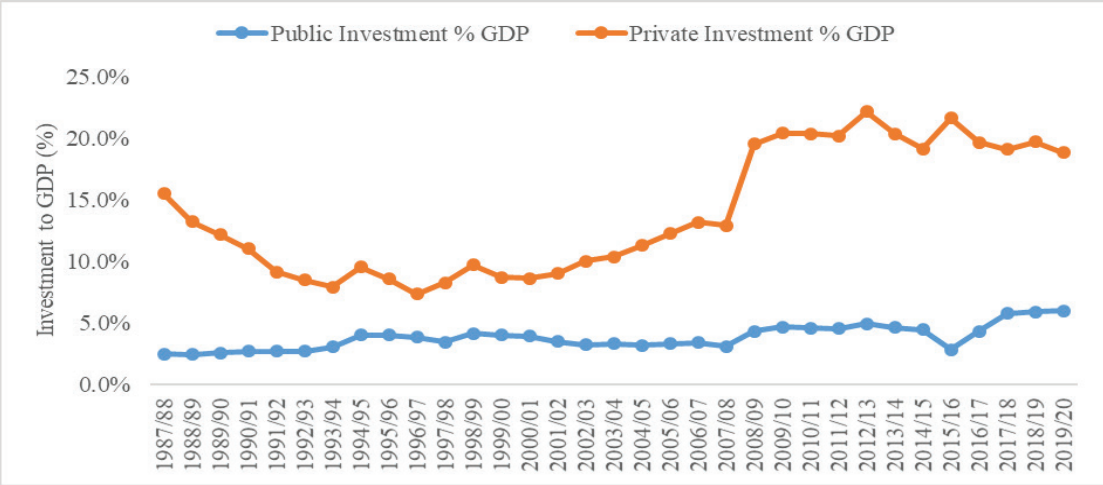
Figure 2: Growth decomposition and total factor productivity (1986/87 – 2010/11).



Source: Calculated using National Accounts data (2016/17 constant prices) from the Uganda Bureau of Statistics (UBOS).

12 Total factor productivity (TFP) was negative in some of the years.

Figure 3: Public and private investments – as percent of GDP.



Source: Calculated using National Accounts data (2016/17 constant prices) from the Uganda Bureau of Statistics (UBOS).

However, even though this period recorded strong growth performance, growth in private investment was largely driven by construction of private residential buildings rather than investment in machinery and equipment which is essential for industrial sector expansion and future economic growth.

In recognition of these developments, the Government expenditure priorities changed from a focus on poverty reduction to investment in public infrastructure to build the country's productive capital as highlighted in the country's National Development Plans (NDPs) that were re-introduced starting with the first NDP of 2010/11 – 2014/15. The objective was to bridge the public infrastructure gap in order to support private investments.

2.2. Explaining economic growth trends; 2011/12 – 2018/19 – What were the key factors?

Between 2011/12 and 2016/17, Uganda's real GDP growth averaged 4.3 percent, which is low compared to growth in the previous two decades and to growth of regional peers in the East African Community (EAC) and other Sub-Saharan African countries like Ethiopia. The lower-than-expected growth was due to both domestic and external factors.

External factors include the more frequent negative external shocks arising from climate change, global economic and health crises. Domestic factors arose from delays and poor implementation of some important policy and structural reforms. The above factors led to further decline in total factor productivity (TFP) a critical factor for sustained growth and poverty reduction

2.2.1. Negative external shocks: The global financial crisis of 2007/08

Even though Uganda was not immediately affected by the impact of the global financial crisis at its onset in 2007/08, it suffered second round effects with macroeconomic instability setting in financial year 2011/12. The impact of the global economic crisis coupled with government fiscal slippages financed by the central bank during this period, resulted in high exchange rate depreciation and inflation. The high depreciation of the exchange rate resulted in rising costs for firms with a high share of imported inputs, negatively impacting growth. Headline inflation peaked at an 18-year high of 30.5 percent in October 2011. In response, Government tightened monetary and fiscal policy, successfully bringing down inflation below Bank of Uganda's 5 percent target. This was necessary for future growth. However, the trade-off was higher interest rates which resulted in a large fall in private sector credit and hence private investment. Non-performing loans increased substantially when interest rates rose in the second half of 2011, and banks consequently cut back lending to households and firms in favour of safer alternatives such as Government securities. Although credit growth subsequently picked up, banks continued to collect more in repayments than they advanced in new lending. The tight credit conditions also contributed to stagnant household demand, reducing the ability and incentive of the private sector to invest. Subsequently, capital equipment imports fell by 15 percent in 2013.

The above policy interventions coupled with tightened fiscal policy (which resulted in lower Government demand) had negative implications for short to medium term growth prospects.

2.2.2. Weak external demand

Trouble in the global economy, particularly the Euro debt crises, hurt Uganda's traditional export markets. Even though this was ameliorated by the fact that Southern Sudan, the Democratic Republic of Congo (DRC) and EAC partner states increasingly account for more of Uganda's exports, political instability in some of those countries and the impact of the global economic crisis on their economies undermined Uganda's exports to these markets, particularly to the DRC and South Sudan. The fall in international oil prices affected export demand from countries like South Sudan a major trading partner with Uganda.

2.2.3. Declining productivity, especially agricultural productivity

Deeper analysis shows that a key factor in the slowdown of economic growth was productivity loss during this period, even though there was also a decline in rate of growth in capital and human capital accumulation compared to past decades.

On average the contribution of total factor productivity to overall real GDP growth declined

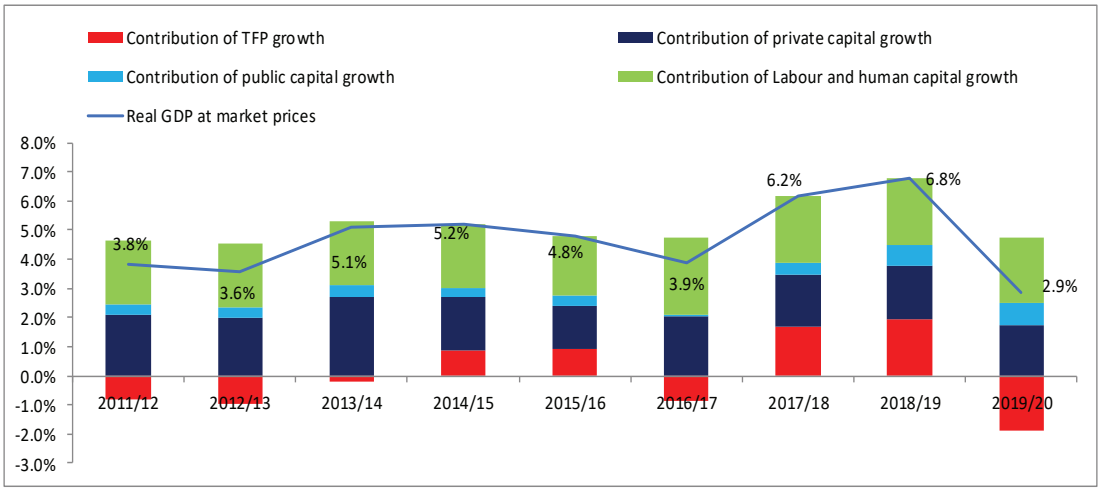
from 1.1 percent in the period 2001/02 to 2010/11 to 0.1 percent in the period 2011/12 to 2019/20 (Table 1). The contribution of physical capital accumulation declined from 4.7 percent to 2.3 percent while the contribution of labour and human capital declined from 2.4 percent to 2.3 percent. As shown in the Figure 4, for the period 2011/12 to 2019/20, the dominating factor in determining the trend in growth was a decline in total factor productivity.

Table 1: Growth decomposition – Contribution of different factors to growth (%).

Time Period	Contribution of public capital	Contribution of Private Capital	Contribution of Labour and Human Capital	Contribution of Total Factor Productivity (TFP)	Real GDP at market prices
1991/92 to 2000/01	0.8	3.2	2.8	0.4	7.2
2001/02 to 2010/11	0.9	3.8	2.4	1.1	8.1
2011/12 to 2018/19	0.4	2	2.3	0.3	4.7
2019/20	0.7	1.7	2.3	-1.9	3.0

Source: Authors calculations using National Accounts data (2016/17 constant prices) from the Uganda Bureau of Statistics (UBOS).

Figure 4: GDP Growth, growth in production factors TFP growth: 2011/12 – 2019/20.



Source: Calculated using National Accounts data (2016/17 constant prices) from the Uganda Bureau of Statistics (UBOS).

Dissecting productivity trends on a sectorial basis shows that the rate of labour productivity loss was highest in agriculture while the rate of labour productivity growth in industry has been declining (see Figures 5 and 6 below). Productivity growth in these two sectors

is critical for accelerating and sustenance of growth because of their strong backward and forward linkages to other sectors of the economy.

Continued decline in labour productivity reflects the country's fast-growing population which is mainly engaged in the low technology agricultural sector, with surplus labour in the sector. It is also due to the fact that the quality pool of skilled and high-level human capital is quite low, in addition to the high incidence of skill and educational mismatches between labour market skills needs and skills acquired by graduates from education institutions.

Figure 5: Labour productivity growth: 1987 - 2019 (Agriculture).

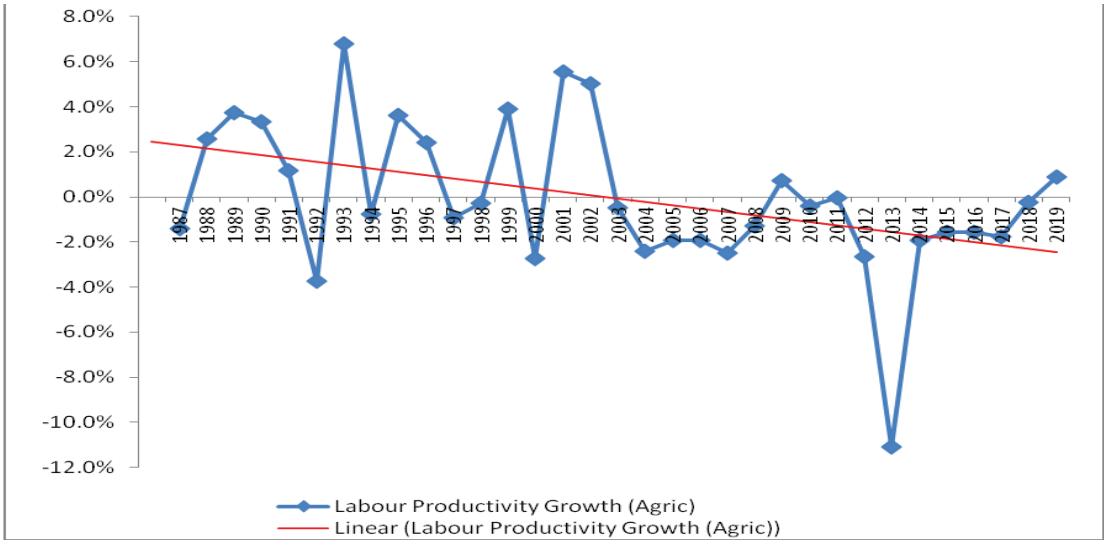


Figure 6: Labour productivity growth: 1987 - 2019 (Industry).

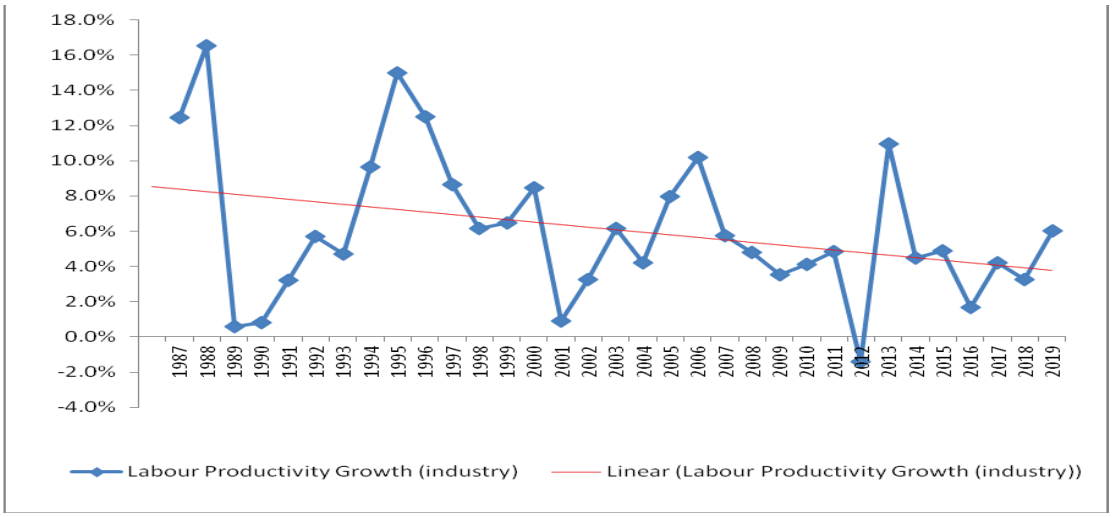
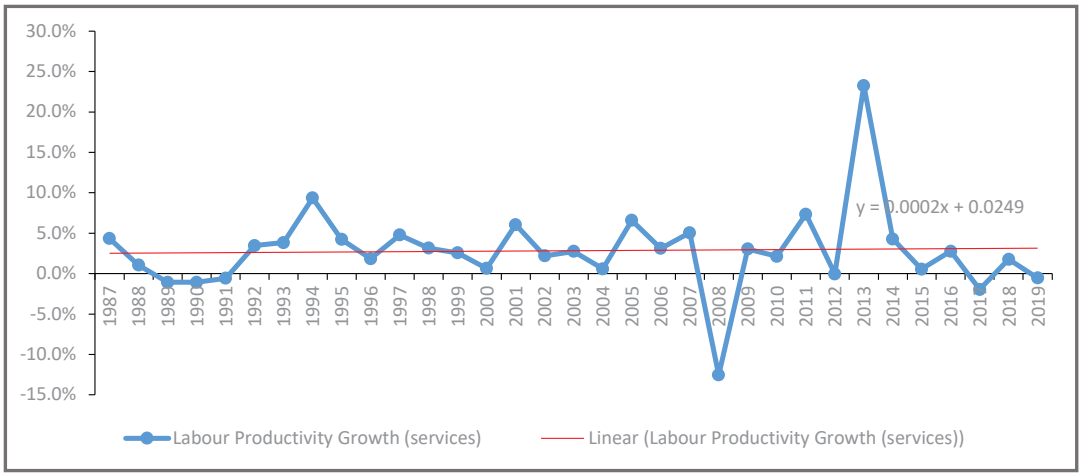


Figure 7: Labour productivity growth: 1987 - 2019 (Services).



Source: Calculated using data from the International Labour Organisation (ILO) and World Development Indicators Databases.

Uganda's score in the World Bank's Human Capital Index (HCI), an index which measures the contribution of education and health towards the productivity of a country's next generation of workers is at 0.38. This level is in the lowest quartile of the HCI distribution and is lower than the average for Sub-Saharan Africa (World Bank, 2019).

Uganda's workforce is estimated to be 28 percent and 68 percent less productive than their counterparts in Tanzania and Kenya respectively (African Development Bank, 2014). These characteristics of Uganda's labour force have serious repercussions for economic dynamism, productivity, global competitiveness and hence economic growth.

2.2.4. Negative impacts of rapid urbanisation on productivity and growth

In recent years, Uganda has undergone rapid urbanization. However, this has not been guided by adequate planning and policy coordination. Rapid urbanization coupled with a lack of an efficient strategic planning and implementation process, has resulted into the benefits of economies of scale and agglomeration being reduced due to congestion, overloaded infrastructure, higher costs of living and higher labour and property costs. It has affected ecosystems (e.g., through pollution). These diseconomies as against agglomeration economies are having an important negative impact on business costs, productivity, private investment, and hence sustainable economic growth.

2.3. The impact of the Covid-19 pandemic on growth in 2019/20

The onset of COVID-19 pandemic in financial year 2019/20 presented unprecedented health and economic challenges for countries in Sub-Saharan Africa (SSA), including Uganda. Like many of these countries, Uganda has a weak healthcare system; hence

this outbreak would overwhelm existing capacity. Uganda is also characterised by wide-spread informality, making health and economic interventions difficult, thus consequences of the pandemic likely to be dire compared to other countries, if a significant outbreak occurred. In addition, the limited fiscal space (budgetary space), meant that without significant external support, policy responses to the pandemic would be inadequate.

As of July 31st 2021, Uganda had registered 93,927 cases and 2,690 deaths to the virus. Due to the health and economic shock caused by the covid-19 pandemic and the associated global and domestic lock-down measures implemented to contain the virus, Uganda's economic growth in the financial year 2019/20 reduced to 3.0 percent well below the earlier projection of 6.3 percent. The covid-19 crisis and the lockdown measures particularly affected small and medium enterprises (SMEs) whose profits dropped by over 50 percent between January 2020 and August 2020. To cope with the crisis, firms cut back salaries and laid off workers (Gulesci et al. 2020). Since SMEs have a significant contribution to growth and employment in Uganda, the negative impact on the SME sector affected real GDP growth in financial year 2019/20 and the growth outcome for the financial year 2020/21 which reduced to 3.3 percent compared to an earlier projection of 6 percent.

The pandemic also worsened Uganda's position with the rest of the world. Inflows of foreign direct investments, tourism, remittances, and exports declined. As shown in Table 2, Foreign Direct Investment (FDI) and tourism, declined by 43 percent and 58 percent respectively, in the second half of 2019/20 compared to the same period in 2018/19 mainly due to domestic and external lockdown measures implemented to contain the Covid-19 pandemic. Remittances declined by 20 percent in the same period, a decline lower than had been projected.

The above developments resulted in lower than projected growth which hampered domestic revenue mobilisation efforts and came at a time when government was grappling with other challenges of the locust invasion and floods which further constrained the fiscal space required for adequate policy response to the pandemic. As a result, government's fiscal position was affected leading to an expansion in the budget deficit. Public debt increased from 35.3 percent of GDP in FY 2018/19 to 41 percent in FY 2019/20. It is also estimated to have increased to 48 percent in the financial year 2020/21. Poverty is estimated to have increased from 21.4 percent 2016/17 based on the national poverty line to 26.8 percent (Younger et al, 2020).

Table 2: Impact of the Covid-19 pandemic on Uganda's external position: Selected indicators.

Million USD	Year	1st Half of Year (July - December)	2nd Half of Year (Jan - June)	Total (Whole Year)
Foreign Direct Investment	FY 2018/19	527.68	689.77	1217.45
	FY 2019/20	570.00	396.29	966.29
	Difference	42.32	-293.48	**-251.16**
Remittances	FY 2018/19	776.61	592.44	1369.05
	FY 2019/20	832.00	474.31	1306.31
	Difference	55.39	-118.13	-62.74
Tourism	FY 2018/19	798.61	698.59	1497.20
	FY 2019/20	764.74	296.86	1061.60
	Difference	-33.87	-401.73	**-435.60**

Source: Author's calculations using Balance of Payments data from the Bank of Uganda.

The evaluation of Uganda's economic growth performance in section two of this paper shows that it was characterised by high volatility with high and low growth rates during the period 1987/88 – 2019/20. This was due to both domestic and external factors. Negative domestic and external shocks as well as policy slippages were critical negative factors causing low economic growth rate episodes. In section 3, key policies and strategies to increase production and productivity are explored, as well as ways to build resilience to minimise exposure to and impact of domestic and external shocks.

3.0. Growth Recovery: Accelerating and sustaining the economic growth momentum

Accelerating and sustaining high growth requires increasing productivity in all sectors and gradually increasing investments. It will also require building resilience to minimize exposure to and impact of shocks which are increasing in both frequency and severity. In the medium term, the Ugandan economy is expected to gradually improve over the medium term as illustrated below in Table 3).

Table 3: Growth projections (2020/21 – 2025/26).

Financial Year	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Real GDP growth (%)	3.3	4.3	6.4	7.0	7.2	7.0

Source: Ministry of Finance, Planning and Economic Development.

Real GDP growth is projected at 3.3 percent in FY 2020/21 and is expected to improve further peaking at 7.2 percent in FY 2024/25. The expected improvement in economic growth over the medium term is mainly on account of anticipated increase in production and productivity in agriculture and manufacturing sectors. A rebound in private sector activity, continued public infrastructure investment and oil and gas sector activities are also expected to support and strengthen economic growth. Furthermore, as Covid-19 vaccination progresses within the country and across the world, with countries continuously easing lockdown measures, Uganda's exports are projected to be boosted, particularly the agricultural and manufactured exports.

3.1. Key policies and strategies to propel growth

The key policies and strategies that are required for economic growth recovery, acceleration and sustaining the economic growth momentum are discussed in the following sections.

3.1.1. Key policies and strategies to increase production and productivity

Increasing production and productivity requires policies that continue to improve the investment climate and incentives that foster improvements in productivity. These policy initiatives include ensuring the maintenance of macroeconomic stability, improving the efficiency of public finances, strengthening competition in markets, as well as policies to increase the skill levels of the work force (Human capital). Implementation of the appropriate policy initiatives and strategies facilitates the process of growth acceleration by shifting resources across sectors from low to high productivity sectors, within sectors to high productivity firms and make firms use capital and labour more efficiently, e.g., through innovations. Going forward, Uganda will need to undertake the following;

Increased Efficiency in Public investments

A key challenge is low returns to public investments and the impact on private investments. The ratio of public investments to GDP has remained stagnant at about 3 percent despite the rise in the share of the government development budget from 36 percent in 2009/10 to 47 percent in 2018/19. This reflects the low investment content of many of the projects in the country's Public Investment Plan (PIP) as well as the slow execution rate of infrastructure projects. Currently returns to public investments are less than would be expected due to inefficiencies in project execution, inefficiency in management and poor absorption of available resources especially borrowed funds.

Reforms in public investment management are required including investing in investment management capacity, improving crowding in of private capital by facilitating the rise in the productivity of capital and increasing local content in public investments.

Greater domestic revenue mobilization to finance public investment is critical to ensure debt sustainability as well as avoid the crowding out of private investments through borrowing constraints in the domestic money market.

Private investment – raising firm-level productivity

To raise firm-level productivity, a key strategy is to reduce the cost of doing business by reducing costs associated with bureaucracy, corruption, and essential business services. It is also necessary to invest in infrastructure needed by the private sector to reduce costs – e.g., industrial parks, export processing zones to lower costs of producing manufactured exports which requires effective investment and export promotion institutions.

Dealing with climate change: Likelihood and frequency of weather and climate-related events

In more recent years, the economy has faced Climate Change challenges which had negative impact on economic growth outcomes. There was and continues to be higher incidences of drastic weather seasonal changes, droughts and floods experienced than in the past. Uganda experienced droughts of varying degrees in the different regions of the country in 2009/10, 2011/12, 2016/17 and 2017/18 which affected particularly agricultural production and productivity, agro-industries, and overall economic growth (see Annex 1). Adverse weather conditions also result in failure of public infrastructure like roads, bridges, energy sources, e.g., dams (power outages), health infrastructure etc., which disrupts economic activity.

The rainfall trend in Uganda has been increasing since 2000 according to Uganda National Meteorological Authority (UNMA). There is further expected likelihood of near normal rainfall to be above normal in the months of March, April, and May over the country. However, due to the effects of climate change some studies, e.g., Christelle et al, 2020 suggest that Uganda, particularly central and north-western Uganda will face increasing drought risks in the future. The declining precipitation is attributed to rising surface temperatures of the Indian Ocean which is expected to persist up to the next decade.

This calls for immediate attempts to mitigate the effects of climate change, through effecting policies that protect the environment and establish short term measures to curb the already existing effects, to allow a favourable environment for economic growth.

Increase productivity in the agricultural sector

There is need to increase productivity in key sectors, particularly agriculture and the associated agro-industry. This in turn would require improving the quality of inputs (e.g., seedlings, fertilizers), providing productivity enhancing services (agricultural extension, supportive research and development), as well as improving irrigation and water supply.

Increase the contribution of labour and human capital to growth

To increase the contribution of labour and human capital to economic growth requires strategies that lead to the release of surplus labour in agriculture to other sectors by improving agricultural technology (use of better tools and farm practices) that enable

more production with less inputs e.g., manpower and land.

More public investment in education and health is required to improve the efficiency and productivity of human capital. Increased investment in the health sector will improve the accessibility of quality health services while increased investment in education should focus at improving quality and completion rate at primary level and expand access and quality at secondary school level.

To deal with the problem of skill and education mismatches, education and training policies need to take into account particular human capital needs of the labour market. Interventions should strengthen and promote linkages and collaborations between employers and training institutions and increase multi-skilling, up-skilling and re-skilling of the workforce.

Maximize opportunities provided by the oil and gas sector

To maximize opportunities provided by the Oil and Gas sector, it is important to maximize local content opportunities along the value chain. It is also necessary to be cognizant of global perspectives and outlook on the future use of fossil fuels as opposed to renewable energies which is likely to have implications on the prospects of the oil sector. It will therefore be important to avoid reliance on oil and use acquired financial resources from the oil sector to develop and implement a diversification strategy to ensure that the other sectors, e.g., the agricultural sector, remain competitive and avoid the infamous 'Dutch disease''

Foster urban productivity as a growth enabler

While urbanization often has the potential to promote economic growth, the extent to which this potential is realized depends on the form that the urbanization process takes. Deliberate supportive government policies and interventions are required to enable the benefits of agglomeration and reduce diseconomies of scale associated with unplanned urbanization. Focus needs to be put on the newly created 15 cities across the country, by investing in connectivity between them, as well as designing appropriate policies to deal with rigidities in the land and housing markets. It is also critical to improve sub-national government coordination in planning and required interventions.

Enhance regional integration

Given the on-going global trade wars, and the fact that Uganda's' exports to the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA) now account for over 50 percent of Uganda's total exports, it is critical to continue to support the enhancement of regional integration. There is also further need to continue to address transport costs, non-tariff barriers, and regional insecurity. It is important to note that together with Asia, these regions (EAC and COMESA) are

expected to be the fastest growing import markets. It is also critical to prepare to take advantage of the market opportunities under the Africa Continental Free Trade Area (AfCFTA) which should enable export diversification, attract foreign direct investment, and accelerate economic growth

Enhance fiscal governance and the effectiveness of the reform

Achieve best Value for Money and maximize impact of available resources, strict implementation of the Public Financial Management (PFM) Act (2015) and related Regulations is key in maximizing impact of public investment and other expenditures. It is also important to increase accountability which requires the strict implementation of Programme Based Budgeting with a focus not only on outputs but also outcomes in line with the National Development Plan (NDP) framework.

Financial sector reforms

Further reforms are needed in the financial sector to deal with the challenge of limited access to long-term capital, particularly for sectors like industry that require access to long-term credit. This would involve continued reform and development of the pension sector as well as the capital market.

3.1.2. Key policies and strategies to build resilience to shocks.

Shocks that affect Uganda's growth are becoming more frequent and more severe including global economic shocks, natural disasters like droughts and floods due to climate change, geopolitical tensions affecting markets and supply chains, cyber-attacks, etc... It is important to understand these risks and to build resilience against them. Policies and strategies to minimize the growing cost of shocks and disruptions include the following;

Strengthening the fiscal policy space

Coping with adverse shocks requires having capacity to respond not only with monetary policy tools but also with fiscal policy tools. This involves creation of fiscal space overtime through government expenditure rationalisation and revenue mobilization reforms, without compromising social and development objectives. Having fiscal policy space strengthens a government's ability to support growth and the overall economy during economic shocks.

Given the increasing frequency of global economic crises, it is important to prepare for eventualities. Uganda therefore needs to strengthen its fiscal position by reducing debt, as well as maintain a financial safety buffer during the good times and focus on proper government cash management during the bad times.

Strengthening economic risk management

Strengthening of economic risk management for sectors like banking which have economy-wide ripple-effects in the event of a financial shock can mitigate the negative impacts on the economy. This involves conducting rigorous stress tests of balance sheets of banks to determine whether they could withstand a severe recession. This approach to risk could be extended to other sectors to assess the impact in the event of disruption and hence to support adoption of risk resilient contingency plans.

Diversification to reduce dependency on primary product exports

Although Uganda is not like countries that depend on a single export commodity like oil, it is dependent largely on unprocessed primary products or very low value-added exports. To mitigate the regular shocks arising from volatility in the price of primary products, diversification into higher value-added products can help mitigate the impact of these kind of shocks. As noted above, it is also critical that the Uganda avoids the "oil curse" or Dutch disease when the country starts producing and exporting oil.

Improve quality of public infrastructure to withstand extreme weather conditions

The public and private sectors are exposed to risk when public infrastructure fails due to natural disasters like extreme weather. Vulnerabilities include disruption to transportation, logistics, energy, and communications, etc. Investment to strengthen public infrastructure is therefore needed to withstand extreme weather conditions.

Environmental protection and mitigation of consequences of climate change

There is need for concerted efforts by both the government and the private sector, to protect wetlands, forests, and water bodies. This can be done by gazetting such areas free from any economic or social activities with penalties to the offenders. In addition to that, environmental laws should encourage the polluter pay principle. In this aspect, firms which pollute the environment can be charged an environmental tax whose revenue can be used to subsidise firms whose production is environmentally friendly. Consequently, majority firms will be attracted to protect the environment.

4.0 Conclusion: Policy and practice

During the period (1987/88 to 2010/11), Uganda had strong growth performance, with the key growth driver being capital accumulation. However, the contribution of Total Factor Productivity (TFP) to growth remained low and continued to decline even in more recent years posing serious challenges to the achievement of sustained high growth and poverty reduction.

Uganda has significant potential to grow at faster economic growth rates – if appropriate policies are fully adopted and implemented aimed at increasing production and productivity

and to build resilience against shocks. Researchers from Harvard University, for example, have predicted Uganda to be one of the fastest growing economies in the world in the new decade (2020-2029) based on Uganda's productive capabilities. Precisely, they project growth to average 7.61 percent over the next 10 years.

Commitment and Policy discipline are important ingredients of economic success (Bigsten & Kayizzi-Mugerwa, 1999). In the case of Uganda, the necessary policies and relevant legal frameworks to deliver robust economic growth and development are in place notably through the Public Financial Management Act (2015), but the major challenge remains with implementation. Moreover, recent research has demonstrated that the growth shortfall of Africa can, to a large extent, be attributed to economic policy failures and to a weak institutional environment (Sachs, Warner, 1997). Greater focus should therefore be directed towards practice (how things are done) and implementation of the already established policies to boost productivity in all sectors so as to accelerate and sustain robust economic growth. It is also important to ensure the right balance between Growth-Enhancing public expenditure and hard-worn debt sustainability

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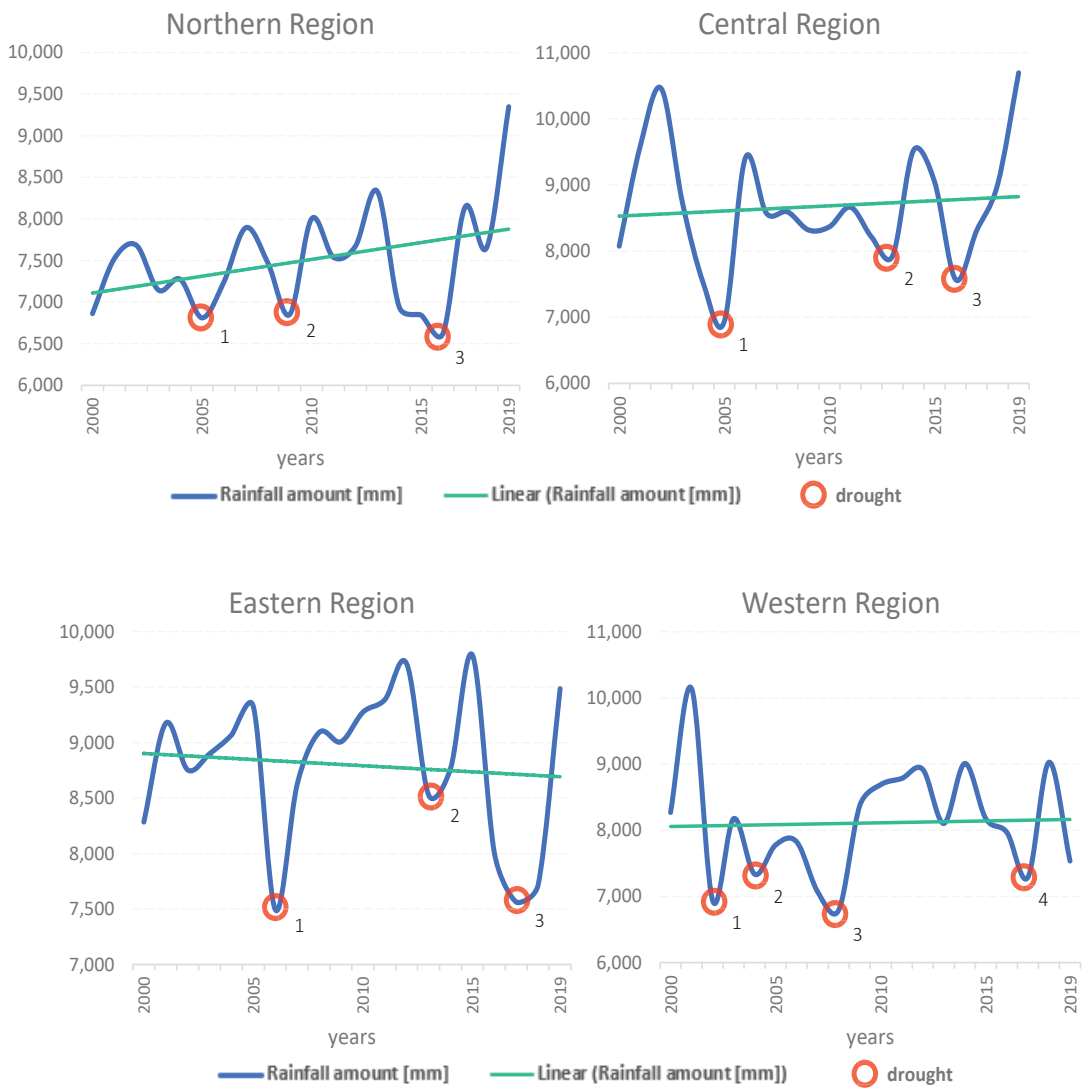
Annex 1: RAINFALL AMOUNTS FOR THE DIFFERENT REGIONS (MM).

Shows rainfall amounts and trend from 2000 - 2019



Source: Drawn using data from Uganda National Meteorological Authority.

CHAPTER 3:

Enhancing Uganda's Domestic Revenue Mobilisation

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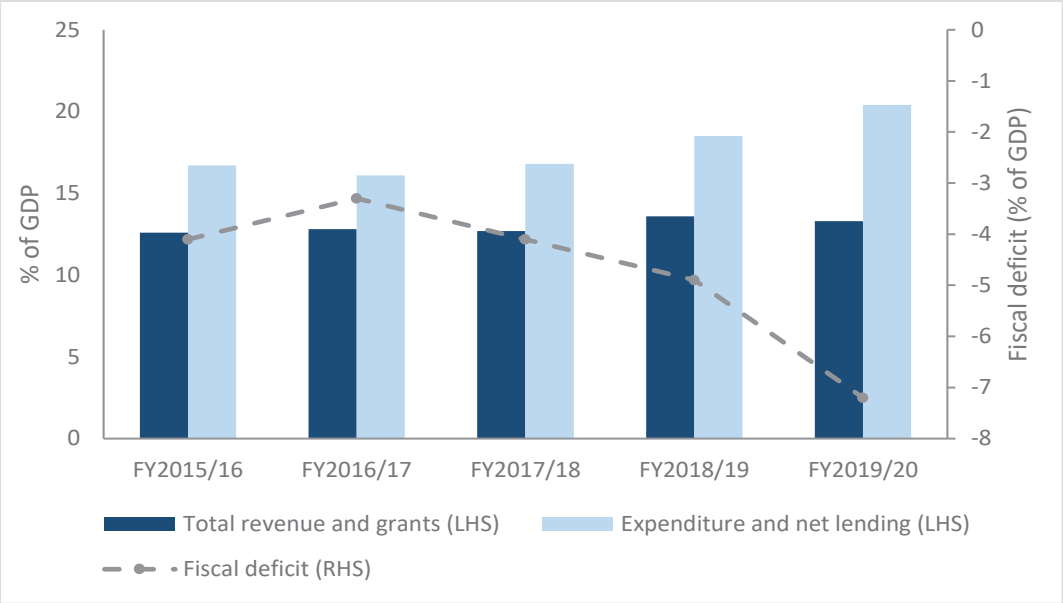
1. Introduction: Unprecedented Revenue Pressures

Prior to the outbreak of COVID-19, Uganda's economy was in a strong position, with real GDP growing by 7.5 percent in 2019 (World Bank, 2020). The Government had made commendable progress in reducing poverty, increasing life expectancies, and expanding education. The outlook was positive, contingent on continued favourable weather to promote agriculture, strong foreign demand for exports, and the execution of planned capital spending. Nonetheless, it was also clear that achieving Uganda's growth and development objectives would require a proactive effort to improve revenue mobilisation. Aid flows had slowed, and public debt was accumulating fast, while debt servicing accounted for a notably high share of the annual budget. Thus, to finance much-needed public investments and social policy spending, without compromising fiscal stability, the Government needed to urgently accelerate growth in domestic revenue collection. While increased taxation is never popular, it plays an important role in funding critical investments: in roads, electricity, and telecommunications infrastructure to ensure that Uganda offers a competitive business environment, and in a well-educated and skilled population with access to modern healthcare. These factors are all acknowledged as engines of growth in the National Development Plans and the Vision 2040.

In 2020, Uganda suffered three concurrent shocks: a locust invasion, devastating floods, and COVID-19. Reduced international demand, falling commodity prices, heightened risk aversion among investors, and domestic containment measures have had a far-reaching impact on the economy and social welfare. As a result, the economy contracted by 0.8% in 2020. This has reversed the recent gains realised by a gradual structural transformation away from agriculture and into industrial and service production. Just as critical spending needs have increased, Uganda has suffered a blow to an already low level of tax revenue mobilisation. This resulted in a historically high budget deficit, compounding concerns about Uganda's debt sustainability. Public debt has risen sharply in recent years, from 26 percent of GDP in FY14/15 to over 40 percent in FY19/20, as spending routinely outstripped revenue collection (see Figure 1). The World Bank (2020) projected that public debt will exceed 50 percent of GDP within the next two years.

Figure 1: *Growth in expenditure has outstripped revenue growth*



Source: *Macroeconomics Department, MFPED (2020)*

Against this backdrop, it is imperative that the Government of Uganda (GOU) strengthens its commitment to improving domestic revenue mobilisation. Stronger and more certain revenue flows will allow the GOU to make the investments necessary to recover from the COVID-19 crisis. The recently launched Domestic Revenue Mobilisation Strategy (DRMS) recognises the value of having a transparent, medium-term strategy for tax reform. It sets out a clear, comprehensive roadmap for the tax system and contains a series of detailed proposals to strengthen tax policy and administration. COVID-19 will inevitably disrupt some of these plans and certain interventions may have to be postponed. However, implementing the DRMS is not incompatible with a post-COVID world. This chapter will highlight several of the most pressing challenges in tax mobilisation and will suggest which reforms to prioritise in the short-term. This will ensure that tax policy and administration supports the wider government response to the COVID-19 crisis, without deviating heavily from the agreed medium-term vision.

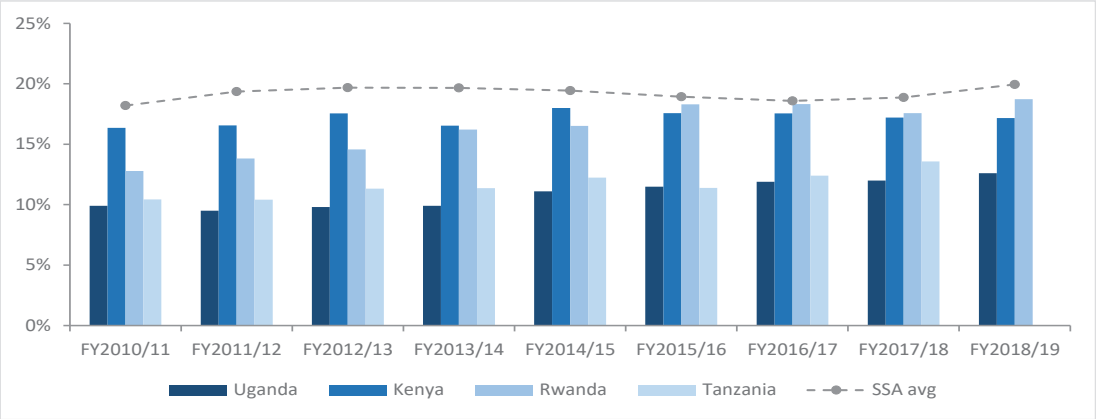
2. Uganda's Recent Revenue Performance

Before 2020, Uganda had seen steady annual increases in the revenue-to-GDP[13] ratio, averaging 0.3 percentage points over the past decade. However, the revenue yield remains below expectations for a country at Uganda's stage of development and, with a revenue-

13 Including non-tax revenues, such as fees levied on public services, payments for government services, royalties, and interest from government investments, but excluding grants and social contributions.

to-GDP ratio of 12.6 percent in FY18/19, Uganda's efforts have historically lagged that of regional peers (see Figure 2). There is a consensus among researchers and development partners that Uganda's tax system has only partially achieved its potential, a sentiment echoed in the DRMS. For instance, Langford and Ohlenburg (2016) estimate Uganda's full revenue potential to lie between 22 and 26 percent of GDP, and the IMF (Baer et al, 2017) placed this at 20 percent. While these estimates may be over-optimistic, they indicate that Uganda's existing tax policy and administration are likely to be leaving money on the table.

Figure 2: *Revenue-to-GDP ratios for East African Community countries*[14]



Source: *Uganda – Macroeconomic Department, MFPED (2020); Others – UNU-WIDER (2020).*

Over FY19/20, Uganda's tax-to-GDP[15] ratio declined by 0.8 percentage points – from 12.2 percent in FY18/19 to 11.4 percent. In addition to the slowdown in economic activity due to lockdown measures, revenue collection was hampered by the introduction of a number of tax reliefs and deferrals to support the private sector through the current crisis. Overall, collections from VAT, excise duties, and international trade taxes suffered the most, as lockdown restrictions reduced consumption spending. The government also registered an overall revenue shortfall of 2,070.4bn shillings (US$ 552m[16]) relative to the approved budget projection of Shs.21,809.7 bn, for FY20/21. Of concern, in simulations using administrative tax data, researchers predicted that after a three-month lockdown, only 51 percent of firms would remain profitable and corporate income tax collections would decline by 22 percent relative to pre-COVID collections (Bachas et al, 2020). While there are some signs of a gradual economic recovery, revenue pressures are likely to persist, especially in the medium-term as Uganda seeks to reverse the rapid public debt accumulation induced by the current crisis.

14 The Sub-Saharan African (SSA) average excludes Uganda. Data for Tanzania for 2018 was unavailable at the time of writing.

15 Excludes non-tax revenues

16 Exchange rate: 1 USD = 3,700 UGX (as of 8 January 2021)

3. Key Constraints to Revenue Mobilisation

Collecting taxes in countries like Uganda is intrinsically difficult. The economy is largely made up of many small enterprises and subsistence agriculture, while non-farm, formal sector wages comprise a small share of total national income. This makes the potential tax base for traditional value-added and income taxes relatively narrow. Where large corporations exist, such as in the mining and telecommunications sectors, they are difficult to tax, as they can usually hire experienced tax accountants and shift their profits abroad using complex international structures, reducing their overall tax burden. The tax system is also a sensitive political issue. Its success in raising revenues depends on it being broadly accepted and supported by citizens. Yet, Ugandan citizens currently perceive a weak link between the taxes that they pay and the services that they receive. Without translating revenues into visible public goods, tax morale and compliance will remain low. These sentiments are further entrenched when citizens see political and economic elites benefitting from the system, with corruption plaguing both the collection and usage of tax revenues.

While important parts of the equation, these economic and political factors will take time to adjust. Addressing areas of weakness in tax policy might bring some more immediate gains. However, increasing tax revenues is not simply a case of adding new taxes or pushing up tax rates, especially if those increases are to be sustainable and fair. Indeed, Uganda already deploys a range of standard tax instruments, generating a broad balance of revenues from taxes on consumption, income, and international trade, as illustrated below. In this sense, Uganda's problems are not due to an absence of "normal" taxes.

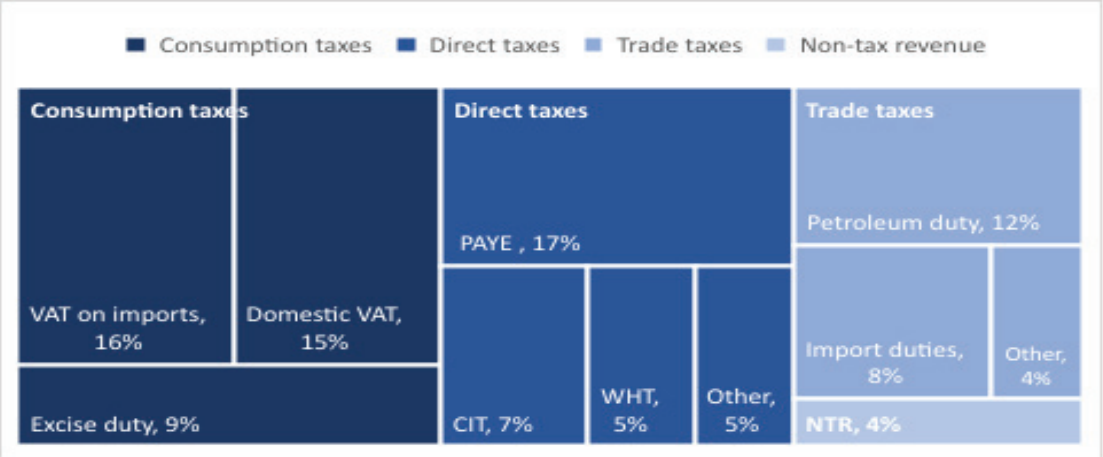


Figure 3: *Revenue Composition in Uganda*[17]

Source: *MFPED (2020)*

17 Abbreviations: VAT – Value-Added Tax; PAYE – Pay-As-You-Earn; CIT – Corporate Income Tax; WHT – Withholding Tax; NTR – Non-Tax Revenues

Nonetheless, as noted above, the overall yield from these taxes is lower than might be expected and below the level required to finance necessary government expenditure. The DRMS highlights a number of areas where tax policy can be refined and improved, but five constraints appear most urgent given the current circumstances and pressures:

1. **The wide range of exemptions and deductions granted to investors,** resulting in a comparably low corporate income tax yield and low effective tax rates. Properly controlled and monitored tax expenditures, linked to specific economic development and welfare objectives, can be very effective. However, Uganda's current tax structure provides for several holidays, exemptions and deductions that may be considered overly generous, especially given mounting revenue pressures. For instance, companies can carry forward previous losses indefinitely, incentivising them to remain artificially in a tax-loss-making position; and foreign and domestic investors making any investment over a certain threshold are afforded a 10-year tax holiday, without a link to specific priority industries or sectors. In addition, there is a perception that certain investors are able to use their influence to secure discretionary, preferential treatment, which is even more difficult to monitor and further damages tax equity. Overall, these incentives result in substantial amounts of "lost" revenue, estimated to be at least one percent of GDP in 2017 in a recent study (Eissa et al, 2020), yet their effectiveness in attracting new, productive investment is questionable. For instance, James (2014) found that 93 percent of investors would have undertaken their activities in Uganda even if tax incentives had not been provided.

2. **Frequent, *ad hoc* adjustments have created an unstable and unpredictable policy environment.** There is a sense that Uganda's tax policy is overly reactive to short-term pressures, with little alignment to a clear, overarching strategy. This is acknowledged in the DRMS. Frequent, piecemeal changes entail high compliance adjustment costs for the private sector and negatively affect investor confidence. In addition, the level of analysis and consultation undertaken in the course of policy development is often insufficient and narrowly focussed on the revenue impact of a proposal, without understanding the full picture of economic, distributional, social, and welfare effects.

4. **A "leaky" Value-Added Tax (VAT) system, with a long list of exempt and zero-rated items complicating administration.** VAT accounts for approximately one-third of Uganda's tax revenue, however, there is scope for improvement, through both policy adjustments and stronger enforcement. Many of the current VAT exemptions support various government objectives (e.g., those applied to educational services), or reflect legitimate policy choices to exempt goods primarily consumed by the poor (e.g., on unprocessed food). Recent research indicates that Uganda's VAT system is slightly poverty-inducing, which is somewhat

offset by VAT exemptions and zero-rates, since the revenue foregone from these is concentrated more among the poor (Mejia-Mantilla et al, 2019). However, certain exemptions are inefficient in their scope and poorly targeted, and these should be considered for removal to expand the VAT base. This would make the VAT a relatively more regressive fiscal instrument, but direct transfers have been shown to be more efficient and better-targeted redistributive tools than exemptions (Harris et al, 2018). In addition, the DRMS indicates substantial gains will accrue from proper enforcement of the VAT. A recent study of VAT returns data indicated that misreporting by firms costs the government at least US$ 383m in uncollected revenue between 2013 and 2016 (Almunia et al, 2020). These losses are in part due to inefficient compliance management, particularly inadequate analysis of taxpayer information and limited use of available data to reconcile returns. For instance, the authors found that sellers and buyers report different amounts in 79 percent of cases, despite invoices being easily cross-checked (Alumina et al, 2020).

5. **Balancing the competing objectives of import substitution, export promotion, and revenue generation is increasingly difficult.** Import duties have been an historically important source of revenue, especially given the relative ease with which they can be imposed and collected on observable goods imports. In addition, the Government has been pursuing an import substitution strategy to protect local production, raising tariffs on a wide range of imported products. However, COVID-19 has brought into stark focus the dependence of many Ugandan firms on imported inputs. Total imports fell by 18 percent in March 2020 relative to March 2019, largely attributable to lower imports from China, as crucial suppliers closed (Spray & Rauschendorfer, 2020). This reduction was almost entirely due to reduced imports of capital and intermediate goods, while imports of consumption goods were barely affected. Research has also indicated that, if import interruptions to the same degree as found at the outset of the pandemic had continued, 6.6 percent of formal firms would have closed, reducing formal employment by 4.7 percent (Spray & Rauschendorfer, 2020). These results suggest that pursuing protectionism without considering the knock-on effects risks harming the private sector, reducing firm profitability and formal employment, and raising consumer prices.

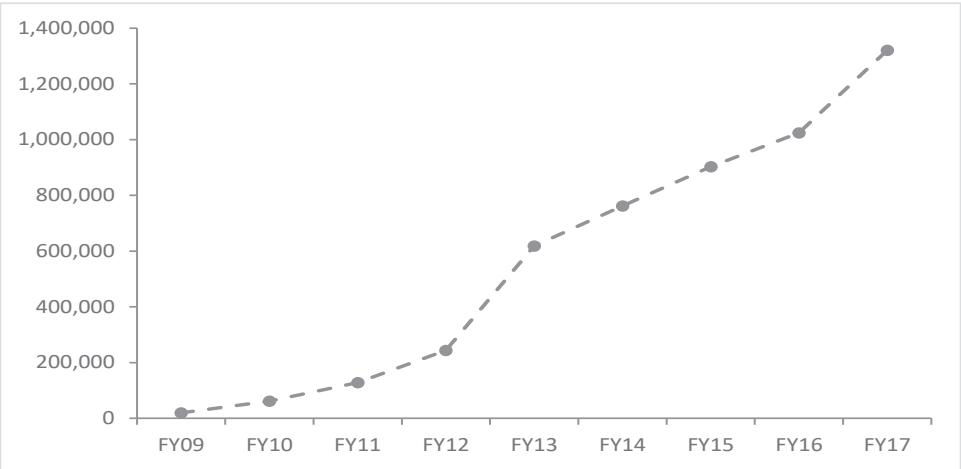
6. **Missed opportunities to use tax levers to address major economic and social policy problems.** Work done by the Tax Policy Department (TPD) at MFPED has historically been organised on a tax-by-tax basis. This can encourage the development of strong technical knowledge. However, this also unintentionally narrows the scope of the department. Typically, TPD's engagement with other ministries and agencies is insufficient and precludes the development of cross-cutting

policy initiatives. This narrow focus is compounded by limited dialogue with the private sector and other external stakeholders and insufficient recognition of the range of interfaces that businesses have with the tax system. As a consequence, tax policy is not always in alignment with wider government objectives, and too little attention is paid to ensuring that taxation does not hamper the growth of firms.

In practice, the quality of tax administration determines how successful tax policies will be. As the adage goes, in developing countries "tax administration *is* tax policy" – *how* revenue is raised is just as important as *how much* revenue is raised. Weak governance and accountability, poor performance management, extensive non-compliance, and frequent political interference remain fundamental barriers to effective tax administration in Uganda. It is here that the DRMS anticipates that the most substantial gains will be made. Specifically, four issues loom large and demand immediate attention:

1. URA suffers from **serious problems with the accuracy of its taxpayer register**. An accurate register is the cornerstone of any tax administration. Without it, basic verification, reconciliation, and reporting procedures are impossible. A recent examination of the integrity of URA's register found that while a push to register new taxpayers has dramatically increased the size of the register (see Figure 4), many of these "new taxpayers" are inactive, never engaging with URA or paying any tax (Mayega et al, 2019). Indeed, 51 percent of all registered taxpayers were classified as inactive. Loose controls have also allowed duplicate and inaccurate taxpayer information to remain undetected. For instance, Mayega et al (2019) found over 16,000 individual taxpayers were recorded as having the same National Identification Number and some 29,000 taxpayers possessed more than one Tax Identification Number.

Figure 4: *Number of taxpayers registered with the URA*



Source: *Mayega et al, 2019.*

2. Relatedly, **digital technologies and available data are under-exploited**. URA has concentrated on deploying digital technologies for taxpayer-facing purposes, such as e-filing and electronic payment. While this does ease compliance, there is untapped potential for technologies to be deployed to support internal control processes and to address problems of weak accountability. Among the key concerns: some data-upload processes remain manual, which is time-consuming and prone to error; several non-interfacing software systems are used simultaneously across different units; URA's systems have a limited interface with other government agencies; and digitalisation and automation are missing from several key revenue-raising functions, particularly in audit. Furthermore, available data is not fully exploited to promote revenue generation and enhance voluntary compliance. Most crucially, data-sharing between URA units, and between URA and other government agencies, is weak, possibly stemming from a lack of trust. Among other issues, this hampers the ability for tax officials to validate information and detect evasion, as well as limiting the ability of MFPED to properly hold URA to account for its performance.

3. **Poor compliance management, especially of high-income individuals** who should be taxed more effectively. The registration drive seems to be entangled with a popular narrative that the allegedly untaxed informal sector, with its multitude of small, low-income enterprises, is a significant cause of revenue shortages (Moore, 2020). Yet aggressively registering many small-scale businesses is unlikely to bring in significant revenues, and whatever they do bring in comes at a high administrative cost. This diverts attention away from the real source of uncollected revenues: significant under- and non-declaration of incomes by wealthy individuals and firms. Uganda's personal income tax system is designed to be progressive – indeed, the rates climb steeply, with income tax starting at very low levels (235,000 shillings per month, equivalent to US$ 2.12 per day) and the top band applied from incomes above 410,000 shillings per month (US$ 3.69 per day).[18] However, substantial non-compliance among wealthy professionals undermines this progressivity, since their total incomes routinely outmatch workers who have tax deducted directly from their salaries (e.g., nurses and teachers). The DRMS highlights that compliance efforts should target those individuals (and firms) who hide behind a cloak of informality, failing to report for tax purposes, all, or part, of their economic activity. Despite some recent interventions, such as establishing a unit dedicated to high-net-worth individuals, non-compliance with filing and payment obligations from wealthy self-employed individuals, professionals, and highly profitable businesses remains high. Recent research by URA staff indicates the scale of the problem: in FY13/14, only 5 percent of

18 Any income over 120m shillings per annum (10m shillings per month) is subject to a further tax of 10% on the amount over this threshold, so capture the ultra-rich. However, the majority of incomes fall far below this threshold.

company directors and one out of a sample of 71 top-ranking government officials, who owned extensive assets, paid personal income tax (Kangave et al, 2016).

6. **Extensive human resource challenges at URA and MFPED,** with gaps in both staff numbers and skills, especially on data analysis and in complex, specialised areas of taxation. The capacity within the GOU to carry out sophisticated analysis of tax policy options is weak, hindering policy design. The deployment of staff at URA is heavily biased towards taxpayer-facing functions, with a relative shortage of staff working in audit, investigations, and verifications functions, which are more likely to be revenue-raising. Finally, poor talent management processes have resulted in few opportunities for career development and promotion, especially for technically gifted staff. This contributes to poor morale and may lead to integrity issues.

4. Opportunities for Reform

A thin silver lining of the COVID-19 pandemic is the apparent acceleration of slow-moving trends, especially with respect to digital transformation. The dramatic rise in e-commerce and remote working, and the extraordinarily rapid development of a working vaccine against a virus, would have seemed impossible a year ago. Taxation is one area where governments can harness this energy, and leverage feelings of solidarity that have emerged to command public support for a reform agenda. What should Uganda's tax priorities be?

On the policy side, first, tackle areas where too much revenue is being given away by granting excessive, unnecessary exemptions to foreign and domestic investors. Exemptions can be valuable, to attract investment or to focus resources on certain sectors or social policy objectives. This is acknowledged in the DRMS. However, the DRMS also recognises that exemptions work best when they are used strategically, properly monitored, and time-bound. To enable the GOU to monitor the effectiveness of tax exemptions and increase transparency in their governance, developing a Tax Expenditure Governance Framework should be prioritised. This should include an extensive cost-benefit analysis for each proposed new exemption and an assessment of whether existing exemptions are still beneficial and relevant.

Second, resist the temptation to "expand the tax base" by introducing new, poorly designed tax handles in response to short-term revenue pressures. This is especially true for measures that would fall most heavily on small businesses, as they will have been particularly hard hit by the pandemic and are most unlikely to have benefitted from formal tax reliefs. Instead, when designing revenue-raising proposals, the GOU should consider measures that will contribute to the recovery and that are aligned with other government objectives. One area ripe for attention is an environmental tax designed to

target a range of pollutants. Uganda's air pollution is dangerously high,[19] mainly due to vehicle emissions, heavy traffic congestion, manufacturing, and waste burning. Taxes can play a role in combatting the scourge of pollution and the cause is likely to enjoy wide support. On this issue, tax design would benefit significantly from cross-governmental collaboration, with TPD drawing in the knowledge and experiences of relevant regulators and ministries, as well as the private sector and business groups.

Third, reconsider the scope of current VAT exemptions to curb unjustifiable revenue leakages. Although most of Uganda's exemptions support welfare and economic objectives, exemptions that do not effectively benefit the targeted parties should be removed. While perhaps politically difficult, exemptions currently applied to the agricultural sector may be a prime candidate. These are wide-ranging and exempt large and small businesses alike. As a result, highly profitable agricultural businesses are subject to very light-touch taxation. Instead, allow small businesses to be protected by the VAT threshold, and examine where large amounts of revenue is being foregone for little benefit.

Finally, safeguard the sustainability of trade by achieving a balance between the various objectives of trade policy, without unnecessarily undermining private sector growth or artificially propping up inefficient industries. In the face of revenue pressures, it is tempting to leverage "simple" tax handles, applying higher tariffs on commonly imported goods. However, higher tariffs, especially on key intermediate inputs in the production process, will have knock-on effects along the supply chain, and ultimately result in higher prices for consumers. Instead, the GOU should seek to balance suitable protection for key domestic industries with ensuring that the importation of critical inputs is not hampered.

With respect to tax administration, first, embark on an extensive register-cleaning exercise. A taxpayer register of questionable reliability with vast inaccuracies will increase administrative costs and result in deficiencies in collection and enforcement. All inactive and duplicate taxpayers should be deregistered, and taxpayer information should be cross-checked with other databases to ensure that it is accurate and up to date. This should not, however, be a once-off exercise, but rather a continuous process of verification and validation. Furthermore, URA's performance should be judged on growth in the number of active taxpayers, who file returns and pay taxes, rather than simply reporting the number of new TINs.

Second, concentrate on more actively taxing the incomes and wealth of Uganda's richest citizens. This might require small policy adjustments to ensure that the wealthy pay their fair share, such as improving the progressivity of personal income tax brackets. However, stronger audit and enforcement action to detect hidden incomes is likely to yield more significant revenues. This should include better use of existing, third-party data to cross-check taxpayer declarations and undertake risk-targeted compliance strategies, for instance by using consumption patterns to infer incomes. One particularly visible

19 https://www.iamat.org/country/uganda/risk/air-pollution

indicator of personal wealth is land and property, which, despite being economically efficient and progressive revenue sources, are historically under-taxed in many African countries, Uganda included (Moore & Prichard, 2017). Recent experiences from other countries (most visibly in Sierra Leone[20]) indicate that improvement could be relatively straightforward, starting with adopting a simplified and transparent method for valuing properties, based on observable characteristics. Since political and economic elites are likely to bear the brunt of these taxes, reforming this area is difficult. However, if the GOU can overcome these political barriers, significant revenues would quickly follow.

Third, enhance the adoption and governance of digital technologies within URA. It may be tempting to deploy an entirely new system. However, not only will this be expensive, but it is also unlikely to resolve the underlying problems, especially if messy data is simply migrated into a new system. As the expression goes, "garbage in, garbage out" – the quality of output is determined by the quality of input data. Rather, upgrades and new investments should be undertaken based on a review of available options and the benefits and costs involved. Importantly, data cleaning efforts should be undertaken concurrently, to ensure that new technologies can be used effectively. URA should also enhance the use of its own data for cross-checking, as well as be empowered to access relevant third-party data. The example of VAT enforcement indicates the power of data – automatically cross-checking transaction-level VAT data would enhance URA's ability to detect tax evasion. In the medium-term, cross-government data sharing would be greatly enhanced by developing a framework for data management, to ensure that data is captured, stored, and shared in a systematic, standard way.

Finally, ensure that TPD and URA are properly equipped with adequate human and financial resources. COVID-19 has accelerated the pace of digitalisation of the economy, and there is a risk that tax officials are "left behind". Skills gaps mean that currently available data is often under-utilised, and tax officials struggle to stay abreast of developments in the private sector. A comprehensive training strategy should be developed, leveraging opportunities such as remote learning and secondments between URA and TPD, with a focus on data analytics, policy appraisal, and modelling. Further, performance management practices should be reviewed to ensure that high-performing staff are rewarded, that salaries are appropriate, and that staff are well-motivated.

5. Concluding Remarks

The COVID-19 pandemic and accompanying global economic shock have undeniably increased pressures on Uganda's already strained public finances. Reduced international trade and tourism, declining commodity prices, and lockdown measures to contain transmission have already had a significant impact on government revenues, just as demands for social spending have increased. This calls for carefully designed tax policy

20 https://www.economist.com/middle-east-and-africa/2020/06/18/a-mayor-is-reforming-sierra-leones-rotten-property-tax

responses, to support the most vulnerable while simultaneously safe-guarding revenues. It is thus somewhat fortuitous that the GOU have just concluded a long period of research, consultation, and collaborative working that resulted in the Domestic Revenue Mobilisation Strategy. This document transparently identifies constraints in Uganda's political economy, tax policy, and tax administration, which have acted as a brake on revenue generation. A number of detailed proposals have been developed to fortify the design of the tax system and to ensure that the URA is equipped to administer tax policies efficiently. COVID-19 has not changed these fundamental challenges, and so the GOU should not let the pandemic derail its plans. The sequencing of certain interventions might change, postponing some of the more difficult, potentially painful, adjustments for when the economy is in a healthier state. However, the DRMS remains a sound strategy for the development of the tax system, and close implementation of its recommendations will contribute to sustainable and equitable increases in domestic revenues.

This paper has highlighted several areas for immediate attention: rethinking tax exemptions; steering away from potentially damaging "quick fixes"; properly taxing the rich, and their property; aggressively cleaning the taxpayer register; advancing the adoption of digital technologies; and concentrating on building staff capacities. This is likely to be a difficult period for tax officials and administrators, with pressures mounting on all sides. However, the GOU also has an opportunity to redefine the tax system, to be more balanced and responsive to the needs of ordinary Ugandans. This approach will generate long-lasting improvements in the fiscal-social contract and contribute to more enduring increases in domestic revenue mobilisation.

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CHAPTER 4 :

Public Investment Management as a driver for growth – Uganda's experience

By Justine Ayebare (Ministry of Finance, Planning and Economic Development, Macro-Economic Policy Department)

1. Introduction: Public Investment Management is a priority for Uganda

Public Investment is a key priority area for the Government of Uganda. The Government has more than doubled its spending on public investment projects from USD 1.2 billion in 2010/11 to USD 4.4 billion in 2020/21. Public investment can be defined as investment by government aimed at creating physical assets or capital to support the delivery of public services. These physical assets are typically infrastructure facilities, systems and structures owned and operated by the public sector, which can be categorized into two. The first is economic infrastructure such as airports, roads, railways, ports, power, and telecommunication and the second is social infrastructure such as schools and hospitals.

Over the past decade, through the National Development Plans (NDP I and NDP II), Uganda has scaled up public investment, with the aim of accelerating economic growth with the objective of transforming the economy to middle income status (National Planning Authority, 2012)including; ideological disorientation, weak private sector, underdeveloped human resources, inadequate infrastructure, small market, lack of industrialization, underdeveloped services sector, underdevelopment of agriculture, and poor democracy, among others. The Vision 2040 is conceptualized around strengthening the fundamentals of the economy to harness the abundant opportunities around the country. The identified opportunities include: oil and gas, tourism, minerals, ICT business, abundant labour force, geographical location and trade, water resources, industrialisation, and agriculture among others that are to date considerably under-exploited. Achieving the transformational goal will thus depend on the country\u2019s capacity to strengthen the fundamentals including: infrastructure (energy, transport, water, oil and gas, and ICT. Out of the cost of the NDP II (2015/16 to 2019/20) of USD 33.6 Billion, over 52 percent (USD 17.6 Billion) was allocated to public investment projects (National Planning Authority, 2015). Key public investment installations include energy generation projects such as the Karuma and Isimba hydro electricity dam projects, upgrading and modernizing Uganda's road network, as well as investments in the oil and gas production and distribution facilities.

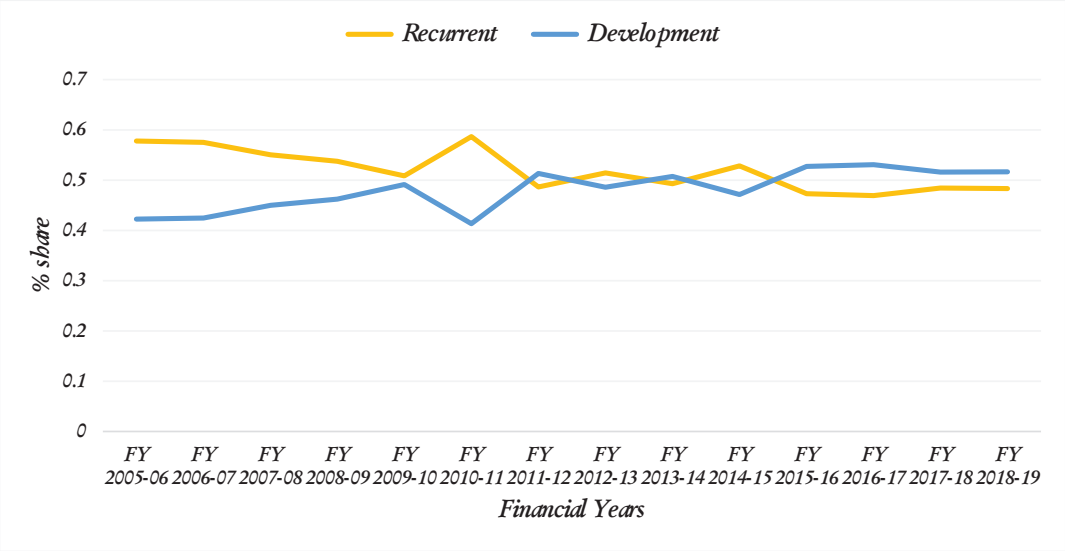
The aim of this paper is to assess the state of Uganda's Public Investment Management System and its contribution to growth. It highlights the progress made by the Government of Uganda in strengthening public investment management and the additional reforms required to ensure adequate value for money from these investments and hence sustainable growth.

2. Trends in public investment and capital stock in Uganda

There has been a shift in the Ugandan Government's funding priorities from poverty eradication to structural transformation. Figure 1 shows a significant increase in the proportion of Uganda's annual budget allocated to development expenditure compared

to the recurrent budget for the period 2005/06 - 2018/2019.

Figure 1: Expenditure trends: Fiscal years 2005/06 - 2018/19.



Source: MoFPED (2017).

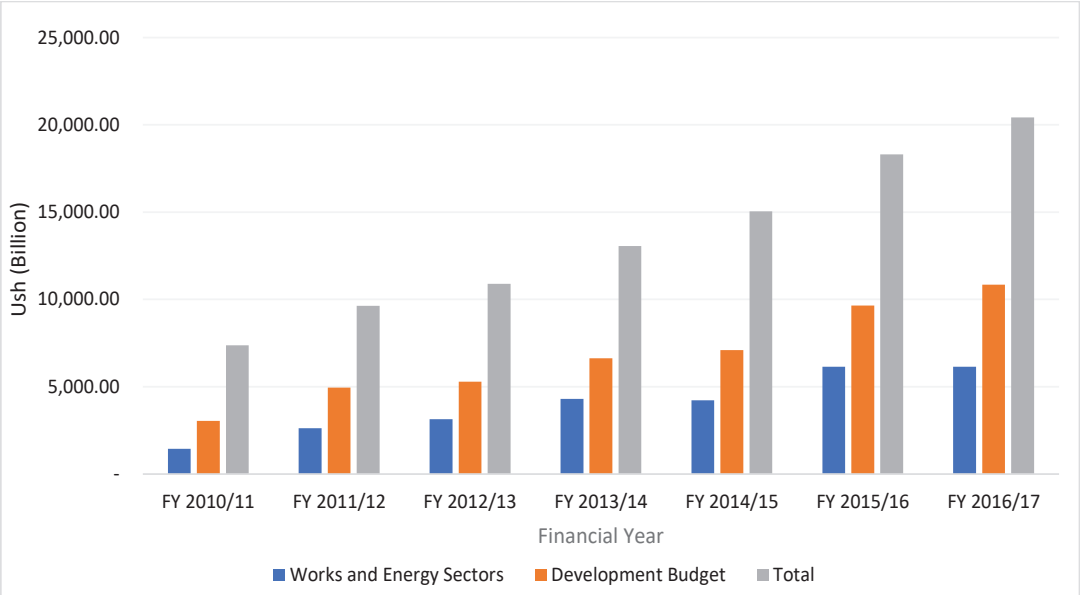
Table 1: Break down of expenditure Trends (in UGX billion), fiscal years 2010/11 - 2016/17.

Financial Year	Recurrent	Development	Total
FY 2005-06	2,146.38	1,569.74	3,716.12
FY 2006-07	2,362.33	1,744.19	4,106.52
FY 2007-08	2,723.24	2,226.34	4,949.58
FY 2008-09	3,148.96	2,709.71	5,858.67
FY 2009-10	3,583.21	3,461.30	7,044.51
FY 2010-11	4,327.22	3,049.32	7,376.54
FY 2011-12	4,685.21	4,944.79	9,630.00
FY 2012-13	5,606.17	5,296.67	10,902.85
FY 2013-14	6,438.01	6,626.77	13,064.79
FY 2014-15	7,948.51	7,093.36	15,041.87
FY 2015-16	8,657.25	9,654.72	18,311.96
FY 2016-17	9,586.72	10,843.90	20,430.61
FY 2017-18	10,652.69	11,349.93	22,002.62
FY 2018-19	12,129.69	12,963.54	25,093.23

Source: MoFPED (2017).

Table 1 demonstrates a breakdown of the expenditure trends (in UGX billion) for FY 2005/06 – FY 2018/19. As seen in Figure 1 and Table 1, the Ugandan Government has increased the resources spent on public investment in comparison to recurrent budget. Figure 2 further illustrates Government's decision to reorient expenditure towards infrastructure. As seen in figure 2, in addition to a significant increase in development budget and its proportion to the country's budget, there is also an increase in the proportion allocated to the infrastructure sectors namely *Energy and Mineral Development* as well as *Works and Transport*. From the financial year 2015/16, infrastructure has been allocated more than half of the development budget in line with Government's development priorities as stated in the second National Development Plan (NDP II).

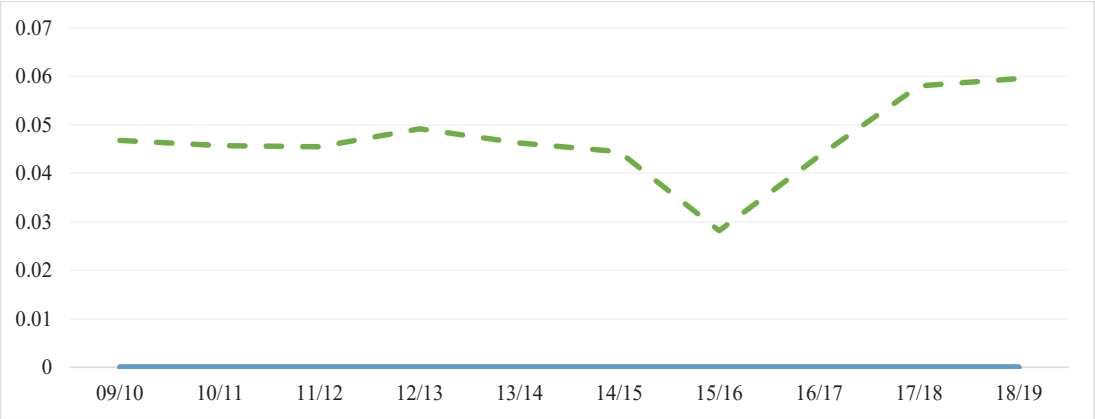
Figure 2: Infrastructure sector expenditure trends, fiscal years 2010/11 - 2016/17.



Source: MoFPED (2017).

In the past decade, Sub-Saharan African countries have increased the resources that they spend on public infrastructure to approximately 10 percent of GDP (Presbitero, 2016). Most of these countries face an infrastructure deficit which poses a major constraint to doing business and increasing productivity. Although across Lower Income Developing Countries (LIDCs) public investment rates as a share of GDP has partially recovered, as figure 3 shows the trend in Uganda has been almost constant with an average of 4.7 percent (between 2009/10- 2018/19).

Figure 3: Public Investment as a share of GDP in Uganda: fiscal years 2009/10 – 2018/19.



: UBOS (2019).

The World Bank (2010) estimates the cost of the infrastructure gap in Africa at around $ 93 billion per year. The state has a key role to play in increasing the stock of infrastructure due to market failures and the public good nature of public investments. While the budget allocations to development in support of public investments have gradually increased, their impact to economic growth tends to come with a lagged effect and this mainly due to the inefficiencies in public investment. The IMF (2014) has developed the concept of Public Investment Productivity which is the relationship between investment and economic growth measured by the ratio of average real rate of capital stock growth to the average real rate of economic growth. It highlights that for public investments to perform, there is need for efficiency and productivity. This framework is illustrated in figure 4 below.

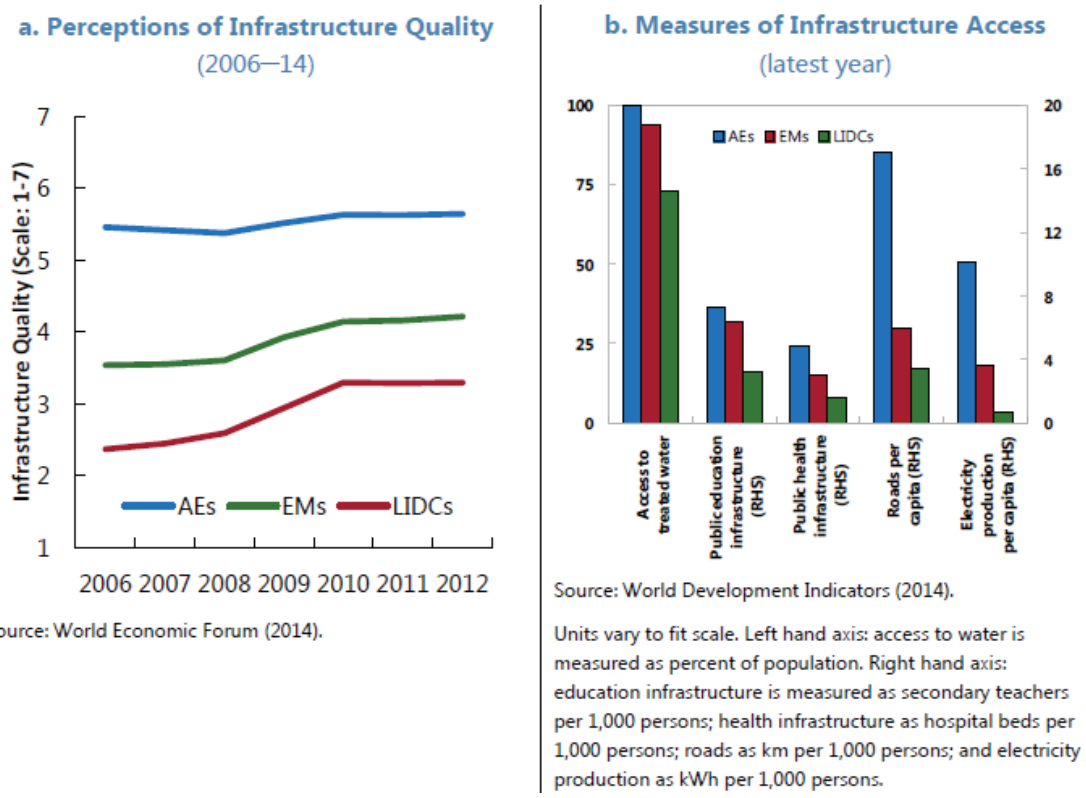
Figure 4: Public investment performance.

Source: IMF (2014).

3. Trends in infrastructure coverage and quality

Gaspal et al (2015) find large discrepancies in infrastructure coverage and quality across countries although higher rates of Public Investment in Emerging Economies and Low-Income Countries had brought some convergence in access to social infrastructure. Survey-based measures of infrastructure quality suggest that the recent ramping up of public investment in LIDCs had helped reduce the perceived disparity in infrastructure across countries (Figure 5a). Physical measures of infrastructure also suggested significant convergence across countries in the coverage of social infrastructure however there were large and persistent disparities between higher and lower income countries within the coverage of economic infrastructure (Gaspal et al, 2015).

Figure 5: Perceptions of infrastructure quality and measures of infrastructure access.



Source: World Economic Forum (2014).

Source: World Development Indicators (2014).

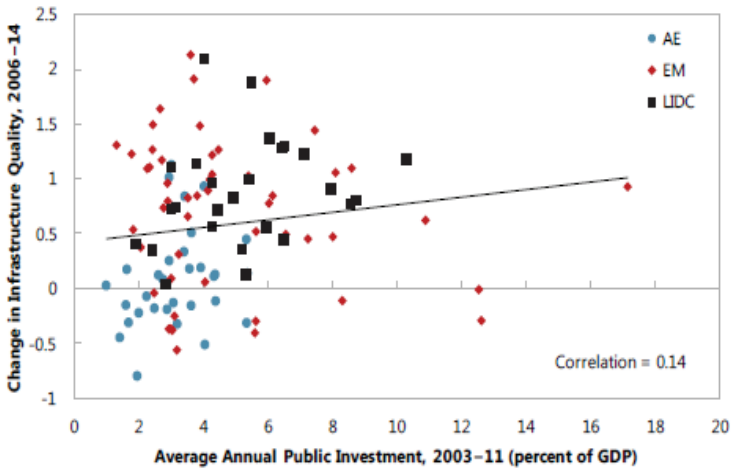
Units vary to fit scale. Left hand axis: access to water is measured as percent of population. Right hand axis: education infrastructure is measured as secondary teachers per 1,000 persons; health infrastructure as hospital beds per 1,000 persons; roads as km per 1,000 persons; and electricity production as kWh per 1,000 persons.

AEs- Advanced Economies, EM Emerging Markets, LIDCs- Low Income Developing Countries

Source: Gaspal et al (2015).

Gaspal et al (2015) also find that improvements in infrastructure coverage and quality were only loosely correlated with public investment pointing to significant levels of inefficiency across countries as shown in Figure 6.

Figure 6: Public Investment and Infrastructure Coverage quality



Sources: Center for International Comparisons (2013); OECD (2014); WEO; World Economic Forum (2014); and IMF staff estimates.

Source: Gaspal et al (2015).

4. Public investment and growth

Public investment supports the delivery of key public services, connects citizens and firms to economic opportunities and can serve as an important catalyst for economic growth (Gaspar et al., 2015). Both theoretical and empirical studies reveal that increased public investment particularly in infrastructure raises output in both the short and long term, boosts private investment through improved accessibility to markets and social services, reduced transport costs, increased production and competitiveness, improved trade, industrial growth and job creation (Abiad et al, 2016).

The relationship between public investment efficiency and long-run growth tends to be that that the most efficient public investors get twice the economic return from their investment than the least efficient (Gaspar et al., 2015). The literature shows that countries with more efficient public investment also see stronger relationships between investment and economic growth. Gupta (2014) presents evidence that public capital when adjusted for efficiency is a significant contributor to growth. Abdul et al. (2014) found that public investment shocks raise the level of output by around 0.4 percent in the same year and 1.5 percent after four years in advance economies. In developing countries, the impact on output was smaller at around 0.25 in the same year and 0.5 after four years.

In Uganda, the low level of efficiency in public investment has been costly to growth. Sebudde et al, (2017) find that whereas the Ugandan government had starting in FY08/09 embarked on a major investment drive by increasing the value of public investments, their contribution to total value addition remained only at 26 percent while additional

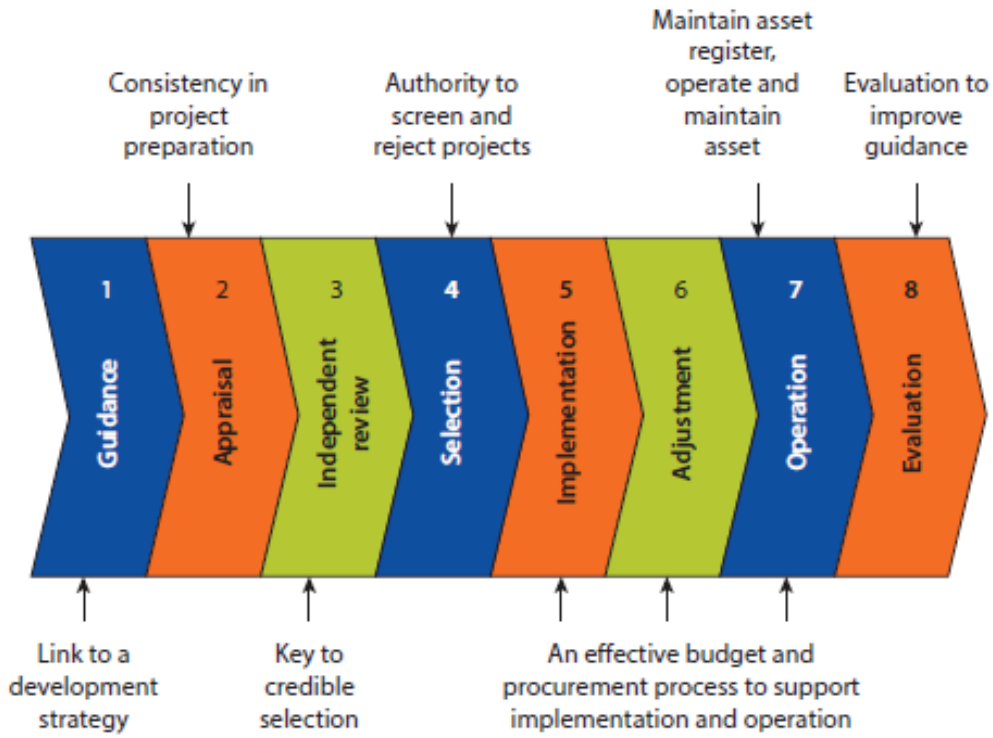
capital increasingly resulted into lower additional output over the decade 2004 to 2014. The Incremental Capital Output Ratio (ICOR) averaged about 6, which also remained significantly above the average of 3 for a developing country using capital inputs efficiently. Due to inefficiencies in public investment management, the same analysis estimated that every dollar invested in the development of public capital stock between 2004 and 2014, generated only USD 0.8 worth of economic activity. In the USA, for every dollar invested in the development of the interstate highway network in the period from 1954 to 2001, USD six of economic productivity was generated.

Gaspal et al (2015) note that improvements in PIM system could significantly enhance the efficiency and productivity of public investments. They note that thirty percent of potential gains from public investment are lost due to inefficiencies in the public investment process.

5. Developing an efficient Public Investment Management (PIM) system

For Uganda to get good returns from its public investments, it must put in place a more efficient Public Investment Management System (PIMs). Global experience demonstrates that the establishment of an efficient PIM system involves building institutional capacities to manage the wide range of technical aspects of investment management and coordinating these processes across many institutions in a range of different sectors in a manner that will maximize economic value for the country. Some jurisdictions have defined Public Investment Management (PIM) as an approach to managing government expenditures for public investments strategically and efficiently (JICA, 2018). Based on a sample of 25 countries, the IMF's new Public Investment Management Assessment (PIMA) finds that strengthening the 15 key institutions which shape planning, allocation and implementation of public investments could close up to two-thirds of the public investment inefficiency gap. It therefore proposes that Low Income Countries (LICs) should focus on strengthening the institutions related to funding, management and monitoring of project implementation. In an approach that focusses on the identification of those institutional features that would minimize risks, define indicators for inputs, processes, and outputs to enable a meaningful assessment of the functioning of public investment system, Rajaram et al (2014) identify eight features that logic and country experience suggest are essential features for achieving PIM efficiency (see Figure 7).

Figure 7: Essential features of an effective PIM.



Source: World Bank (2014).

Stage 1: Investment Guidance, Project development and preliminary Screening: This stage sets the foundation for the planned investments and has the key aim to ensure that investment choices are justified in terms of the country's development objectives. It anchors government decisions through a strategy. In Uganda's case the investment decision is guided by the National Development Plans. This stage also provides a formal process for project development detailing the basic project information needed for project submission. It also provides a preliminary screening for all the projects submitted. In Uganda guidelines have been provided by the Development Committee (DC) on this formal process.

Stage 2: Formal Project Appraisal: After the projects have undergone the preliminary screening, they are subject to feasibility analysis to assess whether the implementing agency should proceed with the project. It includes pre-feasibility and feasibility before the project can be approved for funding. This function is currently assessed by the PAP department within the ministry of Finance.

Stage 3: Independent Review of Appraisal: This is usually necessary to check for any subjectivity or self-serving bias in the evaluation. This function can be performed

by the ministry of finance or a designated specialised agency. In Uganda this is done by the Development Committee (DC) on behalf of Ministry of Finance.

Stage 4: Project selection, Detailed design and budgeting: This stage deals with projects that have been selected but have not yet been included in the development budget to ensure proper costing. It is essential that the process of selecting public investment projects is linked to the budget cycle. In Uganda, the Medium-Term Expenditure Framework provides the budget constraints for the public investment projects. In budgeting, operation and maintenance costs need to be provided for to maintain existing assets.

Stage 5: Project Implementation: This stage greatly benefits from effective measures such as efficient procurement plans, guidelines, and institutional capacity to manage and monitor project implementation, project cost management system and multi-year budgeting.

Stage 6: Project Adjustment: This stage caters to any changes that may arise in the project implementation process. It allows for active rather than passive monitoring. The implementing agency should provide frequent progress reports.

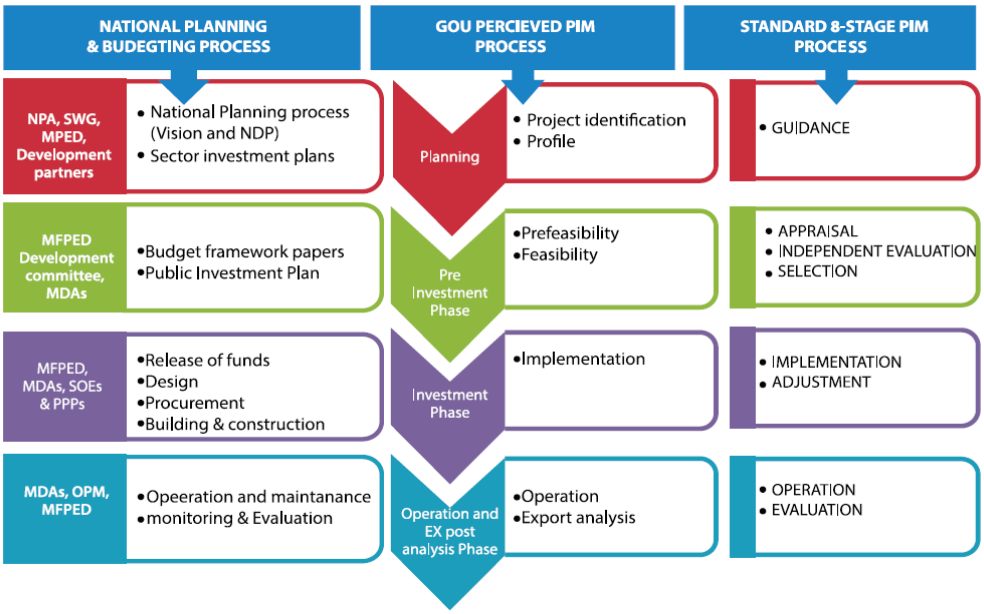
Stage 7: Service delivery: After project completion, there should be a process to ensure that the facility is ready for operation and services can be delivered. Asset registers need to be maintained and asset values recorded. It is important that the quantity and quality of the service delivery associated with asset operation is tracked through time.

Stage 8: Basic completion Review and Evaluation: This stage includes a basic completion review and ex-post evaluation of finished projects. The basic completion review comprises of assessing whether the project was completed within the original budget and timeframe. The ex-post project evaluation should focus on comparing the project's outputs and outcomes with the earlier set objectives. This is usually carried out after 2-3 years.

(Rajaram et al., 2014).

Over the past three decades, the Government of Uganda has developed systems and processes to ensure a higher level of efficiency throughout its operations. As a result, Uganda's PIM system is intertwined with a number of other public processes, including planning, budgetary, procurement, and monitoring and evaluation. The institutions and processes that currently constitute Uganda's PIM closely match the country's planning and budgetary system (see Figure 8). Nonetheless, there are deficiencies, particularly in quality at entry, which results in problems during implementation. Some of those problems include cost escalations, time-overruns; contract disputes; abandonment of projects; poor quality of some completed projects; and rapid depreciation of public capital stock. These are discussed further in the next section.

Figure 8: Aligning Uganda's PFM processes to the 8-stage PIM process.



Source: World Bank (2017).

6. Reforms to strengthen Public Investment Management in Uganda

The Government of Uganda has undertaken some reforms following a diagnostic study carried out by the Ministry of Finance, Planning and Economic Development to assess the state of the Public Investment Management System in Uganda (MoFPED, 2016). The primary ones are:

a. Institutional reforms

i. To champion reforms in Public Investment Management, the Department of Project Analysis and Public Investment Management (PAP) was set up in 2015 in the Ministry of Finance, Planning, and Economic Development with the mandate of undertaking overall policy formulation, coordination, appraisal, analysis, monitoring and evaluation of development projects to ensure sustainable economic growth and development.

ii. The Development Committee which is responsible for approving projects has

also been strengthened and issued guidelines on project Preparation and Appraisal which outline the process of developing a project. It has also increased its frequency of meeting to review projects monthly to enable timely review and approval of projects all year round.

iv. To ensure close monitoring, reporting and accountability to ensure timely utilization of resources and value for money the Ministry has strengthened the Budget Analysis and Monitoring Unit, undertaken annual project reviews with line Ministries, Departments and Agencies (MDAs) to establish any bottlenecks during project implementation and hence propose timely remedial action. In addition to this, the Ministry has commenced annual portfolio reviews with the Development Partners and Project Coordinators to review the performance of externally funded projects.

b. Policy reforms

To improve project appraisal and ensure that only feasible and bankable projects are admitted into the Public Investment Plan (PIP), the Ministry of Finance, Planning and Economic Development has since carried out the following reforms:

i. Updated the DC guidelines for the approval and review of the Public Investment Plan (PIP) projects. The guidelines are basic processes and controls designed to generate value for money across the entire project cycle.
ii. Developed a new Public Investment Management Systems framework which emphasises the gradual development of each project idea through the mandatory stages of the project appraisal cycle. The admission of projects into the budget requires four stages of approvals which will include the following requirements:

    a. prepare a concept which demonstrates the alignment of the project idea to the national development plan,
    b. prepare a project profile which demonstrates the key results to be delivered and how these results shall be measured,
    c. undertake a prefeasibility study which demonstrates whether all alternative interventions have been evaluated and,
    d. Undertake a detailed feasibility study for the option that contributes greatest to the economy.

iv. Developed National Parameters estimates and developed a database of Commodity-Specific Conversion Factors (CSCFs) for Uganda to support project appraisal. This helps convert financial costs produced in the cost benefit analysis to economic costs which link to inclusive growth.
v. Carried out a stock-take exercise on all the projects in the PIP in order to obtain

reasonable and reliable information for medium-term expenditure planning.

vi. Accountability for externally funded projects has been strengthened by starting the process of migrating the management of externally funded project financial transactions onto the IFMS. It is now mandatory that all externally funded project disbursements are warranted in line with the PFMA (2015).

vii. The Ministry of Finance, Planning and Economic Development, National Planning Authority, Office of the Prime Minister and Uganda Bureau of Statistics have developed the National Standard Indicator (NSI) framework to support national development as well as act as a measurement of progress against International and Regional development frameworks committed to by government. The NSI framework will further guide planning, budgeting, monitoring and evaluation as the indicators are aligned to the overall goal and objectives of NDP II and the mandates of the respective MDAs within the sector planning frameworks.

viii. The Ministry has also developed a project preparation and appraisal manual: The manual will provide guidelines and procedures of developing a project through the first two stages of identification and pre-investment. The manuals on implementation, monitoring and evaluation will be developed starting this financial year. These manuals make the process formal and provide guidance for the various stages.

7. Challenges facing Public Investment Management in Uganda

Despite attempts at reform the mid-term review of the National Development Plan III, revealed that investment projects still performed poorly. Some of the key challenges still facing Uganda's PIM are discussed below:

a. Funding 'Un-ready' projects

There is tendency to allocate resources to projects in the national budget before they are ready for implementation. This practice is most common with projects approved by the Executive which tend to be fast tracked to implementation without the requisite due diligence and feasibility studies. For instance, the Standard Gauge Railway project sought funding before carrying out feasibility studies. This practice contributes to low absorption of funds and high commitment fees in the case of donor funded projects.

b. Limited institutional capacity to prepare, implement, supervise, monitor and evaluate projects

There is a challenge with inadequate staffing and capacity in Ministries Departments and Agencies (MDAs). Few civil servants have the right skills to carry out feasibility studies

and designs of infrastructure projects, including PPPs (Public Private Partnerships). This is more evident in the case of externally funded development projects, which are prepared by the Development Partners with limited counter-factual scrutiny by MDAs. For the domestically funded projects, there is a tendency for some MDAs to outsource this function to consultants due to the limited capacity by sectors to undertake feasibility studies which are essential to guiding the investment decisions. This eventually culminates into problems of cost and time overruns, limited absorption capacity, prolonged delays in the acquisition for the right of way and the Environmental and Social Impacts (ESI) for projects which all dampen the implementation pace and efficiency of public investments in the country.

c. Inadequate counterpart funding and budgetary allocations

Due to an over stretched Public Investment Plan, there is insufficient counterpart funding and budgetary allocations in line with agreed project schedules. The low compliance to and intermittent release of funds for counterpart obligations is sometimes due to failure to adequately budget for counterpart funding within the sector ceiling combined with the poor prioritization of quarterly warrants within the sectors.

The failure to avail timely counterpart funding in line with agreed project schedules affects loan disbursements and project implementation. It also leads to the government incurring large sums of commitment fees.

d. Poor coordination among MDAs

Interventions of a cross cutting nature among sectors are often undermined by lack of relevant institutional arrangements and policy frameworks to ensure proper coordination. Inadequate coordination of the MDAs has affected project implementation which has resulted into poorly sequenced projects and duplicated activities.

e. Limited options for infrastructure financing

Due to underdeveloped financial markets in the country, there are limited options for infrastructure financing which requires exploring sources including Public Private Partnerships, infrastructure sovereign, cooperate and municipal bonds, among others.

f. Weak legal framework for PIMS

The legal framework surrounding Public Investment Management is relatively weak and does not explicitly provide for the PIMS process and the Development Committee which is responsible for the overall coordination of Government's project portfolio. In addition, the PPP approval process runs parallel to the PIMS framework with separate institutional and technical arrangements for PPP preparation, approval, and implementation. The main challenge with the current legal situation is that the Development Committee has no formal role in overseeing the development of PPPs. This may in the long run lead to large fiscal risks to the Government.

The Government of Uganda is cognizant of the growing mismatch between conceptualization of development priorities and acquisition of required financing including external Loans and Grants. Uganda is estimated to lose up to $300M annually due inefficiencies in spending which must be addressed for increased rate of capital accumulation and envisaged significant positive social-economic transformation (World Bank, 2017).

8. Policy recommendations to strengthen PIM and harness economic growth

To address the challenges identified and build on the progress made in strengthening PIM System in the Country the following policy recommendations are proposed.

i. Link the major infrastructure corridors to the investment promotion programme and production/marketing centres. This will help address the problem of duplication of interventions and strengthen the physical planning function and coordination at both Central and Local Government levels.

ii. Pursue alternative sources of infrastructure financing (e.g., PPPs, blending, bonds) along with necessary financial sector reforms, aimed at addressing inefficiencies in implementation such as contraction process and risk sharing agreements.

iv. Address weak legal framework and enhance credibility of PIM framework by incorporation of PIM reforms into the PFM Act, 2015. The Acts should provide for: (a) the role of Development Committee as the overall coordinator of Government's project portfolio and (b) the integration of PPPs in the Public Investment Management System Framework.

v. Establish an integrated databank of projects to align project information and create a reliable source data for decision making.

vi. Shift focus of budget expenditure from development expenditure to Operations and Maintenance (O&M) costs. This means that Government not only pursues

funding for the construction stage but also adequately provides for the operation and maintenance of the completed assets.

vii. Improve coordination across and within implementing MDAs, to better align related processes (e.g., joint planning, joint monitoring, etc.)

ix. Strengthen MDAs absorption capacity to implement projects through specialized training for Public Investment Management (PIM). There is a proposal for Government to collaborate with the Civil Service College and Makerere University School of Economics in establishing an appropriate curricular for tailor made courses on PIMS.

x. Liaise and co-ordinate with Development Partners to avoid distortionary off-budget support and supply-driven projects that do not match demand.

9. Concluding remarks: Public Investment Management can be a catalyst for economic growth in Uganda

Public Investment Management (PIM) can act as a catalyst to economic growth through the provision of both social and economic infrastructure, by boosting output and private investment in both the short and long term and reducing unemployment. Notwithstanding the potential contribution of public investment, there is need to ensure a strong and efficient Public Investment Management System is in place to increase value for money from investments undertaken and in so doing attain the much-desired goal of transforming Uganda from a low-income country to a competitive upper middle-income country. This requires that the country not only concentrate on improving project design and selection but also commit to long term investment in administrative capacity to improve project implementation and eventually growth.

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CHAPTER 5 :

Reaping the demographic dividend: the case of Uganda

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1. Introduction: the demographic dividend and economic development

This paper considers the question of how Uganda can reap the demographic dividend and spur economic development. Uganda has a young population, with fifty-four percent of the population under the age of eighteen and seventy-five percent below the age of thirty (UBOS, 2016). This paper analyses how labour productivity with a young population can be enhanced. The country has a high dependency ratio, which means that a few people in the labour force are taking care of many dependants especially children and young people. One of the major causes of this high dependency ratio is the high population growth rate which is in turn caused by a high fertility rate (UBOS, 2016). This paper argues that if well planned for, the current population can be used to increase productivity. The planning should target the provision of relevant education and skills, provision of affordable medical facilities including family planning, and ensuring that produced goods have markets within and outside the country through export promotion strategies. In the paper we propose that national planning should include a strategic management of high dependency ratios to ensure more sustainable economic development.

Economic development and demographic transitions are interlinked. Economic development can trigger a reduction in fertility and mortality rates, while changes in the population size, growth and age structure influence the pace of economic growth. Therefore, demographic transitions can be either a cause or effect of economic development. The world over, countries experience demographic transitions which occur due to changes in the population age structure as countries develop from traditional societies that are characterised by high fertility and mortality rates to modern societies that have low fertility and mortality rates (Demeny, 1968). As the share of the working age population increases, economic growth is boosted, which is referred to as the demographic dividend.

Demographic transition refers to a shift of fertility and mortality rates from high and fluctuating levels to low and stable rates (Lee and Reher, 2011). Mortality rates decline first followed by fertility rates. This pattern of demographics increases life expectancy and may lead to a population bulge if the fertility rates do not decline. Eventually, the size of the working age population will increase creating an opportunity to reap the demographic dividends if the economy is able to sufficiently absorb and productively employ the growing labour force. The existing population bulge in several developing countries presents a window of opportunity, which can be seized by providing the young population with employment opportunities before the growing size of the elderly population erodes the gains in growth by increasing the level of consumption in the economy.

Mason and Lee (2007) suggest that the demographic dividend can occur at different stages of the demographic transition. The first stage of demographic dividend occurs when the

effective number of producers grows more than the effective number of consumers[21]. This is when fertility rates reduce significantly, which frees up resources for investment in economic development (in social and productive sectors) and family welfare. The second phase arises when the age structure and high life expectancy leads to a more rapid accumulation of assets and capital deepening. As the working age population declines due to a fall in the fertility rate, it has an incentive to save for old age and accumulates assets for future consumption. The second phase comes at a cost of generations reducing current consumption in favour of future consumption.

In Uganda, increased domestic production has led to progressive economic growth from 1980s up to date. During the same period, the government invested in health care especially primary care such as early childhood immunisation and maternal care, which have contributed to a significant reduction in infant and maternal mortality rates. Diseases such as HIV/AIDS, which increased the death rate among middle aged population during the 1980s, have also been managed over time (Matovu, et al; 2013).

Therefore, the downward trend in fertility rates from 6.9 percent in 1995 to 5.4 percent in 2016 (UBOS, 2016) which would have reduced population growth rate has been counter acted by the impact of reduced mortality rates resulting in a continued high average population growth rate of 3.3 percent, a high percentage of young dependent population (0 to 18 years) of fifty-four percent (UBOS, 2016) and a longer life expectancy from forty six years in 1969 to sixty-four years in 2019. Unfortunately, throughout this period labour productivity has not significantly changed, yet it is expected that to reap the demographic dividend, labour productivity should change. This paper investigates the challenges and how best Uganda can reap the potential population dividend.

In section two, we present the current debate on the relationship between population and economic growth. In section three we discuss Uganda's population composition. In section four, labour force participation and productivity is discussed. Section five analyses the available opportunities for Uganda to reap demographic dividends and lastly in section six we provide the policy implications for Uganda's demographics.

2. The relationship between population and economic growth

The debate on the effect of population size (fertility rates) on economic growth has resonated because of the impact on per capita income, fixed resources (Malthusian theory), capital dilution (Solow model) and human capital. The per capita income is a ratio of the average income (GDP) to the total population. An increase in the total population

21 Effective consumers/producers - is the weighted average of the members of each age group by their labour income.

will reduce per capita income holding the average income constant. Malthus (1798) argued that population grows geometrically yet other resources such as food increase arithmetically and therefore if population is unchecked individuals will have a subsistence standard of living. However, reality has shown that with advancement in technology, agriculture has kept pace with population growth. The neo-Malthusian theory advocated for birth control measures to limit population growth since some resources such as land are fixed. The Solow model (Solow, 1956) suggests that when the country's population grows, more workers are added to the labour market. When this happens, capital will be increasingly divided amongst the workers, which is termed "capital dilution". A country with a high population growth rate, holding other factors constant will therefore have lower levels of capital per worker and output per worker. Families in developing countries believe that large families provide insurance against high child mortality and increase labour availability for increased agricultural production. In reference to human capital, most microeconomic studies have established a negative relationship between large families (higher fertility) and investment in human capital (Joshi and Schultz, 2007; Schultz, 2009). The empirical evidence on the relationship between population and economic growth is not robust. Some studies find a positive relationship between population growth and economic growth (Kuznets, 1967) while others find a negative relationship (Coale and Hoover,1958; Enke, 1971; Lee and Mason, 2010) and others find no relationship (Kelly, 1988), the lack of consensus is attributed to the endogeneity of population variables – fertility, working age population, population growth rate etc.

3. Trends in Uganda's population composition

According to the most recent population census of 2014, Uganda's population is estimated at thirty-four million, which represents an increase of thirty-two million in the last 103 years (See table one). If Uganda's population growth rate remains constant at 3 percent, its population will double in the next twenty-four years.

Table 1: Trends in Uganda's population size, 1911-2014.

	1911	1921	1931	1948	1959	1969	1980	1991	2002	2014
Population (millions)	2.47	2.85	3.54	4.96	6.45	9.53	12.64	16.67	24.23	34.63
Size relative to 1911 (1911=100)	100	115	143	201	261	386	512	675	981	1402
Average increase per annum ('000)		39	68	83	143	300	262	367	647	882
Crude birth rate (CBR) per 1000						48.9	49.1	49.8	47.9	43.0
Crude death rate (CDR) per 1000						17.1	16.6	18.9	15.1	9.7
Annual growth rate (% p.a.)		1.5	2.2	2	2.5	3.9	2.7	2.5	3.2	3.0
Youth Population (16 to 30 years) (millions)	1.2					1.6		3.3	11.9	16.6

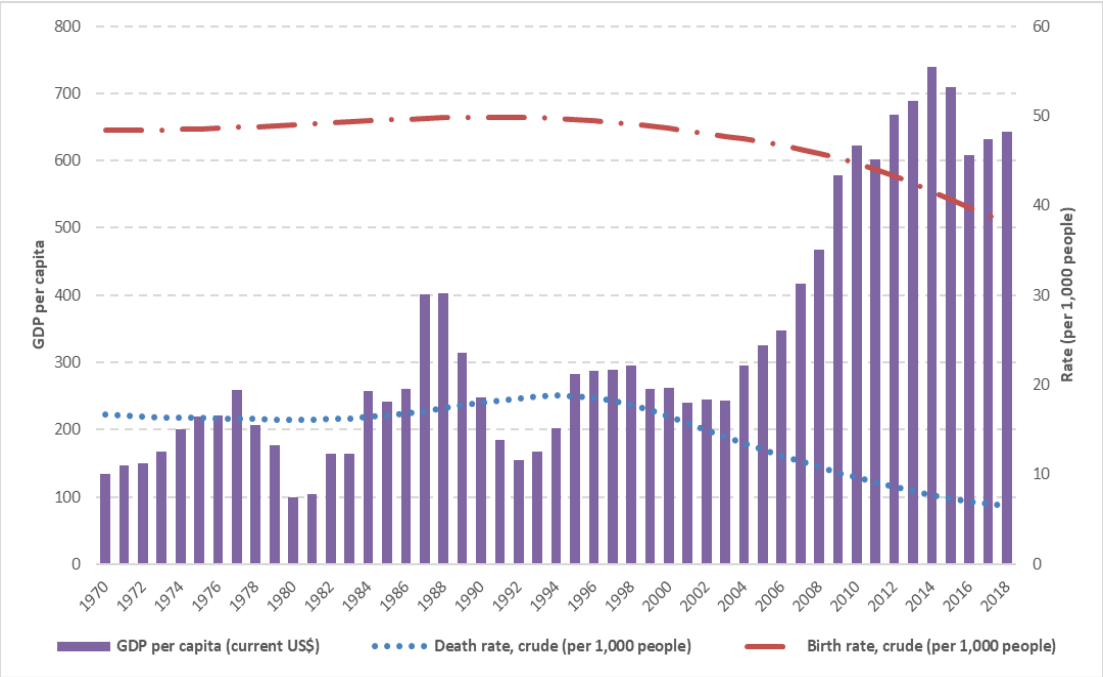
Source: UBOS (2016).

Uganda's increase in population size is driven by both the birth and death rates**.** Table 1 shows that the crude birth rate rose over time and only started to fall after the census of 1991. Similarly, the crude death rate generally increased in the period preceding the 1991 census. This was largely due to high infant mortality rates as a result of a breakdown in the health care system and the HIV/AIDS pandemic that increased deaths of able-bodied people (Matovu et al, 2013). The trend suggests that Uganda started its demographic transition after 1991, which is likely to continue if birth and death rates continue to decline. Though the reduction in the crude death rates signal a transition from a traditional to a modern economy, the fall in birth rate was modest and remains above the sub-Saharan average of 36.47 (2015). The high birth rate mirrors Uganda's fertility rate, which is estimated at 5.8 children per women down from 7 children in the 2002 Census and skewed towards rural woman (UBOS, 2016). The high fertility rate is partly attributed to limited access and usage of family planning methods, early marriages, high school dropout rates for girls, and a preference for large families (Asiimwe, 2007). Though Uganda's fertility rate has reduced over time, it is still above the average rate for sub-Saharan Africa of 4.9 children per woman (McCullough, 2017) The high fertility rate is a concern to development actors, because of the strain it exerts on the country's budget and natural resources, which may reverse the gains made in economic growth, poverty reduction and sustainable development.

According to the demographic transition model, economies have four stages of demographic

transition; stage 1, where both the fertility rate and death rates are high and almost equal, stage 2 where the death rate is dropping but the fertility is still high, stage 3 where both the death rate and the fertility rate are dropping but with a much lower death rate compared to fertility rate and stage 4, where death rate and fertility rate are at their lowest and almost equal. For Uganda's case the death and birth rate are following the same trend with the birth rate lower than the death rate (Figure 1) implying a population increase at a constant rate. From the mid-1990s we notice a drop in both death and birth rate at the same pace with a corresponding increase in Gross Domestic Product as a proxy for economic development (Figure 1).

Figure 1: Uganda's demographic transition model.



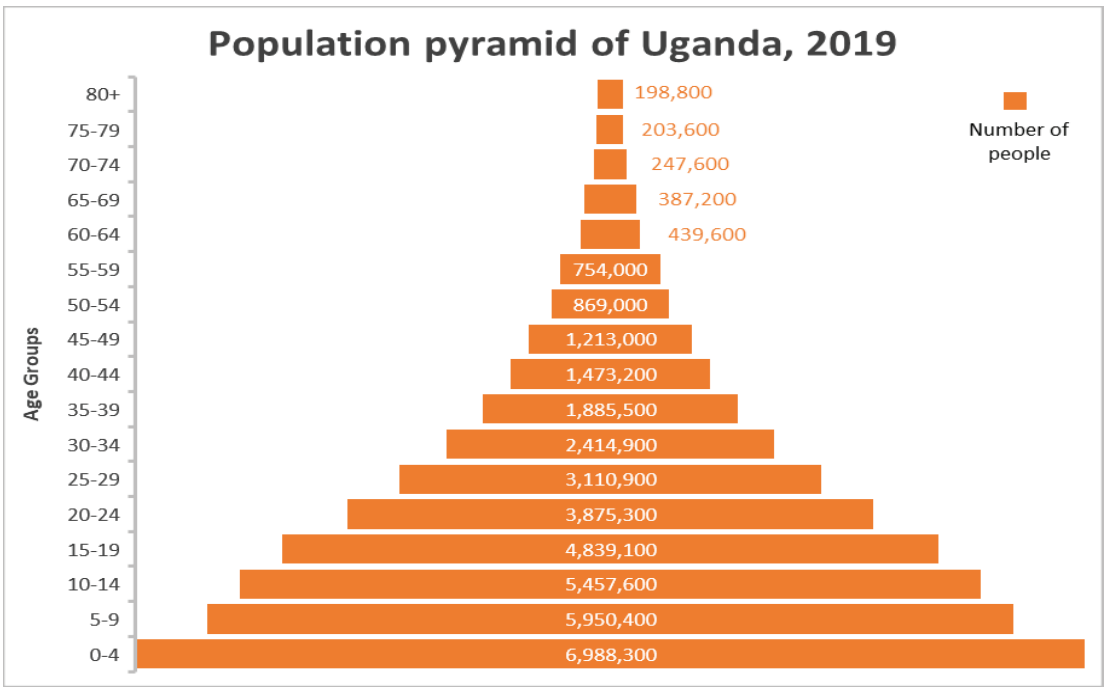
Source: World Bank (WDI).

The fall in death rates between previous and the most recent census was drastic from 15.1 per 1,000 people to 9.7 per 1,000 people, which is slightly lower than the average rate for sub-Saharan Africa of 9.95 per 1,000 (World Bank Data, 2015). The statistics imply that Uganda has achieved remarkable progress in reducing death rates occurring to children (e.g., Child and infant mortality) or mothers (e.g., maternal mortality) over time as confirmed by the statistics in the recent demographic survey of 2016. For example, the under-five mortality rate reduced from 116 deaths per 1,000 live births in the period 2002-2006, to 64 deaths per 1,000 live births in the period 2012-2016.Childhood mortality as a result of poor sanitation and lack of medical access, reduced significantly in the reference period except neonatal mortality that increased from 24 deaths per 1,000

live births for the period 2002-2006 to 27 deaths per 1,000 live births for the period 2012-2016. In reference to maternal mortality, Uganda still has high pregnancy related mortality ratio of 368 deaths per 100,000 live births (UBOS, 2017)) down from 524 deaths per 100,000 live births in the 2000-01, according to the Uganda Demographic Household Survey (UDHS). Similarly, the government should address the factors that lead to pregnancy related deaths.

Uganda's age population structure is bottom heavy, reflecting the high fertility and mortality rates as shown in Figure 2.

Figure 2: Uganda's age structure.



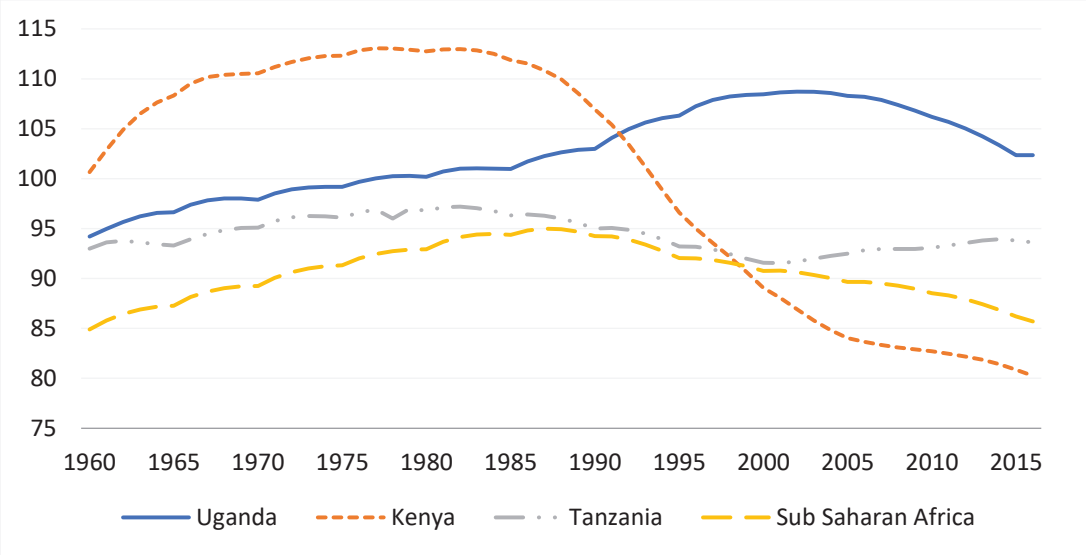
Source: World Bank (WDI).

The country has 75 percent of its population below the age of 30 years, which places Uganda as one of the countries with the youngest population in the world. The current population composition will persist for years given the country's high population growth rate of 3 percent (UBOS, 2016). Uganda's youthful population provides an opportunity for the country to reap the demographic dividend if development policies and strategies cater for the active population . Policy makers must formulate policies that increase job opportunities for the young population with the aim of making this age group productive.

Relatedly, Uganda has a relatively high age dependence ratio of 102, which is above

the average for sub-Saharan Africa of 86 as shown in Figure 2. Even in East Africa, Uganda's dependence ratio is above its peers, for example Kenya is 80 and Tanzania 94. The dependence ratio is computed as the proportion of the non-working population (0-14 and 65+) to the working population (15-64). It should be noted that Kenya had the highest dependence ratio between 1960 and 1990 but has over time reduced the ratio to the lowest in the region as shown in Figure 3. Uganda should put measures to reduce the dependence ratio because it poses a challenge to reaping demographic dividends. The high dependence ratio presents the case of a high proportion of consumers (dependants) than producers in the working age group, which undermines the saving rate and investment growth in the economy.

Figure 3: Age dependence ratio for selected East African countries.



Source: World Bank Data (2016).

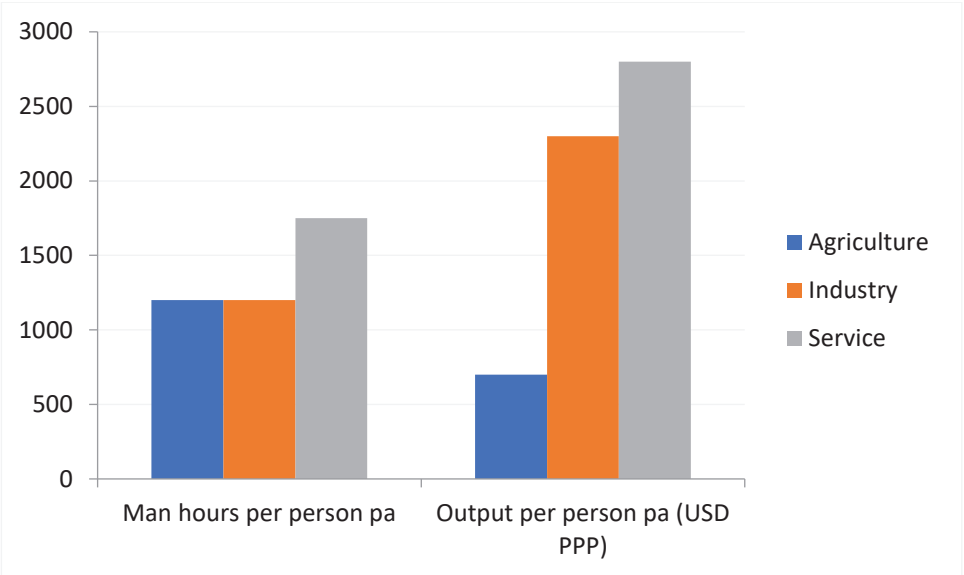
4. Labour force participation and productivity

Uganda has a large labour force estimated at 17.2 million, which is growing fast because of the country's high population growth rate (LO/FTF Council Analytical Unit, 2016). Uganda also has a high labour participation rate of 82 percent, which is above the average for sub-Saharan Africa of 65 percent. Unfortunately, the level of inactivity is highest among the youth (18 to 30 years) at 25percent, which is higher than the national average of 15 percent, signalling a low rate of job creation for the youth compared to other sub-Saharan countries (LO/FTF Council

Analytical Unit, 2016). On the other hand, Uganda has a low unemployment rateof about 9 percent because of the large size of the informal sector that absorbs the surplus labour in insecure work that pays low wages. The formal sector only absorbs limited labour because of its small size as it constitutes only twenty percent of total labour force and is growing marginally. The surplus labour has gained entry in the informal sector not by choice but as a survival strategy in the absence of social protection. Consequently, informal employment is widespread, especially self-employment, which absorbs half (fifty-two percent) of the labour force (LO/FTF Council Analytical Unit, 2016).

The sectorial distribution of the labour force is highest in the agricultural sector estimated at seventy-four percent up from sixty-six percent in 2002 and is dominated by women (fifty-four percent). The service sector is the next largest sector of employment absorbing nineteen percent, while manufacturing employs only 7 percent (LO/FTF Council Analytical Unit, 2016). Therefore, in Uganda's labour market, agriculture employs more labour than any other sector and accordingly policies should target this segment of the labour market to raise the country's productivity. In reference to labour productivity in Uganda, the LO/FTF Council Analytical Unit (2016) reports a rise in labour productivity during the 2000s, which has stalled since 2010. For instance, labour productivity increased from USD 1,393 in the mid-1990s to USD 2,965 in 2010 but was below the average for sub-Saharan Africa of USD 3,903 in 2010 (Overseas Development Institute, 2015). The source of productivity gains stemmed from the growth of labour productivity in the urban industrial sector, which did not only increase on its own but attracted the less productive labour from agriculture and services. McCullough (2017) reports lower labour productivity in the agricultural sector, with a worker more productive outside agriculture by 1.9 times, attributed to differences in hours worked due to the seasonality of agricultural production. The high level of participation and low productivity in the agriculture sector can also be attributed to low barriers of entry faced by workers. For instance, agriculture production is largely subsistence, which requires low skills. Given the high participation rate and low productivity in agriculture, it is therefore not surprising that workers earn lower wages than their counterparts employed in services and manufacturing.

Figure 3: Labour productivity levels by sector.



Source: McCullough (2017).

5. Opportunities for reaping the demographic dividend

Several factors influence the magnitude of the demographic dividend such as the speed of fertility rates, features of the economic life cycle, dependency ratio and the cost of each age group in the population (Mason and Lee, 2012). A rapid decline in the fertility rate reduces the share of children in the population while raising the share of working age group, which will boost the economy. This trend is beneficial in that; fewer children suggest less consumers in the economy and a higher proportion of the working age group implies more producers in the economy, which has implications for savings and investment levels in the economy. In the case of Uganda, there is a high fertility rate, implying a high population growth rate, leading to a young population and consequent high dependency ratio. Life expectancy has also increased over time implying that the burden on the working population is increasing from both sides, the young and the old population. If this situation continues, then it will be difficult for the country to reap the dividends. It is therefore very important for the country to strategically put in place policies and plans that will make the current young population acquire skills that will make them productive. In addition, causes of high fertility such as lack of family planning facilities, school dropouts for the girl child and early marriages should be addressed.

The economic life cycle determines the economic burden of the young and old on the

working age population. Individuals change their production and consumption patterns throughout the life cycle determined by the physiological needs. Children are largely consumers of education and health, the working age group constitutes mainly producers, and the elderly are more consumers than producers. The elderly tend to consume more health than the other population groups. It should be noted that the burden of one population group on another is influenced by the productivity levels of each group compared to the cost of maintaining that group (Mason and Lee, 2012). Therefore, countries offering young adults employment opportunities are likely to reap more demographic dividend, since this group produces more than they consume. Providing employment opportunities to young workers is useful because they will work for a longer time (over their lifetime) and have the capacity to save and earn non-labour income in their prime ages. Therefore, it is important for Uganda to design public policies that offer young adults employment opportunities and incentives to invest their savings. Some government schemes such as the youth livelihood programmes, which provides start-up capital to the youth and emphasis to vocational institutions to provide adequate skills training will give young people an opportunity to engage in productive ventures. However, such programs still need to be refined to ensure that the youth get the required and marketable skills in addition to getting involved in viable projects and gainful employment.

It is argued that a declining youth dependency ratio contributed to the economic growth miracle that was witnessed in East Asia (Coale and Hoover, 1958). This has contributed to the argument that developing countries can also experience rapid economic growth because of a decline in the dependence ratio. Many developing countries, Uganda inclusive, are experiencing a population increase that is likely to constrain growth if the dependency ratio is high. In other words, for a country to reap demographic dividends, population growth should be lower than the growth in the working age population. Consequently, as the proportion of the working age increases more than the total population then it would mean there are more producers than consumers to boost the economy as the savings and investment ratio increases. When this is realised, the economy must create enough employment opportunities to absorb the labour and expand the economy but also the country must make savings on the expenditure to support children or young people and invest it in long term economic growth. On the other hand, as life expectancy increases, the population changes its consumption behaviour, saving more for old or retirement age. If these savings are invested in the economy it will lead to capital deepening and accelerated growth in output per worker (NTA Bulletin, 2012). Accordingly, Uganda should strategically make plans that will reduce on the dependence ratio.

6. Policy implications: How to reap the demographic dividend in Uganda?

There is an urgent need to manage the population growth rate

The first policy implication of Uganda's current population size and composition is the need to manage population growth rate with the aim of reducing the dependency ratio, which will reduce the pressure on financial and natural resources. A substantial decline in the fertility rate will reduce the dependence ratio and free up resources that would be spent on children for investment in economic development. However, to deal with the issue of fertility there must be in-depth understanding of the causes, such as large families for insurance, provision of family labour and early marriages. Therefore, the country may need to design large scale appropriate programs to control population growth. This was the motivation behind the vigorous family planning programs which were implemented in Asia in the 1960s and 70s such as the 'One Child' policy in China. Uganda may not adopt China's 'One Child' policy, which was mandatory but backed by political commitment may devise a voluntary program that encourages parents to reduce their fertility rates by providing quality public services in education and health to few children per family. With the current trend of declining mortality rates and increasing literacy levels, it is expected that targeted government programs can yield good results in terms of reducing population growth rate.

Large investments in social services need to be made to increase productivity

Secondly, Uganda will need to make large investments in social services such as education and health to make its population more productive. Investments in these two sectors have enormous multiplier effects since investment in human capital has large positive externalities and leads to a higher human capital per worker boosting the economy. For instance, a healthy and educated population is not only more productive but also efficient in utilisation of the available resources. In addition, research has established an inverse relationship between education and fertility and therefore investments in education are expected to trigger a reduction in fertility (Basu, 2002). On the other hand, a direct investment in health services will reduce mortality and morbidity rates, which eventually leads to a reduction in fertility rates due to raising the parent's confidence in the survival of their children. Moreover, more investment in the children's education and health raises the cost of raising children, and parents are likely to have fewer children as predicted by the economic theory of fertility (Leibenstein, 1974).

Employment opportunities need to be created

There is need to create employment opportunities for the growing working age population to make it more productive in the economy. Uganda has a high unemployment and underemployment rate among the youth (aged 18-30) who constitute 21 percent of the

total population Unemployment among the youth needs to be addressed because it may lead to social unrest. Therefore, the country needs to design policies and programs that specifically target the youth and the working age group in general to increase labour participation and labour income in order to spur increases in levels of savings and investments in the economy. In this respect, the country will have to design strategies and programs that ensure the youth have a smooth transition from school into productive employment. The solution may be two pronged; on the supply-side there is need to emphasise vocational training that equips learners with practical skills whose demand is likely to increase given the rising standards of living and on the demand-side there is need to create more job opportunities for semi-skilled workers, who are the majority in Uganda's labour market.

Focus on policies targeted at surplus labour in the agriculture sector to increase productivity

The country should design policies that release the surplus labour in agriculture to other sectors to increase labour participation and productivity. These policies must aim at increasing productivity in the agriculture sector by increasing the capital per worker. These investments could include promoting production of high value agricultural products, intensive farming and adopting technologies that increase both labour and land productivity. Promoting high value agricultural products will increase agricultural incomes and smallholder farmers will be able to tap into lucrative markets and earn profits to reinvest in their farms. Access to lucrative markets will act as an incentive for farms to be more efficient which will improve total factor productivity. In addition, an active market development strategy, such as export promotion and import substitution will increase farmer outlets for their products. Alternatively, the country should devise strategies to promote intensive farming which aims to increase yield per unit of land. Intensive farming will require farmers to fertilisers and improved seeds and animal species to increase farm yield and trigger an increase in total factor productivity. Finally, farmers could adopt technologies that increase both labour and land productivity which will boost production and release labour to output sectors as well as improve levels of efficiency as firms learn from each other. To increase adoption of appropriate technologies the country will be required to invest in research and development.

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CHAPTER 6:
Education and skills for growth

By Nicole Ntungire (International Growth Centre, Uganda)

1. Introduction

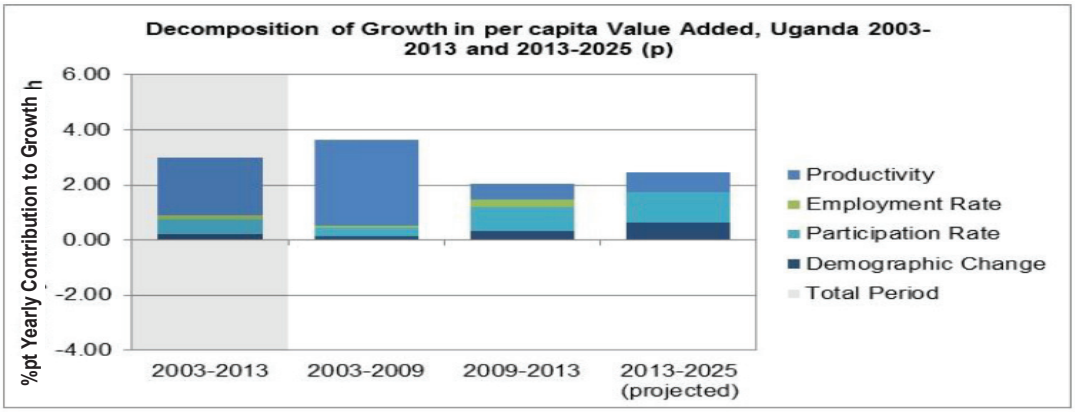
With one of the fastest growing populations in the world (at a rate of 3 per cent per annum) and with over 500,000 new entrants estimated to be coming into the labour force every year, investment in human capital and skills of the growing workforce is becoming increasingly critical for Uganda's long term per capita growth - especially since an overwhelming body of evidence has consistently shown that enhanced educational and skill attainment at the national level is correlated with an increase in labour productivity, growth and higher desirable living standard outcomes.

Indeed, a decomposition of GDP growth in per capita Value Added, suggests that the recent tapering of Uganda's growth rates over the last decade could be partly attributed to a decline in labour productivity (*see* Figure 1 below). It must be noted however, that like many developing countries, labour market data in Uganda suffers many limitations and is very sporadic making it extremely difficult to have detailed labour-market analysis over time or across countries .

Box 1: Rwanda's Labour Force Survey: a source of high frequency labor indicators.

To address similar data limitations and unmet demand for its labour statistics, in 2016, Rwanda's National Institute of Statistics (NISR) introduced the Labour Force Survey (LFS). The survey which was launched after a pilot in February 2016 aims to provide high-frequency data on: structure and trends of the labour force, employment and unemployment as well as other labour market statistics, therefore guiding the implementation and evaluation of policies related to job creation, skills development and income generation. Initially launched as a bi-annual survey, starting February 2019, the survey was designed to be conducted on a quarterly basis. In addition, its rotational design which interviews each sampled household three (3) times a year, one every quarter, allows for greater precision at the household level.

Figure 1: Decomposition of Uganda's GDP in per capita Value Added



***Source**: Merotto, 2017*

This recent decline in productivity notwithstanding, considerable progress has been made - especially with regards to enrolment and access to primary education, over the last two decades. Following the rollout of the Universal Primary Education in 1997, the number of enrolled primary school-aged children more than doubled between 1995 and 1997 with further increases to 7.6 million in 2003. By 2017, this number had surpassed the nine million mark .

Regrettably, however, this commendable and positive increase in school enrolment has come with its own challenges: including supply-related shortages such as a lack of teachers, instructional materials, and classrooms. Even more concerning, is that the country is still lagging (and in some cases even falling further behind) in terms of the quality of education and resultant learning outcomes. The general decline in the quality of education has been attributed to several factors, key among them: high rates of teacher absenteeism and comparatively high dropout and repetition rates, resulting in low progression rates and low completion rates.

To this end, the last three Growth Forums have aimed to generate discussion and policy insights regarding four key questions, namely: (a) What are the trends in Uganda's population growth i.e., the composition, labour force participation in productivity? (b) What policies can help Uganda reap its demographic dividend, and what are the corresponding constraints and opportunities? (c) How can government and the education institutions help to equip the growing labour force with applicable skills? and (d) What policies can help to increase labour productivity? This chapter focuses primarily on the latter three questions, from the lens of improvements to education and skill acquisition whilst Chapter 02 on *Population and Inclusive Growth* addresses the first question.

The rest of the Chapter is structured as follows: Section 2 delves into the key constraints to Uganda's education sector and therefore human capital base, Section 3 explores the skilling mismatch between labour demand and supply in Uganda, drawing on recent experimental evidence to propose potential reforms that would equip the labour force with applicable skills. Section 4 concludes and highlights key policy considerations that the government should bear in mind as it progresses to achieve its targets on growth, employment, and human capital development.

2. Investment in Education to build the human capital

According to the World Bank's Human Capital Index (HCI), which measures the contribution of human capital towards productivity of the next generation of workers, Uganda was ranked 137 out of 157 countries (the lowest quartile of the distribution). More specifically, the index showed that a Ugandan child born today is expected to complete only 7 years of education by age 18, compared to a regional average of 8 years. Adjusted for quality of learning, the 7 years is equivalent to only 4.5 years of learning, with 2.5 years 'lost' due to poor quality.

1.1. Poor Completion and Retention Rates for both Primary and Secondary

There are several factors to which this poor HCI result can be attributed, but key among them is a high dropout rate throughout the education cycle: in 2017 the primary survival rate stood at 44 percent - considerably below the primary survival rate in Kenya which is close to 100 percent, Ethiopia at 72 percent, or Rwanda at 68 percent (*see* Figure 2 below)

Several factors have been cited for these high dropout rates including: long travel distances and a lack of proximity for remote areas, teenage pregnancy and cultural practices such as early marriage for girls and high indirect school costs (such as scholastic materials, meals and uniforms). Indeed, several studies suggest that financial constraints remain the most prominent factor explaining both non-enrolment and high dropout rates
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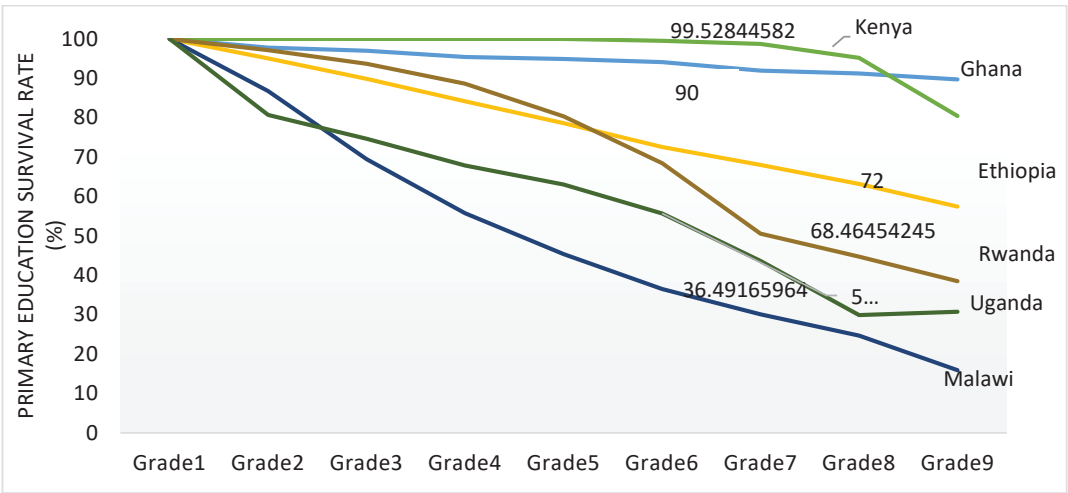
Figure 2: Survival rates in primary education.



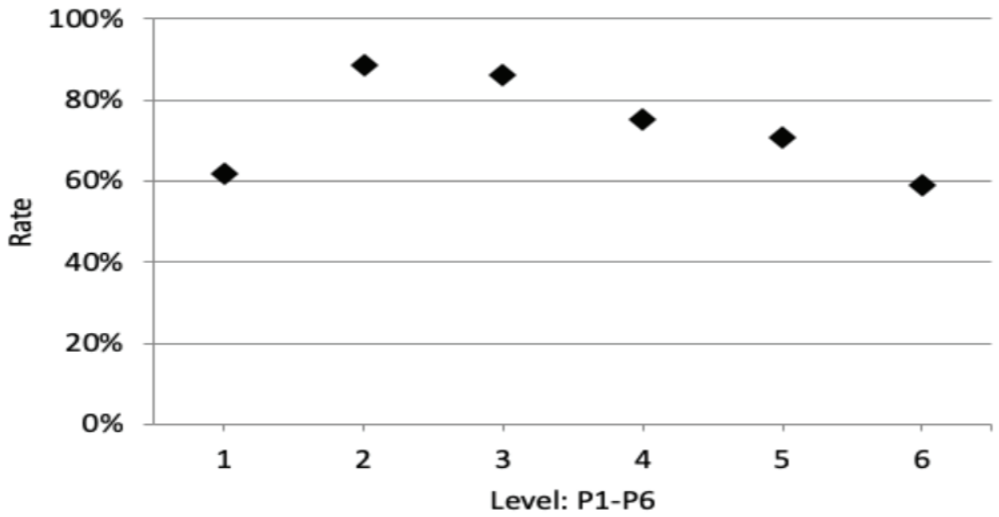
***Source**: Facing Forward: Schooling for Learning in Africa, 2008.*

In addition to the above challenges, more recent evidence from the IGC , suggests that the focus on a single performance metric (i.e., Primary Leaving Exams - PLE) and the high stakes attached to the outcome, could also be a key contributing factor to the relatively high dropout rates between P6 and P7 (*see* Figure 3 below). Primary school in Uganda involves seven grades: P1 through to P7 (at which point enrolled students sit for the PLE to qualify for entry into secondary school). Other than the PLE, there is no other official government measure of student performance over the seven school years and the Ministry does not collect any attendance or performance data from individual students or teachers. As a result, PLE outcomes are very closely scrutinized by government officials, parents, and educators alike.

Gilligan et al. 2018, postulate that this focus on a single performance metric distorts the incentive

and accountability system for educators in such a way that teachers would take deliberate, hidden actions to shape the composition of students who register to take the PLE; by encouraging weak students to drop out before they are promoted to P7. To test this hypothesis, the study ran an experiment in rural Uganda address that gave rewarded each P6 teacher with bonus payments for the performance of each of her students relative to comparable students in other schools. The rationale being that this pay-for-performance (PFP) would incentivize teachers to refocus their efforts on learning across the entire class distribution in P6 and not just meeting PLE grades.

Figure 3: Primary School Promotion rates, 2014.
Promotion rates fall steadily over the upper primary grades (P3 to P6) and by the end of P6 have dropped below 60%.



***Source**: Facing Forward: Schooling for Learning in Africa, 2008*

The issue of teacher absenteeism reflects a critical barrier and bottleneck to achieving quality education in Uganda that directly reflects broader challenges of teacher motivation, professionalism and job satisfaction and needs to receive the attention it deserves as a critical issue affecting the quality of the teaching force currently deployed in schools.

Following up this experiment a year later (when students who stayed on track would have been finishing P7), the research found that the bonus payments increased *attendance rates* by four percentage points, but surprisingly had no impact on *overall learning outcomes* – as proxied by math test scores. However, a disaggregation of the results showed that for schools which provided textbooks for P6 students, the bonus payments had a positive impact (over 0.1 SD) on achievement and learning outcomes - for those

students at or near the P6 grade level of learning. In contrast, students who were well below the P6 level of competency, were simply unable to catch up, and registered no significant achievement gains (even if their schools provided textbooks).

These results carry several policy considerations for Uganda: first, the study adds to the growing body of evidence that well-designed teacher incentives can indeed improve performance in rural low-income schools, especially in settings where schools provide adequate instructional resources (such as textbooks). A second and related policy consideration, is that the Ministry of Education should aim to provide all schools with adequate instructional resources tailored, preferably, to the current achievement levels of their students.

Third and perhaps more importantly, the study points to the need to 'deflate' the high stakes of the Primary Leaving Examinations and move away from a single performance metric at the primary level – one way this could be achieved is by using the recently acquired student National Identification Numbers (NINs) to create measures of achievement growth between P1 and P6 – for example, students could be tested at the start and end of each school year and their progress over time measured by Head Teachers. In this sort of setting, 'Pay for Percentile' interventions could reduce dropout rates by rewarding educators for each student who is in school on both testing days (attendance) and for the achievement growth of each of these students during the school year.

There is, however, an important caveat from of the findings of the study and from broader literature – such PFP interventions are not a 'silver bullet' and must be accompanied by components that address the multiple constraints of learning such as coaching of teachers by trained tutors or teacher supervision. Otherwise, the incentives could instead encourage teachers to 'teach to the test' .

Compounding the problem of high primary dropout rates, is an extremely low transition rate to lower secondary. Statistics show that since 2010 the Gross Enrolment Rate (GER) for lower secondary, the minimum education level expected, has stagnated between 31-35 percent compared to neighbouring Kenya and Rwanda where it stood at 58 percent (2009) and 37 percent (2016), respectively.

1.2. Teacher absenteeism and poor teacher time on task

A second key issue adversely impacting learning outcomes and service delivery in the education is teacher absenteeism. Data collected as part of the World Bank Service Delivery Indicator (SDI) program[22] suggests teacher absence in Uganda is very high, both in absolute and relative terms. On any given day, 28 percent of teachers on the school's payroll will not be in school. However, even when in school, many teachers

22 The SDI program has to date been implemented in Tanzania and Senegal in 2010, Kenya (2012), Mozambique (2014), Nigeria (2013), Tanzania (2010, 2014), Togo (2013), and Uganda (2013).

will not be teaching, resulting in classroom absence of 57 percent, the highest in the sample of seven Sub-Saharan African countries for which SDI has collected data so far. According to a comprehensive evaluation of the Universal Primary Education (UPE) by the National Planning Authority (2018)[23], teacher absenteeism and poor time-on-task is estimated to cause financial loss to the government of approx. UGX 26 billion absenteeism, a substantial loss given the sector's already constrained resource envelope.

Table 1: Teacher absence[24]

	Uganda	SSA Average
Absence from school	28%	44%
Absence from class time	57%	23%
Orphaned classrooms	45%	33%
Observations	16,543	3,017

To address the critical issue of teacher absenteeism, a recent IGC study tested a scheme that made use of fiscal incentives (bonus payments for teacher attendance), combined with mobile or SMS-based local monitoring of teacher presence. 'Local monitoring' referring to the crowdsourcing of attendance reporting from local stakeholders, namely: parents and head teachers. A key finding of this work was that local monitoring schemes can indeed provide a cost-effective accountability tool and help reduce teacher absenteeism, but careful consideration must be given to the design and management of the accountability reporting to mitigate the risk of collusion and biased reporting.

More specifically, the study showed that when bonuses were given to teachers marked as present and head teachers held responsible for monitoring, teacher presence increased by 11 percentage points. In contrast, effects of non-incentivised schemes and schemes managed by parents alone, had weaker and statistically insignificant effects because parents were more likely to underreport teacher absenteeism than head teachers. Interestingly, however, when the monitoring of teacher absenteeism involved multiple stakeholders — namely both head teachers and parents— attendance gains were similar to the head teacher (only) managed scheme, but at a lower cost. Translating this evidence to policy, suggests that improvements in communications technologies (e.g., SMS-based accountability platforms) when combined with pay-for-performance schemes could hold great promise as a tool for addressing teacher absenteeism in rural schools, particularly when managed

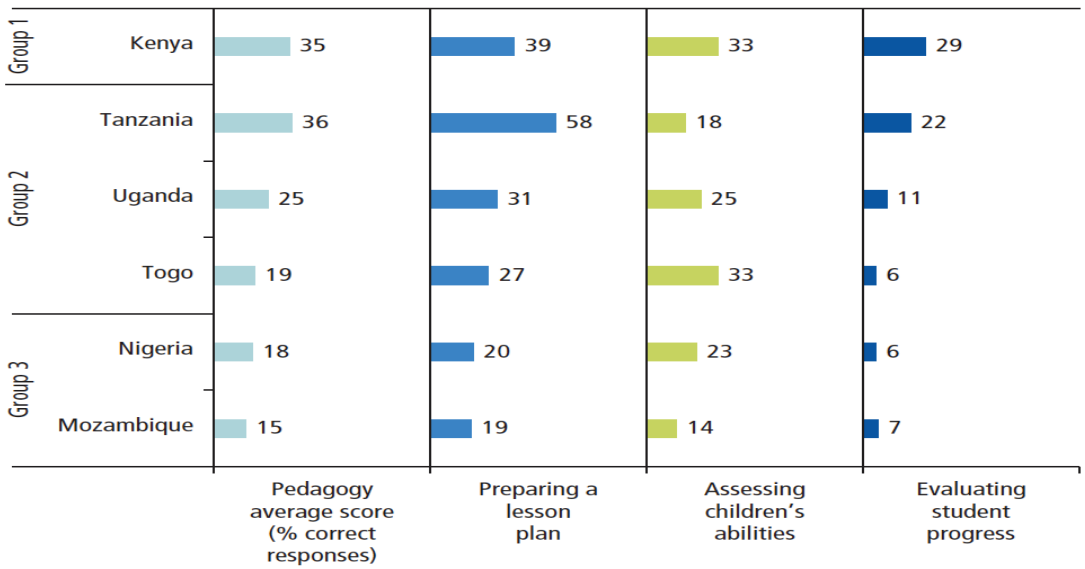
23 National Planning Authority (2018)

24 Teachers are marked as absent from school if during the second unannounced visit, they are not found anywhere on the school premises. Otherwise, they are marked as present. Teachers are marked as absent from class if during the second unannounced visit, they are absent from school or present at school but absent from the classroom. Otherwise, they are marked as present. The orphaned classrooms measure is the ratio of the classrooms with students but no teacher to the number of classrooms with students with or without a teacher.

by multiple local stakeholders (e.g., school principals and parents). Indeed, one such approach has been developed by the Makerere University School of Informatics and Technology, which, together with SNV, developed a mobile-phone-based platform for reporting teacher presence.

1.3. **Poor instructional pedagogy**

Further compounding the issue of high teacher absenteeism rates is the fact that for the times when teachers are present and are teaching in class, their ability to transfer knowledge is limited by their instructional capacity (i.e., while teachers know *what* to teach, they do not know *how* to teach it).



Source: Constructed from data in Molina and Martin 2015.
Note: SDI = Service Delivery Indicators. For definitions of country Groups 1–4, see chapter 1 or figure 4.2. For the SDI survey year in each country, see table 4.4.

Figure 4: Selected Pedagogy Skills, Fourth Grade Teachers in selected SDI Countries.

According to a recent World Bank survey , which tested pedagogy and language skills for Grade 4 teachers across six (6) Sub Saharan countries, only one quarter (25 percent) of Ugandan teachers answered pedagogical questions correctly – a lower average than peer countries like Kenya and Tanzania. The pedagogical skills tested in the survey included: teacher's ability to evaluate their students' academic progress, prepare a lesson plan and assess students' abilities. Results were then scored to obtain an overall index of the teachers' pedagogical knowledge (see Figure 4 above).

3. Skilling Uganda for Job Creation

Away from the poor quality of learning in the formal school system and low levels of

human capital, Uganda also faces a growing challenge of youth unemployment and a rising mass of both skilled and unskilled, young workers are failing to find work. Therefore, addressing the shortfalls in human capital investment alone (without the existence of job opportunities), will not suffice in raising long term per capita growth. A more comprehensive policy approach should also involve issues on the labour demand side: understanding labour market constraints (i.e., what is stopping firms from hiring workers?) and secondly on the supply side: why do workers not acquire the skills that might help them secure these jobs?

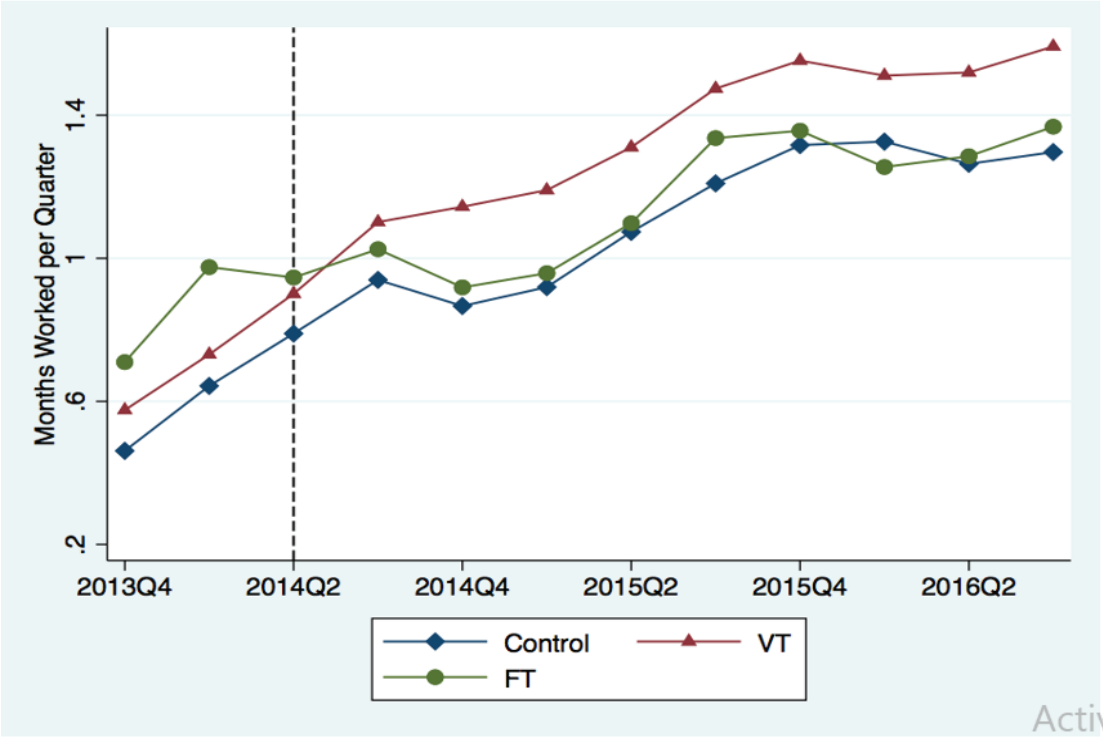
Presentations at the Growth Forum focused on the findings of a recent IGC study that aimed to understand this mismatch between labour demand and supply in Uganda, by conducting a labour market experiment (involving 1700 workers and 1500 firms over four years) that contrasted two different policy interventions: (i) On the supply side: *sector-specific, in-class vocational training* for workers before they enter the labour market and (ii) On the demand side: *informal on-the-job training*, implemented by offering wage subsidies to firms as an incentive to train and hire a new worker. The researchers then tracked the outcome of the two interventions on worker's skills, employment, wages, productivity.

The workers taking part in the study where young people who applied to a skills training program implemented by BRAC Uganda and offering both vocational training and apprenticeships in small scale trades and services such as hairdressing or motor-mechanics. To be eligible for the program, the workers had to be young, unemployed and from a disadvantaged economic background.

Vocational training and apprenticeship training both lasted 6 months. Vocational training was provided by a number of reputable vocational training institutes accredited with DIT. The apprenticeships were provided by small and medium enterprises in a number of urban areas across the country. A key difference between the two interventions is that vocational training came with a formal certificate of training, while apprenticeship trainees did not get a certificate from their training firms.

Findings from the study showed that, on average over the three years after the intervention, vocational training (VT) and on-the-job training (FT) workers not only had higher employment rates than the control group (21 percent and 14 percent respectively) but also earned more than the control (34 percent and 20 percent, respectively). However, whereas both vocational training (VT) and on-the-job training (FT) were equally effective at increasing workers' skills and productivity, those with vocational training were in fact more likely to find a job when unemployed and, therefore, over time, employment rates for workers with vocational skills were significantly higher than those of the control and apprenticeship group (*see* Figure 5 below).

Figure 5: Comparison of Treatment Impacts on Months Employed Per Quarter.
Over time FT (apprenticeship) converges to the control group, while employment rates for VT (vocational training) increase and diverge away from the control group



***Source**; Alfonsi et al.,2017.*

To understand the difference in returns to VT and FT over time, the study estimated a job ladder model of worker search, and found that the certification component of vocational training (VT) made it easier for VT workers to signal skills to potential employers, whenever they fell off the job ladder into unemployment. On the other hand, apprentices started off well in terms of employment as some were retained by the training firm as employees after the end of the 6-month apprenticeship, but as they lost their initial job at the training firm they faced difficulties in finding another job due to the lack of certification. That is, the history of labour market attachment to the initial firm did not count much when the apprentices were unemployed because of the lack of certification. As a consequence, over time the employment trajectories of the apprentices converged back to the control group.

In terms of translating the evidence from this study to policy, several recommendations and reforms were suggested: First and perhaps most important was the need for the government to increase its return on investments in vocational training by emphasizing certifiable skills. This could be achieved through various interventions such as accrediting all vocational training Institutions (VTIs), instituting formal certificates, and encouraging the use of reference letters for workers undergoing on the job training/apprenticeships. However, the verifiability of skills is hinged critically on the quality of training received.

A second recommendation, therefore, was that the government develop a mechanism for continuously monitoring the quality of training services offered. For example, in the case of the study on Uganda, the research team undertook random spot-checks but also had explicit contractual agreements establishing payback of the wage subsidy (or tuition) if the worker was not trained (or dropped out). Lastly, coupling formal schooling with on-the-job training as well as involving the private sector in defining competences and developing training plans for VTIs, could be ways to ensure that acquired skills are tailored to match the demands of the labour market.

Beyond vocational skills, another set of skills that were recognized as being critical to propelling Uganda's labour productivity were digital skills. Digital skills, according to the World Bank, can categorized in three levels: first, Digital User skills which are the basic skills required for effective use of ICT tools, systems, and devices – these skills would be the minimum skill-level expected of an average citizen or school student, enabling them, for example, to make use of a financial services application or log in to an online digital services platform. The second level of digital skills, Digital Specialist skills, are more advanced in that they involve researching, developing, installing, and managing ICT tools and systems and would be the skill-level expected of certain professionals such as doctors, engineers, scientists, etc. The last and most advanced of the digital skills – e-Business Skills – involve being able to identify and create new digital technologies for business models and service delivery.

Of the three levels, it was noted that Uganda needed to focus its efforts especially at the bottom of the pyramid, i.e., on basic Digital User skills for technological investments to be inclusive and transformative (going beyond incremental 'islands' of success). For instance, improving rural farmer's basic digital user skills, would enable them use mobile phones to identify potential buyers for their produce. However, you cannot improve what you cannot measure. To measure improvements in the level of digital skills, the World Bank has recommended the following indicators and targets: 1. Percentage of 15-year-olds who have basic digital skills (target: all 15-year-olds by 2030) and 2. Number of graduates produced annually with advanced digital skills (target: 100,000 annually by 2030). However, these targets would not be achieved without improvements in the quality of learning at the basic level of education and without raising basic literacy and numeracy skills.

4. Conclusion and Policy Considerations

This chapter aimed to consolidate the discussion and policy insights on education and skills over the last three Economic Growth Forums by looking at three key questions critical to Uganda's long-term growth trajectory: first, what are the key constraints to Uganda's education sector and what potential reforms could be adopted to raise the level of human capital. Second, how can government and education institutions help to better match workers with productive employment and bridge the mismatch between labour demand and supply skills and lastly, what specific skills will be needed by Ugandans to increase labour productivity but also gain employment in the country's future high growth sectors.

In terms of key constraints to human capital development, three key issues were identified, namely: comparatively high dropout rates for both primary and secondary; rampant teacher absenteeism and poor pedagogical skills that limited teachers' instructional capacity or ability to transfer knowledge. Drawing on a wide body of literature and novel experimental evidence, several policy measures were proposed to address these challenges. Some worth mentioning include: developing a continuous measure of assessment for the basic primary level (P1 to P7) so as to mitigate the risk of educational triage and distorted educator incentives, created by the dependence on a single performance metric (PLE). On absenteeism, evidence shows that 'smart' accountability contracts i.e., well-designed local monitoring programs that involve multiple stakeholders and harness digital innovations (such as SMS reporting platforms), can deliver a low-cost improvement in teacher attendance gains particularly for remote, rural areas.

These policy measures aside, addressing shortfalls in the formal school system alone (without the existence of job opportunities), will not suffice in raising long term per capita growth. The chapter therefore looks at ways the government and the education institutions can help to equip the growing labour force with applicable skills for the labour market. Here, a key recommendation (based on a four-year long experiment in Uganda) is that the government invest in certifiable vocational training. This, could be achieved through various interventions such as accrediting all existing vocational training Institutions (VTIs), instituting formal certificates, and encouraging the use of reference letters for workers undergoing training at firms. A second recommendation was that the government develop a mechanism for continuously monitoring the quality of training services offered as a form of quality assurance and bridging information asymmetry between firms and workers.

Beyond vocational skills, digital skills, were another set of skills that were identified as being critical to propelling Uganda's long-term growth. Here, it was recommended that Uganda focus its efforts especially at the bottom of the pyramid, i.e., on basic Digital User skills – defined as the minimum skill-level expected of an average citizen or school student, enabling them, for example, to make use of a financial services application.

However, a necessary condition for investments in these skills would be improvements in the quality of learning at the basic level of education and raising basic literacy and numeracy skills.

In summary, as Uganda seeks to attain its vision of middle-income status by 2040 and tap into its burgeoning youth population, greater emphasis will be placed on job creation and having a competitive labour force. Both of which cannot be achieved without quality education and applicable skills.

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CHAPTER 7:

Unlocking investment for growth: policy considerations for Uganda

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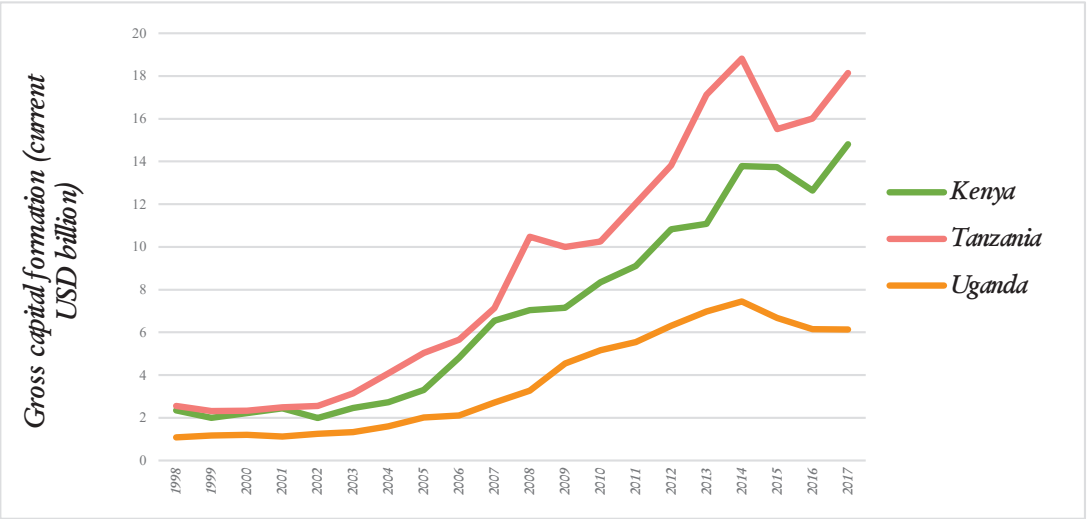
1. Low productivity investment in Uganda: a key growth challenge

Attracting and promoting productive private investment is essential for Uganda's economic growth and job creation and remains an urgent policy priority in the short-medium term in responding to the global recession caused by the COVID-19 crisis.

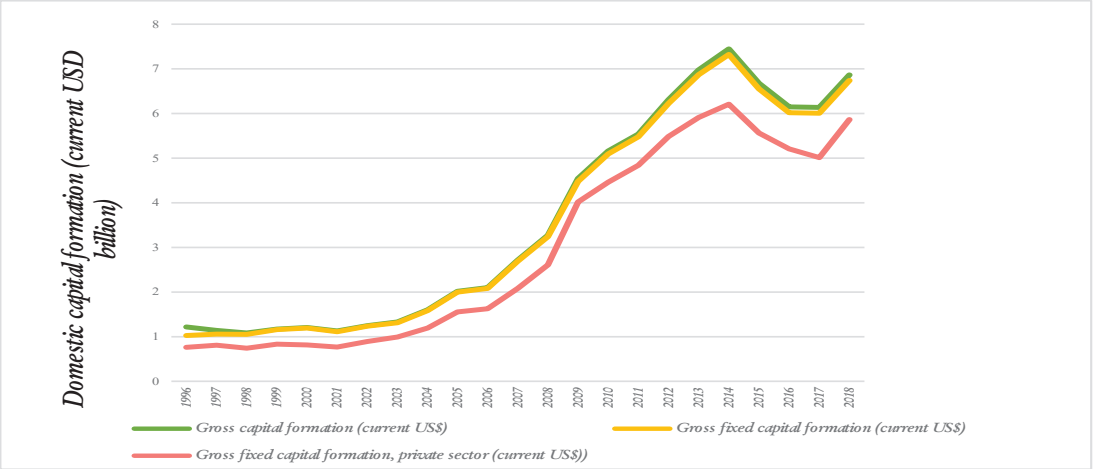
Until the recent crisis there had been significant recovery in growth rates in the country since 2016 that were accompanied by rising domestic and foreign investment (Kasaija, 2018). However, Uganda's level of private investment remained relatively low compared to neighbouring countries and was met with **limited and falling returns for growth** over time.

Figure 1: Total domestic investment as measured by gross capital formation in Uganda trails behind its neighbours.



Source: World Bank Development Indicators (2020).

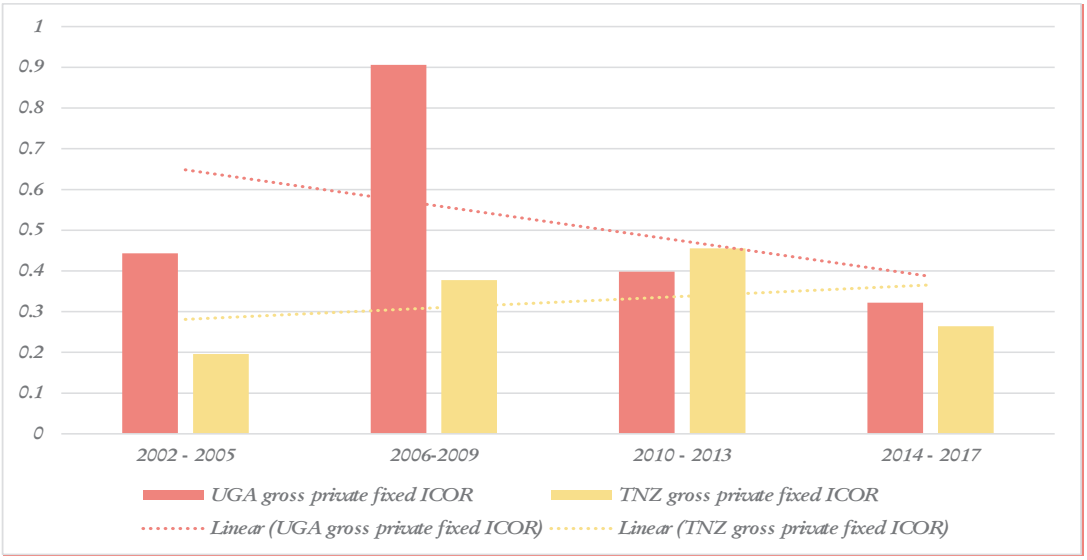
Figure 2: As private investment makes up the majority of domestic investment, low domestic investment overall reflects lower rates of private investment compared to neighbouring countries.



Source: World Bank Development Indicators (2020).

Figure 3 below illustrates (inverse) investment capital:output ratios (ICORs)[25] measuring the marginal impact of private capital on GDP growth for Uganda and Tanzania over the last two decades. This reveals worrying trends over time; while in Tanzania investments have generated increasing returns over time, returns to private fixed capital investment in Uganda have on average decreased over the last 20 years.

Figure 3: Three year average Investment Capital:Output Ratios for Uganda and Tanzania.



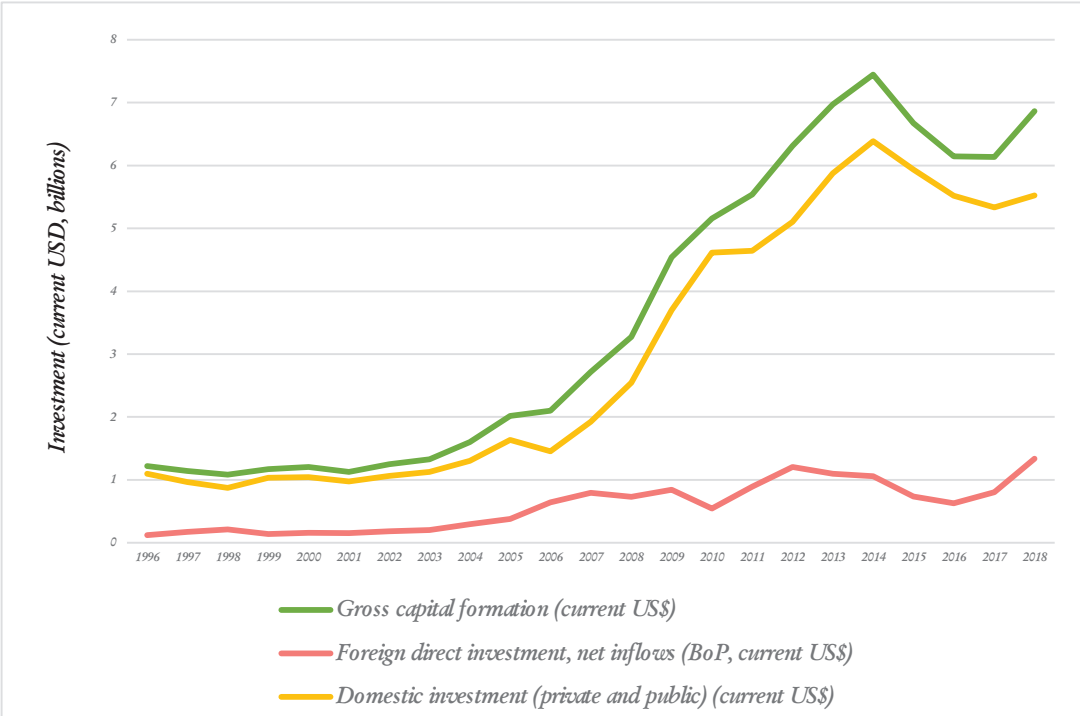
Source: World Bank Development Indicators (2020).

25 Investment Capital: Output Ratio (ICOR) measures the marginal impact of capital on GDP growth. The higher the inverse ICOR, the higher the growth enhancing effects of marginal capital investments. Inverse ICOR calculated here as GDP growth between $year_n$ and $year_{n-1}$ divided by gross capital formation in $year_n$

Limited and low productivity capital investment reflects in part the concentration of Uganda's economic activity in low value-added agricultural production, non-tradable services and manufacturing activities such as construction, which offer only a limited scope for productivity growth and high-wage employment.

At the same time, foreign direct investment has to date been relatively untapped at less than five percent of GDP (World Bank, 2020a) - and with it, its potential to raise domestic productivity. Evidence from a number of countries including Kenya, Vietnam and China suggests that allowing foreign firms to invest in higher value activities can create spillovers of knowledge and technology that have long lasting effects on domestic manufacturing and structural transformation (Chen et al, 2015; Farole and Winkler, 2014; Görg and Seric, 2016). The rise of global value chains, whereby firms import partly finished products, add value, and re-export, mean that there are increasing opportunities for Uganda to specialise and attract foreign investment in particular stages of the manufacturing process, and to upgrade these tasks over time.

Figure 3: Domestic vs. foreign investment in Uganda.



Source: World Bank Development Indicators (2020).

Limited domestic and foreign investment in high cost, high value activities in the country is not surprising. There remain a number of barriers to profitable production in Uganda, including periodic volatility in exchange rates and inflation, high interest rates, poorly

implemented public investments in critical infrastructure, unreliable electricity access, and difficulties in accessing land. At the same time, skill gaps in the local labour force continue to present a long-term barrier to investment. These challenges are perhaps most obvious in Uganda's urban areas, where rapid population growth has outpaced necessary public investments and land management, limiting the potential for sharing of ideas and knowledge between firms to drive productivity gains.

These issues will only be compounded by the downturn in national and global growth resulting from the recent COVID-19 pandemic. With economic growth estimated to have dropped from a projected 6.0 percent to 3.3 percent in 2020/21 alongside commensurate reductions in domestic revenues (Minister of Finance, Planning and Economic Development, 2020; UNDP, 2020), domestic resources for investment will be increasingly scarce. At the same time, FDI into Uganda is estimated to have reduced from 3.5 percent of GDP in 2019 to 2.6 percent in 2020 (World Bank, 2020b).

1.1. The role for policy

Active policy is needed to attract productive private investment that can drive long term growth in Uganda. Broadly speaking, there are three main areas for policy in attracting and promoting private investment:

- Providing price **incentives** for firms, including preferential credit, taxes, and tariffs as well as subsidized inputs
- Providing and facilitating **infrastructure** needed for productive activity, such as electricity and transport
- Developing well-functioning **institutions** that can effectively respond to private sector needs, including for example registry and resolution of property rights, and efficient customs procedures

In an attempt to promote productive private investment for long term growth, the Ugandan government has implemented a number of reforms across these areas, ranging from targeted marketing and communication with multi-national companies to large scale investments in roads and electricity. Fiscal incentives in particular have been extensively used in Uganda to attract private investment, with a range of tax incentives offered to firms engaging in different activities, including firms operating in industrial parks and free zones in the country.

This chapter considers the potential costs and benefits of recent policies towards investment promotion in Uganda, and ways in which policy can be designed to be more effective in promoting productive investment for the future. Section 2 examines the use of fiscal incentives in the country, considering the potential benefits and enabling conditions of these in addition to their limitations. Section 3 considers the importance of further government attention on infrastructure and incentives in promoting productive private

investment in Uganda, highlighting the role that Special Economic Zones can productively play in this. Section 4 considers cross-cutting policies to enhance effectiveness of policy in attracting investment and maximizing its benefits. Section 5 concludes.

1. **Price incentives for investment**

As in many developing countries, there has been extensive use of price incentives in Uganda to attract and sustain certain kinds of private investment. This includes, for example, the provision of subsidised inputs, preferential credit, and the use of tax incentives for investment promotion. Given budgetary limitations that are likely to continue to be particularly pressing following the ongoing global crisis, the use of tax incentives has been particularly widespread.

2.1. Tax incentives in Uganda

Tax incentives are preferential deviations from national or regional tax benchmarks that are specifically targeted towards inducing sector- or firm- specific changes in investment activity, such as the promotion of a particular sector or region for development. These incentives can include tax holidays, investment allowances, and preferential tariff rates.

By reducing the costs of investment or providing exemptions to taxes on profit, these incentives are used to attract or direct foreign or domestic investors in line with national industrial strategies. Tax incentives are commonly used in both developed and developing countries in order to promote new industries or exports, promote positive spillovers between related industries, and to protect industries during periods of downturn.

There are a number of tax incentives offered to investors in Uganda, ranging from corporate income tax exemptions for aircraft operators to total tax exemptions on imports of machinery used for oil and gas exploration.

Table 1: A taxonomy of tax incentives offered to firms in Uganda.

Tax	Type	Example
Corporate Income tax	Exemptions	CIT exemptions on income derived from the operation of aircrafts
	Holidays	CIT 10-year holiday for income of operators in industrial parks and free zones
	Income deductions	Taxable income deduction for bad debt from agro-activities
	Rate deductions	5% CIT rate for non-resident telecom companies
	Accelerated depreciation	100% depreciation rate for depreciable assets acquired for mining exploration
	Reduced or zero import taxes (duties and VAT) for firms engaging in specific sectors or firms located in Special Economic Zones (SEZs)	0% duty on approved quantities of inputs for Ugandan manufacturers of "sanitary towels" (e.g., tissue paper, microfiber towel fabrics, double sided adhesive tapes) through the EAC Duty Remission Scheme.

Value Added Tax	Exemptions/0% rate applied	0% VAT rate on the supply of leased aircraft, aircraft engines, spare engines, spare parts for aircraft and aircraft maintenance Equipment.

Notably, tax incentives are a crucial aspect of the incentive package being offered to firms locating in special economic zones[26] in Uganda.

SEZ programmes in Uganda

There are two major SEZ programmes in Uganda:

- Industrial Parks, which are managed by the Uganda Investment Authority (UIA). In publicly managed parks, firms are offered discounted land leases and basic infrastructure, while in private parks these are provided by the private developer. In both public and private parks, 10-year income tax holidays are offered to operators and developers.
- Free Zones, which are managed by the Uganda Free Zones Authority (UFZA). Similar to industrial parks, these can be either publicly or privately managed, through there can also be privately managed single firm zones. In all zones, firms are offered customs duty exemptions, 10-year income tax holidays, and on-site customs inspection. Under the EAC Customs Union Protocol, 20 percent of good produced in Free Zones can be sold locally – i.e., within the East African Common market.

Both of these schemes include the application of tax incentives for firms.

2.2. The hidden cost of tax incentives

Providing tax breaks to firms does not require significant budgetary outlays, and so the costs of these incentives are less obvious to taxpayers. However, by reducing tax burdens on particular firms or sectors, tax incentives effectively represent forgone revenue or *tax expenditure* by government. In other words, this is spending by the government that is channelled through the tax system. By reducing revenues tax incentives therefore have a strong *opportunity cost* in the value of spending not undertaken as a result (e.g., in infrastructure).

Tax incentives also create distortions both at the firm and at the industry level:

- At the firm-level, incentives targeted towards particular kinds of capital and labour expenditures distort firm choices about factors of production;
- At the industry-level, incentives provided for specific firms create market distortions by providing some firms a competitive advantage over others, and by encouraging rent-seeking activities. Evidence from Egypt and Tunisia suggests that tax incentives offered to politically connected firms have suppressed effective competition and the potential for job creation (Schiffbauer et al., 2015).

26 There is no clear consensus over the exact definition of the term 'Special Economic Zone'. For the purposes of this chapter, SEZs are defined as geographically delimited areas for production, with a different regulatory, customs, or fiscal environment from the rest of the country.

While there is limited available evidence on the costs of tax incentives in Uganda, initial estimates from the International Growth Centre suggest that the direct costs of customs and corporate income tax incentives provided to Ugandan firms amounted to UGX 904 billion in 2017/18 - 1% of GDP (Eissa et al., 2020). Further analysis is essential to better understand the full costs of tax incentives, taking into account indirect effects on economic activity.

2.3. Weighing up costs and benefits

The key question for policymakers is whether the investment induced by tax incentives is worth the associated direct and indirect costs over the period these incentives are applied. Without knowing the associated benefits of tax incentives in terms of growth-enhancing investment induced, it is impossible to say whether the costs of incentives are too large or small.[27] While tax incentives may have been offered to industries which have gone on to generate jobs and exports, without further analysis it is difficult to say whether these benefits *would have regardless happened in the absence of tax incentives.*

It is not a given that the returns to tax incentives will be significant –if tax incentives target firms that are planning to service the Ugandan market, for example, there is relatively limited competition from other destinations. Tax incentives to these firms are likely to be less influential on location decisions and purely serve to distort competition to benefit firms who receive these. At the same time, the potential benefits of tax incentives can be outweighed if they prompt tax competition from neighbouring countries and encourage a 'race to the bottom' in tax rates. Understanding the actual impact of incentives on investment in Uganda and the social benefits they generate can help to inform more cost-effective and targeted design for future growth.

While there is limited evidence on the benefits of tax incentives in Uganda, **there is good reason to believe that tax incentives will not be sufficient – and perhaps not necessary - to attract investment.** Investor surveys from a number of countries suggests that in many cases taxes are not the most important factor influencing investment decisions. Consistent with the views of investors, cross-country analysis using data from 40 Latin America, Caribbean and African countries finds that corporate income tax rate deductions and tax holidays do not have a demonstrable effect on FDI attracting in Africa, nor do they generally have a significant effect on total investment and growth (Klemm and Van Parys, 2012; World Bank, 2018).

27 A full cost-benefit analysis of tax incentives can enable policymakers to estimate the social returns to taxes forgone. This requires a) an estimate of direct and indirect costs of tax incentives over the period applied, b) an estimate of the value of actual or predicted benefits over a specified period e.g., in terms of employment, output, growth, and c) assumptions about the social discount rate over these periods to be able to effectively compare future gains with current revenues forgone

Best practice for tax incentives to minimize costs and maximise benefits

Where tax incentives are used, cross-country experience highlights two key lessons to limit their potential distortive effects on the economy. The first is that tax incentives should, as far as possible, be **non-discretionary,** and automatically cover well-defined economic activities. Discretion in the application of tax incentives increases both policy and economic uncertainty for investors (with lack of clarity on whether a firm or its competitor will be receiving incentives). Evidence from the U.S., Europe, China, and cross-country evidence from developing countries has shown that uncertainty regarding profits and policy has a significant negative impact on investment (Meinen and Roehe, 2017; Wang et al., 2014; Baum et al., 2008; Handley and Nuno, 2015; Kange et. al., 2014; Feng, 2011). At the same time, clear and transparent criteria for incentives reduces the potential for these benefits being provided to uncompetitive and/or unproductive firms.

Second, incentives should ideally **target the cost of capital** rather than profits. In other words, capital allowances and accelerated depreciation should be favoured over tax holidays and exemptions. Conditioning tax incentives on capital expenditure (as opposed to profits) means they are based on investments that yield social benefits rather than shareholder returns: companies can only claim these if they invest in certain kinds of socially beneficial activities. At the same time, tax holidays can only be enjoyed by those firms that have positive returns and therefore may be less effective in attracting long term capital investments which often involve significant sunk costs and limited profits in the short run (World Bank, 2018).

2. **An enabling investment climate**

Given limited evidence on the effectiveness of price incentives in attracting investment worldwide, it is important to consider what the **binding constraints** to productive investment in Uganda are likely to be and how best these can be addressed.

While customs duties and corporate taxes have been noted as some of the major constraints to business in Uganda, fewer firms view this as an obstacle to business than the sub-Saharan African or global average – in general, Uganda performs relatively well on indicators relating to 'regulation and taxes.

Indicator	Uganda	Sub-Saharan Africa	All countries
Percent of firms identifying tax rates as a major constraint	21.6	36	32

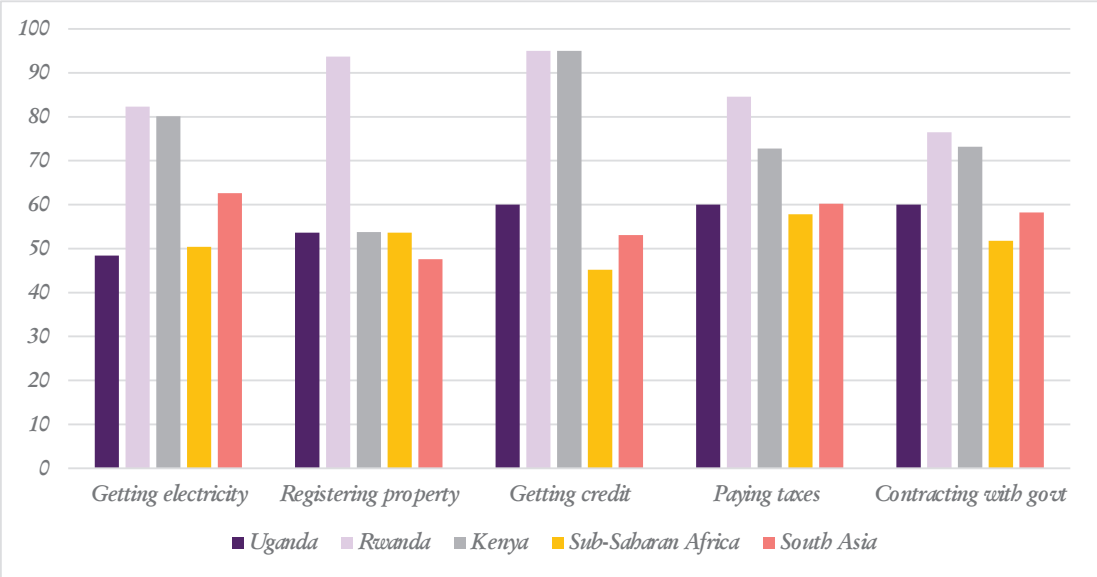
Table 2. Comparing perceptions on tax rates.

Source: World Bank Uganda Enterprise Survey (2013).

By contrast, 2013 World Bank Enterprise surveys, recent Doing Business indicators and

data from annual Private Sector Investment Surveys in Uganda[28] suggest that *non-fiscal incentives* are likely to be particularly important for attracting investment in Uganda.

Figure 4: Uganda's ease of doing business scores.



Source: World Bank Doing Business Indicators (2020).

Across a number of measures, ease of doing business in the country trails behind its neighbours, and in some cases falls below the average for the continent. Macroeconomic instability, unreliable electricity access, high costs of capital and costly trade procedures remain key constraints to profitable investment.

Related to this, there has been limited progress if any on a number of indicators of government performance in the country, including regulatory quality and corruption, over the last 10 years (World Bank, 2020c). Like many developing countries, weak institutions in Uganda limit the attractiveness of investment by raising costs and increasing uncertainties associated with investment. This includes poor customs services, overlapping regulations and registration procedures, and weak protection of property rights.

3.1. Investing in infrastructure and institutions

Addressing these constraints through investments in infrastructure and effective institutions are crucial in lowering costs of investment in Uganda. Priorities for reform include:

1) **Improving reliable electricity access.** Currently, access to electricity remains a key

28 Annual survey data on investor perceptions is collected on ~500 enterprises with FDI and unrelated foreign borrowing operating across a range of sectors by the Bank of Uganda/Uganda Investment Authority/Uganda Bureau of Statistics

constraint to competitive production in Uganda. While there have been significant improvements in expanding access and reliability of electricity since 2001, some key constraints to investment remain. The price of electricity remains relatively high at 16.9 cents per kWh (compared to 13.7 cents in Rwanda, for example), access remains low, and there are significant transmission distribution losses at 17 percent due to technical issues, power theft and non-payment (World Bank, 2020d; Ministry of Finance, Planning and Economic Development, 2019). Further investments in expanding access to reliable and affordable electricity is likely to be a determining factor in attracting investment for more productive activities. After basic infrastructure and utilities have been provided, the government can turn its attention to more attractive infrastructure packages for firms. In Sri Lanka and Ghana, for example, governments have provided specific infrastructure useful for firms engaging in value-added apparel and wood processing respectively (Farole, 2018).

2) **Enhancing trade facilitation,** including well-functioning roads, ports and airports, as well as customs clearance and other trade logistics services (Farole, 2011). According to the World Bank 2020 Doing Business indicators, Uganda ranks 121st out of 190 countries in terms of ease of trading across borders. This reflects a number of 'non-tariff barriers' that face Ugandan exporters including high fees and charges, delays and subjective decisions by officials associated with meeting technical requirements, export licenses, pre-shipment inspections and other necessary requirements for trade (International Trade Centre, 2018). Many of these barriers are locally imposed, and **t**he returns to addressing these constraints to trade can be significant in reducing costs for businesses. The time and cost of transportation of goods has been exacerbated by the recent crisis and additional safety precautions that have been taken in light of this, particularly at national borders. As such, efforts to reduce these costs will be more pressing than ever.

3) **Reducing barriers to entry from regulation.** Firm surveys and Doing Business Indicators suggest that firms face a significant number of barriers to starting a business in Uganda, including lengthy and costly procedures for starting a business and high costs of construction permits. At the same time, 17.6 percent of firms surveyed in the 2013 World Bank Enterprise Survey noted that they expected to pay bribes to obtain operating licenses.

4) **Enhancing protection of rights.** Both registration of property and enforcement of contracts are highlighted as key constraints to doing business in Uganda. Contested claims to land in particular act as a significant barrier to investment. Without effective systems for identifying, registering, and securing property rights, many investors are likely to shy away from costly capital investments.

Going beyond one stop shops

Effectively addressing many of the constraints firms face to doing business requires improved coordination and communication between government agencies to streamline both support and regulations for businesses. Within UIA, there have been attempts at improving the ease of firms' interaction with government by creating a 'one stop centre' to reduce the number of places and people firms have to engage with to obtain various licenses and government approvals.

It is important to note that while this may go some way to improving coordination between ministries, such centres require ministerial representatives to be effectively empowered to act on behalf of their ministries. If this is not the case, coordination failures between ministries will continue to hamper the effectiveness of SEZs. At the same time, if business regulations are particularly onerous, or if part of the difficulty of complying with them is having to interact with a number of agencies, these centres cannot do much to help. Improving state support and effectiveness requires reforming unnecessary regulations themselves and moving from 'one-stop' centres to 'single window' facilitators who can effectively represent and respond on behalf of government authorities (Farole et al., 2013).

Crucially in the case of Uganda, improving effectiveness of both infrastructure and institutions requires serious reform to enhance *implementation* of policy. Currently, poor implementation of policy severely undermines the potential for reform, with overall budget compliance only 54 percent in FY 2017/18 (Guloba, 2019). The IMF's 2019 risk assessment notes weak project preparation and implementation in public investment as one of the highest short-to-medium term risks, and with the highest expected impact on the economy (IMF, 2019). Improving implementation capacity of government will crucially require better coordination between different MDAs in achieving national objectives, as well as more effective systems for monitoring and oversight of government performance.

3.2. SEZs as a testing ground

In this context, special economic zones can be a useful tool for testing out and expanding reforms to **remove the most pressing obstacles to investment** that exist at the national level and to leverage productivity-enhancing linkages between firms in a dedicated area. This can include providing access to land and secure property rights, investing in necessary infrastructure and services for businesses, and improving the regulatory and administrative environment for production and trade. Implementing reforms at a smaller geographical scale means SEZs can act as a laboratory to experiment with new policies that may be financially or politically costly to initially implement as country-wide reforms. Policies that successfully promote investment can be tested and scaled up to the rest of the economy over time.

Enabling conditions for successful SEZs

While SEZ programmes have been implemented in a number of developing countries, evidence of the effectiveness of SEZ policy is notably **mixed** (Rodriguez-Pose and Hardy, 2014; Farole, 2011)**.** While in some countries, SEZs have proven to be catalytic to growth, in others, they have proven to be expensive 'white elephant' projects with limited contribution to economic development.

In addition to using these zones to tackle **the most pressing constraints** to investment in a country, cross-country experience highlights two key features of successful SEZ policy:

1) **Start small and learn by doing**

Addressing investment constraints is not an easy process – it involves an iterative process of experimentation and adaptation with regular feedback from the private sector. Even if initial cost benefit analyses suggest that the potential benefits of zones outweigh their costs, there is a large degree of uncertainty about how to achieve these benefits. As such, reducing the scale of reform to a select few zones and anchor firms can allow policymakers to test out new policies for training, infrastructure and regulation on a smaller scale and see how they affect investment before potentially scaling up, without the risks involved in large scale policy experimentation. Countries such as India have overstretched resources in implementing a large number of SEZs that fail to overcome constraints to investment completely, limiting their potential to attract investment (Alexianu et al.,2019). By contrast, SEZs in China were introduced in phases, with the success of the first four zones then leading to further scale up of reforms.

Current plans to implement 27 industrial parks alongside 19 free zones in the country limits the ability of policymakers in Uganda to target scarce resources and *comprehensively* overcome investment constraints and learning over time. Based on estimates from UFZA, the full costs of land acquisition, infrastructure provision, warehousing facilities, and institutional support for one 640-acre publicly managed Free Zone in Uganda would cost roughly UGX 340 billion (92 million USD) (UFZA, 2015). In comparison, budget allocations to UIA and UFZA in 2018/19 amounted to less than half that amount, UGX 129 billion in total (Ministry of Finance, 2018).[29] Assuming a number of these planned zones are to be publicly managed or at least require significant public support e.g., in land acquisition, it is **important to focus policy attention and limited resources on implementing at most 4-5 large and successful zones before any further t up**.

2) **Tap into existing markets**

Special economic zones and parks have often been attempted to be used as place-based policies, to revitalize left-behind regions in a country. However, **cross country evidence suggests that SEZs are not good tools for regional development - the further away these zones are from big cities and existing markets, the lower their chances of generating economic activity** (World Bank, 2017; Farole, 2011). It is no surprise that the most SEZs in China are located close to the coast or to major cities. In countries where SEZs have been implemented in peripheral regions, such as Bangladesh, Turkey and Kenya, the level of effective subsidy required to attract investment to less connected areas with weaker infrastructure and smaller markets typically exceeds what is feasible for governments to provide. Firms are attracted to the large pools of labour, suppliers, markets, ideas, and infrastructure that come with existing urban areas (Krugman, 1991; World Bank, 2009).

29 In FY 2018/19, the approved budget allocation to UIA was UGX 116.9 billion, of which approximately UGX 103 billion was allocated to industrial parks. The estimated budget allocation to UFZA was UGX 11.964 billion, of which less than 8.5 billion went to business development activities.

4. **Making the most of investment promotion**

Having a clear idea of what policies should be implemented to attract productive investment in Uganda is, however, only half the battle. The success of these policies will ultimately depend on how far these policies actually encourage productive investment, and the impact of this investment on the wider local economy. Without these, even the best intended plans for investment are unlikely to yield significant benefits for long term growth.

4.1. Predicting and monitoring the returns from investment promotion

Crucial to the success of any policies aimed at enhancing private investment in Uganda are effective systems for ensuring positive outcomes. This requires:

1) **Cost benefit analysis** to ensure expected benefits of these policies exceed their costs

It may seem obvious – but policies aimed at attracting or directing investment should only be implemented if the expected benefit from their establishment exceeds their cost - and do so more than an alternative industrial policy:

- **Benefits:** is there significant demand for this particular programme/policy? What are the expected benefits in terms of investment, exports, jobs?
- **Costs:** what is the cost of this policy– including foregone tax revenues?

Not only can *ex ante* cost benefit analysis prevent money from being wasted on inappropriate policy design, mapping out expected benefits and costs can be a useful benchmark against which to monitor and evaluate performance of policies. Cost-benefit analysis of SEZ policies as a whole would be particularly important in Uganda, for example, given the current plans to implement a number of industrial parks and free zones in the country targeting similar sectors and providing somewhat similar incentives to firms[30].

2) Effective **conditions** on the support provided to firms

Once a clear idea of expected benefits has been established, it is particularly important to link support provided to firms to clear monitorable conditions. Currently, this does not appear to be the case – a number of different tax incentives, for example, are offered to firms that fit a range of pre-specified criteria, but these are provided without clear and monitorable performance conditions that could be associated with continuation of this support over time. The most reliable measure of productivity gains in the long run is the ability of these industries to compete on global markets.

3) **Monitoring and evaluation** of policies and how they affect investment.

Finally, crucial in both learning about the effectiveness of policies and enforcing conditions on firms are monitoring and evaluation systems to track outcomes over time.

30 While free zones offer customs exemptions to firms, industrial parks do not impose limits on the destination of outputs – other than this, incentives offered between the two schemes are very similar.

In many cases, it may be difficult to predict the expected benefits of different policies, and monitoring outcomes can help inform cost-benefit analysis for future investments. Key to quantifying benefits is understanding what investments would have taken place in the absence of these programmes – this requires comprehensive data collection on firm behaviour and outcomes before and after the implementation of investment promotion policies, as well as on firms who are not subject to these policies, to be able to undertake effective comparisons.

A cost-efficient approach to monitoring and evaluation

There are a number of data sources government agencies can rely on to monitor and evaluate the performance of investment promotion policies. In Uganda, domestic tax and customs data can provide a clear picture of investment, value-added and exports, as well as the level and types of supplier linkages between firms.

It is important to ensure that any further data required from firms for evaluation does not represent an additional administrative burden. By using soft reporting systems such as text or online forms, more granular data can be collected in particular at the worker level. In Myanmar, the Thilawa SEZ Management Committee has worked closely with the International Growth Centre in developing online high frequency survey tools to collect firm and worker level data on production capacity, investments, supply chain details, worker demographics, remuneration, current/past employment, commuting patterns, and benefits and challenges of working in the zone. These surveys are administered by text messages for workers and are used for monitoring and evaluation alongside administrative data collected from firms through online forms.

4.2. Planning for spillovers

In the long run, it is important to ensure that firms attracted by investment promotion policies do not just become offshore assembly lines, repatriating profits and only investing until another country offers lower wages or more attractive tax breaks.

Globally, even where SEZs have proved successful in boosting export growth and employment, it has often proved difficult to further use zones to promote transitions to higher value-added production and to encourage linkages to the rest of the local economy (Farole et al., 2013). Export processing zones focused on garment and textile production in the Dominical Republic, for example, played a hugely important role in boosting exports, investment, and job creation between from the 1970s to 2000s, with free zone firms contributing to 7.5 percent of GDP in 2003. However, without additional policies to promote diversification, long-term upgrading through education and skills, and backward linkages to the wider local economy, zone policies reached a natural limit in their ability to spur growth when cheaper labour supplies from East Asian countries began to draw investors away (Farole and Akinci, 2011).

In order to ensure knowledge and technology upgrading is spread beyond the specific

firms that are targeted by investment promotion policies, policymakers should also consider how best to encourage linkages between large investors and local markets and workers in the medium-long run.

Improving these linkages can offer a 'win-win' for firms. Large firms can access a reliable local network of suppliers, enabling them to produce at lower cost, while domestic suppliers can benefit from selling to and learning from large firms. There are likely to be significant potential benefits from fostering linkages between local suppliers and the types of firms that are being targeted by investment promotion policies. Evidence suggests that domestic supply chains benefit particularly from linkages with exporting and FDI firms, whose global markets mean they force suppliers to reduce production costs and innovate, drawing on international best practices (Godart and Görg, 2015; Javorcik and Spatareanu, 2009; Görg and Seric, 2016). Evidence from Rwanda suggests that suppliers of large exporting firms grow faster and are more productive on average – and can even begin to export themselves (Spray, 2017).

4.2.1. Overcoming information asymmetries

One key obstacle to linkages between large investors and domestic suppliers is information asymmetries. Large firms, and in particular foreign investors, may not have extensive knowledge of what domestic suppliers exist and what they can provide. In Uganda, where there are a large number of potential suppliers of varying quality, as well as poor contract enforcement, there is an obvious role here for government to actively provide information on what suppliers exist and their quality.

Improving access to information can be best achieved through the development of supplier databases such as Yellow Pages, Yelp and Ali Baba, which are used across developed and developing countries to provide information on firms. Supplier databases can be more or less ambitious in the information they collect and provide, ranging from contact details of businesses to information and reviews based on their previous transactions.

Once this information is available, governments can also play a more active role in facilitating introductions between firms and working closely with these firms to help them to negotiate agreements. Governments can also facilitate introductions through industry specific trade fairs and conferences, as is seen in Malaysia and Singapore.

4.2.2. Local supplier upgrading

However, information is not enough. In many cases, large firms rely on imported inputs because domestic suppliers are unable to provide high quality and reliable goods at competitive prices. Buying companies often have particular standards and certifications they require regarding the quality of inputs, production techniques and labour standards that new suppliers struggle to meet without additional support.

Providing support to local supplier firms to raise their competitiveness can range from

investments in the overall business climate such as infrastructure and access to finance, to targeted programmes that provide subsidies to suppliers to larger firms who engage in capacity building and technology upgrading with their suppliers. The latter type of arrangement proved to be extremely successful in encouraging supplier linkages in Chile over the 1990s.[31]

4.2.3. Knowledge transfer within firms

At the same time, governments can implement active policies to encourage knowledge transfer within firms, including incentives to gradually replace senior foreign employees in FDI firms with local managers, or imposing a fixed tenure for workers in SEZs so that they can bring the knowledge acquired in FDI firms to domestic companies. One potential option could be to make labour permits for foreign employees contingent on monitorable plans provided by employers to train local workers.

5. Concluding remarks

Productive private investment offers significant promise for Uganda in driving higher value addition, growth, and employment. However, there are significant barriers to private investment that mean active policy reform is needed to encourage more productive foreign and domestic investment. Smart policy that can make the most of Uganda's resources to attract investment is all the more crucial given the current global downturn in economic activity.

There are three key areas for policy in promoting private investment: price incentives, infrastructure, and institutions. While the focus of policy in Uganda has so far been on the former, in particular through the use of tax incentives, there are good reasons to expect that this will not be necessary nor sufficient to attract productive private investment. Cross-country evidence highlights the need for:

- Careful design and evaluation of price incentives to ensure that they are effectively targeting the major constraints to investment in the country and limiting unnecessary public expenditure.
- Greater focus on other more important determinants of private investment - including investments in public infrastructure and effective institutions associated with trade and investment
- Starting small and focusing policy attention on a few zones, firms and key constraints can help investment promotion agencies to learn and improve by doing over time, and experiment with policies that can be scaled up if successful. This is particularly important because these policies are not cheap – tax incentives, for example, represent a significant cost to government in the form of foregone tax revenues that could be otherwise be publicly invested.

31 For more information, see Arraiz, Henriquez, and Stucchi, "Supplier Development Programs and Firm Performance."

The success of any investment promotion policies will ultimately depend on monitoring and evaluation to assess and adjust policies over time, and on planning for wider spillovers of investment to the rest of the economy.

By better targeting incentives and complementing these with necessary reforms to effectively attract and promote productive activity, it may be possible to leverage private investment this as a key driver of growth.

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CHAPTER 8 :

Proactive Urban **Policy:** A Recipe for Productive and Liveable Cities

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1. Introduction: the need for proactive policies for urban development

Cities can be engines for economic growth, or sites of overcrowding, congestion, and contagion. While across a number of countries, urban development and economic growth have gone hand in hand, this relationship breaks down in many sub-Saharan African countries, including Uganda. Rather, for these countries we see rapidly growing cities hosting under-productive activities and falling living standards, and urban development that is not happening concurrently with industrial transformation and economic growth. Cross-country experience suggests that for Uganda to move towards a path of sustainable urbanisation and develop productive and liveable cities, it requires sound policies for proactive development as well as effective institutions for implementation. This in turn will help foster a favourable investment climate for firms, allowing them to scale, specialise and ultimately act as an engine for economic growth for the whole country. It will also ensure that Uganda's cities are ready to absorb the rapid population growth that is set to happen in the next 30 years, providing them habitable environments.

This paper explores the relationship between urbanisation and growth, and, through this, the policy options for Uganda to embark on a path of developing productive and liveable cities. Section 2 examines both theoretical linkages and empirical evidence on urbanisation and growth, demonstrating that while urbanisation is a necessary condition for economic transformation, it is not sufficient; rather it is well-managed urbanisation process that is key. Section 3 sheds light on the some of the challenges facing Uganda's urbanisation process to date, with a focus on land-tenure, connectivity, and job creation. We also highlight how some of these challenges have been exacerbated with the current COVID-19 pandemic. Section 4 then concludes by proposing some policy implications for driving and harnessing urbanisation that generates productive and liveable cities.

2. Urbanisation and growth

The process of urbanisation refers to an increase in the proportion of a country's population living in urban settlements. Although the proportion of people living in urban areas in Africa is still relatively low, it is expected to increase rapidly as economies develop and populations grow. Across Africa, the urban population is expected to triple by 2050, and two thirds of the urban space that Africa will have in 2050 does not yet exist and so must be built in the next 35 years (Collier, 2016).

Through history, there has been a clear correlation between urbanisation and growth across Europe, North America, and large parts of Asia. Importantly, no country on these continents has ever reached middle-income status without a large shift of its population into cities (NCE, 2016). In the United States, for example, urbanisation rates and per capita income moved together until about 1940, when urbanisation reached close to

60 percent; thereafter per capita income expanded much more rapidly (World Bank, 2009). More recently industrialising countries such as China have also followed the path of urbanisation, through the rapid take-off in per capita incomes in China began at an urbanisation rate about half that of the United States (ibid), and were accompanied by rapid urban development, which makes it an interesting place for African countries to study.[32]

Figure 1: Urbanisation and per capita GDP in the USA, 1980 – 2006.

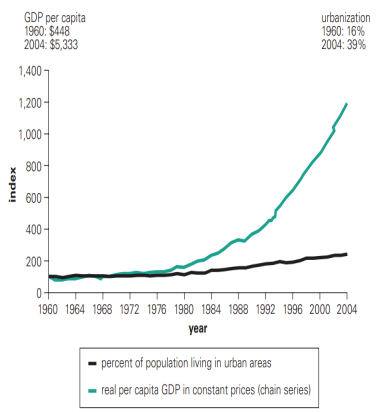
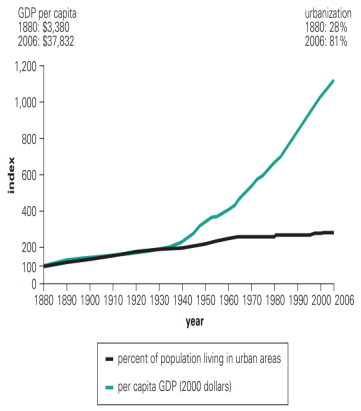


Figure 2: Urbanisation and per capita GDP in China, 1980-2006.



Source: World Bank (2009) Commission on Growth and Development.

In all cases where urbanisation has been associated with economic growth, the process has been intricately interlinked with industrialisation. Yet to date, this strong link between urbanisation and structural transformation in Africa has not materialised; in contrast, Africa's manufacturing and service sectors have remained small and unproductive (McMillian et al., 2011). In essence, most of Africa is urbanising without industrialising. While there is some evidence of structural change through a reduction in agriculture's share of output and a commensurate rise in services, this has been very small (Fox et al. 2013). Manufacturing, which is largely concentrated in major cities, is dominated by small, informal firms that are not particularly productive. Rodrik (2018) observes that the share of formal employment in overall manufacturing employment appears to run as small as 6 % in Ethiopia and Senegal, two countries that are deemed to be at the forefront of Africa's industrialisation efforts. These trends have raised a debate about the prospect of African being able to leverage this wave of urbanisation to drive economic growth (Collier, 2016; World Bank, 2012).

32 China is the only place in the world that has reached urbanisation rates as high as those in Africa to date (Dercon et al., 2020).

2.1. Theory and empirical evidence on the nexus between urbanisation and economic growth

The link from economic growth to urbanisation is explained in economic theory by two complementary forces: agricultural push and industrial pull. More specifically, increases in agricultural productivity mean that a continuingly decreasing proportion of labour is required to meet a country's food requirements. This frees up labour to leave rural farming, pushing them out of agriculture in search for work in cities, resulting in the growth of urban populations. If industrialisation happens in conjunction with the rise of agricultural productivity, this labour can then be absorbed by the firms located in cities. Therefore, there is the resulting growth of productive industry, particularly manufacturing, and services in cities, which provide employment opportunities for a growing urban labour force.

There are various reasons manufacturing and service sectors are located in cities, which will be further elaborated in later sections of this chapter. However, a major reason is that these sectors, which are less dependent on land as a factor of production relative to agriculture, greatly benefit being located closer together. As the manufacturing sector tends to pay higher wages relative to the agriculture sector, this also creates an overall pull of the labour from agriculture to industry and therefore to cities.

At the same time, the emergence of cities themselves have further potential to drive economic growth, through *agglomeration economies*. This is because cities have the advantage of scale and density of people, which, with the right conditions, fosters economic and social interactions to occur more frequently and effectively (Venables, 2015). As firms and workers locate close to one another in cities, firms can better match with labour, access inputs as well as benefit from a dense network of shared services and infrastructure. Furthermore, by locating close together, firms can benefit from each other through the sharing and receiving of ideas leading to innovation. Locating in cities also provides access to markets for firms' goods and services, not only within the city itself, but also as a result of relatively better access to regional and global markets, for example through roads, ports and airports. These features of cities allow firms to specialise in particular stages of production and thus produce at scale (Rauch & Reddings, 2012), which in turn fosters what Collier (2016) calls "the miracle of productivity growth" and development of the whole economy.

An example of this is the Industrial Revolution in the United Kingdom. When agricultural yields doubled over the 1600s as a result of technological innovations, those previously working in farming started moving to cities. At the same time, factories, such as the textile industry, were setting up in urban areas, attracted by the infrastructure and improved connectivity. These factories offered low-skilled jobs that was able to employ the labour leaving agriculture. As such, the UK soon became a global powerhouse in manufacturing at

the same time as it was experiencing increasing agriculture productivity. This consequently translated into economic growth, not only for the cities but for the whole of the UK, making it one of the richest countries in the world today.

Aside from the UK, there is also empirical evidence to support the emergence of this virtuous cycle in Europe, China, East Asia and many other regions in the world. Yet, as noted, this is not yet the case in sub-Saharan Africa as further detailed in the comparison between South Korea and Nigeria in **Box 1** (Black and Henderson, 1999; Mitra, 2000; Li, 2011; Dahiya, 2012; Bruckner, 2012; Li and Cheung, 2006; Zhao and Xu, 2008). There is still no consensus on why this is the case, however, one of the leading theories in this respect comes from Gollin et al.'s. (2016) analysis of urbanisation. They posit that increases in income will always result in urbanisation, but that the source of income growth will determine whether urbanisation will lead to productive cities. Analysing a panel dataset of 116 countries, they note that where increases in national income has been the result of structural transformation of the economy, such as in the UK, US and China, urbanisation and economic growth have been concurrent processes. Cities in these countries have been able to attract investment from productive firms, which are then able to scale, specialise and unleash the virtuous cycle of productivity growth as described above.

In countries where exports are dominated by natural resources, this too can result in increasing national incomes through high global commodity prices. However, natural resource production tends to be more capital than labour intensive and therefore does not create sufficient jobs to absorb the large labour force exiting agriculture. At the same time, due to the so-called 'Dutch Disease', an over-reliance on natural resource exports crowds out the potential for a manufacturing export sector to emerge. Therefore, although resource booms will drive higher overall national income that will push labour out of agriculture and to cities in search of jobs, a poor investment climate coupled with the inability to compete with relatively cheap imports will limit overall structural transformation. The majority of firms that do establish themselves in cities will tend to be small-scale and operate in the non-tradable service sector. They are also less productive and provide limited potential for spurring overall productivity growth. This is the phenomenon we see happening in the majority of sub-Saharan African cities, including those in Uganda.

To conclude this section, three important messages can be drawn from the extant theoretical and empirical literature review: (a) urbanisation, industrialisation and economic growth are usually intimately related (b) connected cities attract firms that can scale and specialise, and through this have the potential to drive economic growth (c) however, as is the case many sub-Saharan African countries, this process, is not inevitable. Therefore, whilst urbanisation is likely to be a necessary condition for economic transformation, it is not sufficient. As detailed in the case of South Korea (**Box 1**) and in Section 4 below, policies, proactive planning and investments are needed to move cities towards a virtuous cycle that can allow for improved urban productivity and liveability.

Box 1: Urbanisation as an Engine of Growth: Comparing South Korea vs Nigeria

South Korea: urbanisation, export-led industrial policy, and economic growth

Between 1960 and 1995, the urban population in South Korea increased by over 300 %, at an annual urban growth rate of 4.2 %. During the same period income per capita income increased 115.8 times, from USD 87 to USD 10,076 (Kim, 1999). This urban growth was closely related to structural transformation of the South Korean economy, supported by policies that spurred rapid industrialisation. For example, from 1962, the Korean government launched a series of five-year development plans which had an explicit focus on expanding South Korea's exports. Specific policies were adopted to foster a supportive environment for producers and private entrepreneurs, encouraging them to increase their investments, expand production as well as exports. These policies included targeted export related subsidies, tax concessions, and preferential credit (Rhu et al., 1987). In addition, exporters benefited from unconstrained access to imported inputs as they paid neither tariffs nor indirect taxes on inputs (Westphal and Kim, 1982). The government also increased overall investment in infrastructure by improving and expanding seaports, railways and high-way roads. This enhanced connectivity and thus exporter access to markets within the country but more importantly to markets across the globe. As a result of these policies, during the early stage of industrialisation, South Korean exports grew at an annual growth rate of 40 %.

A further outcome was the creation of nearly 12 million new jobs in the manufacturing sector between 1963 and 1995. Although this was accompanied by 2.3 million job losses in agriculture, the rapid job increase in the non-farming sectors in such a short period was a major pull for labour to move from agriculture to the city, resulting in significant rural to urban migration. This in turn spurred the growth of cities and towns, as well as the further development of private sector enterprises (Kim 1999). Through proactive supportive policies coupled with urban infrastructure development, the government greatly improved the investment climate for firms. Through the government's focus on leveraging opportunities made available by the global economy, they managed to attract productive exporting firms to their cities, which was the foundation for South Korea's urbanisation-industrialisation driven economic growth miracle.

Nigeria: urbanisation, weak manufacturing, and lacklustre growth

Rapid urbanisation in sub-Saharan Africa has already resulted in the first megacity in Lagos, Nigeria, and the World Bank estimates that 85 million people already live in Nigeria's urban settlements (Blochet al., 2015; World Bank, 2016). There have been two main drivers of the rapid population growth in Nigeria's cities: first, an incomplete demographic transition characterised by a fall in mortality yet persistent high fertility rates which have resulted in natural population increases in both urban and rural settlements (Fox, 2012). Secondly, the expansion of the oil sector between 1980 and late 2000s, resulting in a windfall of oil revenue that has boosted per capita incomes. This has led to disinvestment in the rural sector and as a result, large migration from rural areas to cities (Bloch et al., 2015; World Bank, 2016; Lamond et al., 2015).

Therefore, although the share of urban population in Nigeria increased from 4.5 percent in 1921 to 47 percent by 2014 (World Bank, 2016) the lack of accompanying structural transformation has meant this has not translated into growth. In fact, despite this nearly four-fold increase in urban population, real GDP per capita in Nigeria in 2007 was the same as in 1977. Contrary to the case of South Korea, growth in Nigeria's urban population has been met with a decline in manufacturing growth; manufacturing in Nigeria has stagnated for decades, plummeting from over 10 percent of GDP in 1984 to only 2.5 percent in 2009 (ibid). Between 1990 and 2005, manufacturing contributed only 5 percent of output growth.

As a result of this decline in manufacturing, the Nigerian economy has not produced enough jobs in the formal employment sector to absorb the increasing share of urban workers. This in turn has given rise to the growth of the informal sector as new urban arrivals struggle to find means of livelihood. Estimates have the share of urban informal sector at up to 53 percent of the active labour force (Oviedo et al., 2009). The challenge with this is that informality in the urban sector is characterised by low levels of productivity. Despite this, the increasing depravity in rural areas following decades of low growth has encouraged more rural workers to move into major towns and cities of Nigeria. A lack of planning and investment in urban infrastructure mean cities cannot meet the needs of the current population.

3. Urbanisation in Uganda: rapidly growing cities without jobs

Uganda's main long-term strategic planning document, *Vision 2040*, identifies urbanisation as a key driver of development in Uganda's aspirations to become a middle-income country. This is indeed a significant opportunity, as Uganda is currently one of the fastest urbanising countries in the world: from 2002 to 2014, the urban population in Uganda grew by an average rate of 5.4 percent (World Bank, 2020). Whilst overall Uganda was only considered to be 21 percent urbanised in 2014 (UBOS, 2014), projections show that the total urban population will be 20 million by 2040 and 32 million by 2050, accounting for almost one-third of the country's population (World Bank, 2015).

3.1 Limited formal employment opportunities

Until July 2020, Uganda had only one official city, namely the capital Kampala. This city dominates Uganda's urban system, with over 4.3 million inhabitants in the metropolitan area (Sladoje et al., 2019). The Greater Kampala area accounts for 31.2 percent of the country's GDP (ibid). It is also the focus of Ugandan industry, with 70 percent of the country's manufacturing plants and responsible for about a third of Uganda's manufacturing GDP (Lall et al., 2008). Compared to other urban areas, Kampala has a higher GDP per capita, at USD 2,440, as well as far higher wages; real wages are 50 percent higher than in anywhere else in Uganda. Therefore, the city also has relatively more formal job and wage employment opportunities.

However, urbanisation in Uganda has, like in the previous example of Nigeria, not been accompanied by structural transformation and therefore in absolute terms the number of productive firms is very low. As a major coffee exporter, Uganda has seen increasing GDP growth, in some years over 10 percent per year, since the 1990s, following various liberalisation reforms (Musumba and Gupta, 2013). This rise in income has pushed many out of agriculture in search of new opportunities in Ugandan's cities, in particular Kampala. However, at the same time, the manufacturing sector has stalled and there have not been commensurate investments from large-scale industry. Rather, firm entry appears to be largely driven by negative push factors, with small-scale entrepreneurs having no other choice but to start their own business to support their livelihood, rather than the pull of profitable economic opportunities.

Related to this, formal sector firm failure in Uganda is high: for example, only 24 percent of the firms established in 2001 were still operational nine years later (see Table 1 and Figure 3). Furthermore, 65 percent of the formal jobs created by new firms in 2001 had been lost through firm exit by 2010/11. Therefore, rather than providing much-desired stability, formal jobs are inherently insecure, further pushing urban dwellers

into informality. As Uganda's cities continue to grow rapidly, both as a result of natural population growth and with migration from other parts of the country, declining real wages and increasing unemployment, indicate that the formal labour market is quickly becoming saturated (Sladoje et al., 2019).

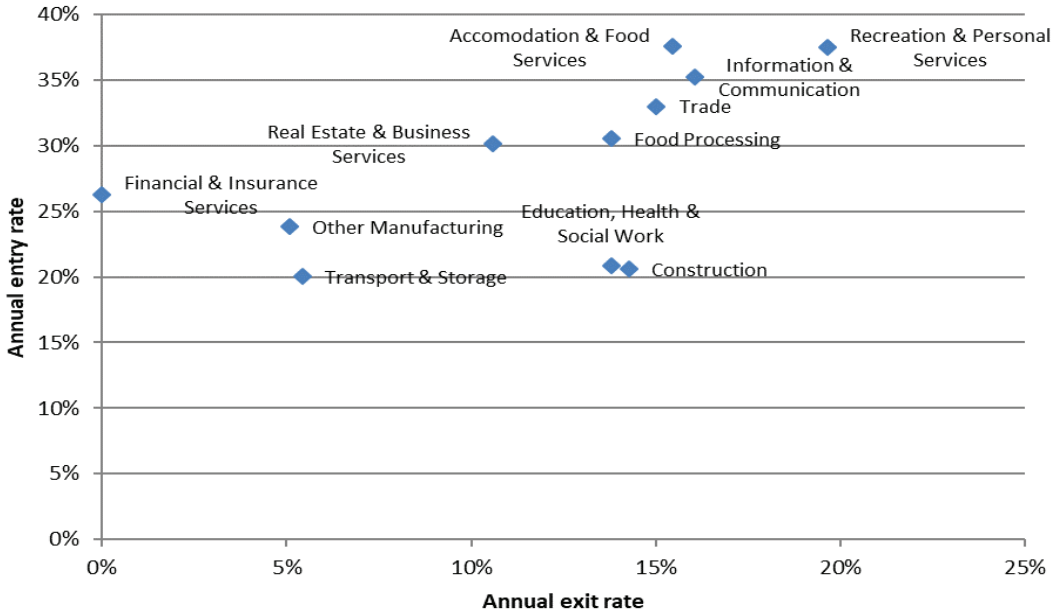
Table 1: Firm Survival and Growth by Sector in Uganda.

	Number of firms established in 2001 (2001/02 census)	**Proportion still operational in 2011**	**Average annual risk of failure**	**Average size in 2001**	**Average size of surviving firms in 2010/11**
Food Processing	457	26 %	14%	3.36	12.70
Other Manufacturing	801	62%	5%	2.94	4.22
Construction	32	25%	14%	42.75	7.50
Trade	21,207	23%	15%	1.45	1.70
Transport & Storage	81	60%	5%	6.11	4.73
Hospitality	4,469	22%	15%	2.26	3.36
Information & Communication	256	21%	16%	2.92	9.45
Financial Services	54	100%	0%	7.54	6.47
Real Estate & Business Services	386	37%	11%	4.21	9.38
Education, Health & Social Work	863	26%	14%	5.19	7.10
Recreation & Personal Services	3,870	14%	20%	1.83	2.23
ALL	**32,476**	**24%**	**15%**	**1.87**	**2.72**

Source: MoFPED 2013 Internal Memo.

Notes: calculations based on Census of Business Establishments 2001/02 and 2010/11.

Figure 3: Firm Entry and Exit Rates by Industry, 2001/02-2010/11.



Source: Author's calculations based on Census of Business Establishments 2001/2 and 2010/11. The annual entry rate is estimated as the average share of new firms in 2001/2 and 2010/12. The annual failure rate is estimated based on the number of firms established in 2001 that are captured in the 2001/02 and 2010/11 censuses.

3.2 A large and growing informal sector with limited opportunities

As a result of the lack of formal employment opportunities, nearly half of employment in Greater Kampala is now in informal non-tradable services; according to the Uganda Urban Labour Force Survey (2009), 57 percent of the city's employment is in informal firms. A defining characteristic of the informal sector is that it is dominated by a large number of very small, and usually unproductive, firms. Therefore, although it may provide occupations for many, under-employment is estimated at 23 percent (ibid). Furthermore, if formal urban employment is not keeping pace with population growth, this competition is likely to intensify as those without other opportunities increasingly join the informal sector (World Bank, 2018).

Evidence from two comprehensive business censuses conducted in 2001/02 and 2010/11 (UBOS 2003 and 2011) provide further evidence for the fact that the business landscape in Uganda's cities is increasingly dominated by many very small firms mostly operating

informally and in low production sectors. This survey shows, for example, that the average size of these firms is 3.41 employees (Walter et al., 2015). Importantly, the turnover of each of these firms is very small: a complimentary detailed census of informal sector firms in the Greater Kampala area carried out in 2016 showed that 93 percent of microenterprise owners would be beneath the World Bank's poverty line of USD 1.90/day, in purchasing power parity, if the business were their only source of income (World Bank, 2016b).

These informal firms face increasing competition due to the lack of viable markets and competitive business models. For example, when asked about the biggest constraints to expanding their business, 45 percent of respondents reported that it was a lack of customers, competition, or the profitability of their business model (World Bank, 2016b). As Rodrik (2018) observes 'there is little reason or evidence to believe that informal firms are on the same productivity escalator as modern firms with access to technology, markets and finance.' As such, without interventions to foster a sufficient investment climate, small, informal firms are unlikely to eventually grow into large formal sector firms and there will be a continued dominance of informal microenterprises in Uganda's cities.

3.3 COVID-19: A crisis of the urban informal sector

At the start of the COVID-19 pandemic, initial epidemiological models predicted dire health consequences for sub-Saharan African countries. This was due to the nature of transmission of the virus, the morbidity and mortality rates that were being seen in other parts of the world coupled with the prevailing extremely weak health systems. However, to date these predictions have not been realised. For example, according to the Ministry of Health as of 31st July 2021, Uganda had registered a cumulative total of 93,927 cases with 2,690 deaths. Rather, the way this crisis has manifested itself in Uganda, like in many other sub-Saharan African countries, has been primarily as an economic crisis. In Uganda it is estimated that the combined effect of the global economic crisis as well as nearly four months of lock-down has, to date, eroded nearly 10 years of poverty eradication efforts for the country (Younger et al., 2020). Like in many other sub-Saharan African countries, in Uganda the highest impact of this crisis has been felt by the urban poor, particular by Kampala's informal sector (ibid).

As noted in the previous section, the urban informal sector in Kampala is small and operates teeteringly close to the poverty line (World Bank, 2016b). Much of this sector operates in the service industry, which necessitates face-to-face interactions. Therefore, as the country went into total lockdown at the end of March for a period of four months,

many of these businesses were not able to operate. Prior to the lockdown turnovers were extremely small already: a census of the informal sector in the greater Kampala area, conducted in 2016, estimated percent of businesses in this sector had annual turnovers of 10 million UGX (≈ 2,600 USD) or less (ibid). At the outset of the pandemic and the lockdown, the majority of respondents to a high-frequency phone survey (UBOS, 2020) reported making losses or no income at all. While markets did remain open for the period of lockdown, falling household incomes meant many were not able to purchase food. Data from other African cities shows similar effects; for example, during lockdown, a survey of traders in Lagos showed them earning zero revenue (Bishi et al., 2020).

In Uganda, according to the UBOS survey, the share of respondents in urban areas who report working is still 8 percent lower than it was pre-lockdown (UBOS 2020). Similar long-term effects can be seen through surveys conducted in Freetown, Sierra Leone (Meriggi et al 2020). These same surveys indicate that the protracted recovery time is as a result of continued lower demand. Given we are still in the midst of the pandemic and it is unclear how it will evolve, dampened economic conditions may be a persistent effect over a longer period of time.

3.4 Two constraints to job creation: property rights and connectivity

The pandemic and the global economic crisis are not yet over. Furthermore, with the rapid urbanisation that is taking place in Africa over the next 30 years, it is likely that this will not be the last health crisis we will face: all of the last 30 epidemics and pandemics were started and spread rapidly in cities (Blake et al., 2020). Not only it is important to ensure that the cities that we have and those that are still to be built become more resilient to health crises more generally -this pandemic has once again highlighted the precarious existence of many working in the informal sector. Therefore, finding ways to improve their economic opportunities, through an investment climate in which their businesses can grow and flourish or through more secure wage employment, will be key. Below, we consider two key areas for policy reform in Uganda to improve the urban investment climate, namely security of property rights and constrained connectivity.

3.4.1. Property Rights

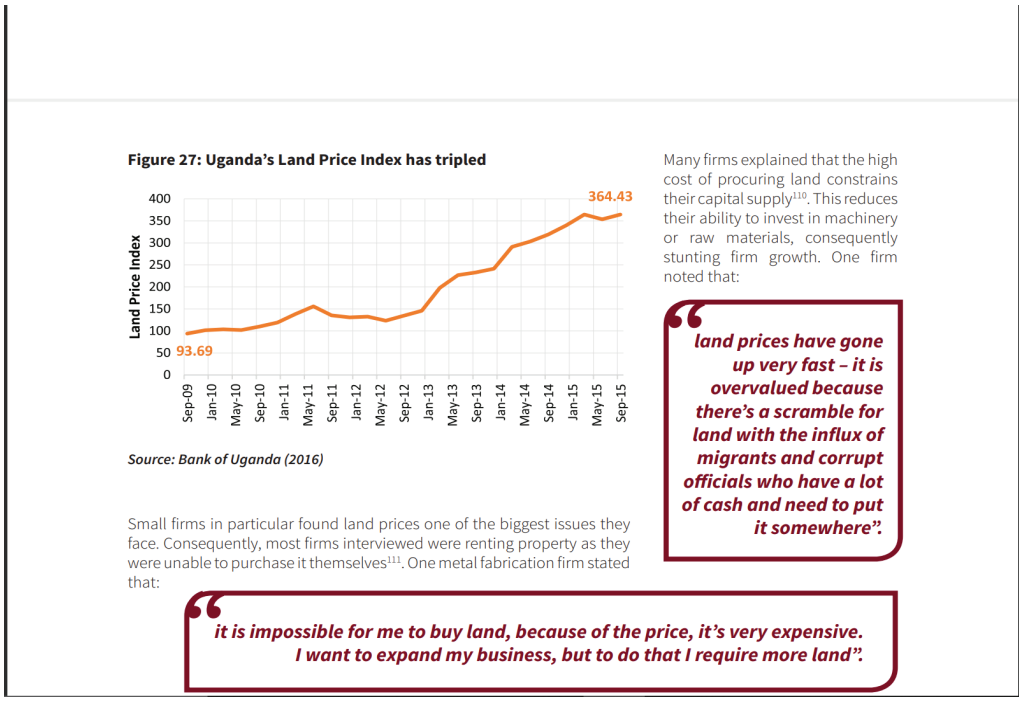
An important foundation for productive clusters of firm activity to emerge is the existence of secure, marketable, and legally enforceable property rights (Collier et al., 2018). Security and legal enforceability of rights provides certainty for owners to make substantial investments. At the same time, if property rights that can easily be bought and sold on markets, they can be transferred to encourage more productive uses. Clarity of legal rights over property is also critical to enabling governments to facilitate the productive use of land, for example, through land use planning or through acquisition of land for public investments.

In Uganda, however, we have one of the opaquest property right systems in the world.

The complexity of the land tenure system, with four concurrent system as stipulated in the Ugandan Constitution, coupled with weak land administration and overburdened legal courts, significantly impede the security and marketability of land. Furthermore, a land tenure system particular to Uganda, and the most prevalent in the Greater Kampala area, namely the *mailo* system, is characterised by dual ownership structures: both registered owners and lawful occupants have legal rights over the land. These overlapping structures are complex to negotiate as they can involve multiple individuals, and thus further frustrate efficient transactions of land. This situation has only been worsened since the implementation of the 2010 Land Amendment Act, which increased the powers of tenants over landlords (Bernard et al., 2016).

Alongside this unique tenure system, the lack of a widely used and systematic land title and ownership database has resulted in legal disputes over land, corruption, and costly processes of compensation for land for public investments (Deininger & Ali, 2008; Irumba, 2015; Obaikol, 2014). These has inflated the value of land. As seen in Figure 4, Uganda's land price index has more than tripled in the past decade (Bank of Uganda, 2016). Firms have explained that the high cost of procuring land constrains their capital supply and reduces their ability to invest in machinery or raw materials (World Bank, 2017).

Figure 4: Uganda's Land Price Index.



Source: Bank of Uganda (2016)

3.4.2. Connectivity

The 2001/02 and 2010/11 firm census data has shown that 61 percent of employment in Greater Kampala is located in a 5km radius of the central business district (Bird, 2019). This concentration is further highlighted by the fact that with each kilometre one moves away from the centre, employment opportunities decrease by 32.4 percent.

As a result of rising land prices and scarcity of land in a city, as cities grow households and firms will need to locate increasingly further away from the city centre, increasing the distance residents must travel to be able to access jobs and the distance between firms and markets. Yet the lack of a mass public transportation system anywhere in Uganda is a major constraint to this and inhibits connectivity in Ugandan cities. One outcome is that people increasingly take to their own private vehicles, and the supply of low-capacity transport in the paratransit sector is increasing. This results in worsening congestion, particularly in Kampala as the number of vehicles on the roads is increasing at a faster rate than the road infrastructure can keep pace. In fact, the existing roads in Kampala were constructed in the 1960s for 100,000 vehicles per day; today 400,000 vehicles use the roads every day (KCCA, 2016). Compounding the issues of increased use is that 73 percent of roads in Kampala are unpaved, which slows traffic and increases the likelihood of accidents (ibid). Recent estimates suggest that congestion in GKMA results in daily losses of USD 1.5 million due to time lost by commuters in traffic jams (Baertsch, 2020). This is costly for medium and large firms in the tradable sector, who rely on the transportation of workers and goods around and outside of the city (World Bank, 2017). The World Bank Enterprise Survey (2013) found that 15 percent of firms in greater Kampala considered transportation a major or severe constraint to their businesses.

4. Policy options to enhance productive urbanisation

Both theory and experience of regions that have successfully leveraged urbanisation as a positive force for growth highlight the importance of well-managed and well-planned density. It is this that will help create a conducive investment environment for firms, which in turn can foster productivity, at the same time ensuring liveability for urban residents (Collier, 2016). These lessons are particularly pertinent for cities in Uganda more generally and Kampala in particular, which is projected to become a mega-city of more than 10 million by 2040. As such, the Government of Uganda needs to urgently implement conducive policies ensure well-managed density. These include:

4.1. Strengthening property rights through incremental land reform

There is a clear need for the national and local government to address the issue of overlapping and unclear land rights, which is one of the greatest impediments to investments in cities. This can be done through improved land administration, to both register land and keep accurate records in the form of a centralised online land registration and management system (Iddawela, 2016). The land registration exercise in Rwanda has

shown the benefits of using aerial and satellite photographs, alongside locally trained surveyors and participatory mapping exercises, to help accurately map and reflect land ownership. This was done successfully for the whole country in under 5 years and at an average cost of about 6 USD per parcel (Collier et al., 2018). The Ministry of Lands, Housing and Urban Development has already taken significant steps in improving land administration, through the development of a National Land Information System (LIS). It is important, however, that the LIS provides open, accessible, and up-to-date information to help foster a competitive and transparent land market. In addition, continued coordination between various land management institutions like Kampala City Council Authority (KCCA) and Buganda Kingdom, will be key. This is particularly with the focus to improve cities' abilities to acquire land for infrastructure investment, but also to improve resolution mechanisms to greatly reduce the time to settle land ownership disputes (World Bank, 2017).

4.2. Coordinated investments in high-capacity mass public transport

Good transport infrastructure enables cities to achieve connectivity by allowing firms to interact with each other more seamlessly, improve workers' ability to reach jobs, and ensure easier access for residents to markets and public services. At the same time, since enhanced transport investments make a location a more attractive destination for investment, this can help attract larger clusters of productive firms.

Particularly for cities like Kampala which are sprawling rapidly, investments in connectivity are urgently needed to ensure that large numbers of commuters can travel between their residential areas and jobs, which as previously noted are clustered in the centre of the city. Relying on car usage or the low-capacity paratransit systems that exist today will not be sufficient for a rapidly growing population and will only serve to increase congestion and pollution.

To alleviate this and facilitate improved connectivity for the city, the Government of Uganda will need to make crucial investments in mass public transport. Promising options here include a Bus Rapid Transit (BRT) system for the Greater Kampala Metropolitan Area, which will need to be complemented by lower capacity feeder route systems from the outskirts of a city. The BRT system launched in Lagos in 2008, for example, served over 200,000 passengers daily in its first year of operation and cut average in-vehicle journey times by 40 percent (Otunola et al., 2019). The government is also assessing various rail-based options, such as reviving the meter-gauge railway, as well as water transport, which has the added benefit of potentially being able to contribute to tourism, recreation, transportation, and fishing (Word Bank, 2017). In making these investments, it is important to take into consideration not only the hard infrastructure, but also the institutional and other associated investments that will need to be made around this. Each of these investments will require significant capital financing, and given that resources are limited, detailed cost-benefit assessments of each mode are key, to ensure the highest

impact and value-for-money investments. Furthermore, with each investment, the re-funding opportunities should be considered and agreed from the outset.

4.3. Land zoning and pro-active city planning

Credible planning can facilitate industrial clustering of manufacturing firms in the city and maximise the benefits of agglomeration. To do this, KCCA and other local governments will need to work closely with major landowners, such as the Buganda Land Board. A first step could be to identify vacant and underdeveloped land through GIS mapping. The potential for land swaps can then be further explored with landowners in order to facilitate land development in essential city locations. As KCCA and other local governments do not have much land themselves, they could coordinate to purchase vacant and underdeveloped land through a land banking mechanism, which could potentially make use of the Government of Uganda's Land Fund. The efficient purchasing and reallocation of underused or vacant land could help increase the supply of land in central locations for commercial and industrial activities, as well as for the development of affordable housing. Additionally, in order to prevent speculation and corruption, land should be earmarked and reallocated in a transparent process, ensuring that it benefits a large number of firms and residents.

4.5. Effective and empowered institutions

Key to implementing the reforms outlined above are effective and empowered institutions, both for coordinating investment across larger cities, and for establishing new cities for development.

All the challenges outlined in this chapter transcend administrative boundaries, because the economic and geographic footprint of a city spans multiple jurisdictions. Without a formal institutional entity for the Greater Kampala Metropolitan Area, challenges arise in the financing and delivery of public services as well as when it comes to infrastructure investments for that would benefit the whole metropolitan area (Slack, 2018). Without effective coordination of investments, local governments cannot tap into the economies of scale that come with large scale investments in urban infrastructure. Establishing administrative coordination structures that can help coordinate service deliver, investments, share the costs of these fairly across the metropolitan area and formulate coherent public policy for the region overall is essential.

At the same time, the Government of Uganda has recognised the importance of cities as drivers of job creation and economic development, and as such has recently announced the formal creation of 15 new cities. These cities, located across the country, will in particular act as service and market centres for rural hinterland and have the potential to expand rural households' access to non-farm employment. Although to-date non-farm employment opportunities in these smaller urban settlements remain limited (Sladoje et al., 2019), they are likely to have their own advantages compared to Kampala; for

example, lower land and labour costs, greater proximity to agricultural and natural resource endowments and shorter distances to international borders. These are all potential assets, which with the right policies and infrastructure investments, but perhaps most importantly, proactive planning, can greatly benefit their growth and development. Clear and effective governance structures for these new cities, along with adequate financing from own source revenues as well as central transfers, will be crucial in tapping into this potential.

Effective urban governance can help to enable forward-planning, which is essential as approximately two-thirds of cities is yet to be built. Proactive planning to ensure investments can be made before people settle will be key. Examples from Colombia and Ethiopia show that actual infrastructure does not have to be placed for this planning to happen: it is sufficient to just leave the space to accommodate the growing city, including future roads and utilities, for when people settle (Collier et al., 2020). Then, as and when the government has the capacity and financing to make the investments they can do so at a later stage. This is important as retrofitting infrastructure can be up to three-times more expensive, as well as very disruptive to resident's livelihoods (ibid). Furthermore, proactive planning in this way has the additional benefit of being able to shape and coordinate people and firm's expectations on where to settle, as they know where the infrastructure is likely to emerge in the future.

For institutions involved in urban governance to be effective, there is an urgent need to improve the ability of cities to raise necessary finance and funding to manage their ever-growing demands. This is both intimately linked to policies that unleash the potential of land, a city's most valuable asset, as well as conducive policies for local governments to be able to attract financing and generate own-source revenues. This is even more urgent now given the decline in income in urban areas has already significantly impacted cities' municipal revenue. In Kampala, for example, the KCCA registered an 83 percent decline in tax collection during lockdown, compared to the same period in the previous fiscal year (The Independent 2020). This was particularly due to declines in business license fees, building permits and property tax, which in turn were driven by the fact that revenue collectors were not able to serve demand notices, as these are based on field-based interactions (Ibid). At the same time, the demands on city governments during the pandemic were high and will continue to be as there are calls to make cities safer and more resilient. This includes, for example, ensuring that markets were able to operate safely, such as ensuring sufficient hand washing points, regular disinfecting and stalls so vendors could work within the standard operating procedures.

5. Concluding remarks

The success of cities is intimately linked to economic development of the whole country: no country has reached middle income status without urbanising. However, this link is not automatic – productive and liveable cities require sound management through conducive policies and pro-active planning and investments to both to enhance to facilitate productive clustering in cities coupled with the provision of adequate affordable housing and improved service delivery. With most of our cities still to be built, instituting this now will help unlock the potential for Uganda's cities as engines for growth for the whole country in the future.

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CHAPTER 9:

How can Uganda harness trade and regional integration for economic growth?

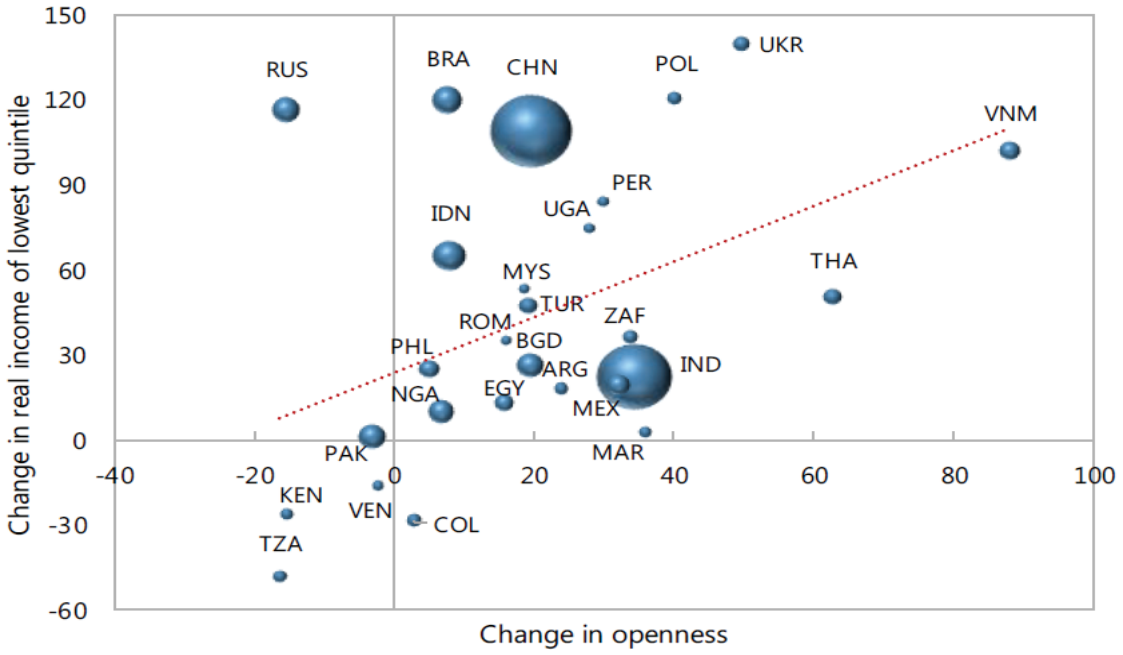
By Jakob Rauschendorfer (International Growth Centre, Uganda)

1. Trade, growth, and poverty

International trade boosts economic growth through access to high-quality inputs for production, by increasing competition in final goods markets and by enabling firms to overcome small domestic markets. Beyond well-documented growth benefits of international trade, there is evidence that trade-induced growth is inclusive and reduces poverty. To illustrate, Figure 1 correlates changes in a country's openness (its imports plus exports divided by its GDP) with changes in the real income of the poorest quintile of a population. Increases in openness are associated with higher incomes of poor people, providing prima face evidence for the poverty reducing effect of trade in developing countries (World Bank 2017: 43). As evident from this figure, Uganda is no exception to the global pattern: An increase in the country's trade over the considered 15-year period was accompanied by a sizeable increase in the real income of poor Ugandans (red circle in the figure).

Figure 1: More trade is associated with less poverty.

Notes: Taken from World Bank (2017). Change in openness ((imports plus exports)/GDP) and change in real income of lowest quintile are percentage changes over 1993-2008. Circle size is proportional to a country's population.



The Government of Uganda is cognizant of the beneficial effects of international trade.

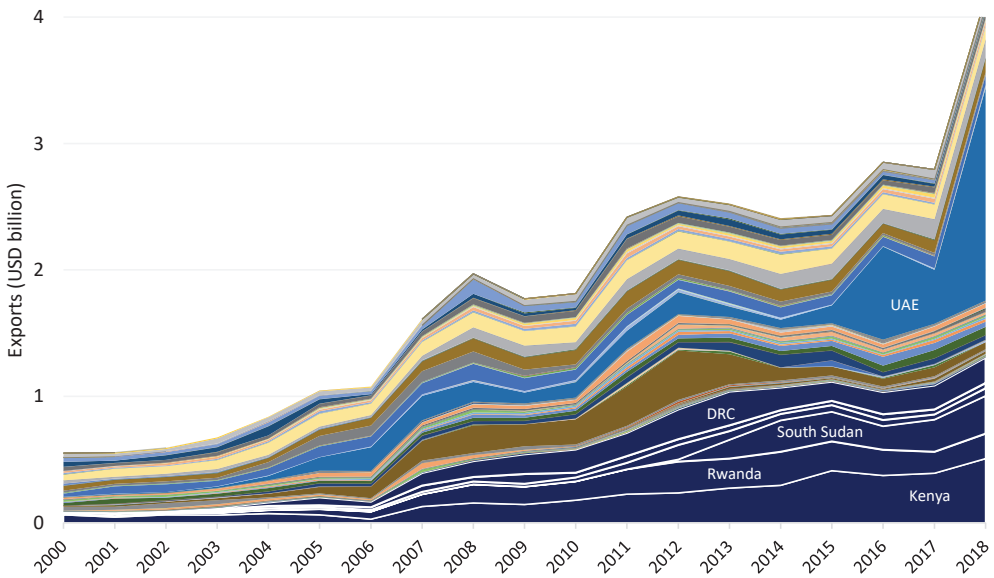
However, a number of issues prevent the country from fully reaping regional and global opportunities. Among these are the outstanding review of the EAC Common External Tariff, the prevalence of high transport costs and Non-Tariff Barriers as well as global and regional tensions like protectionist movements in the north or the closing of the Katuna border with Rwanda. At the time of writing, the COVID-19 pandemic has led to a significant slowdown of global production and trade with ramifications of Uganda's trade performance as well. Equally, it is already clear that trade will play a crucial role in enabling Uganda to achieve high rates of growth once the pandemic subsides. Based on the Economic Growth Forums 2017, 2018 and 2019, this article explores how Uganda can harness trade and regional integration for inclusive growth.

The paper is organized as follows. Section two provides an overview of Uganda's trade performance. Section three considers the role of regional and global trade integration for Uganda, with particular emphasis on the EAC. Section four explores supply side constraints that prevent Uganda from fully realizing existing opportunities. The chapter concludes with policy recommendations in section five.

2. A brief overview of Uganda's trade performance

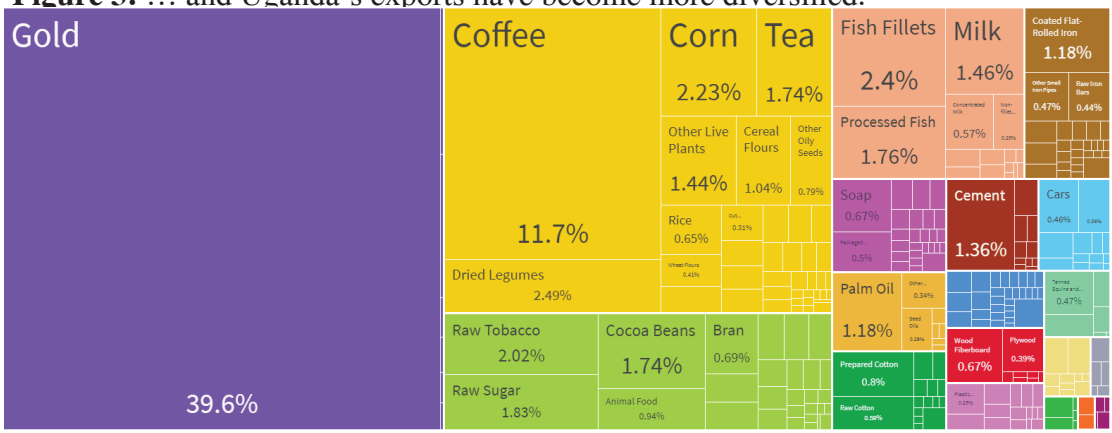
Against the background of a positive relationship between trade, economic growth, and poverty it is advisable to briefly assess Uganda's trade performance. Figures 2 and 3 consider volumes, destinations, and composition of Uganda's export basket.

Figure 2: East Africa has become Uganda's most important export destination …



Notes: Exports (USD billion) per destination country and year. Data taken from the Atlas of Economic Complexity (2020).

Figure 3: … and Uganda's exports have become more diversified.



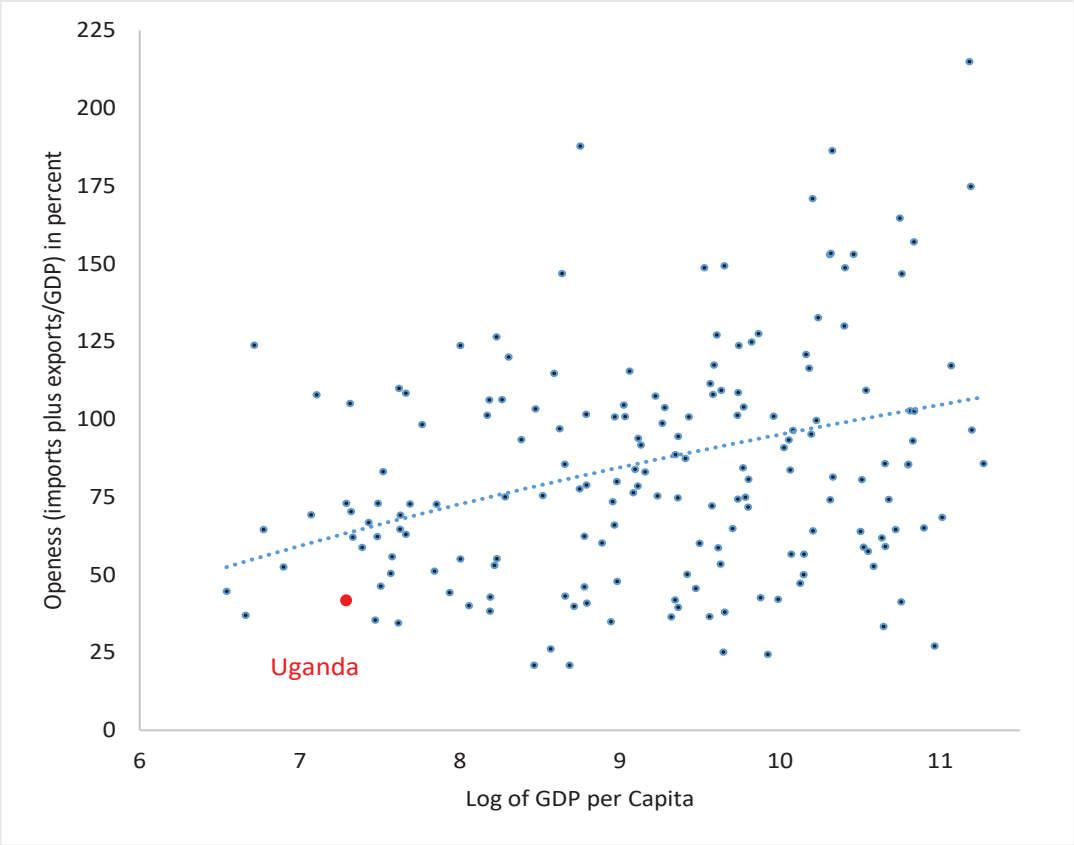
Notes: Contribution of different products to Uganda's export basket. Total export basket in 2018: USD 4.16 billion. Taken from the Atlas of Economic Complexity (2020). Almost all exports to the UAE are gold. This figure does not include exports of services, which accounted for approximately USD 1.64 billion in 2017, comprising mostly tourism (USD 940 million) and ICT (USD 510 million), as well as Uganda's small scale trade with neighbours (totalling about 420 million USD in 2016).

Three key messages emerge from these graphs. First, Uganda has increased its export volume considerably over the past 20 years, from about USD 0.6 billion in 2000 to about USD 4.16 billion in 2018 (ca. 15 percent of its GDP in the same year). Second, regional markets have become Uganda's most important export destinations. Absorbing as little as a tenth of all Ugandan exports in 2005, in 2018 the members of the East African Community imported roughly a third of Uganda's exports (about half, if gold exports which are shipped almost exclusively to the UAE are subtracted). The DRC has established itself as the most important African destination outside of the East African Community accounting for almost five percent of Uganda's exports. Third, as shown in Figure 3, Uganda's export portfolio is now relatively diversified. Beyond the traditional cash crop coffee (which is exported almost exclusively to the developed countries in the north), the country's export basket also includes a variety of higher-value (mostly agro-based) manufactures, such as processed fish, dairy products, baked goods, beverages, plastics, and paper products. Most of these higher-value agro-based goods are exported to partners in the region. For example, almost all of Uganda's milk exports are shipped to Kenya, while soap products reach Rwanda, South Sudan, and Tanzania. Finally, it is encouraging to note that some products beyond coffee and tea reach high value markets. For example, processed fish is exported to countries in Asia, the Middle East and Europe.

These positive long-term trends and developments are encouraging and showcase Uganda's potential to compete in international markets. Nonetheless, it is important to highlight that Uganda still trades comparatively little compared to other countries

at similar levels of income. Figure 4 illustrates this point by correlating (log) GDP per capita of countries with their openness (imports plus exports divided by GDP). As evident from this illustration, compared to other countries at similar income levels, Uganda has a lower trade to GDP ratio.

Figure 4: Uganda trades too little given its income level.



Source: World Bank World Development Indicators (2018). Luxembourg, Hong Kong, Singapore and Malta have been omitted to facilitate comparability. Trade to GDP ratios include exports and imports of services and goods and all values are averages over 2015-2017. Taken from Rauschendorfer (2019).

3. Regional integration and Uganda's trade: The EAC and beyond

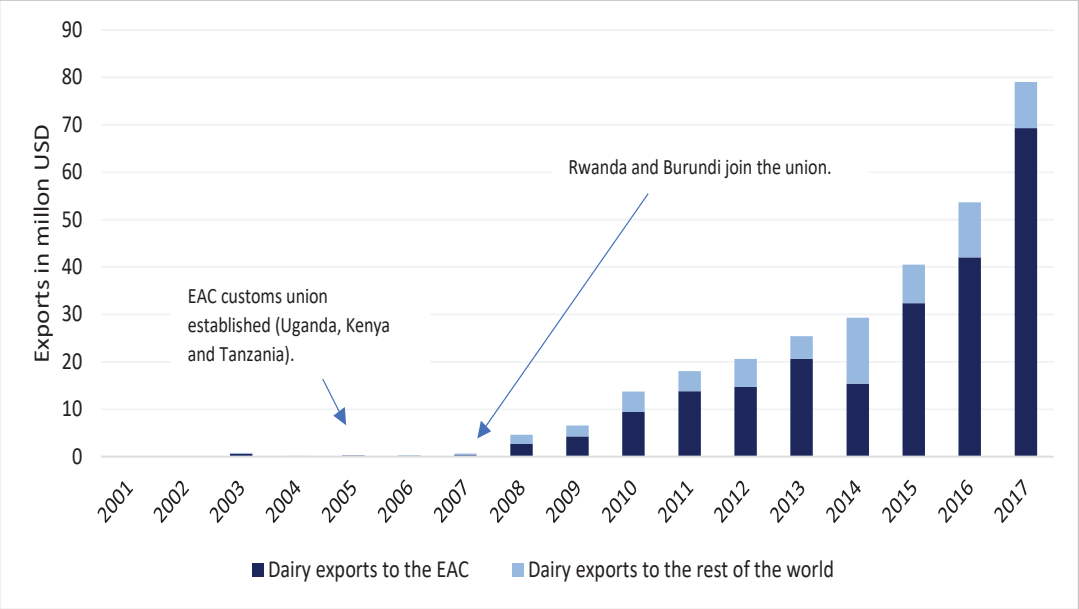
As illustrated in the last section, regional markets absorb a large share of Uganda's export. In general, regional trade agreements offer an opportunity for countries and firms to "learn globalization" on a small scale by engaging with countries at similar levels of economic development. For example, exporters are found to have higher chances of survival in global markets when they first learn to export at a regional level (*cf.* Kamuganga 2012).

3.1. The role of the East African Community in Uganda's trade

Uganda's most important trade agreement is the customs union of the East African Community (EAC). Established in 2005 by Uganda, Tanzania and Kenya, with Burundi and Rwanda joining in 2007, the union is a corner stone of the regional integration project of the EAC. Per the agreement, intra-EAC trade between member states is free while imports from third countries are subject to the union's Common External Tariff (CET). Regarding exports, members of the EAC absorb about a third of all Ugandan exports, showcasing the importance of free intra-EAC trade for Ugandan firms. Crucially, EAC members not only import Uganda's raw agricultural produce like maize but also absorb a large share of Uganda's more high-value exports like paper and paper products, vegetable oils, chemical products, or plastics.

Figure 4 illustrates the importance of the EAC by reference to a product group of interest to the recent agro-industrialization push of the government. The graph tracks dairy exports (milk and milk-products, cheese, and butter) to EAC members and to the rest of the world. As shown, following the establishment of the customs union, Uganda did not only become a successful exporter of dairy products to the region, but gradually started exporting these products to countries outside of the EAC as well.

Figure 4: Following the formation of the EAC Ugandan firms started to export dairy.



Notes: Export values in million USD. Author's illustration updated and extended from Karingi et al (2016) using data from ITC-*TradeMap* (2020). Dairy products include: milk and milk products, butter, dairy spreads and cheese (HS-Codes: 0401.1000 – 0406.9000).

On the import side, the EAC customs union is even more important for Uganda and its growth pattern: Its Common External Tariff (CET) regulates tariffs for almost 90 percent of Uganda's overall import volume in any given year. Crucially, when cancelling out imports originating from EAC members (which export to Uganda tariff-free) the CET regulates close to all imports actually subject to taxes.

Taken together, the EAC customs union is of paramount importance to Uganda's economic development and success as a trading nation. On the export side, the union provides market access for Ugandan firms to high-growth markets in the country's immediate vicinity. On the imports side, the CET of the EAC determines the price of imported goods that Uganda relies on to produce internationally competitive products and shapes consumer welfare through final goods prices.

3.2. Threats to regional integration in the East African Community

Against the background of its importance, the following provides a brief discussion of two key issues that constitute a threat to the cohesion of the EAC customs union: The review of the CET as well as regional tensions that prevent Uganda from fully realizing existing opportunities within the EAC.

The comprehensive review of the CET

Given its role in shaping Ugandan economic development, a pressing contemporary policy issue is the review of the Common External Tariff, ongoing since 2016. Currently, the regime assigns tariffs to products imported into the EAC from countries outside of the union in line with a three-band system (0 percent for raw materials; 10 percent for semi-processed goods; and 25 percent for finished goods) as well as a List of Sensitive Items with high rates of 35 percent and above for selected products.

For the review, the following proposals are under consideration by member states. First, an increase in external protection against imports from third countries through the introduction of a new regular tariff band of 30 or 35 percent. Second, a general increase in the total number of tariff bands. EAC members are planning to abandon the relatively simple three-band tariff structure of the CET and expand options for product specific protection by introducing an additional 5 percent rate, the new peak rate of 30 or 35 percent as well as keeping the List of Sensitive Items with high tariffs above 35 percent for a number of products. In sum, EAC members are opting for a more complex CET and an increase in overall levels of external protection (cf. Frazer and Rauschendorfer 2019: 1). Research targeted at improving Uganda's negotiation position in the CET review has concentrated on three issues. **First, high import tariffs undermine the competitiveness of Uganda's products and reduce welfare.** As outlined above, current sentiments in the EAC are in favour of higher external protection for local industries from international competition. These protectionist sentiments bear the potential to significantly harm Uganda's future growth path.

Beyond decreasing consumer welfare through the increased cost of consumption, high external tariffs on goods reduce competition in final goods markets, which can prevent Ugandan firms from realizing the necessary efficiency gains that would allow them to successfully compete on world markets. A plethora of studies investigating the effects trade liberalization on growth have documented the positive long-run experience of countries with tariff reductions and show that liberalizers grow faster than non-liberalizers. For example, from Wacziarg and Welch (2008) explore economic growth in 81 countries that implemented trade reforms and report that liberalizing countries achieve higher rates of growth.

For the review of the CET, an increase in the regular peak rate from 25 percent to 30 or 35 percent would simply provide an additional cushion against international competition for already existing firms in protected sectors. If not accompanied with definite sunset clauses higher external tariffs provide little incentive for firms to improve their production processes. Instead, firms could exploit the higher external tariffs to charge their clients higher prices.

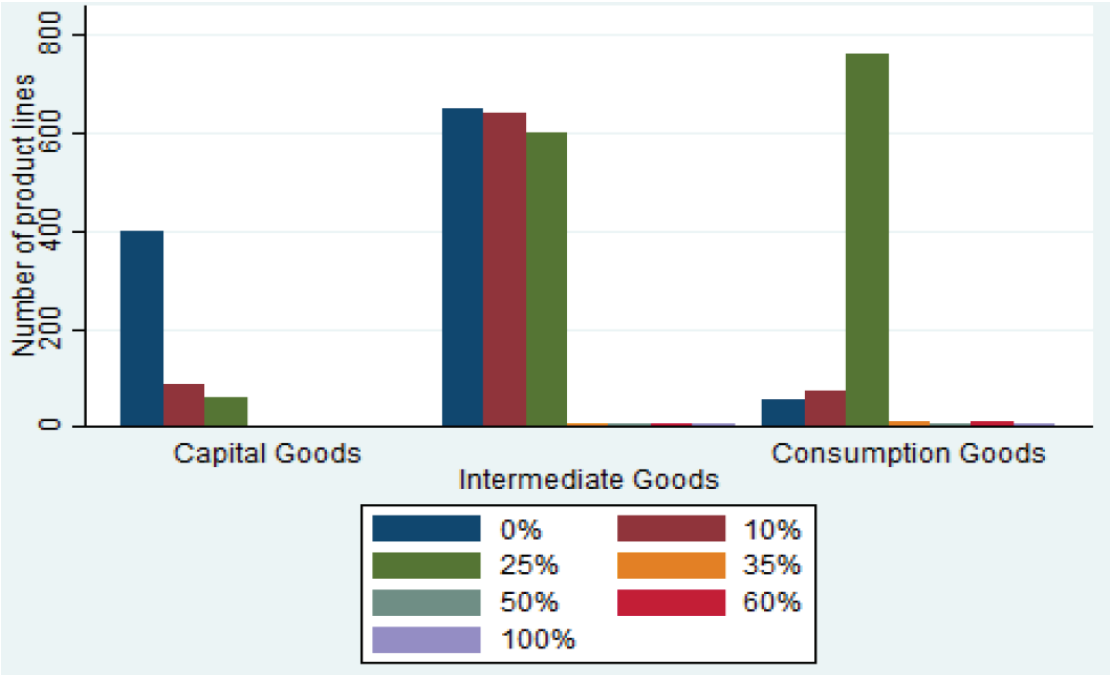
Abstracting from the domestic and adopting a regional perspective, Uganda's rationale to agree to the introduction of an additional band imposing a tariff of 30 or 35 percent on selected finished goods is to promote regional consumption of its own products. The central risk with this strategy is that it provides an opportunity for other EAC members to equally employ the new peak rate to issue additional protection on their own strategic goods. Many of these (e.g., inputs into construction like steel) are used as inputs by Ugandan industries or are consumed directly by Ugandan consumers (e.g., footwear). As argued by Frazer and Rauschendorfer (2019), for every product for which it seems logical for Uganda to raise the rate of external protection, Uganda can expect that there is a similarly strategic product for each of the other EAC members. This means that for every final good that Uganda would like to accommodate in the new peak rate of the CET, Ugandan consumers and producers will have to suffer increased tariffs on three or four other products for which the country is not the leading supplier within the region, but one of the other four members.

Second, misclassification of goods is rife in the CET and negatively affects Ugandan firms. To recap, the three-band structure of the CET aims at taxing import in line with their degree of processing. Imports of raw materials should be subject to a tariff of 0 percent, intermediate inputs should be taxed at 10 percent and finished goods should be subject to the regular peak rate of 25 percent. Contrary to this rationale many products in the CET are found to be misclassified.

Frazer (2017) employs the *Broad Economic Classification* (BEC) developed by the *United Nations*. The BEC categorizes different goods into three categories in line with their usage according to international standards: Capital goods (e.g., machines), intermediate goods and consumption goods. Frazer then examines for each product imported to Uganda

in which of these three categories it falls into and what CET tariff rate it attracts. The result is shown in Figure 6.

Figure 6: Misclassifications are rife in the CET.

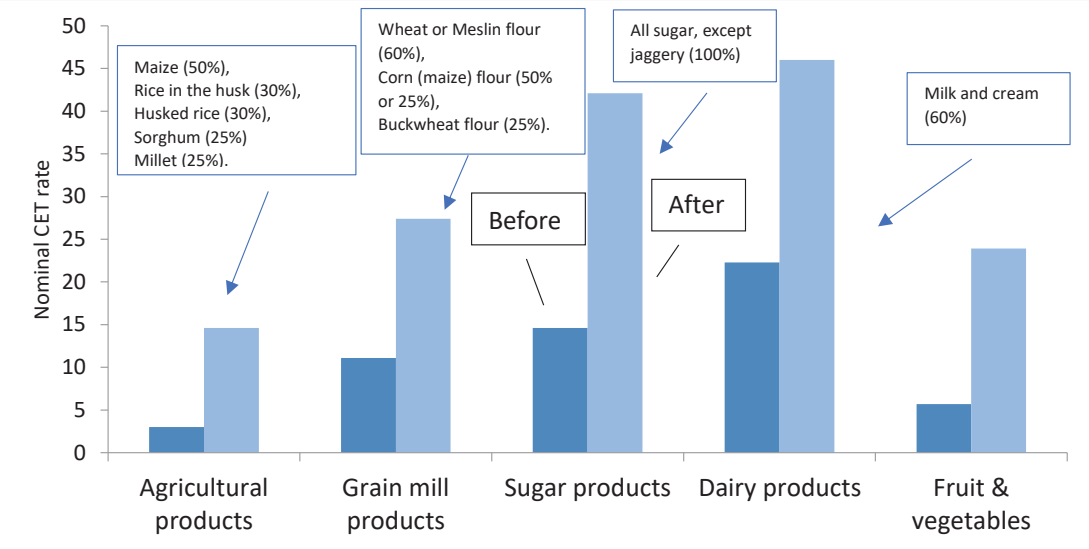


Source: Frazer (2017).

The exercise reveals that many of the goods that Uganda imports are not taxed in line with the rationale of the CET's three band structure. As apparent from Figure 6, capital goods as well as consumption goods are mostly taxed in line with the CET's rationale and most products attract 0 and 25 percent, respectively, despite there being minor deviations from this rule. However, when focusing on intermediate goods a large number of products are misclassified. In about equal shares products that should all attract the 10 percent tariff are taxed at either 0 percent, 10 percent or 25 percent. These misclassification issues are likely to have detrimental consequences for Ugandan manufacturing firms and consequently Ugandan growth altogether. Many Ugandan firms rely on importing intermediate inputs at competitive prices for their activities. While already bearing high transportation costs, additional misclassification of products into the peak tariff band of 25 percent further increases the cost of production in Uganda. In line with the previous paragraph this higher price of production also severely undermines the competitiveness of Ugandan products on the world market. **Third, the List of Sensitive Items works against Uganda's poor.** A final point relates to the role of the List of Sensitive Items and its impact on poor Ugandans. The List of

Sensitive Items of the CET consists of 66 products that are subject to excessive tariff rates of 35 percent or higher. Notably, these "sensitive items" make up a disproportionally large share in the consumption basket of poor Ugandans: They include food staples like maize (50 percent tariff), wheat flour (60 percent), rice (75 percent), sugar (100 percent) or products like milk and cream (60 percent). Figure 7 provides an illustration of tariff rates on sensitive items before and after the implementation of the CET, showing that tariffs on a number of socially relevant goods increased substantially following the agreement. While the rationale for high external protection is to provide protection for Ugandan industries, this strategy seems to have shown only limited success to date in terms of industry growth. The literature suggests that these tariffs also come at a definite social cost. Frazer (2012) estimates that due to the increased tariffs agricultural items the real income of a typical low-income household declined by about 3.8 percent. Artuc et al (2020) develop a dataset of 54 low-and middle-income countries and estimate that on average unilateral elimination of agricultural tariffs would boost household incomes by 2.5 percentage points.

Figure 7: CET rates on goods consumed disproportionally by the poor are high.

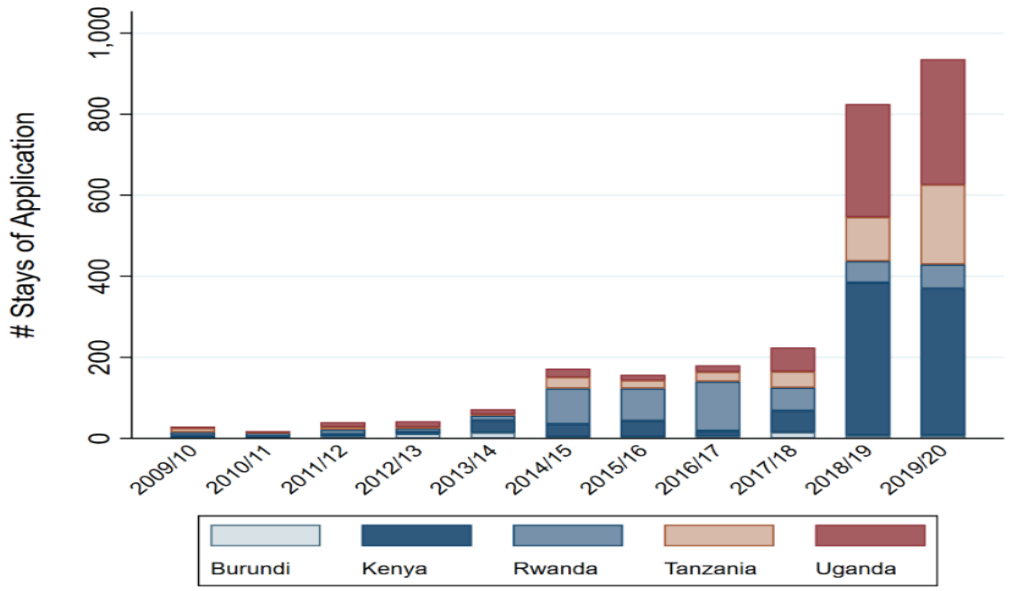


Notes: Taken from Frazer (2016). Some of the tariff rates for *Sensitive Items* have increased further, e.g., rice is now rated at 75% ad valorem.

The preceding discussion has concentrated on the question how to set tariffs against countries outside of the EAC through the CET. It is therefore important to highlight the importance of a successful CET review in ensuring continuous Ugandan market access to adjacent high-growth EAC members. With the review being ongoing since 2016, countries have increasingly made use of Stays of Applications, a mechanism that allows individual EAC members to deviate unilaterally from the CET for specific products and specified periods of time. Figure 8 tracks the number of product specific deviations

from the CET by country and fiscal year. For example, in fiscal year 2017/18, Uganda implemented tariffs different from the CET regime for 59 products through the Stays of Application. These deviations have the potential to undermine intra-EAC trade. If for example, Uganda can import a product at a much lower rate than, say, Kenya this can result in Kenya blocking the same good for importation due to concerns that Ugandan traders import from third countries and exploit the price differential. Issues like these are partly behind the tensions discussed in the next section.

Figure 8: Increased use of Stays of Applications make the CET less common.



Notes: Taken from Rauschendorfer and Twum (2021). The figure shows the product specific deviations by EAC members per fiscal year (Stays of Application).

In sum, IGC research suggests that Uganda should renegotiate the EAC-CET with a focus on solving misclassification issues, abolishing the List of Sensitive Items, and avoiding increases in external protection, at least not without sunset clauses. Going forward Uganda should also adopt similar principles for the negotiation and implementation of future agreements.

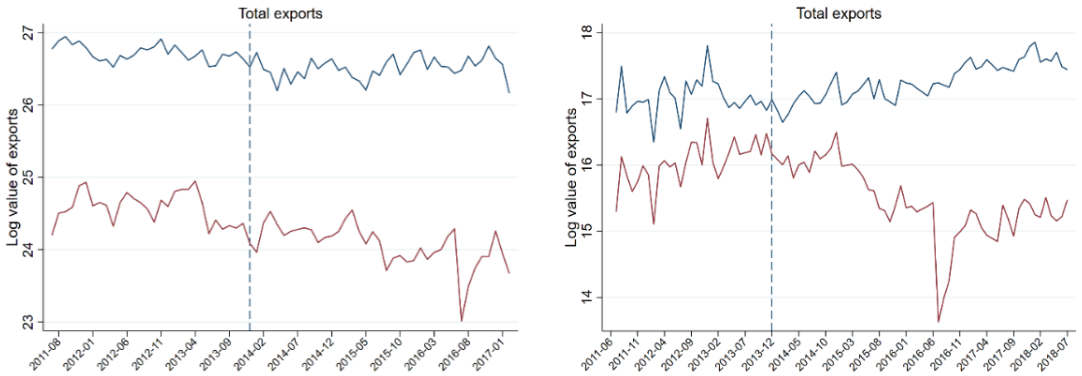
Regional tensions undermine Uganda's trade with the EAC

The review of the CET is an issue that needs to be resolved with urgency. However, while at least for now, the incomplete review of the CET has not impeded Uganda's trade performance visibly, other issues that are mostly political in nature have prevented Ugandan firms from fully harnessing EAC market access. Regional tensions have intensified the prevalence of Non-Tariff Barriers that undermine Uganda's regional export success. The following are three examples.

Dairy feud with Kenya. In January 2020, Kenya denied entry of Ugandan milk products to its market thereby severely hurting the Ugandan dairy industry. At the heart of the dispute was the accusation that Ugandan producers had simply remanufactured imported milk powder from abroad, thereby violating the EAC rules of origin. Kenya imports ca. 90 percent of Ugandan milk exports in any year.

The impact of the South Sudanese civil war on Uganda's trade. South Sudan gained independence from Sudan in July 2011 and quickly became an important destination for Ugandan exporters. While in 2018, Uganda again exported about 7 percent of its total export volume to the country, the country's "third" civil war which broke out in December 2013, severely impeded on Uganda's trade. Estimates provided in Rauschendorfer and ss (2021) suggest that the civil war reduced overall Ugandan exports by about two percent, mostly driven by lower exports of industrial products. Informal exports to South Sudan, an important source of income for poor Ugandans were reduced by a staggering 80 percent (*cf.* figure 9).

Figure 9: The South Sudanese civil war reduced Uganda's formal (left) and informal exports.



Notes: Taken from Rauschendorfer and Shepherd (2021). Blue lines show exports through borders unaffected by the South Sudanese civil war, while red lines show Uganda's formal and informal exports through the borders of Oraba and Busi, Uganda's major borders with South Sudan.

The closing of the Katuna border with Rwanda. Diplomatic feuds between Uganda and Rwanda reached a peak in March 2019, when Rwanda closed the country's main border with Uganda, Katuna. While a thorough evaluation of the effects of this border closing on Uganda's trade performance is missing, effects are likely to be detrimental due to Rwanda's importance as an export market. In 2018 the country absorbed about 5 percent of Uganda's exports, including high-value products like soaps, vegetable oils, iron products or paper (Atlas of Economic Complexity 2020).

These and other regional tensions undermine the potential of Uganda harnessing EAC market access for higher trade and economic growth. There is therefore need for the highest political leadership to address these issues.

4. **Beyond the EAC: Uganda's access to global markets.**

Outstanding issues on EAC regional integration aside, it is important to note that Ugandan exporters enjoy tariff and quota free access to almost all important export destination and for almost all of their products. The following provides an overview, excluding trade with EAC members.

- Uganda exports duty free to the European Union under the *Everything But Arms Agreement* for Least Developed Countries. The EU absorbed about 15 percent of Uganda' exports in 2018, mostly horticultural products and fruits and vegetables like coffee, cut flowers, cocoa and soy beans, but also processed fish (cf. Atlas of Economic Complexity 2020).
- Exports from Uganda to the United States are free under the *African Growth and Opportunity Act* (AGOA). The USA accounted for about 1.4 percent of Ugandan exports in 2018, mostly coffee, vanilla and other agricultural produce (cf. Atlas of Economic Complexity 2020).
- Within Africa, Uganda is also a member of the *Common Market for Eastern and Southern Africa* (COMESA), which includes the DRC (absorbing 4.9 percent of Uganda's imports in 2018), Zambia, Madagascar, Mauritius and Malawi (together accounting for less than one percent of Uganda's exports). COMESA trade is subject to lower tariffs than the ones implemented on imports originating from other WTO members.
- Finally, Uganda now also exports a significant portion of its exports (coffee, processed fish, cocoa beans, vanilla) to markets in Asia, like India, China, Hong Kong, Malaysia, Turkey, Indonesia, or Pakistan. Altogether, destinations in Asia (excluding the UAE) absorbed about 8.15 percent of Ugandan imports in 2018. While some of these countries (e.g., China and India) have unilateral preferential agreements for Least Developed Countries in place, little is known about their utilization so far.

While this exposition seems to suggest that for some countries (e.g., COMESA members) Ugandan products still face tariffs, a 2016 review by the International Trade Centre explored whether goods that Uganda actually exports are subject to tariffs in their destination markets. Except for a small number of non-agricultural products exported to the UAE, none of the products Uganda actually exports faced tariffs in their destination markets (cf. ITC 2016: 4-5).

Beyond these current agreements that Ugandan traders can take advantage of, the African Continental Free Trade Area (AfCFTA) will further increase market access for Ugandan

exporters on the continent and has a significant potential to boost Ugandan exports. However, the new agreement also bears challenges for Ugandan firms. First, while Ugandan exporters currently enjoy preferential access to an EAC market that is protected by sizeable external tariffs (e.g., 60% for dairy products or maize), these tariffs are going to be phased out as AfCFTA implementation proceeds. This implies that Ugandan firms will have to prepare for increased competition in the region from countries like South Africa or Nigeria. Second, as EAC members move toward implementing the AfCFTA, it is important that tariff reductions take place at the level of the customs union, so as to ensure that the integrity of the CET is not further undermined. Finally, recent research by Ewards (2021) showcases that reduced tariffs by other African countries is not enough. In order to leverage emerging opportunities, it is critical that Uganda and Uganda's partners further decrease the cost of trading with each other.

5. What supply side constraints does Uganda have to solve to boost its trade?

Given this considerable market access, an important question is the following: Which factors that are subject to policy action hinder Ugandan companies from exploiting regional and global opportunities?

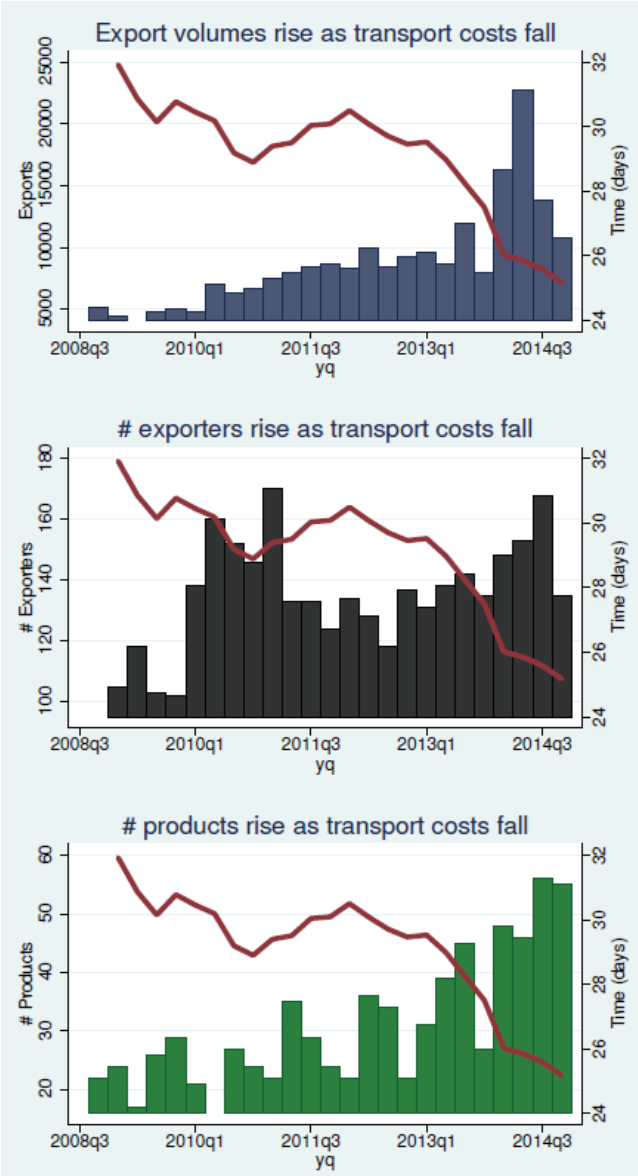
Part of the answer is that Uganda is characterized by a vast number of "supply side constraints" that hamper exports. Such constraints include the prevalence of high transport costs, limited access to electricity and water or cumbersome bureaucratic procedures for exporting and importing. Crucially, such obstacles (unlike securing market access through diplomatic dialogue with foreign countries) are to a large degree subject to policy choices by Ugandan institutions. They therefore provide relatively simple yet powerful levers to boost Uganda's trade performance. IGC research and discussions on Ugandan supply side constraints have largely concentrated on three areas: The role of transport costs in improving export performance, the potential of certification and standards in promoting exports as well as the prevalence of Non-Tariff Measures.

Reductions in transport costs boost export performance. A first candidate for constraints that hinder Ugandan firms from exploiting available market opportunities abroad are high transport costs. In Uganda's case these are especially constraining due to the country being land-linked and due to the long distance to crucial ports in Mombasa and Dar es Salaam.

It is insightful to illustrate the full extent of the role that transport costs play in facilitating Ugandan trade. Figure 9 employs data on Ugandan exports from 2009 to 2015 and maps various indicators of export success against the days it takes to export from Kampala through the northern corridor to the nearest port, Mombasa. The top panel of the figure shows that reductions in the time to export are accompanied by increases in export volumes. More interesting relationships are found in the middle and the bottom graph of the figure. In addition to higher export volumes, reductions in transport costs are equally

associated with a greater variety of goods exported and with the number of individual companies that engage in exporting (Spray 2017: 8). In sum, reductions in transport costs are a strong driver export performance along several dimensions of interest to policy makers.

Figure 9: Transport costs matter for exporting.



Source: Spray (2017: 9). Time to export is a weighted average of data obtained from the Northern Corridor Transport Observatory as well as the World Bank's *Trading Across Borders Index*.

Against the background of these findings, it is important to note that Uganda has made great progress in reducing the time to export and import over the last years through targeted trade facilitation measures. For example, over the past five years, the government has worked with other EAC members to implement One Stop Border Posts (OSPBs) at the country's most important borders, with the latest one going into operation at the Nimule border with South Sudan. OSBPs have the potential to significantly reduce the cost and time to cross a border by allowing traders to only engage with the customs officers on one side of the border. For example, the OSBP introduced at the Busia border with Kenya reduced the time to cross from Uganda to Kenya across this border by about 80 percent (TMEA 2017).

However, there is still ample room for improvement, for example according to the World Bank's *Trading Across Borders Index*, which captures the time and costs (excluding tariffs) associated with exporting and importing goods. In 2018 Uganda ranked 121 out of 213 economies included in the index. To export a standardized shipment of 15 metric tons it currently takes about 161 hours to comply with document requirements in-country and processes directly at the border before a shipment can leave the country and be on its way to a port in Mombasa or Dar es Salaam. The costs associated with these procedures are an estimated 310 USD (World Bank 2020). Needless to say, additional time and cost of trading incur to traders as a result of poor roads and blockages domestically and the long distances to ports in neighbouring countries.

The recommendations coming out of studying the role of transport costs in explaining Uganda's success as an exporter are as follows: Uganda should further work on reducing transport cost through partaking in regional initiatives aimed at reducing trade costs (such as the *Northern Corridor Transit and Transport Coordination Authority*) and should continue to pursue trade facilitation measures like the implementation of *One Stop Border Posts*, improved road surfaces or the removal of multiple police check points on key roads.

Certification and adherence to international standards matter for Uganda's export success. Product quality matters for export success along many dimensions. Certification refers to companies subscribing to mandatory or voluntary good norms through independent assessments of their products. Certifications are conducted by independent third parties and in line with internationally set standards. The process allows companies to publicly showcase the quality of their products along different dimensions and to distinguish themselves from the competition. Certified standards can relate to quality, social, health or environmental issues and are often incorporated into a country's legal framework (Pruthi, 2017).

On the country level, product certification in line with international standards guarantees and signals product quality and competitiveness to international customers. It also standardises goods: Every firm showcases the same quality, thereby allowing for competition to largely work through the price mechanism, which is visible compared to product characteristics

that may often be hidden during purchase. Crucially, in a country like Uganda where many successful export products are agro-based, certification of products eliminates possible health hazards and signals that products are safe for human consumption in line with the strict standards enforced in high-value northern markets. The current partial ban on Ugandan exports to the *European Union* due to the *false cuddling moth* disease illustrates the importance of adhering to such standards. Finally, enforcement of country-wide product certification also increases the confidence of international buyers in a country's products and helps to build long-lasting customer relationships (Pruthi, 2017).

In line with the importance of certification and standards, a clear recommendation coming out of presentations and discussions on this topic at previous Economic Growth Forums is that the government should assign adequate funding to certification services (e.g., through investment in test laboratories). In 2016 only two out of a total of five testing laboratories nationally were internationally accredited (ITC 2018: 38). The government should also consider subsidising product certification. Additionally, Ugandan companies need to be better informed about the importance of certification and existing possibilities to get their products tested.

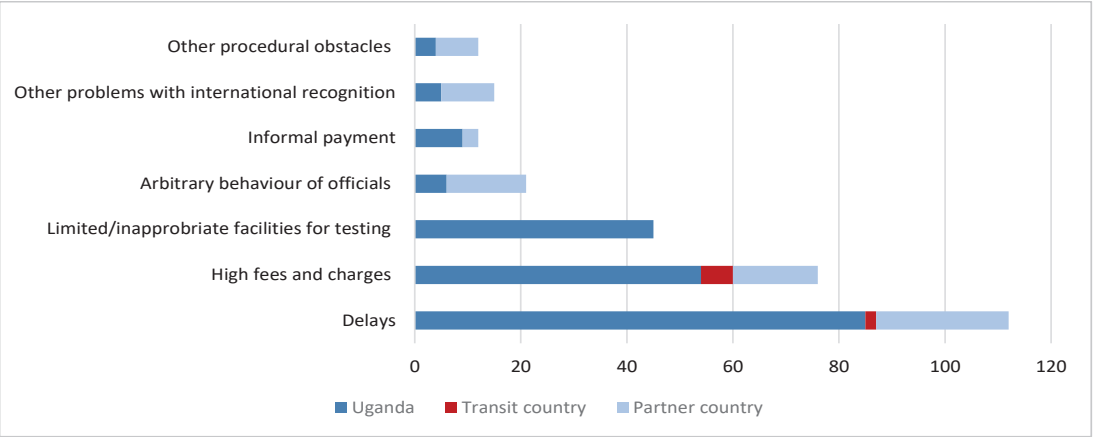
Non-Tariff Measures are rife in Uganda (and in the EAC) and hamper export growth. A final supply side constraint discussed in this paper concerns the considerable volume of Non-Tariff Measures (or "barriers") that hinder Ugandan firms from exploiting market access. Non-Tariff Barriers include both domestic obstacles to trading (e.g., cumbersome bureaucratic procedures) as well as barriers imposed by trading partners (e.g., fees for road usage, outright import bans or rejection of shipments or discrimination in bidding for public procurement).

Regionally, Non-Tariff Barriers imposed by major trading partners like Kenya, Tanzania and Rwanda have the potential to severely undermine the EAC's regional integration project and hamper Uganda's exports to the region. To illustrate, as of 2019, the *Mechanism for Reporting, Monitoring & Eliminating Non-Tariff Barriers* established under the goal of COMESA, the EAC and SADC to create the Tripartite Free Trade Area listed a total of 659 cases of NTBs between the participating countries. In the database, Ugandan traders registered complaints relating to the denial of entry for products into Tanzania, high charges for road usage in Tanzania that only applied to Ugandan trucks or Kenya restricting a Ugandan company to partake in the bidding process for the supply of electric cables thereby violating the EAC's common market protocol.

Domestically, Ugandan traders experience significant procedural obstacles to trading as one key category of Non-Tariff Measures. Figure 10 reports procedural obstacles by type and where they occur as reported by 162 Ugandan exporters during a survey conducted in 2016. In total, these companies report that over the course of the year 2016, they experienced 294 cases of procedural obstacles affecting their trading activities. Crucially, the vast majority of these obstacles (ca. 70 percent) was caused by Ugandan institutions,

demonstrating the potential for improving export performance through cutting "red tape" and through improved administration and government services. To illustrate the severity of existing barriers to exporting, consider a Ugandan exporter of live animals who reports that "*[t]he Ministry of Agriculture, Animal Industries and Fisheries in Uganda requires any export of farm products to obtain a phytosanitary certificate. This certificate is only issued at the ministry in Entebbe. To export cows, they have to be transported to Entebbe to be physically inspected – this is very expensive"* (ITC, 2018: 31).

Figure 10: Most procedural obstacles affecting Ugandan exporters are homemade.



Source: Adapted from ITC (2018: 22).

As indicated by the large number of reported procedural obstacles for the *Uganda National Bureau of Standards* and the *Ministry of Agriculture, Animal Industry and Fisheries* (ITC 2018: 23) such obstacles largely concern agro-based products. This is a remarkable finding as agriculture is both the backbone of Uganda's high-value exports to the region and beyond as well as the focus of the government's recent agro-industrialization push.

While arguably Non-Tariff Barriers are harder to solve when imposed by trading partners, removing burdensome procedural obstacles and other Non-Tariff Measures domestically has the potential to greatly boost Uganda's trade performance. This could be achieved through better government services, fighting informal payments or by reducing and simplifying the number of administrative steps required for trading (e.g., through the adoption of online systems for document submission).

In closing it seems important to reiterate that the issue of securing market access for domestic firms is largely a diplomatic effort. As such Uganda's participation and adequate fulfilment of its role in the dialogue with other countries is a necessary but not sufficient condition for regional and global market access. Solving supply side constraints, however, is at large subject to the country's own independent policy choices. Tackling these issues through decisive action will help Ugandan exporters to reach more markets,

export a greater variety of goods and increase exporter survival rates (Brenton, 2018). Vice versa, without tackling these issues Uganda will not succeed in fully exploiting available regional and global opportunities.

6. Concluding remarks and policy recommendations

This article explores how Uganda can harness trade and regional integration for growth. On the basis of research presented at the Economic Growth Forums 2017, 2018 and 2019, the paper proceeds in three steps. First, the article provides a brief overview of Uganda's trade performance. Second, the paper explores the role of the EAC and other arrangements in Uganda's trade and discusses contemporary issues. Third, the article reviews supply side constraints that Uganda would have to solve in order to fully reap existing opportunities. In line with the focus of the Economic Growth Forums to identify policy solutions to growth constraints, this chapter closes with a list of policy recommendations. These are related to the topic areas covered in this article and reflect the consensus of various stakeholders at past Economic Growth Forums.

1. Finalize the review of the EAC Common External Tariff, with a focus on a.) resolving misclassification issues, b.) collapsing the list of Sensitive Items into the peak tariff band and, c.) ensuring that the economic implications of tariff changes are fully considered in Uganda's negotiation position, including their effects on industrial competitiveness and consumer welfare.

2. Reduce the cost of trading in Uganda through resolving Non-Tariff Barriers (NTBs) domestically (eliminate burdensome procedures and improve government services) and regionally (strengthen the dialogue with other EAC members through the EAC secretariat). Begin with a review of identifying the most important obstacles to trading that Uganda could resolve domestically.

3. Revise and work towards the implementation of the National Export Development Strategy, by conducting a review of progress on each component and developing an implementation schedule of revised actions.

4. Expand Uganda's export base by sensitizing companies on export procedures, standards, certifications, and regulations as well as opportunities to access finance through publications or workshops.
6. Conduct a joint, comparative review of the National Export Development Strategy and the Buy Uganda Build Uganda strategy to ensure that the two guiding documents on import substitution and export promotion are mutually consistent and contain monitorable benchmarks of action.

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CHAPTER 10:

Import substitution and export promotion for sustainable economic growth

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1. Introduction: Import substitution and economic development in Uganda

In Uganda, imported goods are often blamed for reducing the domestic market share captured by domestic firms in turn resulting in a reduction of employment opportunities for the country's citizens. The inflow of foreign goods is therefore subject to considerable consternation and concern, paving the way for government interventions aimed at replacing imported products with domestically produced goods. In Uganda, and the East Africa Community (EAC) more generally, prominent proposals in this regard include discrete policies like higher tariffs in the *Common External Tariff* of the EAC customs union or programmes like *Buy Uganda Build Uganda* with a focus on mandatory domestic procurement. Most recently, the Ugandan parliament passed the *National Local Content Bill 2019* giving preference to Ugandan companies in public procurement. This legislature was only rejected at the very final stage of the approval process by H.E., the President himself on the grounds that the bill contradicted the laws of the EAC customs union.

Over the course of 2020, the COVID-19 pandemic severely disrupted global supply chains and curtailed imports. In response to these developments, the Government of Uganda tried to seize the opportunity and encouraged the private sector to identify sectors where imported goods could be replaced with domestic products. As a result, for example the local manufacturing capacity for sanitizers and pharmaceutical products was ramped up to meet growing domestic and regional demand for these products.

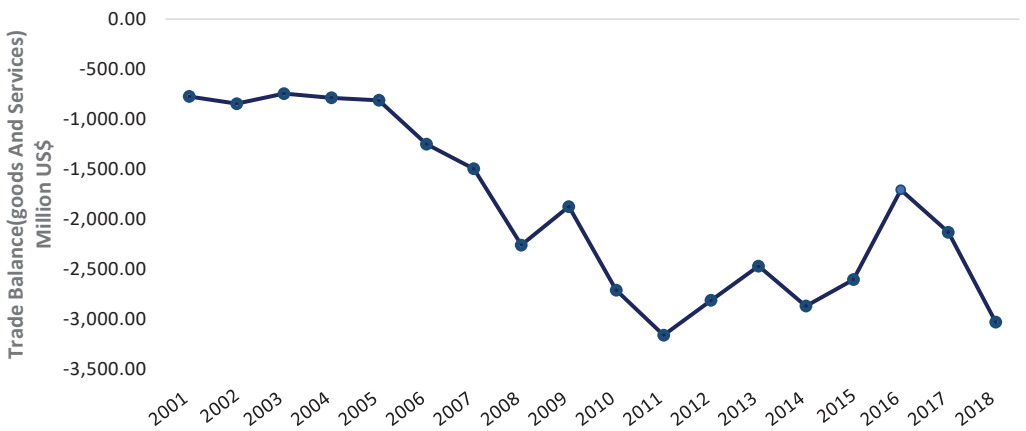
While this push to secure part of the domestic market for local firms is understandable, it is important to note that even in the face of a global pandemic, complex intermediate inputs simply cannot be produced locally. For a developing country like Uganda, it is therefore critical to ensure that import substitution policies do not undermine the development of globally competitive firms by cutting of the supply of high-quality inputs or curtailing competition in final goods markets, a key driver of innovation and growth. Additionally, it is vital for such "inward looking policies" to be combined with outward looking ones that promote exports and support firms in overcoming the small size of the domestic market. In short, a country like Uganda should pursue a parallel strategy of import substitution and export promotion. This chapter is concerned with the debate around import substitution and export promotion in Uganda and considers the following questions.

- What is the role of the "trade deficit" – a variable often considered to be a suitable indicator for an economy's health – in Uganda's development?
- Which imported products could Uganda target for substitution with locally produced goods?
- What is "good" import substitution policy and how does it compare to Uganda's current set of strategies and actions?

2. The trade deficit: What is its role in Uganda's development?

Uganda operates a current account deficit: the value of imported goods and services is greater than the value of exports. For example, in 2017 the country spent USD 7,697 million on imports compared to its earnings of USD 5,057 million from exports. A concern with operating a current account deficit is that it puts pressure on the local currency which in Uganda led to the depreciation of the shilling. A trade deficit also means that the country may forego benefits of employment by importing goods that could be produced domestically. Over the last five years, Uganda's significant trade deficit has primarily been with Asia and the Middle East. On the other hand, within the East African region and the rest of Africa, Uganda has registered trade surpluses while achieving only marginal trade deficits with Europe. Figure 1 illustrates the evolution of Uganda's trade balance since 2001.

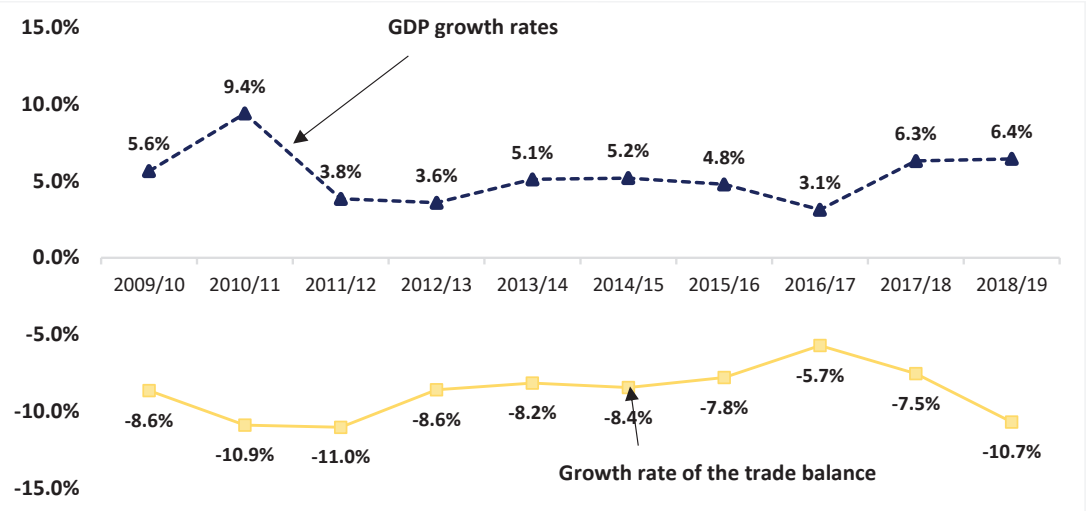
Figure 1: Uganda's trade balance (goods and services) in USD million, 2001 - 2018.



Source: Bank of Uganda (2019).

How is Uganda's trade deficit related to the country's economic growth performance? Figure 2 shows that the movement in GDP growth rates has not always been analogous to the (negative) growth of the trade deficit. In particular, between the fiscal years 2009/10 to 2010/11 GDP growth was on an upward trend while the deficit growth rates were increasing. This was also the case for the period between 2016/17 to 2018/19.

Figure 2: Movements in GDP growth and changes in the trade balance are not analogous.



Source: Uganda Bureau of Statistics (2019) and Bank of Uganda (2019).

Figure 3 rationalizes this relationship by showing that Uganda's import basket includes a large number of products that are essential for the productive capacity of the economy. As evident from this illustration, the majority of imported products are inputs for productive activities like manufacturing, construction or agriculture (e.g., machinery, fuel or vehicles). Figure 4 additionally demonstrates that these imported inputs directly fuel the country's most productive firms: Ugandan exporters, which have higher productivity and employ more workers than non-exporting firms (*cf.* Spray 2017), account for a large volume of the country's imports in any given year. In sum, imports matter for Uganda's growth as well as its export performance.

Figure 3: Uganda's imports are dominated by intermediate inputs and capital goods…

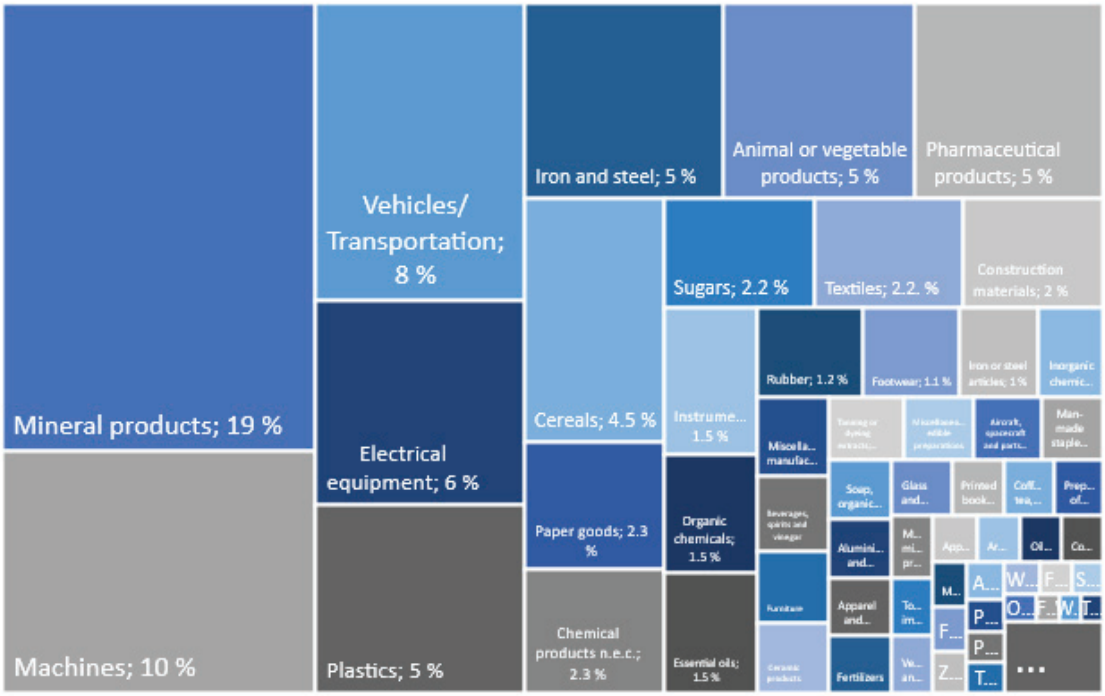
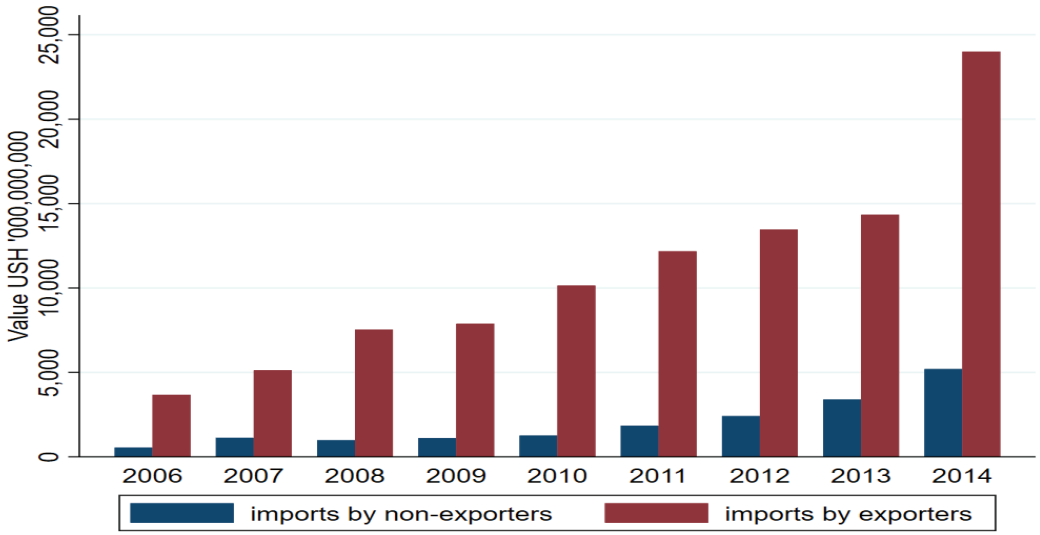


Figure 4: … that are mostly imported by exporters.



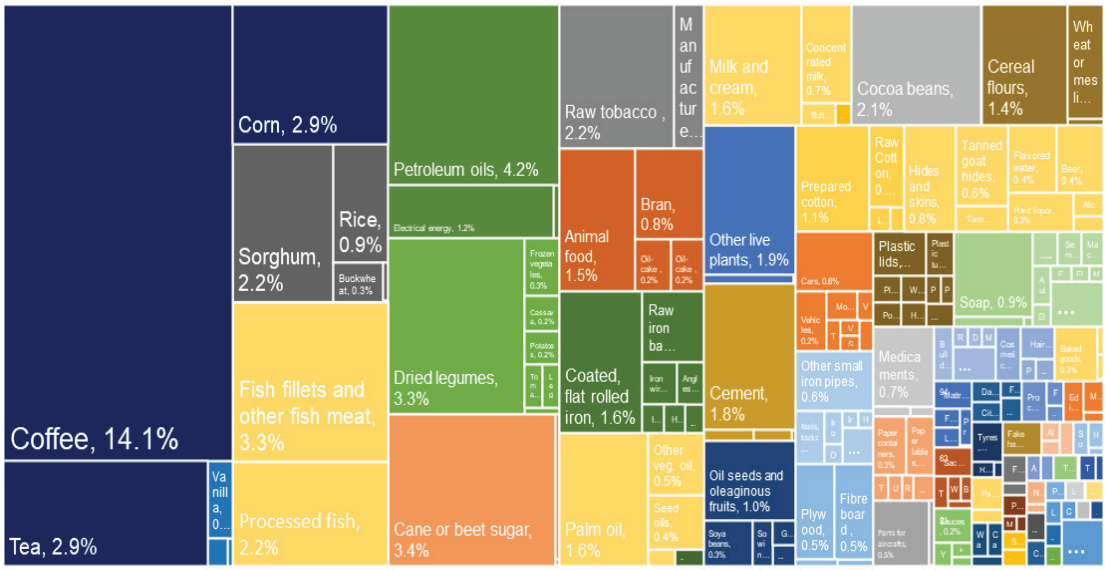
Notes: Figure 3 is constructed from UNComtrade data for 2017. Total import volume: 5.59 billion USD. Figure 4 is taken from Frazer and Rauschendorfer (2019).

Considering the findings presented above, the trade deficit may not necessarily be a good indicator of an economy's health: In Uganda, periods of a worsening trade deficit were accompanied with higher economic growth, likely due to the importation of inputs crucial for local production.

Generally, trade deficits can be detrimental when they are financed by large and eventually unsustainable debt inflows (e.g., Mexico in the early 1970s; Argentina in the late 1970s). The same applies when foreign inflows involve short-term money flows (e.g., Chile in the 1970s; Thailand in the mid-1990s); or when governments sell their foreign reserves over some period to maintain an overvalued exchange rate. Conversely, trade deficits can be beneficial for long term growth when foreign direct investment comprises of a large share of the inflows (e.g., Korea in the 1960s; Chile in the late 1990s); when development partners provide grant financing or access to concessional finance; and when the investment that these foreign savings finance increases in the productivity of the economy (IGC 2019). Trade policy should therefore ultimately concentrate on increasing the export growth rate rather than focusing on the trade deficit as a target variable.

In this regard, it should briefly be noted here that Uganda's exports have been growing over the past years and that the export basket has become more diversified. The latter point is illustrated in Figure 5 highlighting major goods exports, which now also include higher value-added products like soaps, processed fish, vegetable oils and steel products.

Figure 5: Uganda's export basket is becoming more diversified (2018 data).



Source: UNComtrade (2020). Total formal exports in 2018: 3.09 billion USD. Illustration excludes gold exports.

3. What imports could Uganda target for substitution with locally produced goods?

The central rationale behind import substitution policies is that the importation of goods should be discouraged so as to stimulate domestic production through higher local consumption. However, sound import substitution policy needs strategic arguments for the protection of industries: if the "right" industries are protected they should continue to thrive even as protection is gradually removed.

Hausmann et al (2014) develop a methodology that allows to determine potential new products and industries adjacent to the existing sectors of an economy that could feasibly be developed. The industries or goods that could be suitable for import substitution in Uganda's case can be adopted from this kind of analysis. The methodology Hausmann et al (2014) develop considers the complexity of existing products of a country and the sophistication of the technology required to produce new products compared to the country's current efficiency frontier. They propose two strategies to identify new, and realistic, production opportunities: "parsimonious transformation" and "strategic bets" (see Table 1 below for their definitions). Their analysis yields that "food processing" and "construction materials and equipment" are industries that offer a sizable opportunity to Uganda while also being attainable from a technological perspective. The results of their analysis are presented in Table 1 below. Crucially, Uganda imports many these products in sizeable quantities (cf. for example Figure 3 in the preceding section).[33]

Table 1: Imports that could be substituted with locally produced goods.

Strategy	
Parsimonious transformation	***Strategic bets***
This strategy emphasizes industries that are in the vicinity of a country's current set of capabilities but have higher sophistication, thus making the development of the new products faster and less risky. This strategy should emphasize labour-intensive industries.	*This strategy emphasizes sectors that are more sophisticated and provide a larger strategic value, even if they lie at a significantly greater distance compared to Uganda's current technology frontier. These industries are important for driving economic growth and foster diversification.*

33 A question worthwhile of consideration is whether Covid-19 affected which products could be suitable for import substitution, for example due to changing demand patterns or because rising transport costs affected the price of imports from some trading partners more than others.

Industry	
Food processing	***Construction and industrial materials***
Products/goods	
Margarine etc.	Printed matter
Confectionery, non-chocolate	Varnishes and lacquers; distempers etc.
Jams, jellies, marmalades, etc.	Miscellaneous articles of base metal
Edible products and preparations, nes	Paper and paperboard cut to size or shape, nes
Fruit, temporarily preserved	Wadding, wicks and textiles fabrics for machine use
Other materials of vegetable origin, nes	Aluminium and alloys, worked
Tobacco, manufactured	Structures and parts of, of aluminium;
Bakery products	Wood packing cases, boxes, cases, crates, etc.
Plastic packing containers and closures	Metal casks or drums for packing goods
Fixed vegetable oils, nes	Trailers and transports containers
Cigarettes	Articles of paper pulp, paper, paperboard, nes
Packing containers of paper	Polyvinyl chloride
Beer made from malt	Polyethylene
Bottles etc. of glass	Structures and parts of, of iron, steel
Flour and meals of fruit and vegetables	Builders` carpentry and joinery
Vegetables, frozen or in preservative	Printed books, pamphlets, maps, and globes
Non-alcoholic beverages, nes	Gauze, cloth, grill, netting, reinforced fabric, etc.
Insecticides	Plastic packing containers and lids
Fertilizers, nes	Fiber building board of wood or vegetable material
Propellant powders and other explosives	Paper and paperboard, creped, crinkled, etc.
	Other sheet and plates, of iron or steel, worked
	Polypropylene
	Packing containers, box files, etc., of paper
	Construction materials of cement

Source: Taken from Hausman et al (2014: 21 – 23).

4. What is good import substitution policy?

Having established that imports matter for productive firms and after proposing a set of goods that could be targeted for import substitution in Uganda, this section reviews the experiences of other countries with import substitution policy. The goal of this review is to identify suitable measures and policy instruments that Uganda could adopt to substitute imports with domestically produced goods. Crucially, many of the import substitution tools available to policy makers have the potential to undermine the development of strong and competitive domestic industries that can compete on the world market by cutting off access to crucial inputs and by undermining competition in final goods markets (Rauschendorfer and Twum 2019). The notion that imports matter for economic growth and firm productivity as much as exports is the key to designing pro-competitive import substitution policy.

Historically, many developing countries in Latin America, Asia and Africa adopted import substitution policies especially in the 50s, 60s and 70s in an attempt to fix their trade imbalances, attain self-reliance and foster economic growth. These countries used a wide range of government tools to recapture domestic markets through import substitution policies. However, not all these tools proved to be ideal for promoting the development of strong and competitive industries that could ultimately survive in global markets. To foster economic growth, import substitution policies must i) be targeted towards addressing market failures, ii) take into account sector-specific characteristics and, most importantly, iii) ensure that selected interventions do not undermine competition, a crucial driver of productivity, innovation and economic growth.

Where import substitution policies are implemented on a broad basis and without taking into consideration product and sector specific characteristic, they may protect and foster inefficient industries or be detrimental to export-led growth by affecting exporters who use protected goods in their production. In theory, trade barriers protecting industries singled out for increased protection should be lowered gradually as the industries become more and more competitive. However, in reality such barriers are rarely removed and if anything, tend to grow over time due to intense lobbying of firms that benefit from protection.

Based on the experiences of East Asia, Latin America and Sub-Saharan Africa, the following provides an overview of import substation instruments, divided broadly into those that foster competition and encourage market entry and those that undermine competition and entry.[34]

34 This overview is taken from Rauschendorfer and Twum (2019).

Import substitution policy that fosters competition

1. Industrial and trade financing through development banks and funds. One of the biggest challenges of developing an industry is access to credit at friendly rates. Long-term industrial and trade financing provides firms with much needed capital to set up and scale production chains. The importance of strong financing models is seen in the success of the horticulture and cement industries in Ethiopia where the government injected large amounts of capital by leveraging financing programs through the Development Bank of Ethiopia and the Commercial Bank of Ethiopia. In the case of cement, access to finance was crucial in setting up the local production of high quality and price competitive cement products for the construction industry.

2. Investment promotion. Facilitative investment programs can help develop domestic production capacity to cater to both the local and international markets. A strategic and effectively managed investment promotion is one where the government guides investors towards high-potential sectors while also focusing on creating an enabling environment for private-led financing of industry. Increasingly, governments have set up Investment Promotion Agencies tasked with attracting and retaining investors such as the Uganda Investment Authority in Uganda.

3. Supplier development programs. Connecting local suppliers with large exporters and multinational corporations can have the direct benefit of reducing the reliance of these firms on imported inputs while creating reliable, accessible, and cheaper domestic supply chains. By fostering backward firm linkages, domestic firms improve their quality and efficiency by upgrading their knowledge and technology to meet higher standards. One of the most successful supplier development programmes currently in operation is implemented in Chile. The government actively partakes in the financing and design of programmes aimed at improving the management and adherence to standards of Micro, Small and Medium Enterprises that supply large exporting firms.

4. Strategic state-owned enterprise investment. In some cases, the state has the capacity to de-risk strategic industries with high growth potential and in the process open them up to the private sector. In East Asia, government support was central to the formation of South Korea's plastic industry which created robust downward and upward linkages for the economy. More recently, the Government of Rwanda successfully supported its tourism industry through substantial public investments in its national airline and targeted support for the hotel industry.

Import substitution policy that undermines competition

1. **Import tariffs**. A recent global trend is that countries in both the developed and the developing world turn to increasing import tariff as a tool to reduce demand for foreign products and make domestic goods more appealing through the price differential between foreign and homemade goods. However, empirical evidence from Brazil, Chile, the USA,

Indonesia and India show that high tariffs can severely hamper long-term economic growth whereas low tariffs can foster firm productivity and growth through at least two important mechanisms: i) low tariffs on final goods increase competition in final goods markets, forcing domestic firms to innovate, upgrade the quality of their products and realize productivity gains that are crucial to creating internationally competitive products. ii) tariffs on intermediate inputs (with the intention of incentivizing upstream firms to source their inputs domestically) carry the risk of rendering domestically produced final goods less competitive due to higher production costs and lower final product quality.

2. Subsidies. Similar to tariffs, which render foreign products more expensive relative to their local alternatives, broad and unconditional subsidies to domestic production can make domestic goods comparatively cheaper and thereby more affordable to consumers. Consequently, the same reasons suggesting that tariffs are an inappropriate instrument to achieve the goals of import substitution policy apply to subsidies. Through easing the pressure from international competition, subsidies effectively prevent local industries from innovating and realizing productivity gains that would position them to compete in international markets. A notable exception are subsidies targeted specifically at increasing firm Research & Development expenditures which have the potential to foster innovation.

3. Local content requirements (for private firms and government entities). Local content requirements come in different forms, all of which have the intention of diverting demand for targeted products and services away from foreign supplies to domestic suppliers. Among the most prominent tools for such policy are i) prescribed mandatory shares of domestic goods and services purchases by firms and government entities, ii) restriction of licensing procedures to favour domestic firms, iii) bidding preference for domestic firms or tax exemptions conditional on local procurement. The main risks associated with such policies are the following. First, domestic firms face lower incentives to innovate and become more productive due to already having demand "secured" for part of their output. Secondly, the quality of final products (in the case of firms) and government services may be lower compared to when private firms and government are able to freely source the best inputs from the international market.

4. Discretionary and selective tax incentives (tax holidays, duty remission schemes, preferential corporate income tax rates etc.) Selective tax incentives, which are granted on a case-by-case basis have the potential to favour some firms over others in the same sector, thereby undermining within-sector competition and entry, and, in the long run, sector- and economy-wide productivity and growth. Arguably, the companies granted access to a form of selective tax incentives are also subject to political influence. For example, in Uganda duty remission on the importation of radio batteries was used by a politically well-connected firm to force out competing enterprises active in the distribution of the same product.

Complementing this elaboration, Table 2 additionally provides an overview of study findings on different import substitution tools in developing countries. In summary, the adoption of anti-competitive, inward looking import substitution policies alone often led to a number of negative outcomes in the countries that implemented them, such as a decline in competitiveness due to protectionism, stunted stages of industrialization or, perhaps especially relevant in the case of Uganda in light of recent trade feuds in the East African Community, the retaliation of trading partners.

Interestingly, some countries such as South Korea, Singapore and Taiwan successfully supplemented inward-looking import substitution policies that often tended to curb competition with outward looking policies. These countries initially focused on import substitution, but unlike the Latin American countries, they also adopted export promotion strategies in the 1960s and 70s (Oman and Wignaraja 1991). Under this model, the industries of these countries remained protected and subsidized but their governments strictly adhered to credible time limits and required protected industries to meet set export targets. This seems to suggest that a policy mix of import substitution and export promotion is critical to attain sustainable long run benefits, while pure import substitution policies may have benefits in the short run, they may not lead to long-run sustainable economic growth (Abhyankar and Dharmadhikari 2011).

Table 2: A review of the empirical literature on import substitution policy.

Publication	Country	IS tools utilized by the government	Findings
Balassa (1982)	Argentina	- Tariffs - Advance deposits on imports - Tax incentives and credit incentives for Exporters	- System favoured production for domestic market and discouraged exports - Led to a vicious cycle of growth and stagnation
	Colombia	- Import licenses - Official Customs Valuation - Advance deposits on imports - Export financing/Tax incentives	- Subdued growth in industry sector exports -Muted economic growth
	Israel	- Quantitative import restrictions - Import duties (tariffs) - Export subsidies, investment grants etc.	-Increased outward orientation after short initial period of import substitution -Led to high economic growth

	South Korea	- Multiple exchange rate system to limit imports - High tariffs on imports - Quantitative import restrictions **1960s**: - Shift to export promotion - Relaxation of import controls - Export subsidies - Strong role of the state in monitoring export sector including setting annual export targets	- Resulted in efficient allocation of resources - Increased growth in exports which led to high economic growth rates overall
	Singapore	**Import substitution phase: 1965-67** - Tariffs - Import quotas **Export Promotion Phase 1967-69** - Tax exemptions on increase in exports - Reform of education curriculum to align skills with high technology industries - Provision of physical and social overhead facilities (e.g., industrial sites, technical training for employees)	- Even in the import substitution phase, levels of external were lower compared with other countries - Strategy led to high economic growth rates overall

	Taiwan	**Import substitution phase** - Multiple Exchange rate system to limit imports - Strict import controls through tariffs and advance deposits on imports **Export promotion phase** - Use of exchange rate policy to boost exports. - Reduction of import tariffs and abolition of exchange rate controls - Export promotion facilities including the duty-free export processing zone - Tax incentives for investment.	- Short import substitution phase - Achieved high economic growth rates which were to a considerable extent attributable to outward looking policies
Fajgel-baum et al (2019)	United States of America	- USA increased import tariffs in 2018 from 2.6% to 16.6% on 12,043 products (corresponding to 12.7% of annual imports).	- Trade partners imposed retaliatory tariffs affecting 8.2% of US annual exports. - Large decline in imports - Decline in exports. - Subsequent short run loss on aggregate real income (0.04% of GDP).

Source: Author's illustration based on the cited studies.

6. Import substitution and export promotion policy in Uganda

Against the background of tools and policies to foster import substitution and export promotion discussed in the preceding section, it is important to take stock of current Ugandan policies and initiatives in this area. The country has launched a number of different policies concerned with the objective to reduce imports and grow exporting, including the following:

The National Strategy for Private Sector Development, 2017/18 - 2021/22. The strategy envisages a competitive private sector that supports inclusive growth and sustainable economic development.

The National Industrial Policy, 2008. The policy largely focusses on value addition

and on increasing the proportion of manufactures in both exports and GDP.

The National Trade Policy, 2007. This policy was in part created to support productive sectors of the Ugandan economy for increased trade (both domestically and internationally).

The National Export Development Strategy, 2017/18 - 2021/22. The overriding objective of the national export development strategy is to increase the value of Uganda's exports to targeted markets.

The *Buy Uganda Build Uganda* (BUBU) policy. The BUBU policy is mostly concerned with encouraging the consumption of domestically produced goods. It is associated with the *National Local Content Bill 2019*, which proposes mandatory domestic procurement for government entities. After being passed by parliament, H.E. the president rejected the bill in the last instance on the grounds that it contradicts the laws of the EAC customs union.

The National Development Plan (NDP) III. The NDP III outlines the importance of "import replacement/promotion of local manufacturing" (NPA 2020b) as one key development strategy for the financial years 2020/21 to 2024/25. **The Import Substitution Action Plan (ISAP)** was developed to guide the implementation of this component of the NDP III.

Cognizant of the above policies, the Ugandan government undertook deliberate actions (mainly through the budget process) to foster import substitution and export promotion in Uganda. These actions include the following:

- Issuance of tax incentives to promote local investments and industrialization. Examples include tax holidays to individual companies, preferential access to imported factors of production through the Duty Remission Scheme or VAT exemptions for specific sectors (e.g., rice milling).

- Development of a number of industrial parks and free zones;

- Investments in public infrastructure (like roads, storage facilities and electricity). For example, in the budget for the 2019/20 fiscal year, UGX 147 billion was allocated for the electrification of industrial parks with an additional UGX 103 billion allocated to the development of supportive infrastructure in export processing zones and industrial parks;

- Support to domestic industries in the form of higher protection from foreign competition through tariff increases. For example, the Ugandan budget speech 2019/20 states that to "*promote investment and industrialization, import tariffs on products which are locally manufactured have been increased"* (Ministry of Finance, Planning and Economic Development 2019). Over the last number of years, Uganda increased tariffs on a number of products (*cf.* Rauschendorfer and Twum 2021).

- Access to finance schemes, specifically targeted at fostering import substitution and export promotion. For example, in 2020, the Uganda Development Bank issued a call for applications focussed on "Production, Import Replacement & Export Promotion", with the goal to support the "(…) production of essential goods and services for import replacement and export promotion" (Uganda Development Bank, 2020).

Crucially, and in line with the review of the global experience provided in this paper, not all of these measures are likely to support the formation of globally competitive industries in Uganda. For example, the issuance of tax incentives in a case-by-case fashion could undermine within sector competition and entry, while import tariffs do not only undermine competition in final goods markets, but also have the potential to hurt companies that use protected goods in their production processes.

7. Concluding remarks and policy recommendations

This paper argues that import substitution and export promotion are not mutually exclusive. Much rather, simultaneously implementing a pro-competitive import substitution and an effective export promotion strategy could be critical for the development of globally competitive firms in Uganda.

To ensure that economic policies do not undermine competition and entry, the Government of Uganda should consider the following guidelines, principles and concrete policy actions when designing strategies targeted at raising the competitiveness of Ugandan companies:

- Work towards the goal of increased usage of locally produced products by emphasizing pro-competitive import substitution policies that encourage entry instead of competition-restricting polices (such as tariff increases). Pro-competitive measures that encourage entry include (but are not limited to) supplier development programs, establishing a program to overcome search constraints among Ugandan firms, promoting electronic commerce as well as improve access to credit for targeted firms and sectors.

- Provide firms and investors with access to preferential treatment (like tax incentives) only in exchange for concrete performance targets, either in terms of export volumes to be achieved or in terms of local jobs created.

- Implement protectionist policies (e.g., import tariffs) only hand in hand with credible time limits and under full consideration of the economic and social costs of such measures.

- Prioritize commodities for interventions that have low import content (available domestic raw materials), and show strong backward and forward linkages for import substitution and later export promotion (for example milk, tiles, agro-processing, cement, pharmaceuticals).

- Conduct a joint, comparative review of the *National Export Development Strategy* and the *Buy Uganda Build Uganda* strategy to ensure that the two guiding documents on import substitution and export promotion are mutually consistent and contain monitorable benchmarks and targets of action.

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CHAPTER 11:

Agricultural transformation and Agro-industrialization in Uganda

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1. Introduction: Agriculture as a driver of transformation in Uganda

Agriculture is the backbone of Africa's economy. It is the primary source of livelihoods and accounts for roughly twenty-five percent of the continent's GDP for seventy percent of the population. In Uganda, the agriculture sector is the mainstay of the Ugandan economy, employing two-thirds of the labour force and accounting for approximately half of export earnings (Fowler and Rauschendorfer, 2019). With most of Uganda's population living in rural areas, agriculture is the main source of income and has potential to be the main pathway out of poverty for many Ugandans (MacCartee, 2018). The agriculture sector has already made a substantial contribution to poverty reduction accounting for nearly four fifths of the poverty reduction that Uganda has experienced over the past 20 years. For instance, from 2005 to 2013 the poverty count declined from fifty-three percent of the national population living in poverty to around twenty percent of the national population as assessed in a comprehensive World Bank review for the period (World Bank, 2018).

The agriculture sector's contribution to employment is important to Uganda. The most recent household survey shows that approximately seventy percent of the labour force derives some form of employment from the sector while forty-three percent of the labour forces are engaged in subsistence agriculture (UBoS, 2017). The living standards of those whose primary income source is from agriculture is closely linked to the performance of the largely rain-fed agriculture sector and corresponding environmental shocks. Hence, when agriculture commodity prices decline or rainfall is erratic, crop income growth falters and consumption falls, with further consequences for poverty reduction (World Bank, 2020). Despite the high contribution to employment, the agriculture sector contributes only a quarter of Uganda's total GDP. This points to low productivity and calls for strategies to stimulate productivity within the sector. Although in FY 2018/19, the sector contributed only 23.7 percent to the growth rate of 6.4 percent, both primary and processed agriculture-based products accounted for about forty-five percent of exports in FY 2018/19. At around 6 percent of total exports in FY 2018/19, fish and fish products were Uganda's fourth largest export, after coffee and industrial products (MoFPED, 2020). The sector's importance for livelihoods, poverty reduction and the broader economy is therefore extremely significant (World Bank, 2020).

Recognising the enormous potential of adding value to the country's sizeable agricultural output as a means of boosting inclusive growth and creating productive employment across the country, the government is aggressively promoting agro-industrialisation.[35] The upcoming

35 The literature on this agro-industrialization is replete with different names for what is being promoted: "agri SMEs", "agro SMEs", "agribusiness", "agro-processor", "agriculture-related business", "agro-manufacturing industries" and "agro-industries" are just some examples of terms used to describe the same group of enterprises. The term "agro-industries" (or "agro-industrial development") will be used in this paper to connote the transformation of agricultural raw materials into higher-value products,

National Development Plan III, Uganda's five-year plan for economic development, identifies, "natural resource-led industrialisation, especially agro-industrialisation" as one of its priority programs and the Agriculture Sector Strategic Plan (ASSP) 2015/16–2019/20 which proposes the introduction of a new Agriculture Extension Directorate. Policies include a National Coffee Policy (2013), which sets ambitious targets for increasing coffee output; a National Fertilizer Policy (2017); the National Agricultural Extension Policy (2016), and a draft National Seed Policy.

The rest of this chapter is arranged as follows. The next section gives a brief overview of the COVID-19 pandemic as it relates to Uganda's agriculture sector. Section two focuses on the question on how Uganda's agriculture sector can be transformed for sustained economic growth. Section three follows with a focus on agro- industrialisation and comparison of agricultural developments with the EAC and other countries. The last section focuses on policy recommendations for agricultural transformation to attain growth.

2. The Ugandan agriculture sector during the COVID-19 Crisis

The COVID-19 pandemic has taken a major toll on human life and brought major disruption to economic activity across the world. This slowdown of the global economy has already had a negative impact on Uganda's economy. Since the third quarter of FY2019/20 (January-March 2020), the economy has faced disruptions in economic activity arising from both the global and domestic impacts of the pandemic. For example, merchandise exports receipts in March 2020 amounted to US$ 315.5 million, which was a reduction by eleven percent from the value recorded in February 2020. Most of the major agricultural export commodities: cotton, flowers, maize, tea and simsim registered declines in March 2020 arising from reduction in their respective export volumes. The reduction in export volumes arose from trade disruptions caused by the pandemic (MoFPED, 2020).

The Ugandan government has continued to support agricultural activities during the COVID-19 lockdown period as farmers have been allowed to continue engaging in farming. Food markets have remained open to the public such that food is accessible to the people and in so doing farmers have been able to access the markets. Factories including agro-processors also remained open to produce output. Uganda Coffee Development Authority (UCDA) put in place skeleton staff to maintain certification of export during the lockdown period as a way of ensuring that coffee exporters have access to the market. All these efforts are in a bid to reduce the negative impact of Covid-19. Compared to other sectors, the agriculture sector has proved to be resilient in terms of performance with overall growth only falling from 5.3 percent in FY2018/19 to 4.2 percent in FY2019/20. The key subsectors of food crops and livestock actually recorded better performance

regardless of the complexity of the process.

compared to FY2018/19 which is a preliminary indication that the sector wasn't as badly affected as other sectors.

3. Transforming Uganda's agricultural sector for sustained economic growth

Agricultural productivity in Uganda is below its potential largely constrained by limited use of modern methods. Weather is increasingly volatile, yet few farmers use irrigation. Modern seed and fertilizer available on the market are of low quality and avoided by farmers. Public agricultural-support services can rectify these issues but are understaffed and underfunded. To unlock Uganda's agricultural potential, some of the areas the government should focus on include: i) improving delivery of agricultural-support services ii) facilitating farmers' access to price and weather information iii) promoting market-oriented production, by improving agricultural markets.

3.1 Economic context

To demonstrate that the sector has been growing slowly, we are going to look at GDP trends of other sectors in comparison to the agricultural sector. As seen in Figure 1, sectoral GDP trends in the service and industrial sectors experienced rapid growth from 2000-2015, each doubling in value, whereas agriculture grew at an annual rate of 2 percent. This growth rate was exceeded by the population growth rate (3.3 percent), raising the threat of food insecurity.

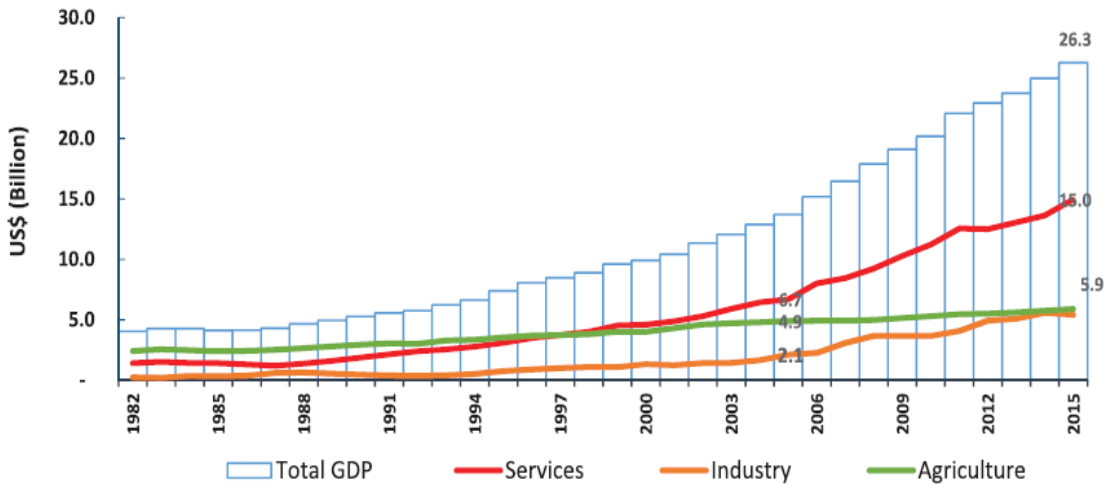
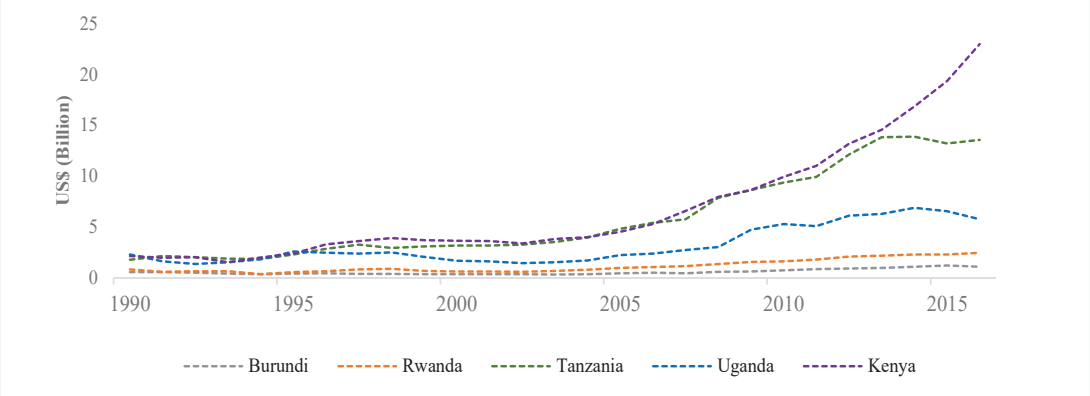


Figure 1: Trends in GDP by sector (1982-2015).

Source: Mwesigye et al. (2017).

The challenges facing Uganda's agricultural sector are highly correlated with regional climatic trends since there's difficulty in predicting weather patterns. Between 2010 and 2015, East Africa experienced one of the longest droughts in history. Within a range of 10 to 12 years, Uganda has experienced cyclical, frequent, and severe droughts in most parts of the country, especially the northern and western parts. Historically, drier-than-average seasons have occurred during La Nina years (UNDP, 2008). From 2010 to 2011, Uganda experienced rainfall deficits across most parts of the country, which resulted in depleted soil moisture (USAID, 2015). Agricultural production declined in all East African states except for Kenya (see Figure 2). It is interesting to note that by 2016, Kenya's agricultural output was four times the size of Uganda's, despite starting from a similar base in 1995. Kenya has also developed flourishing markets in certain cash crops with an integrated and functioning value chain. It has also established itself as a hub for "agri-preneurs" who are redefining farming. Kenya has also embedded technology in its agricultural scene leading to handsome profits and remarkable results as it launched 14 mobile apps designed to assist farmers to enhance agricultural productivity through the country's premier agency called Kenya Agricultural and Livestock Research Organisation (KALRO). Kenya is also a major exporter of horticulture out of Africa.

Figure 2: Agricultural GDP trends in the EAC



Source: WDI Database (2017).

3.2 Uganda's Agricultural productivity challenge

There is sufficient potential to raise agricultural productivity and bridge Uganda's yield gap. The main priorities to achieve this should be (i) improving delivery of agricultural-support services, (ii) facilitating farmers' access to price, and weather information, and (iii) promoting market-oriented production by improving agricultural markets. Agricultural production in Uganda operates at less than forty percent of its attainable potential for key staple crops (Kraybill, et al., 2012). Modern agricultural inputs can increase yields,

but adoption rates are low[36] because most farmers aren't aware of these inputs and the ones that are well informed about them are resistant to use them. For instance, studies based on the Living Standard Measurement Study–Integrated Surveys on Agriculture Initiative (LSMS—ISA) survey data on twenty-two thousand households and sixty-two thousand plots in Ethiopia, Malawi, Niger, Nigeria, Tanzania, and Uganda reported that two-thirds of farmers do not use inorganic fertilizer, eighty-four percent do not use agrochemicals, only 1 to 3 percent of the land cultivated by smallholders is irrigated, and no more than 10 percent of households have any form of water control on agricultural plots (AfDB, 2017).

This leaves farmers vulnerable to adverse weather conditions. Farming practices can be improved through agricultural extension, but regional agricultural offices are understaffed and underfunded. In FY 2015-16, only fifty percent of approved extension staff positions had been filled (Mwesigye, et al., 2017). Furthermore, similar conditions in other support-sectors such as education and infrastructure further amplify the problems in agriculture.

Commercialized farming can encourage backward linkages, with the private sector often providing these services. However, farming contracts are rare, and only credibly provided by large corporate companies. In addition, missing markets for credit, insurance, and savings in rural areas are likely to discourage productivity-enhancing investments, which would enable smallholder farmers to participate in commercial farming.

Low annual labour productivity remains the root cause of rural poverty and inhibits growth in the Agricultural sector. This is explained by the seasonality effect in the agriculture sector, pointing to rudimentary agricultural practices of reliance on natural factors. Due to lack of irrigation systems, farmers are more productive during the rainy season and become redundant during the dry spells. In times when the farmers are engaged, they are almost as productive as their counterparts in the non-agriculture sectors. The challenge is that this level of productivity cannot be maintained throughout the year due to the variance in seasons. Therefore, a solution should be looked for to mitigate these seasonality effects and to smoothen labour calendars through the diversification and intensification of agricultural production systems.

3.3 The role of agro-industrialisation in enabling the transformation of the agricultural sector

To realize Uganda's potential for agro-industrialization, policymakers and development practitioners need to focus on getting the fundamentals right. More emphasis should be put on increasing competitiveness through closing the infrastructure gap, skills gap, reforming regulations and institutions, deepening value chains, attracting foreign direct

36 The proportion of farmers using modern farming methods in 2015 was: twenty-five percent for fertilizer, fifteen percent for improved seed, 6.5 percent for both fertilizer and improved seed, and 1% for irrigation. (Mwesigye et. al., 2017)

investment through preferential taxes, and creation of industrial clusters and Special Economic Zones (SEZs) for agro-allied industries to enable transformation of agriculture and enhance growth (AfDB, 2017).

According to McMillan et al (2017), growth through structural transformation is less effective than through sector productivity growth. Agricultural transformation generally refers to the process by which individual farms shift from highly diversified, subsistence-oriented production towards more specialized production oriented towards the market. In brief, it is a process of moving away from subsistence agricultural activities to commercial production. The process involves a greater reliance on input and output delivery systems and increased integration of agriculture with other sectors of the domestic and international economies.

Agro-industry is broadly defined as post-harvest activities involving the transformation, preservation and preparation of agricultural production for intermediary or final consumption. It is comprised of artisanal, minimally processed and packaged agricultural raw materials, the processing of intermediate goods, and the fabrication of final products derived from agriculture. Agro-industry includes not only agriculture-related industries but also distribution and trading activities.

Food-processing and beverages account for more than fifty percent of the total formal agro-processing sector in low and middle-income countries and are the most important subsectors within the agro-industry sector reference. The contribution of the agroindustry is eminent. Studies show that due to their forward and backward linkages, agro-industries have higher multiplier effects in terms of job creation and value addition. Agro-industry stimulates businesses well beyond the closest links with its direct input suppliers and product buyers. It has the potential to bolster a range of ancillary services and supporting activities in the secondary and tertiary sectors. Kondylis et al. (2017) demonstrate that combining irrigation interventions with agro-training and facilitation can increase the cultivation of high-value crops and raise farmers' incomes.

The weakest point in agricultural transformation is policy implementation, not technology or other enablers because these are influenced by policy. To realize full transformation of the Agricultural sector, a number of interventions must be undertaken. The African Centre for Economic Transformation (ACET) (2017) identifies key areas that governments in Africa, including Uganda, should attach critical importance to in order to transform the agriculture sector and have it meaningfully contribute to economic growth and development. The most salient ones are:

a. Securing Land Tenure and Easing Access to Land: This is vital since it gives confidence that is necessary to make meaningful investments in agricultural land use. Besides it also makes it easy for farmers who are landowners to access financial resources in terms of credit to invest in agriculture. With secure land

tenures, the land market becomes efficient enabling the resource to move to those that have capacity to utilize it to its full productivity.

b. Boosting Agricultural Productivity: This involves planting improved crop varieties, improving farmers' access to improved and quality seeds, increasing the availability and use of fertilizers, improving farmer education and farm management, expanding irrigation and access to water, and finally mechanization which will lead to expanding of cultivated area and raising yields.

c. Commercializing Agriculture: At the farm household level, agricultural commercialization is more than marketing agricultural products. It is attained when household product choice and input use decisions are made based on the principles of profit maximization. This entails Government making agriculture profitable and helping small farmers to transition from a mainly subsistence orientation to a commercial orientation, with farms running as businesses that interact more with markets for the purchase of modern inputs and for the sale of outputs. It is important to note that not only is there a rapidly growing local market for agro-processed products, but that in addition the regional market is expanding rapidly with constant efforts to bring about more intra-regional and continental trade. For example, Africa Continental Free Trade Area (AfCFTA) with a single market of 1.2 billion people (Agro industrialisation in Uganda, 2019). This should be a base for Ugandan farmers to establish themselves on the world market. More efficient management of price risks with approaches such as adoption of national buffer stocks, warehouse receipt and commodity exchange systems; and contract farming should be implemented within the Agricultural sector for commercialisation.

e. Agribusiness: Attempts to transform Africa's agriculture must be linked to modern and well-performing agribusiness. This puts emphasis on value addition and agro-processing to drive the country's industrialization plans. Agro-processing covers the post-harvest activities involved in transforming, preserving, and preparing agricultural production for intermediary or final consumption. It includes transforming outputs into food and beverages; tobacco products, leather, and leather products; textiles, footwear, and apparel; wood and wood products; and rubber products. This process brings about value addition to the agricultural products enabling farmers and the country to earn higher incomes from the sector

4. Concluding remarks and policy recommendations

For Uganda's agricultural sector to become more productive, to allow farmers earn more income and to contribute to reducing rural poverty, government policies and their implementation are key. Combining irrigation with agricultural training, facilitation, and better market access can increase yields and foster the cultivation of high-value crops

leading to higher incomes of farmers. A productive and climate-smart agricultural sector requires an effective enabling environment. Providing that environment is the role of the government. Uganda's agriculture sector may not be transformed overnight but making the right adjustments now will be critical to realize Vision 2040. This paper closes with policy recommendations that the government should consider going forward.

Enforcement of quality standards along input supply chains. This will build farmers' trust and encourage their adoption. Modern inputs available on the market tend to be of low quality and are not trusted by Ugandan farmers. Bold, et al. (2017) found that fertilizer sold in retail stores contained sixty-seven percent of the nitrogen it should, and only fifty percent of hybrid maize being sold was authentic. They estimated that investing in modern inputs at current prices could result in financial losses for some farmers, which can explain low adoption rates. Existing official quality control mechanisms, including E-Verification should be expanded to capture more brands, and monitor the entire input supply chain. Enforcement gaps can be filled by partnering with local communities-which has already proven to be effective in monitoring quality of service delivery[37]. Districts such as Nakaseke have passed ordinances[38] against selling counterfeit seed, but require the Ministry of Agriculture, Animal Industry and Fisheries' (MAAIF) support to detect and penalize violators. An ongoing IGC-funded project is studying input supply chains and will identify priority areas for strengthening regulation.

Provision of educational platforms to Ugandan farmers about Quality Declared Seed (QDS). QDS produced by local seed businesses requires less monitoring. Because of this, it costs less than certified seed, but still more than traditional seed. Willingness to pay for QDS is low but has been seen to increase once higher returns are experienced (Otim, 2015). Short-term subsidies can overcome liquidity constraints and encourage long-term adoption. This has high potential to transform agriculture productivity since eighty-five percent of seed is acquired through informal trade. However, this knowledge must be transferred to farmers by agricultural extension. The role of the Ugandan Government is providing proximity extension services and facilitating contract farming arrangements which will therefore be critical to ensure that farmers learn to consistently produce the standards required of agricultural produce in internationally competitive supply chains. Targeting networks and multiple people have been shown to be more effective for knowledge diffusion, than traditional extension strategies (Beaman, et al., 2015).

Building a climate resilient agricultural system in Uganda. The escalating challenge of climate change means that climate smart agriculture is now no longer an option but a core necessity. Climate change has and will continue to have significant direct and indirect impacts on agricultural infrastructure in Uganda. It is predicted that Uganda

37 See *The Impact of Social Accountability on the Quality of Community Projects in Uganda: Impact Evaluation Results from NUSAF2 Transparency, Accountability and Anti-Corruption Sub-Component,* World Bank (2017)

38 Ordinance number 11 of 4th December 2055 passed by Nakaseke District Local Government

will continue to experience rising temperatures, which will increase by more than 2 degrees Celsius by 2030 (Caffrey et al., 2013) A higher incidence of drought, caused by climate change, undermines food production. Medium and small-scale irrigation solutions (including sprinklers and fuel-powered pumps) are currently deployed in Rwanda and enable cultivation during dry seasons. However, the high cost of irrigation infrastructure puts this out of reach for most smallholder farmers in Uganda and requires government subsidies[39]. The sustainability of irrigation depends on the farmers' ability to pay, which can be enhanced through higher income. Agricultural insurance policies like Uganda Agricultural Insurance (UAI), piloted by Government of Uganda crop insurance, and the Agro Consortium, which consists of 10 insurance companies have been put in place, most farmers are unaware of these. Successful practice of climate smart agriculture (CSA) further requires an enabling environment characterized by functional institutions, regulations, and coordination; as well as governance structures favoring the generation, dissemination, and use of CSA.

Sensitization of farmers by the Government should be done to attract financing of agriculture to promote commercialization. Transforming agricultural productivity will depend on the ability to predict and mitigate adverse weather patterns. Technological advances in weather monitoring can be used to generate localized short-term forecasts and provide early drought warnings.[40]. Improved water storage infrastructure would also help to attenuate the impact of rain shortfalls.

Establishment of improved agricultural markets Smallholder farmers should be integrated into commercial farming by improving agricultural markets**.** Supply- and demand-side risks, which are prevalent in rural agricultural markets, discourage productivity-enhancing investments among smallholder farmers. This results in shallow agro-produce markets. Facilitating frictionless exchanges between producers and buyers using transparent and enforceable contracts can deepen markets. Scalable interventions which can be explored include (i) government guaranteed bulk purchases[41], (ii) Out-grower contracts similar to those in Kenya (Casaburi and Macchiavello 2016) (iii) Insurance contracts with premiums charged at harvest (Casaburi and Willis, 2017) in Kenya, and (iv) digital trading platforms such as Kudu in Uganda and G-Soko in Kenya. Timely access to accurate market information reduces regional price dispersion, enabling farmers to respond to market incentives (Aker, 2010). In addition, Casaburi and Macchiavello (2016) illustrated that enforceable contracts offer farmers with tenure security, similar to what is found in formal employment, thus stabilizing agricultural supply.

39 The average cost of irrigation is $1,500 per hectare. This is beyond the means of most farmers. Subsidies of up to 50% of the cost are provided for individuals and cooperatives.

40 See the Trans-African Hydro Meteorological Observatory (TAHMO) available at http://tahmo.org, and the Climate Hazards Group Infrared Precipitation (CHIRPS) available at http://chg.geog.ucsb.edu/data/chirps/.

41 *See IFAD and Swaziland Ministry of Agriculture Smallholder Market-led Project, available at https://operations.ifad.org.*

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CHAPTER 12:
Industrialisation

A driver of growth in Uganda

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1. Introduction: harnessing potential for industrial growth in Uganda

The importance of industrialisation in the process of economic transformation and development is widely acknowledged. Historically, most cases of sustainable economic growth have been linked to the movement of labour from agriculture to higher productivity industries, and in particular the dynamic growth of manufacturing production. Industrial activities not only have positive spill overs to other domestic sectors, but also generate higher value exports that can help promote a favourable balance of payments position. It is on this basis that one of the key aims of the Government of Uganda is industrialisation.

Despite the fact that the country has made a number of efforts to promote industrialisation, with the industry sector registering significant growth since 2016, much still remains to be done. Though Uganda has performed relatively well compared to its neighbours in terms of the share of the economy dedicated to manufacturing, it still only accounts for 16.4% of its GDP.

There are a number of constraints to industrial activity that still exist, including weak institutional support for the manufacturing sub-sector; limited access to credit; inadequate skills; inadequate physical infrastructure; low level of technology; lack of adequately serviced industrial parks across the country; and an unreliable supply of inputs (Obwona et al., 2019)

As China and other emerging economies upgrade to higher industries, there will be enormous opportunities for low-income developing countries to enter a labour-intensive industrialisation development phase, taking advantage of an estimated 85 million manufacturing jobs that will relocate from China (Hai & Versi, 2015). To that end, Africa has a new opportunity to break into global markets in industry. Governments in Africa should therefore proactively and urgently reposition to seize these opportunities by creating successful examples that will generate inspiration and confidence in their respective countries and the African continent as a whole. Examples of this approach can be seen in two countries in Africa: Ethiopia and Rwanda, where investments in the leather and textiles industry have created numerous jobs and transformed people's lives.

The onset of the COVID-19 pandemic, as well as the lockdown imposed to curtail the spread of the virus, have had an adverse impact on general economic activity. Estimates from the Uganda Bureau of Statistics indicate that the economy grew by 3.0 percent in FY 2019/20, less than half of the 6.4 percent realized in FY2018/19 and the 6.3 percent earlier projected for this year. The industry sector registered the largest decline between FY2018/19 and FY2019/20, with growth declining from 9.1 percent to 3.3 percent. As such, this recent setback presents a greater and urgent need for Government support for industrialisation to enhance economic recovery.

This chapter explores policy options for supporting industrialisation in Uganda, drawing on experiences from other countries for which industrialisation has been a key driver of economic development. In particular, it considers policies to promote an attractive business environment, including investments in infrastructure, skills and finance. It also considers policies to promote exports and yield benefits from clustering of firms. Finally, the chapter considers regional and global policies that would be conducive to industrialisation in Uganda.

2. Uganda's national strategies to promote industrial and manufacturing development: a bold vision but with implementation issues

There have been a number of concerted attempts to accelerate industrialisation in Uganda. At a time when confidence in state-guided capitalism was at a peak, the Worthington Plan (1947-1956) was the first development plan to be implemented in Uganda, aimed at developing manufacturing industries to substitute for expensive imports. Brick, furniture, cement, textile, soap and beer factories were set up, particularly in the area of Jinja. In the early years of independence, the Second Five-Year Development Plan (1965/66 - 1970/71) pursued a similar industrialisation strategy, with the objective of achieving structural transformation. The plan was backed by a strategy for regional industrialisation proposed by the 1965 United Nations Economic Commission for Africa. Despite a promising start, the economic transformation of Uganda came to a halt under the political instability which characterized the governments of Milton Obote and Idi Amin. Together with mismanagement and poor economic planning, these policies contributed to the decline of the industrial sector.

From the early 1990s, the Government of Uganda undertook economic reforms with a strong liberal stance. Some analysts argue that this strategy proved successful and enabled the country to become one of the fastest growing economies in the world during that decade. But it is important to note that this period was not accompanied by significant industrialisation of the economy. The major focus of these policies was in maintaining macroeconomic stability and opening the country to trade and investment. Against this backdrop, the Uganda Industrialisation Policy and Framework (1994-1999) put emphasis on the agro-processing sector.

Currently, the major policy paper driving economic planning is Vision 2040. The policy paper was published in 2013 and envisions the transformation of Uganda "from a peasant to a modern and prosperous country within 30 years", putting emphasis on public investment in infrastructure. One of the main objectives of Vision 2040 is to boost the share of the industrial sector in GDP between 2010 and 2040 from 25 percent to 31 percent, as well as to increase the share of the labour force in industry from 7.6 to 26 percent. It targets the manufacturing sector in particular, aiming to raise the share of

manufacturing exports to 50 percent by 2040. The implementation strategy of Vision 2040 relies on six five-year National Development Plans. NDP II (2015/16-2019/20) focused on sustainable and inclusive growth through increased competitiveness. These objectives are consistent with the National Industrial Policy which was published in 2008 and outlined the government strategy for the next decade. NDP III, effective FY2020/21 takes a similar position, focusing on sustainable industrialisation for inclusive growth, employment, and wealth creation.

Table 1: National Industrial Policy Target indicators.

Target indicator	Target	Baseline 2008	Current
Contribution of manufactured exports to total GDP	25%		8.5%
Contribution of manufactured exports to total exports	30%	22% (2007)	24.6% (2015 World Bank)
Value added in industry (as a percentage of GDP)	30%	27.3%	21.3% (2015 World bank)
Competitiveness index score	4.2	3.33	3.69

Source: National Industrial Policy (2008).

Among specific projects implemented since 2008, industrial parks and sector specific public investments are the most significant, with the Uganda Investment Authority (UIA) tasked in 2007 with establishing 22 industrial parks. However, limited results achieved since 2008 have also sparked criticisms over the government strategy and its implementation (Office of Auditor General, 2015). The Office of the Auditor General has highlighted the poor performance of industrial parks in terms of job creation, despite substantial government support. The report revealed that only one feasibility study had been undertaken (in Namanve), and only 13 percent of the investors allocated land were in operation in 2015. A recent analysis of successful examples of such interventions in Africa shows that an emphasis on a few products with a comparative advantage is key to success of the industrial parks (UNDP, 2015). By contrast, Ugandan industrial parks seemed to have lacked specialization and focus. At the same time, experiences with industrial policy in Ethiopia and Zambia highlight the need for better integration of industrial support into national strategies and effective inter-ministerial collaboration.

Apart from the National Industrial Policy, only three sub-sector policies have been adopted, for textile, sugar, and leather production. Analysts highlight the need for sector-specific strategies beyond current general policy targets, while at the same time developing linkages with relevant ministries and taking into account the entire scope of "software" needs for industrial development rather than focusing exclusively on infrastructure development (Muhumuza, 2016).

3. Planning for a new kind of structural change

Historically, across countries in Europe, Asia and the Americas, structural change in which labour moves from low productivity sectors into higher productivity employment has been a key driver of economic growth. However, despite decades of solid economic growth, Africa has experienced relatively little structural change. The industry sector in Africa has played only a minor role in driving changes in the economic structure. In 2015, Africa's share of manufacturing in GDP was about 10 percent, unchanged from the 1970s. This is worrisome, both because manufacturing is a high productivity sector capable of absorbing large numbers of moderately skilled workers, and because it is also a powerful engine of productivity growth.

However, recent studies of the potential for structural change in African countries highlight that changes in the global market and in manufacturing technology now provide new opportunities for structural change that substantially differ from past experience (Newfarmer et al., 2018). From a global perspective, three trends have presented new opportunities as well as challenges for structural change in low-income countries: a revolution of trade in services and horticulture, a rise in global value chains, and major developments in manufacturing technology.

Highly competitive manufacturing in East Asia, the rising importance of service industries such as finance in contributing to countries' GDP, and the break-up of various stages and tasks within the manufacturing process across global value chains mean that for countries like Uganda, industries other than the manufacturing sector could drive structural change in developing countries. Already several modern service sectors such as ICT services, financial services, transport, and logistics have broadened the definition of industrialisation and contributed to structural change in a number of countries.

Given the discovery of these new highly productive sectors and the fact that these sectors have high potential to drive structural change and economic growth along with the manufacturing sector, we outline several policies to support structural change and economic growth.

4. Proactive policies for structural transformation

4.1. Domestic policies

Literature on industrialisation in developing countries suggests that three areas of domestic policy have largely affected levels of industrial investment by attracting new investment and raising the productivity of existing firms.

The first is the investment climate i.e., the policy, institutional and physical environment within which firms operate. The second is access to global markets through FDI and

exports. The third is agglomeration i.e., when firms tend to concentrate geographically. Investments in infrastructure, skills and financial markets raise the potential productivity of all firms, making some of them more likely to succeed in external markets. Connections with foreign investors as well as the process of exporting itself help to build firm capabilities through transfers of knowledge, skills, and technology. Agglomerations or clusters of firms raise firm-level productivity, but they also generate competitive pressures that reduce the incentives to cluster, unless the clusters are export-oriented. Thus, a strategy that encompasses each of these aspects is critical to the success of any industrialisation drive.

Because industries without smokestacks share many of the same characteristics as traditional industry, they too can respond in a similar way to these three factors. Below, we discuss these enabling policies for competitive industry in more detail.

4.1.1. A conducive investment climate

Three key elements of the investment climate that are particularly relevant to industries without smokestacks are infrastructure, skills, and finance.

Reliable electrical power, lower costs of transport, and workers better able to perform their jobs make countries more attractive to domestic and foreign investors by raising the potential productivity of all firms (IMF, 2014). Not surprisingly, ICT based services may be particularly sensitive to infrastructure constraints. The cases of Kenya, Rwanda and Senegal show that high speed data transmission is critical to exporting a wide range of services and especially to IT-intensive exports. At the same time, a necessary condition for fully leveraging Africa's tourism potential is to have adequate tourist-related infrastructure. Limited air travel and road quality constrains tourism development in a growing number of countries (Daly and Gereffi, 2018). Connectivity to the internet and communication infrastructure are also important considerations for travellers.

Over the past eight years, infrastructure improvement has been the priority of the Government of Uganda, which has invested heavily in airport infrastructure, upgrading road networks, and railway lines in partnership with Kenya. Over the next five years, USD 9 billion is budgeted for major infrastructure projects, including the rehabilitation of Entebbe airport, the construction of highways to Entebbe and Jinja, the Standard Gauge Railway project, the setting up of an oil refinery and three hydropower dams (World Bank, 2016). It is, however, essential to improve the efficiency of those investments in order to benefit directly to the manufacturing sector.

In particular, Uganda continues to have very low rates of electricity access. An estimated 15 percent of the population nationally (7 percent in rural versus 39 percent in urban areas) have access to electricity. 2013 Uganda World Bank Enterprise surveys, recent Doing Business indicators and data from annual Private Sector Investment Surveys in Uganda highlight that reliable electricity is a key factor negatively affecting competitiveness in

Uganda.

At the same time, despite significant gains in average levels of schooling in sub-Saharan African countries, skills remain a significant constraint, especially for the IT-enabled services industry. In Kenya, for example, attempts to expand the industry rapidly have encountered manpower constraints due to a lack of software development and project management skills. Senegal's rank among the top 50 potential suppliers of outsourcing services has fallen significantly in the last five years, due to weakness in the quality and quantity of human resources. A workforce that has the skills needed to interact with tourists and to provide the many "back office" services that are inputs into the production of high-quality tourism is also essential to further development of the industry. Management, organization, communication, and computer skills are critical for tourism distribution intermediaries and service providers seeking to upgrade their position in the tourism value chain. Major increases in post-primary and vocational/technical education are needed to address the skills gap, and quality must improve at all levels.

The recent review of Uganda's Industrial Strategy indicated that some progress has been made in bridging skills gaps, with technical and vocational training graduates reaching around 42,000 a year. However, the current scope of vocational training remains limited to traditional courses like carpentry. Many enterprises in Uganda lack the requisite technical expertise for industry. Ensuring that the labour force has the appropriate skills for new industries is needed to boost productivity and attract investment. If the economy is to diversify into new and more complex products, specialised new skills will be required.

There are some targeted initiatives aimed at supporting skills development that can be developed on. For example, the Millennium Science Initiative, with a USD 33 million investment, aimed at producing more and better-qualified science and engineering graduates. This helped increase the number of Ugandan researchers from 158 to 700 between 2007 and 2012 and supported the development of Uganda Industrial Research Institute's activities.555

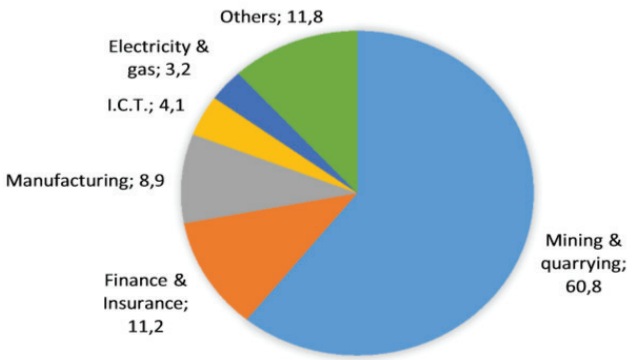
In addition to issues of infrastructure and skills, limited access to affordable finance constitutes a major constraint on Ugandan companies' ability to grow and develop new products. Without access to affordable credit, the manufacturing subsector will continue to struggle to grow. This has prompted the government to recapitalise UDB to provide improved access to affordable and long-term credit for the development of the manufacturing sector. Despite these efforts, most lending is largely short-term and not suitable for long-term investments needed to develop new products. Even after accounting for inflation, real interest rates remained high relative to other African countries. Through public institutions the government may want to improve access to low-interest loans for strategic local companies. Where the private sector is failing, institutions like the UDC can play a critical role in mobilising financing for local companies.

4.1.2. An emphasis on external markets

For most countries in Africa, the regional and global export market represents the best option for rapid growth of manufacturing, horticulture, agro-industry and tradable services.

For low-income countries, foreign direct investment (FDI) is often an important part of a strategy for transferring knowledge about foreign production techniques, overseas markets, and international supply chains (Spence, 2008). Over the past decade Uganda has performed well in attracting FDI, rising from USD 181 million in 2000 to USD 10 billion in 2015. However, particularly in regard to Chinese FDI inflows, the sectoral spread of investment does not seem in line with the government's objectives regarding the industrialisation of the economy.

Figure 1: Sector distribution of FDI investments in 2014 (stock, percent).



Source: Bank of Uganda (2016).

The distribution of FDI has been heavily skewed towards the mining sector, and arguably has done little to further the goals of structural transformation. Targeted policies to make the most of FDI, such as supplier development programmes implemented in countries such as Costa Rica and Singapore (Manwaring and Rauschendorfer, 2020), can go some way to better leverage potential gains from foreign investment.

At the same time, exporting itself allows firms to realize economies of scale and in low-income countries, the act of exporting can raise firm productivity through learning (Harrison and Rodriguez-Clare, 2010). However, because individual firms face high fixed costs of entering export markets, there is a risk that they will avoid exports unless

public policies are put in place to offset the costs to first movers. To deal with these externalities, African governments need to develop a coherent package of trade and exchange rate policies, public investments, regulatory reforms, and institutional changes designed to increase the share of non-traditional exports in GDP.

The structure of protection and the exchange rate are particularly important to ensuring that exporting is as profitable as producing for the local market. Tariffs in general steer investment toward production for the domestic market, and tariffs on intermediates and capital goods place exporters (who often rely on competitive imported intermediary goods for production at a disadvantage relative to global competitors. While duty drawback, tariff exemption and VAT reimbursement schemes exist in many African countries, they are often complex and poorly administered, resulting in substantial delays. At the same time, export procedures – including certificates of origin, quality and sanitary certification and permits – can be overly burdensome (Clarke, 2005; Yoshino, 2008; Farole, 2011). The exchange rate is arguably the most important price in the economy. It shapes the relative attractiveness of producing for the domestic or foreign market, and a competitive real exchange rate has underpinned most prolonged episodes of rapid export growth.

At the same time, trade in tasks has greatly increased the importance of improving trade logistics, including transport, warehousing, distribution, and information management. Poor trade logistics can make it impossible for firms to break into global value chains and are particularly detrimental to the success of agro-processing and horticultural exports (Fukuse and Martin, 2018). Global value chains are much more demanding of logistics than traditional approaches to processing agricultural commodities.

According to the World Bank 2020 Doing Business indicators, Uganda ranks 121st out of 190 countries in terms of ease of trading across borders. Uganda also ranks consistently low (and far below the sub-Saharan average) on the World Bank's Logistics Performance Index in terms of transport related infrastructure. This reflects both poor road linkages to Mombasa and eastern DRC (Centre for Development Alternatives, 2020), as well as a number of 'non-tariff barriers' that face Ugandan exporters. The time and cost of transportation of goods has been exacerbated by the recent crisis and additional safety precautions that have been taken in light of this, particularly at national borders. For this reason, investments in infrastructure and institutional reforms to improve trade logistics are essential to export success.

Market structure and inappropriate regulations can also impede exports, with high costs and limited flexibility of air transport in particular constraining both horticulture and tourism. The aviation industry in Africa is heavily protected, with a plethora of small and uneconomic national airlines. Senegal, for example, has relied on scheduled flights for tourism, and with limited airline competition in its main French market, costs have been high. High costs of air transportation have also prevented Mozambique and Tanzania from competing in the regional tourism market. An open skies policy might endanger

some national airlines, but it would introduce greater competition and reduce the cost of air freight through the development of competing airfreight companies.

4.1.3. Agglomeration

Like traditional manufacturing, agro-processing, horticulture, and ICT based services benefit from agglomeration or clustering of firms. By grouping together in the same area, firms can enjoy access to 'thick' labour markets and can more easily share information, knowledge, and other inputs to production. At the same time, closely located businesses are easier and more cost effective to provide with necessary infrastructure and services. Geography also plays an obvious role in tourism; tourist facilities tend to cluster close to the tourism resource. But despite their benefits, agglomerations pose a collective action problem: if a new location can attract a critical mass of firms, each firm will realize productivity gains from clustering, but until the location reaches critical mass, there is no incentive for individual firms to move.

Governments can foster agglomerations by concentrating investments in high-quality institutions, social services, and infrastructure in a limited area, such as Special Economic Zones (SEZs) or industrial parks (UNIDO, 2009; Farole, 2011). While most first-generation SEZs have been focused on manufacturing, they can offer benefits to services and agro-based industries as well. Services export companies can benefit from customized facilities such as IT parks with modern office space, high-speed broadband links, reliable power supply and ancillary infrastructure. For example, the Software Technology Parks of India Initiative (STPI), launched by the Indian government to attract potential IT investors, proved essential to the growth of India's software industry (Dongier and Sudan, 2009). In agro-industry and horticulture, Indonesia and the Philippines have also established agro-industrial SEZs to promote further processing of agricultural exports.

4.1.4. Supportive economic governance

Crucially, to effectively implement domestic industrial policies and programmes, relevant government bodies need to have good working relationships with each other and also require mechanisms to coordinate their actions. Despite the existence of a strong policy and institutional framework to support and stimulate industrial development in Uganda, a major challenge has been the capacity of these institutions to respond to the needs of their stakeholders. In addition, the duplicative mandate and lack of clarity of who does what within satellite agencies such as the Ugandan Investment Authority and the Free Zone Authority causes an additional layer of complexity.

These weaknesses are partly due to liberalization policies that led to the disintegration of some supporting institutions. Despite the return to more state interventionism, the once strong economic planning framework seems to have been weakened by the multiplication of planning entities and the dilution of governance in those institutions. Streamlining the institutional architecture is therefore required.

4.2. Regional policies

The small size of Africa's economies and the fact that many are landlocked make regional approaches to industrialisation imperative. A sub-regional approach to industrial development is likely to result in a significantly faster rate of industrialisation than would be the case if the process is undertaken on an isolated, country-by-country basis. Neighbouring markets can provide the market access and preference margins to jumpstart a wide variety of exports, offering the opportunity to develop local value chains that could be a springboard to the global market.

Since the Abuja Treaty was signed in 1994, African governments have looked to regional economic integration to expand intra-African trade, to harmonize regulations and policies, to establish coordinated monetary policies and even to achieve political union. These goals have proven elusive. Reductions in tariffs and non-tariff barriers have been implemented only slowly, and other aspects of policy and regulatory harmonization have lagged. Growth in regional trade has barely kept up with exports to the rest of the world (de Melo et al., 2018).

Harnessing regional economic communities to propel trade integration and the development of regional value chains can occur through three main channels: reforming price incentives, strengthening intra-regional trade facilitation and services regulation, and investing in cross-national physical infrastructure.

Despite a complex system of regional preferences, price incentives in African countries still discourage production for the external market and inhibit the emergence of regional and global value chains. Tariffs facing exports to the rest of Africa from the EAC, for example, are substantially higher than to other regions and much higher than to high-income regions. Average protection against African exports is 1.7 percent in the rest of the world compared to 6.1 percent within Africa itself, and tariff escalation in agriculture is particularly notable (Fukase and Martin, 2018).

Another way to incentivise manufacturing is review of the Common External Tariff of the East African Community given its fundamental role in providing price signals to the private sector. Beyond the general stratification of the Common External Tariff between consumer goods (at 25 percent) intermediate products (10 percent) and primary goods (0 percent), there is arguably relatively little discretionary use of tariffs to help bolster particular sectors at a regional level. A full engagement on this issue by the EAC Secretariat and partner member states to review the Common External Tariff would be a step in the right direction to fully implementing the EAC's Industrial Development Strategy.

While regional institutions have made some progress in reducing trade costs, there is much to be done, and much to be gained, from better regulation of trade in services. For example, the introduction of a joint visa program in the Northern Corridor countries of the EAC has facilitated tourist travel among the three participating countries. Initiatives

to better integrate finance, mobile money, education, and professional services as well as to facilitate labour mobility generally would go far toward deepening regional integration.

Interconnection of cross-national physical infrastructure is underway but could be accelerated. The Eastern Africa Submarine Cable System has installed some 10,000 kilometres of fibre optic cable that links most of Eastern Africa to high-speed internet. This effort involved the coordination of various governments and their telecom regulators. The development of IT infrastructure offers a positive example for integrating the power grid, where new installations can lower the cost of power from the current very high rates and improve reliability. The problems associated with power, however, are substantially more complex than for telecommunications.

EAC integration: when the whole is greater than the sum of its parts?

The East African Community (EAC) Industrialisation Policy was adopted in November 2011 (EAC, 2012), aiming at "structural transformation of the manufacturing sector through high value addition and product diversification based on comparative and competitive advantages of the region". Its specific objectives are:

- Diversifying the manufacturing base and quadrupling the local value-added content of resource-based exports to 40 percent by 2032
- Strengthening national and regional institutional frameworks and capabilities for industrial policy design and implementation
- Strengthening research and development, technology, and innovation capabilities to facilitate structural transformation and upgrading of the manufacturing sector
- Increasing the contribution of intra-regional manufacturing exports relative to total manufactured imports into the region from the current 5 percent to about 25 percent by 2032 and increasing the share of manufactured exports relative to total merchandise exports to 60 percent from an average of 20 percent
- Transforming Micro Small and Medium Enterprises into viable and sustainable business entities capable of contributing up to 50 percent of manufacturing GDP by 2032

The EAC Industrial Policy is generally supportive of a market-based approach rather than state intervention and focuses on a few subsectors described as both competitive and strategic for the sub-region. Those sectors are supposed to be promoted through strategic regional investments and the development of regional value-chains.

While it is still early to assess the implementation of this policy, EAC member states have embarked on a series of regional infrastructure projects to create the necessary enabling environment for industrialisation. The modernisation of the East African railway system is one of them. Another area of cooperation is the planned establishment of regional technology incubation centres or centres of excellence based on institutions that are operational in the Member States.

The development of industrial value chains across EAC countries is one of the main objectives cited in the 2016/2017 EAC budget. Towards achieving this objective, there is a campaign to "Buy East African - Build East Africa". However, concrete projects have not yet been implemented. Studies are being undertaken for the set-up of an automotive regional industry and the project is paralleled by individual and competing national initiatives. The development of a regional clothing and leather industry is also under consideration.

The principal problem is that the EAC has limited ability to implement policies to achieve these objectives. Its budget and resources are extremely limited, and it therefore depends on members to align their policies to that of the EAC. So far, there has been little formal alignment despite the ambitious and bold national and regional policies.

4.3. A conducive global environment

The US retreat from leadership on multilateral issues since 2017 has created a vacuum that could impede progress on global efforts to spur structural change in low-income countries. Meanwhile, across the Atlantic, the British vote to leave the European Union in June 2016 threatens a former pillar of multilateralism. These current headwinds notwithstanding, several global initiatives can help to accelerate Africa's structural transformation.

One priority for multilateral action is fully implementing the WTO Trade Facilitation Agreement (TFA). According to WTO estimates, trade costs in developing countries are equivalent to applying a 219 per cent ad valorem tariff on international trade (WTO, 2015). By reducing both the variable and fixed costs of exporting, trade facilitation increases the exports of those firms already involved in international trade, while enabling new firms to export for the first time. The WTO (2015) estimates that full implementation of the TFA could reduce trade costs by an average of 14.3 per cent, and that African countries may benefit from reductions in trade costs in excess of 16 percent.

Trade policy in Africa's main trading partners—especially those in Asia—has an important role to play in facilitating the entry of non-traditional African exports. Although Asia's tariffs on African exports are gradually declining, progress has been slow, especially for Africa's least developed countries. An essential step is to reduce escalating tariffs directed at higher stage processed commodity exports which discourage the development of agro-industrial value chains (Fukase and Martin 2018). China could play a leading role by shifting its preferential trading agreements with Africa from bilateral country-specific arrangements to a single well publicized Africa-wide initiative. This could encourage other Asian trading partners to offer similar tariff reductions.

5. Conclusion

In this chapter, we have explored key achievements, bottlenecks, and challenges to Uganda's industrial performance. While there have been significant efforts to achieve industrial development and structural transformation for growth in Uganda, more can be done - implementation of industrial policies have been fragmented and progress in industrialisation slow.

Looking forward, there are critical opportunities for Uganda to tap into a growing market for 'industries without smokestacks' – high value non-traditional industries such as tourism and agro-processing, that can drive employment and exports. To leverage this opportunity requires active policies at the national, regional, and global level. A particular challenge for Uganda will be to improve the investment climate for competitive industries through investments in infrastructure, skills, and financial access.

In pursuing an industrial strategy for the country, regional collaboration with other EAC member states will be critical to develop regional value-chains and industries in sectors like automobiles, pharmaceuticals, and textiles.

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CHAPTER 13:

Supporting Tourism Development in Uganda

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1. The role of tourism in economic development and job creation

Before COVID-19, which caused abrupt disruptions in the global economy, tourism held the position of the largest industry in the world and the third largest export sector (UN WTO, 2019). Tourism still is one of the most promising industries in terms of future growth potential because demand for travel and tourism is expected to resume and rise as soon as a vaccination for COVID-19 is available. Experts estimate return to normalcy in the next 2 to 3 years. The pre-COVID-19 travel and tourism sector performance suggested an extremely positive outlook. For example, in 2018 the sector generated 319 million jobs globally and contributed USD 8.8 trillion to the global economy, equivalent to 10.4 percent of global GDP (WTTC, 2019). The sector grew by 3.9 percent annually on average, which was higher than the global economic growth of 3.2 percent over the same period (2017/2018) and by 2030 tourists' arrivals were estimated to reach 1.8 billion worldwide. Tourism and travel represented 10 percent complete of all employment and accounted for one in five new jobs created across the world over the past five years (UN WTO, 2019).

It is noteworthy that international tourism arrivals in Africa have been growing at around 9% per year since 2010, making it the best performing region in the world. This is expected to remain so or even increase in the post COVID-19 period. There are several reasons in favour of tourism in Africa: (i) Most African countries such as Uganda have an absolute advantage in the areas of wildlife and cultural heritage; (ii) The tourism sector is not constrained by the land-locked nature of destinations such as Uganda since most clients come by air; (iii) Since the sector is normally rural based, it is good for spreading development, particularly lagging regions in the country side; (iv) Tourism requires limited start-up capital and is therefore a catalyst for economically vulnerable and disadvantaged groups such as women and youth given the limited business start-up financing mechanisms and high lending rates in the developing world; (v) Risk of price declines or fluctuations is low - prices are likely to increase as the supply of destinations cannot increase much but demand will be a function of economic growth; (vi) The tourism sector is relatively labour-intensive, requiring both low-skilled, semi-skilled and high-skilled workers which are generally cheaper in Africa than most other regions. Despite the above opportunities in favour of tourism, its potential has not been fully realized in most African countries such as Uganda. Tourism is one of those core sectors that are currently underexploited yet with the potential to lead socio-economic transformation. There is therefore a need to harness the growth opportunities in this sector. Focusing on Uganda, this paper assesses the state of the sector and identifies strategies which the government can undertake to support its development.

2. Uganda's Tourism Resource Endowment

With a total geographical area of 236,000 square km, Uganda is richly endowed with tourism resources. Some of these are "actual" and others are largely "potential" awaiting optimization for socio-economic transformation. 194,000 square km of Uganda's total land area is land, 33,926 square km is open water and 7,674 square km is permanent wetland. Internationally and within Africa, Uganda is among those countries endowed with the greatest diversity of animal and plant species (NBSP II, 2015-25). Although the country occupies only 2 percent of the world's total geographical area, it has a recorded 18,783 species of fauna and flora (NEMA, 2009), which ranks the country among the top ten most bio-diverse countries in the world. Specifically, Uganda is a home to:

- More than half of the World's population of mountain gorillas (at Bwindi Impenetrable National Park and Mgahinga National Park);
- 11 percent (over 1,063 species) of the world's recorded species of birds (and 50 percent of Africa's bird species);
- 7.8 percent (345 species) of the Global Mammal diversity (which is 39 percent of Africa's Mammal richness);
- 19 percent (86 species) of Africa's amphibian species, 14 percent (142 species) of Africa's reptile species, 1,249 recorded species of butterflies and 600 species of fish.
- There are 30 species of antelope, 24 species of primates including Mountain Gorillas and Chimpanzees, and more than 5,406 species of plants so far recorded of which 30 species of plants are endemic to Uganda (NEMA, 2009).[42]

Additionally, the country is endowed with beautiful landscapes. These include the great rift valley and most importantly the Rwenzori Mountains which at a height of 5109 meters above sea level are the third highest mountains in Africa. Unlike other major mountains in Africa (i.e. Mounts Kenya, Kilimanjaro, and the Aberdares), the Rwenzori is not volcanic but is formed from ancient granite, thrusting directly upwards through the rift valley floor. As such, the Rwenzori is the highest free-standing mountain range in Africa. It is also distinguished by the fact that the range does not rise to a single cluster of peaks but consists of six distinct mountains, each bearing a number of peaks. The highest of these is Mount Stanley, on which Margherita Peak is 5109 meters above sea level. The other five mountains are Mt. Speke (4890 meters), Mt. Baker (4843 meters), Mt. Gessi (4715 meters), Mt. Emin (4797 meters) and Luigi de Savio (4627 meters). Other mountains include Elgon (which has one of the biggest calderas in the world), Muhavura and Moroto. The tourism potential of all these mountains remains to be tapped.

42 Uganda's endemic species are primarily associated with high mountains, forests of the Albertine Rift Valley.

According to United Nations World Tourism Organisation (UNWTO), marine tourism can play a catalytic role in tourism business development in any destination as it leads to extended length of stay and increased tourist expenditure. In fact, over 80 percent of the world's top tourism destinations are countries where key activities occur on or near water bodies. Examples of these are France, United States, Spain, China, Germany, Russia, Mexico, the United Kingdom, and India. Though hugely underdeveloped for tourism, Uganda is blessed with plenty of attractive lakes and rivers. Nearly one fifth of Uganda's total land area (approximately) 42,000 square kilometres is open water or swampland. Five of East Africa's Great Lakes – Lake Victoria, Lake Kyoga, Lake Albert, Lake George, and Lake Edward – lie within Uganda or on its borders. In addition to several other lakes and rivers spread across the country, Uganda is also home to the source of river Nile, the longest river in the world. The environment in and around these water bodies abounds with immense potential and opportunities for the development of water-based tourism.

In terms of geographic distribution, Western Uganda has the highest share of recorded tourism resources/attractions (42 percent) in the country, comprised of national parks, wildlife reserves, hot springs, monuments, lakes (including crater lakes), rift valleys and escarpments, forests, and mountains. The central region follows with 29 percent, rich in traditional heritage and historical sites, and is known for the beaches and islands on Lake Victoria. The Northern region (16 percent) has mainly historical monuments and water bodies while attractions in Eastern Uganda (13 percent) are mainly comprised of waterfalls and adventure activities on the River Nile, scenic landscapes, hiking and mountaineering as well as significant wildlife potential (MTWA, 2014).

3. Tourism in Uganda's national planning framework

The Uganda Vision 2040 identifies tourism among the opportunities to be harnessed for higher inclusive growth in Uganda. The vision is implemented through National Development Plans (NDP) with the current plan (NDPIII) identifying tourism as one of the priority sectors (Agriculture, Tourism, Minerals, Oils and Gas, Infrastructure, and Human Capital Development). As with its two predecessors, NDPIII intends to realize the potential of tourism in Uganda by increasing the country's attractiveness as a preferred destination. Between 2020/21 and 2024/25, NDPIII expects the *Ministry of Tourism Wildlife and Antiquities* as well as the ministry's agencies to:

- Increase annual tourism revenues from US$1.37 billion in 2017/18 to US$2.5 billion;
- Increase the contribution of tourism to total employment from 667,600 to 1,100,000 jobs;
- Increase average expenditure per leisure visitor from $1,052 to $1,239;

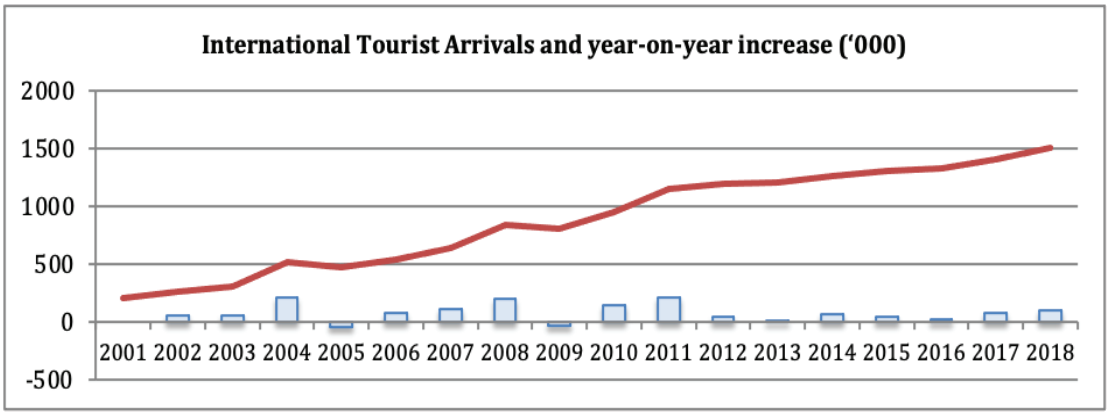
- Increase the number of international tourist arrivals from 1,402,409 to 2,102,486;
- Increase the proportion of leisure to total tourists from 20.1 percent to 30 percent;
- Increase the number of direct flight routes from Europe and Asia from 6 to 15.

Whether Uganda achieves the above goals will depend on how well the country addresses the COVID related bottlenecks and other challenges affecting the sector.

4. Tourism sector performance in Uganda

Over the past 20 years, tourist arrivals into Uganda have steadily increased: from 205,000 in 2001 to over 1.5 million arrivals in 2019. Uganda's tourism registered an increase in revenue in the 2018/2019 financial year, with over $1.6 billion received compared to $1.45 billion in 2017 (MTWA, 2019). This makes the country's tourism sector the top foreign exchange earner. Within the frame of the last National Tourism Sector Development Plan (TSDP) for tourism, the growth rate of year-on-year incremental visitors has seen a decrease in its trend since 2011 before starting again to increase for the last two years.

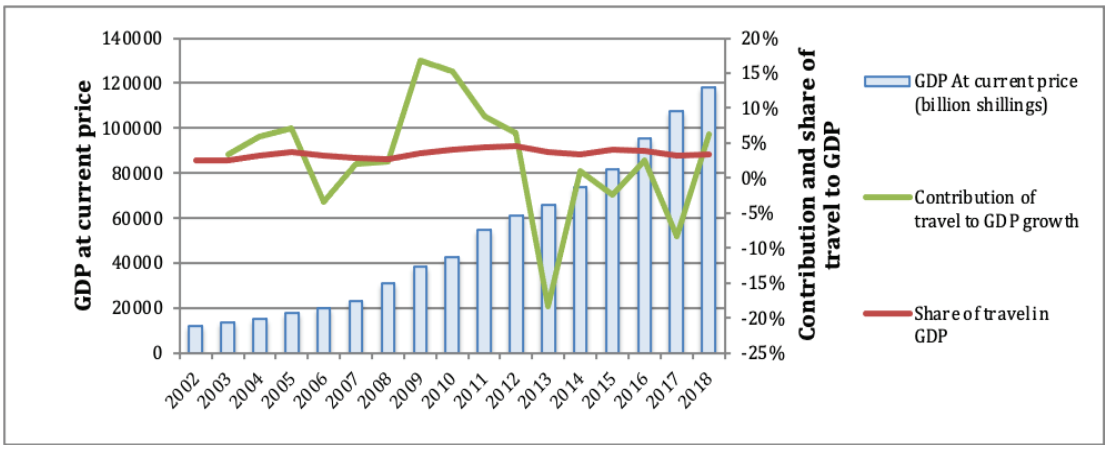
Figure 1: International tourist arrivals to Uganda 2001-2018 ('000)



Source: Uganda Bureau of Statistics.

According to official figures, tourism contributed US$1.453 billion to Uganda's export basket in 2017 compared to USD 1.371 billion in 2016 and was the single highest foreign exchange earner, contributing 23.5 percent of total exports. The direct contribution of Tourism to GDP in 2017 was UGX 2,699.1bn (2.9 percent of GDP) while the total contribution including wider effects from investment, the supply chain and induced income impacts, was UGX 6,888.5bn in 2017 (7.3 percent of GDP), up from UGX6, 171.5bn in 2016 (Figure 2).

Figure 2: GDP and share of travel (2002 – 2018)



Source: Adapted from URA (2020).

While the travel industry's contribution to GDP growth fluctuates from year to year, depending on the performance of other economic sectors, the share of travel in GDP has remained constant over the past few decades. This means that the tourism sector and GDP are growing on a similar trend.

In terms of contribution to employment in the economy, Tourism generated 229,000 jobs directly in 2017 (2.4 percent of total employment). This includes employment by hotels, travel agents, airlines, and other passenger transportation services (excluding commuter services). The total contribution of Tourism to employment (including wider effects from investment, the supply chain and induced income impacts was estimated at 605,500 jobs in 2017 (6.3 percent of total employment).

The Uganda Wildlife Act, 2019 - Section 86 (2d), provides for revenue sharing where 20 percent of the park entry fees collected from visitors entering wildlife protected area is given to the local government(s) of the parishes surrounding the wildlife protected area from which the fees were collected. Through this scheme, and from 2005 to 2017, the Authority generated over 18 billion shillings for revenue sharing in support of community projects (UWA 2018). However, the commercial exploitation of the Ugandan national parks is in fact far less intensive than among its major competitors. If the low rate of visitors per day per square kilometre in national parks represents a comparative advantage for Uganda, needless to say that Uganda has a lot of room to grow before the national parks' maximum carrying capacity is attained.

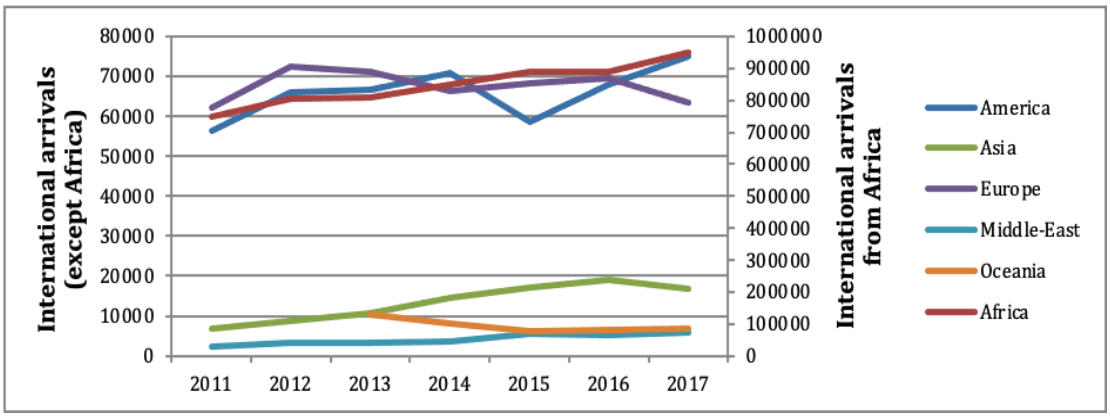
Second, although gorilla tourism is the single most important asset over which Uganda has an absolute advantage when compared to Kenya and Tanzania (Moyini & Uwimbabazi, undated), 12,545 gorilla permits were left unsold in 2019 and 46,470 for the years 2016-2019. An in-depth analysis of the current tourism economy shows that Uganda is missing out on some obvious opportunities. In themselves, the

unsold gorilla permits represent a substantial loss of US$ 27.9 million for the years 2016-2019 despite a much cheaper daily rate than in Rwanda (US$ 600 compared to US$1500 for a Gorilla permit). Overall, the total government revenues from national parks for the year 2019 can be evaluated as the sum of the entrance fees to National parks (US$ 6 655 007), the Gorilla permits (US$ 31,303,200) and the Chimps permits (data not available). Altogether, this is roughly US$ 40 million in 2019.

5. Demand side competitiveness of Uganda's Tourism Sector

Africa contributed the most to international arrivals to Uganda with Rwanda and Kenya sharing 40 percent and 30 percent of the total arrivals respectively. International arrivals from Africa have risen continuously for the last decade. Arrivals from Asia have been rising steadily, at least until 2017; those from the Americas show a slight upward trend. However, those from Europe have been stagnant or declining. It is too early to draw conclusions on them.

Figure 3: Trends of international tourist arrivals to Uganda by region of origin.



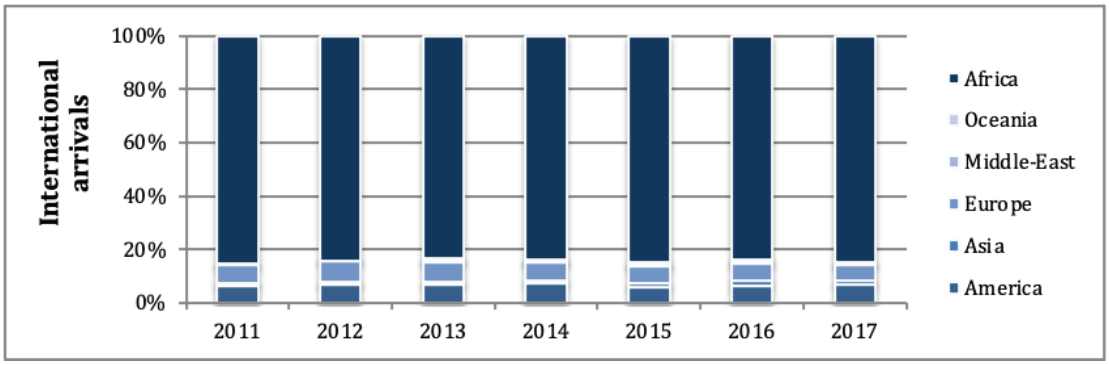
Source: MOTWA (2019)

The regional statistics suggest nevertheless that the Ugandan tourism industry is losing its competitiveness in some markets and consequently its market share is stagnating[43]. The growing and intense competition in the game-viewing tourism market segment has led Uganda to contend with issues of destination competitiveness especially from regional destinations such as its neighbouring countries and its main regional competitors (Tanzania, Rwanda, Kenya, Botswana, Zimbabwe, and South

43 **The measurement of competitiveness adopted here is drawn from the work of Khao-Sard and Unthong (2005). Uganda has a competitive advantage in a particular market if the share of international tourists from that market is greater than the average. The average here is defined as the share of outbound tourists from that market in all competing destinations if the ratio is greater than 1 - this means that Uganda is a relatively preferred destination compared to competing destinations as a whole.**

Africa). Thus, while Uganda experienced a decrease in international arrivals from Asia in 2017, it is still a relatively preferred destination for tourists from Asia and Pacific or has a competitive advantage in this market. The proportion of tourists from Asia and Pacific compared to the total number of tourists that visited Uganda was greater than the share of tourists from Asia and Pacific in competing destinations.

Figure 4: International visitor arrivals to Uganda by region of origin (2011-2017).



Source: MOTWA (2019)

In other words, the absorption of tourists from Asia and Pacific by Uganda is greater than the absorption of tourists from Asia and Pacific by the other game viewing destinations.

From the table below, the competitive advantage of Uganda in the Africa, Asia Pacific and Middle East markets was respectively 1.125, 1.060 and 1.667 in 2017 meaning that Uganda's share of tourists from Africa, Asia Pacific, and the Middle-East was 1.1, 1.06 and 1.7 times greater than the average share of these categories of inbound tourists in the entire region. On another side, Uganda's share of European (0.451) and American (0.975) tourists was smaller than the share of European and American tourists in the region. The same approach is being used for leisure markets in different regions of the world (table 1), including those to which Uganda has directed its marketing efforts.

Table 1: Comparative advantage ratio by regions (2010-2014-2017)

	Africa			Americas			Asia and Pacific			Europe			Middle East		
	2010	2014	2017	2010	2014	2017	2010	2014	2017	2010	2014	2017	2010	2014	2017
Uganda	1,043	1,038	1,125	1,225	1,154	0,975	1,171	1,280	1,060	0,680	0,631	0,451	2,114	1,411	1,667
Kenya	0,262	0,408	0,295	1,505	2,855	2,101	1,941	2,960	2,307	3,429	2,540	3,108	3,453	6,749	2,730
Tanzania	0,694	0,615	0,630	1,531	2,070	1,661	2,460	1,918	1,799	1,682	2,223	1,964	1,869	3,513	4,499
Rwanda	0,519	1,194	1,253	4,104	0,550	0,463	0,929	0,464	0,580	1,905	0,351	0,272	0,891	0,420	0,502
Botswana	1,306	1,170	1,192	0,314	0,578	0,633	0,210	0,490	0,518	0,227	0,467	0,499	0,000	0,130	0,091
Zimbabwe	1,243	1,133	1,127	0,537	0,676	0,876	0,579	0,757	1,010	0,312	0,534	0,535	0,302	0,223	0,214

South Africa	1,047	1,016	1,030	0,905	0,868	0,932	1,003	0,872	0,844	0,854	1,028	0,956	0,815	0,458	0,621	
Conclusion per market	Maintaining market share			Losing market share and comparative advantage			Losing market share			No comparative advantage and losing market share			Regaining market share			

Source: MTWA, 2020.

Table 2: Comparative advantage ratio by country (2013-2017)

	Canada		United States of America		China		France		Germany		United Kingdom	
	2013	**2017**	**2013**	**2017**	**2013**	**2017**	**2013**	**2017**	**2013**	**2017**	**2013**	**2017**
Uganda	1,234	1,517	2,089	2,130	1,019	1,307	0,430	0,436	0,270	0,185	1,113	1,084
Kenya	0,584	0,532	0,807	0,834	0,745	1,257	0,794	0,636	1,365	1,433	0,960	0,704
Tanzania	4,538	4,783	0,381	0,301	0,840	1,075	1,603	1,250	0,676	0,617	0,935	1,018
Rwanda (2016)	1,688	1,510	2,021	1,983	1,066	0,862	1,421	1,163	0,398	0,383	0,646	0,820
South Africa	0,823	0,708	1,209	1,164	1,349	0,686	1,185	1,389	0,694	0,709	1,068	1,318
Conclusion per market for Uganda	Gaining market share		Gaining market share		Gaining market share		Maintaining market share but no comparative advantage		Losing market share and no comparative advantage		Losing market share and comparative advantage	

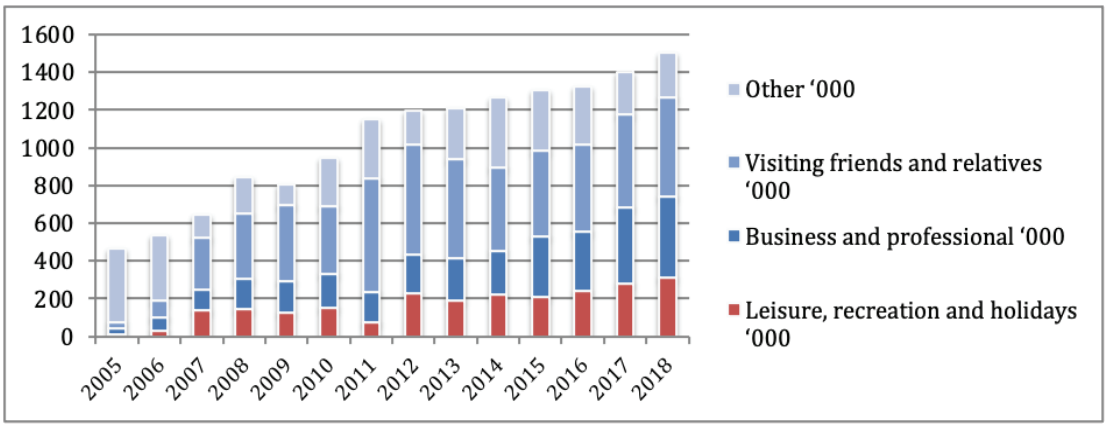
Source: MTWA, 2020.

Uganda has made some modest investments in the diversification and development of tourism products, with tourism marketing in the United States, German-speaking Europe, and the United Kingdom. As a result, the country has registered some success in terms of increasing tourist arrivals and revenue as well as creating jobs along the tourism value chain. The objective of this analysis is however to demonstrate that growth in tourist arrivals is not particularly significant in terms of competitiveness against competing countries. In the analysis by country of origin, the regional statistics suggest that the Ugandan tourism industry is losing its competitiveness in the German and British markets while gaining market shares for North American and Chinese markets. For the North American markets, the competitive advantage of Uganda in the Canadian and USA markets was respectively 1.517 and 2.130 in 2017 meaning that Uganda's share of Canadian and USA tourists was 1.5 and 2.1 times greater than the share of these categories of inbound tourists in the competing destinations.

While experiencing a decline for the British market, the absorption of tourists from UK by Uganda remains, however, greater than the absorption of tourists from UK by the other regional destinations (with the exception of South Africa). Similarly, while Uganda experienced a decrease in international arrivals from Asia in 2017, it is a relatively preferred destination for tourists from China or has a competitive advantage in this

market. Broadly, Uganda does not compete well for the western European markets with a loss of market share for Germany and a stable but limited competitiveness for the French market. These results also highlight that other markets influence the competitive advantage ratio by region of origin. Still using the competitive advantage ratio by region (table 1), for the leisure markets, and especially for visitors from the Americas, Uganda has in fact lost its competitive advantage over the last 3 years while it gains market share for two specific markets (Canada and USA) inside this region. This seems to be especially relevant for the Northern European markets but there was a lack of statistical information from the competing countries to demonstrate it. Over the years, Uganda is constantly losing market share and is getting less and less competitive on the regional scene in the European leisure market.

Figure 5: Share of visitor categories (2005-2018)

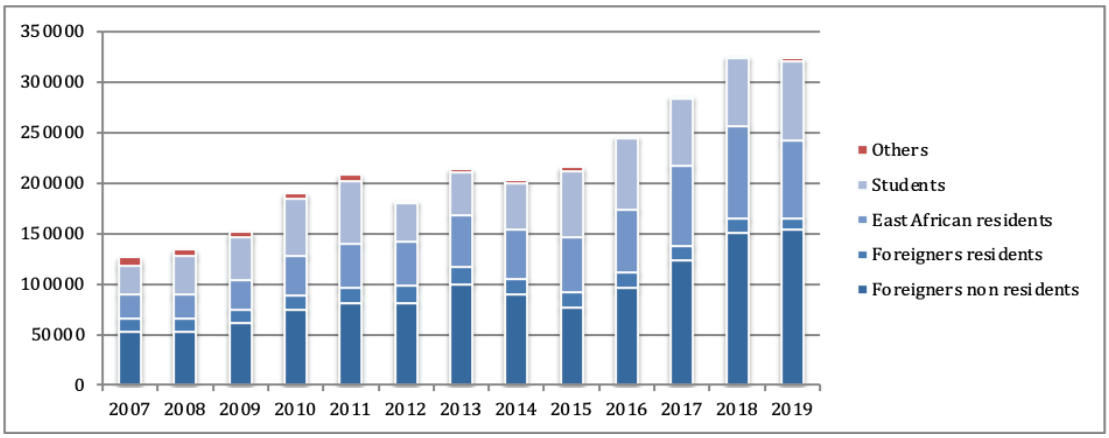


Source: MTWA (2019).

The leisure market is however the main contributor to local economies as it offers the highest levels of spending per person, and provides opportunities for regional and remote communities to diversify their livelihoods, generate higher standards of living and create jobs. Nowadays, the great majority of leisure tourism expenditures occur in the regions through the visit of national parks. Although the proportion of leisure visitors to total visitor arrivals is still relatively small, it keeps however increasing to reach 20.7 percent in 2018. Visiting friends and relatives (VFR) remains the main category (34.8 percent) followed by business visitors (28.7 percent). Again, this increase in the share of leisure tourists is continuous within the implementation of the TSDP. However, Uganda is left behind by its main competitors (Kenya and Tanzania) with respectively 72 percent and 73 percent of all visitors coming for leisure purposes.

In Uganda, we can also observe the increase in the volume of leisure visitors in the number of foreign non-resident visitors to national parks with a continuous growth since 2015. In 2019, they counted for 48 percent of all entries to National Parks.

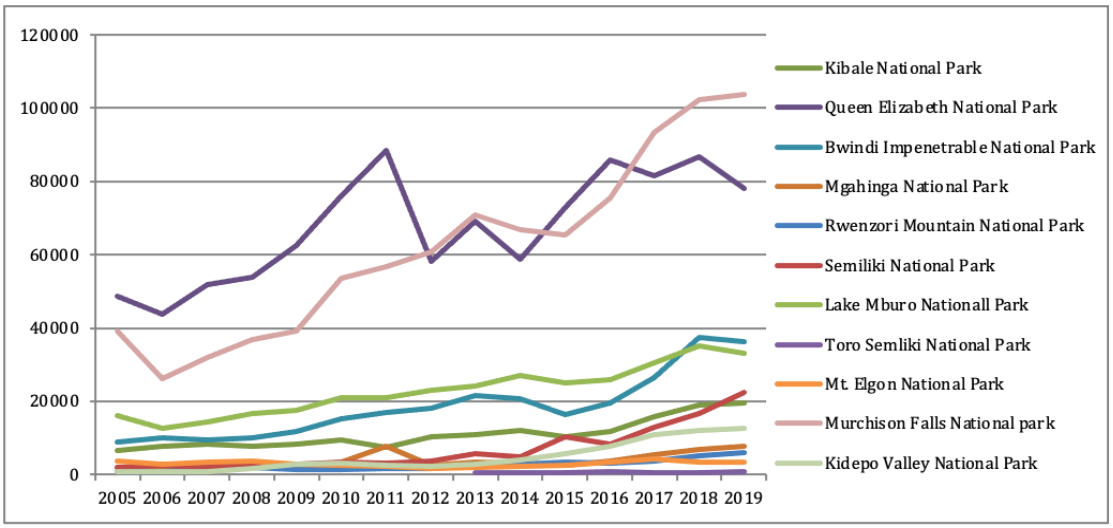
Figure 6: Visitors to National Parks, 2007 – 2019.



Source: UWA (2020).

Although Queen Elizabeth National Park (QENP) was the most visited national park over the last decade, Murchison Falls National Park is now the main attraction for international leisure visitors. But the Bwindi Impenetrable Forest – with Gorilla permits that cost over $ 600 – received the greatest share of these expenditures. In fact, the QENP is the only park to show stagnation in visitor numbers during the last TSDP's implementation period. For the Murchison Falls National Park, we do not perceive any consequences so far due to oil exploration, including the construction of a paved road within the park. While it can be considered as an improvement for some categories of visitors, it may not be the case for others.

Figure 7: Visitors trends in Ugandan's National Parks (2005-2019)



Source: UWA (2020).

6. Supply side competitiveness of Uganda's Tourism Sector

Supply side competitiveness can be measured using a wide range of relevant indicators, namely price, openness, technology, infrastructure, social development, environmental and human resources (Gooroochurn and Sugiyarto, 2004). In this section, we propose a review of indicators to benchmark or rank Uganda compared to regional countries in terms of ease of doing business and in the areas of tourism competitiveness. Considering that government support systems influence the competitiveness of a product and its suppliers, the section also includes an in-depth investment climate assessment and a cost-benefit analysis to evaluate whether the current governmental financial support given to the tourism sector is enough to expect improvement in competitiveness.

Ease of doing business

An important aspect of the competitiveness of a tourist destination is the perceived ease of doing business there. The World Bank "Doing Business" indicator sheds light on how easy or difficult it is for an entrepreneur to open and run a small to medium-size business when complying with relevant regulations. It measures and tracks changes in regulations affecting 10 areas in the life cycle of a business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency.

Uganda's overall Doing Business 2019 ranking is 127, falling back 7 places since 2013. Uganda performed best in enforcing contract, in which it moved from the rank of 117 in 2013 down to 71. While it gets better in protecting investors, paying taxes and trading across borders, in all the other categories Uganda dropped in rankings.

Table 3: Doing business indicators (Uganda – 2013 and 2019)

TOPIC RANKINGS	DB 2013 rank	DB 2019 rank	Change in ranking
Starting a business	144	164	-20
Dealing with construction permits	118	145	-27
Getting electricity	127	175	-43
Registering property	124	126	-2
Getting credit	40	73	-33
Protecting investors	139	110	+29
Paying taxes	93	87	+6
Trading across borders	159	119	+40
Enforcing contracts	117	71	+46
Resolving insolvency	69	112	-43

Source: World Bank – Ease of Doing business (2019).

The most significant improvements were recorded in the enforcing contracts and trading across borders indicators, where the country dropped respectively 46 and 40 spots. Uganda has introduced and improved electronic submission and processing of documents for imports and exports. Uganda fully implemented the Centralized Document Processing Centre, an electronic processing platform that centralizes all documentary checks. Traders in Uganda also began using the Uganda Electronic Single Window, which allows for electronic submission of documents as well as for the exchange of information between trade agencies.

However, Uganda has considerably reduced its competitiveness in terms of starting a business. According to the World Bank, an entrepreneur in Uganda, for example, will spend nearly a month and undertake 13 procedures to set up a new company. The entrepreneur will then be required to manage another 18 interactions with different agencies and wait an additional four months to obtain a building permit. Once the construction of the warehouse is completed, the entrepreneur will need to wait another two months and cash out 7,513.6% of income per capita to obtain a connection to the electrical grid.

Table 4: Doing business indicators (Uganda, Kenya, Tanzania, Rwanda - 2019)

	Kenya	Tanzania	Rwanda	Uganda
2013	121	134	52	120
2019	61	144	29	127
Starting a business	126	163	51	164
Dealing with construction permits	128	150	106	145
Getting electricity	75	83	68	175
Registering property	122	146	2	126
Getting credit	8	60	3	73
Protecting investors	11	131	14	110
Paying taxes	91	167	35	87
Trading across borders	112	183	88	119
Enforcing contracts	88	64	78	71
Resolving insolvency	57	117	58	112

Source: World Bank – Ease of Doing business (2019).

In the meantime, two of its main regional competitors (Kenya and Rwanda) have dramatically improved their ranking and, especially, in the categories where Uganda is getting worse. The World Bank report deals with the most general indicators of the investment situation in the region. Considering that the country's ranking in the ease of doing business indicator does not provide a specific assessment of the investment climate in the tourism sector, the following section is an attempt to shed some light on it.

Assessment of investment climate

Ugandan law allows for 100 percent foreign-owned businesses and foreign businesses partnering with Ugandans without restrictions. The GOU offers incentives for industrial investments, including: a 75 percent import duty reduction on factory equipment, depreciating start-up costs over four years, and a 100 percent tax deduction on research and training costs.

Despite the above-mentioned investment incentives, there remain difficulties in starting a business in Uganda. According to the US Department of State, they can be linked to pervasive corruption and a sluggish, non-transparent bureaucracy that continues to hamper foreign investments in. Uganda was ranked 151 out of 176 countries on Transparency International's "Corruption Perceptions Index" in 2017[44].

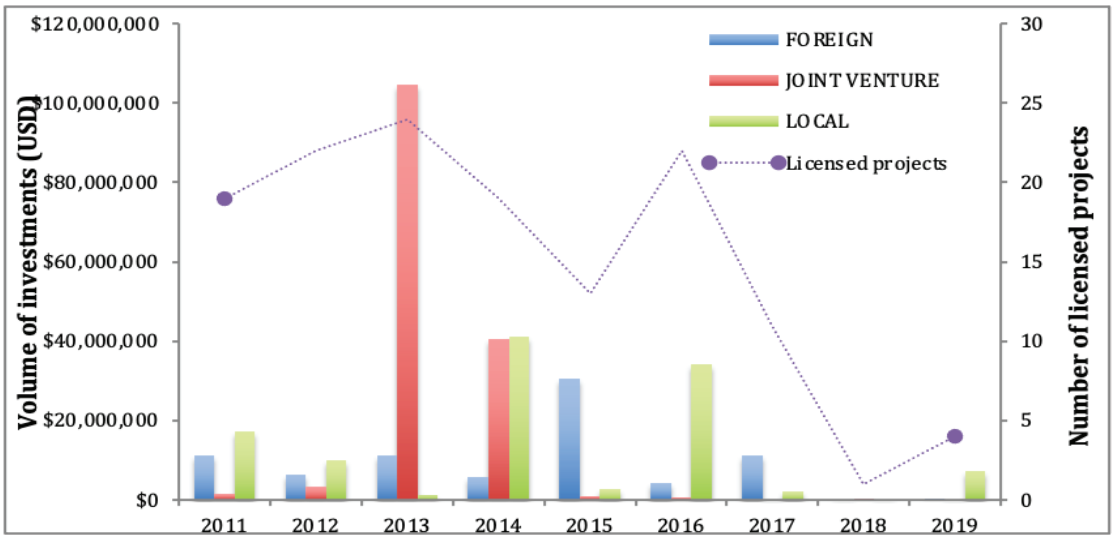
In October 2017, Uganda hosted a conservation investment conference where several multi-national and investment companies showed interest in investing in the country's tourism sector. Out of the 20 investors that submitted proposals, the number was cut to nine following the government's evaluation of the proposals. Following this conference, there was an initiative from Space for Giants[45] in 2019 with an ongoing conservation investment process in Uganda that was on course to bring in more than $60m of new capital investment in five national parks by leading responsible tourism operators (Great Plains, Elewana Collection, Serena Group, etc.). The initial offerings were two areas in Kidepo Valley National Park, four in Murchison Falls National Park, two in Kibale National Park, two in Queen Elizabeth National Park, and an area in Semuliki National Park. To allow flexibility in the scope of investor proposals, the Uganda Wildlife Authority had not required that interested investors cite specific sites. It was anticipated that these would be determined in discussion with successful applicants during detailed proposal and contracting stages. To oversee this investment opportunity, Uganda has created a special transparent application process in partnership with the Giants Club. The deadline for interested investors to submit their initial Expressions of Interest was 29 June 2019. As of today, no information was found regarding this series of new high-end lodges built by Africa's leading responsible tourism operators. This may be attributed to COVID-19 crisis.

Finally, with poor marketing, quality of services and the fact that 80 percent of tourists are residents of East Africa with low per capita tourist expenditure, the hotels have only 44 per cent annual bed occupancy. Such a low occupancy rate impedes on the attractiveness of the country for investors and the low number of licensed projects under the tourism sub-sector translates both a limited attractiveness of Uganda to Foreign Direct Investments and either a low interest from local investors to the sector or the existence of too many barriers for them to invest.

44 http://www.transparency.org/research/cpi/overview

45 Space for Giants is an international conservation charity that protects Africa's elephants and their habitats while demonstrating the ecological and economic value both can bring. www.spaceforgiants.org

Figure 8: Number of licensed projects under the tourism sub-sector and volume of investments.



Source: URA (2020).

Another indicator of the investment climate and the attractiveness of the country for FDI is how Uganda is inserted into the Global Value Chain and, more precisely, how many international chains have facilities in the country. By November 2018, only 3 international hotel chains were operating in Uganda i.e., Marriott International Group (Sheraton Hotel and Protea Hotel brands); Louvre Hotels Group (Golden Tulip Canaan brand) and Best Western Hotels and Resorts (Best Western Premier Garden Hotel, Entebbe) as compared to Kenya (with 15) and Tanzania (also with 15)[46]. Hilton Garden Inn Kampala joined the Hilton Portfolio in 2019 and Royal Swiss Empuku Spa & Resort, Entebbe has joined the Swiss International Hotels & Resorts chain in 2019. But several of the new proposals received come from well-established regional or international chains.

7. Tourism competitiveness index

The World Economic Forum has provided an alternative way of understanding competitive advantage in tourism, ranked across a broad range of criteria – including the tourism enabling environment, the policy and enabling conditions, the travel and tourism infrastructure, and the cultural and natural resources - related to key tourism decision-makers' perceptions of the relative competitiveness of the travel and tourism industry in each of the 140 countries for which data are available.

46 Knight Frank (2018). **Hotels Africa 2018**: Accommodating growth in Africa

Table 5: World Travel and Tourism Index – Main indicators (2019)

2019	South Africa	Zimbabwe	Botswana	Kenya	Tanzania	Rwanda	Uganda
Overall	**61**	**114**	**92**	**82**	**95**	**107**	**112**
Change 2017/2019	-8	0	-7	-1	-4	-11	-5
T&T enabling environment	105	125	99	111	120	104	124
T&T Policy and Enabling Conditions	107	106	82	68	65	89	88
T&T infrastructures	60	113	93	90	110	106	124
T&T cultural and natural resources	17	65	67	42	39	115	55

Source: World Economic Forum (2019)

Uganda scores poorly on the competitiveness index. In 2019 Uganda achieved a total score of 3.2 – a rank of 112 out of 140 countries. This is the lowest ranking of any of the East African countries after Zimbabwe. Other East and South African states have more favourable rankings on the competitiveness index: Kenya (score 3.6, ranked 82), Rwanda (score 3.2, ranked 107), Tanzania (score 3.4, ranked 95) and South Africa (score 3.5, ranked 61). Generally, the competitiveness index score is higher for countries at more advanced stages of development than for countries at a lower level of income. The analysis below illustrates the relative price competitiveness of EAC tourist industries.

Uganda ranked particularly poorly for the enabling environment, which captures the general conditions for operating in a country, and the infrastructure (availability and quality of physical infrastructure). However, it ranked third in the T&T policy and enabling conditions which capture the specific policy and strategic aspects that impact the T&T industry more directly. This means that the policy tools specific to the tourism sector (tourism policy and Tourism Sector Development Plan- TSDP) are viewed positively in light of the negative assessments made of the general framework within which businesses operate in Uganda. The constraints to be addressed therefore seem to be at other levels than that of the sector. This is an important finding for the future TSDP as it encourages more policy coordination issues.

There is one indicator that positively influences Uganda's competitiveness under the T&T policy and the Enabling Conditions Index, and beyond, namely the price competitiveness of the sector. It is the best sub-indicator for the country but also among competing countries. However, from a general perspective, the country has only moved up three places in the last 7 years while Kenya has gained 21 places comparatively.

On a negative note, Uganda performs quite poorly with regards to its cultural resources (1.5) and airport infrastructure (1.7) especially compared to its competitors for the latter. The country has the lowest score in the region for the following categories: Health and hygiene (2.5), Air transport infrastructure (1.7), and tourist service infrastructure (2.3). These are important indicators for visitors as they directly concern their experience in the country.

Table 6: World Travel and Tourism Index – sub-indicators (2019)

	South Africa	Zimbabwe	Botswana	Kenya	Tanzania	Rwanda	Uganda
Enabling environment							
Business environment	4,6	3,3	4,9	4,5	4	4,9	4,2
Safety and security	3,9	5,4	5,3	3,6	5,2	5,9	4,7
Health and hygiene	3,7	3	3,3	3,4	3	2,8	2,5
Human resources and labour market	4,4	3,6	4,3	4,4	3,6	4,4	4,1
ICT readiness	4,6	3,2	4,1	3,5	2,9	3,4	3
T&T Policy and Enabling Conditions							
Prioritization of Travel & Tourism	4,5	4,2	4,8	5,4	4,9	4,1	4,3
International Openness	2,5	3	2,8	3	3,3	3,2	3
Price competitiveness	5,6	5,3	5,7	4,5	5,5	5,3	5,7
Environmental Sustainability	3,7	4,1	4,3	4,9	4,4	4,5	4,2
T&T Infrastructures							
Air transport infrastructure	3,3	1,8	2,1	2,7	2,2	1,9	1,7
Ground transport infrastructure	3,5	2,3	2,8	3,3	2,8	3,4	2,5
Tourist service infrastructure	4,3	3	3,6	2,9	2,4	2,3	2,3
Natural and cultural resources							
Natural resources	4,5	3,6	3,4	4,5	4,7	2,6	3,7
Cultural resources	3,2	1,3	1,2	1,5	1,3	1,2	1,5

Source: World Economic Forum (2019)

Despite a loss of competitiveness in the main leisure markets, tourism still contributes greatly to the Ugandan tax base and economy. The fact that tax from the tourism industry is one of the main sources of government income implies that the government can show its commitment towards the growth of the sector by foregoing this income in exchange for increased investments. While incentives to investment exist to increase the country's tourism competitiveness to foreign investors, they are however not sufficient to increase investor confidence in tourism in an industry. This is particularly because investment incentives are too focused on tax incentives. Such policies (tax incentives) are not followed by other supportive policies in other areas of the economy that help boost investment in the tourism sector. Other factors like corruption, transparency in government policies, length, and cost of starting a business in the country, for instance, are other important factors that need to be urgently taken into consideration.

8. COVID-19 and the Tourism Sector in Uganda

The outbreak of the Novel Coronavirus (COVID-19) in Wuhan China since December 2019 has since spread across the globe with over 67 million people already having been infected and more than 1.5 million succumbed to the virus[47]. The virus was declared a pandemic and has wreaked havoc on all world economies. The tourism sector has not been spared and it is one of the hardest hit, with borders closed, air traffic grounded and travel restrictions across the globe (Figure 9).

Figure 9: Change in Sectoral GDP by Quarter: 2018-2020

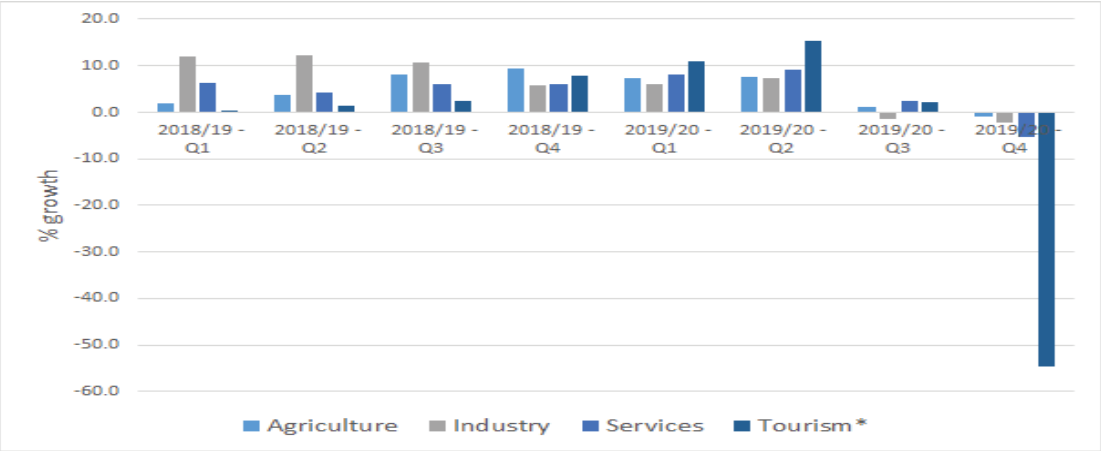


Figure 9 compares the change in output by quarter for tourism with three broad sector categories. In the second quarter of fiscal year 2019/20, that is, March to June 2020, tourism suffered a huge decline while other sectors suffered only moderate drops.

The socio-economic impacts of COVID-19 on the tourism sector of Uganda have been widely studied (NUDP, 2020; AUTO, 2020; UTB, 2020: UTA, 2020; EPRC, 2020). All actors along the value chain of tourism have been significantly affected. These include airlines, tour operators, travel agents, accommodation facilities, destination sites, restaurants, community-based initiatives, handicraft producers and sellers among others. There have also been significant indirect effects arising out of the numerous backward and forward linkages that tourism has with other sectors.

The pandemic hit hardest the major source markets for Uganda. These were particularly the US, UK, Italy, Germany, and other western countries. Uganda mainly depended on these markets for the leisure visitors and they provided the much needed foreign exchange for the country. The positive results shown in the economic analysis of the sector indicated a growth in a number of these markets. Indeed, a number of the value chain operators relied on these markets for business. These actors include tour operators, tour guides, safari lodges in and around the protected areas and other destinations in

47 https://www.worldometers.info/coronavirus/

Uganda, local community enterprises and the major destination sites. These enterprises have suffered from cancellations, and postponement of trips which have had widespread business implications. What is more worrying, the average leisure visitor from western countries was about 45 years and above, with several visitors aged above 55. This is the age group that is especially prone to the coronavirus. They may receive strong advisories against travelling long-haul and thus destinations like Uganda must prepare to wait or switch to other markets. While the regional and domestic markets offer an alternative, their purchasing power is weak, and they are not generally interested in the kind of product that has been predominantly purchased by the western senior visitors. As such, a refocus on destinations that are looking to recover sooner may be of some help, but it will be only limited. The enterprises are experiencing financial stress, they are losing their good employees, to both redundancy and other sectors, operations have become difficult and livelihoods have been ravaged. A five-year outlook indicates that by 2025, Uganda would have lost about US$5 billion in revenue from tourism. Over this period, the government would lose US$1.5 billion in direct tax revenue from tourism. About 4 percent of this loss would go to accommodation facilities, 16 percent souvenirs, 15 percent restaurants, 12 percent tour operators and others 14 percent.

The preceding impacts of the pandemic on the sector will only serve to undermine the competitiveness of the tourism sector in Uganda. The country is on the verge of losing the gains it had made in key markets and all the good work that had been made to build the sector nationally. It is therefore imperative for government to support the tourism sector. Government has the responsibility of steering the sector out of the crisis and helping avoid the projected loss of USD5 billion over a five-year period and the attendant socio-economic problems.

9. Uganda's tourism priorities: 2020/21-2024/25

Before the outbreak of the COVID-19 pandemic, Uganda's tourism was on a positive growth trajectory. The NDP III had set sound ambitions for the sector, meant to consolidate the gains made in the last five years and build on the lessons learnt to develop the sector further. It should be noted that a number of the projected targets may not be achieved and that the focus must be put on addressing the impacts of the pandemic.

For long haul destinations like Uganda, the projection is that tourist arrivals may start to increase from the summer of 2022. This means that over the next two to three years, Uganda should start to build a solid tourism industry that will be strong and meet the expectations of visitors. Many destinations will be in a state of renewal and are expected to return with more aggressive and better strategies. Thus, Uganda needs to renew itself and offer a better tourism experience once the pandemic is over. Beyond these interventions, Uganda should continue to focus on a number of priorities that were identified in the TSDP 2015/16 – 2019/20. A review of the implementation of these priorities showed that a lot of work was still in progress and a number of them should

be continued (MTWA, 2020). It is generally believed that a focus on these priorities, while at the same time instituting short term and medium-term measures to deal with COVID-19, will support building of a prosperous resilient tourism sector. We conclude this paper with six priority areas for the sector over the next five years.

Priority area one: **Crisis response and transformative crisis recovery measures**

The government of Uganda needs to urgently create a crisis response strategy designed to prevent the tourism sector from collapsing. The response should include financial relief to the private sector as well as the government and non-government organizations operating in the area of conservation and tourism development. The financial relief should help to meet liquidity needs for basic operations and maintenance. The sector further needs financing to adjust their facilities to the new COVID-19 Standard Operating Procedures (SOPs). Beyond direct financial support, the sector needs to operate with special subsidies and discounts on key products and services for at least two years.

During the same period, it is important to invest in public relations efforts to create awareness of developments in Uganda, with a focus to establish confidence in the destination's safety. These efforts will need to be supported with marketing and promotion, especially using digital channels, to convince visitors to choose Uganda as a preferred destination to recuperate from the crisis.

Priority area two: **Tourism resources conservation**

Tourism continues to grow as an important sector of the Ugandan economy; however, the sector's growth is heavily dependent on the country's capacity to sustainably manage its resources including natural, cultural, and historical heritage resources.

To harness tourism as a driver of growth after the pandemic it is therefore crucial for the country to put efforts into preserving its two most important resources over the next five years: *Wildlife resources* as well as *cultural and heritage resources*.

The Government's prioritization of resource conservation should be to: (1) ensure biodiversity and cultural diversity of the country is sustained or enriched as a basis of economic growth; (2) recover wildlife population and restore or reconstruct degraded sites and monuments of cultural significance (3) strengthen the sustainable resource use for national transformation and (4) achieve socio-economic development through tourism. These resources are the pillars to the shaping of national development, improved liveability and competitiveness of Uganda in international markets. Thus, our natural and cultural endowments present the basis of national development. Resource conservation is within the Vision 2040 priority areas as the basis to achieve Uganda's competitiveness and promote sustainable use including caring for the benefits of future generations.

Priority area three: **Tourism product development**

Tourism products of Uganda can be defined as a configuration of the core (primary) product, (natural and cultural tourism including wildlife, monuments and sites, cultural events, Meetings, Incentives, Conferences and Events (MICE) and the related specific services) and the additional product (general tourist facilities and services and transportation infrastructure). The core (primary) products mainly consist of attractions forming the central theme of the tourism experience and give the customer a reason to buy tourism products. To further increase earning from tourism, it is vital for Uganda to develop tourism products in line with the following guiding principles:

- Creating economic benefits – spending, taxation revenues, jobs, new business opportunities;
- Improving the quality of life for Uganda's residents both through economic contribution and the creation of more recreational facilities; and
- Using tourism to conserve and preserve Uganda's natural and cultural heritage and way of life.

Following these guidelines, previous work identified the following six products to be developed over the next five years:

1. *Wildlife product enhancement* by focusing on Bwindi Impenetrable National Park land use planning and Craft Village Development at Buhoma, Ruhija, Nkuringo, Rubuguri and Rushaga and Queen Elizabeth National Park and Lake Mburo National Park ecological restoration to consolidate and enhance gorilla tourism and boost game tourism respectively.
2. *Adventure tourism development* by focusing on improving infrastructure and accommodation in Rwenzori Mountains National Park. This is part of upgrading RMNP attractiveness to compete with Mounts Kilimajoro and Kenya in East African marketplace.
3. *Water-based tourism* product development by focusing on establishing Nile Cruising; Lake Victoria Cruising Projects to diversify Uganda's tourism product base. This a continuation of the proposed tourism product development in TSDP, 2014/2015 – 2019/2020, but the Source of Nile should be integrated with and become part of this project instead of being stand-alone project.
4. *Religious tourism* development by initiating Uganda Martyr's Trail with Namugogo Martyrs Shrine as the main centre for Uganda Martyrs Tourism as well as supporting the implementation of Sound and Light show at the shrines. This aims to boost popularity of Uganda realized with the growth in Uganda Martyrs Tourism over the years.
5. *Rock Art Tourism* Development focusing on the Dolwe Island, Nyero, Kapiri, Mugognoro, Komuge and Kakoro. The purpose is to diversify product as well as to expand tourism development in eastern Uganda that has relied on wildlife and mountain climbing in MENP; but a destination marred by landslide problem.
6. *Meeting Incentives Conferences and Events centre development* by focusing on Entebbe Conference & Convention Centre. The Convention Centre Entebbe (CCE)

is proposed to be Uganda's first class purpose-built international convention and event venue and expected to be positioned to become the leading premium mid-sized convention centre in East Africa. It is proposed to be a carbon-neutral centre spread over six levels and accommodates conferences for up to 6000 participants in 22 purpose-built meeting rooms in various configurations, making it one of the most flexible congress centres in East Africa. The CCE is also expected be one of the most sustainable convention centres with an application of the high-level ISO 14001 accreditation.

Priority area four: Tourism quality assurance

Uganda's quality assurance systems for tourism enterprises are guided by the EAC Grading and Classification Criteria which is a mandatory arrangement under the East African Community member states. The criteria have been in implementation in Uganda since 2007, however, some inadequacies in the criteria which affect its ability to effectively support enforcement of quality assurance in Uganda have been noted and it is crucial that Uganda addresses these. These inadequacies include:

- Concerns with the category of restaurants covered by the criteria which range from three to five stars as this excludes the bulk of the micro-enterprise facilities which fall in the lower end and yet they also cater to tourists. If left unregulated, they can impact on consumer protection and destination image and competitiveness.
- The grading and classification criteria for both restaurants and hotels are limited in scope as they exclude some emerging types of facilities such as fast foods and boutique hotels and tourist sites respectively.
- Lengthy and elaborate procedures regarding the review of the EAC criteria have created difficulties in making timely adjustments to it, based on changing circumstances and trends thereby rendering the criteria unresponsive to dynamic industry changes.
- The criteria are limited in flexibility of application. For example, they do not provide for properties that were initially built as residential houses, but which owing to demand driven change of use, may wish to convert to fully fledged hotels.
- The criteria lack in-depth provisions for sustainable tourism, yet it is an emerging trend and a global requirement in tourism management.

Priority area five: Marketing and promotion

Marketing and promotion are a critical component of destination development since this function is responsible for attracting visitors to a destination. Over the next five years, Uganda's tourism related marketing and promotion should focus on the following:

- ***Develop and implement a national tourism marketing strategy, through the following actions:***
    - Build Market Structures to promote access to source markets through measures

such as digitalization, connectivity, trade representation and Tourism Information Centres.
    - Establish a Market Intelligence Framework to monitor trends and status of tourism growth in the country.
    - Build the capacity of frontier services and foreign intermediaries.
    - Train Ugandan diplomats to support tourism marketing and handling, and Visa/consular staff in customer care.
    - Introduce mechanisms to allow online purchase or pre-approval of visas.
    - Develop digital capability in the tourism industry to market and improve access to products.
- ***Activate Uganda's tourism brand 'The Pearl of Africa'***
    - This includes a digital/online strategy. There's need for brand activation, a mix of marketing activities aimed at building an emotional connection between the brand and the potential tourist.
- ***Improve online presence and marketing of private sector players***
    - The presence of Ugandan tour operators and the Ugandan tourism industry at large is weak. This goes for their own homepages, their social media channels and for review and booking sites. They often do not function well, are badly written, outdated and in many cases not secure. In addition, the content presented often does not appeal to an international market. Most players themselves lack the capacity to improve their online presence. There is need to support digital marketing capacity of the players.

Priority area six: Tourism human resource development

The 'bedrock' of a growing tourism sector and enhancing tourist experience is a better skilled tourism industry apart from quality of the natural and built environment and transport infrastructure. In Uganda's tourism development process, human resource development needs to be continuously pursued through training and skilling to improve competence and increase professionalism for enhanced sector performance.

The following suggested priorities of human resource development are in line with emerging realities including the COVID-19 pandemic.

1. Building Resilience of Tourism Enterprises in Uganda to adapt to disease realities like Ebola, Marburg, COVID-19, etc. including safety and hygiene handling skills
2. Building skills in Crisis Response Communication Strategy in Tourism
3. Media training for key players
4. Capacity-building programmes in tourism development and management for Accelerating growth and recovery
5. National Tourism Human Capital Strategy for public and private employees and workers through adequate training infrastructures and programmes
6. Build capacities of UTB, UWA, UTA, AUTO and UCOTA to develop and

strengthen Uganda's Marketing and Promotion for an accelerated sector growth targets including recovery from COVID-19. The training areas include: (1) Growth Scenarios and Priority Markets Review; (2) International Tourism Marketing Strategy; (3) Domestic Tourism Marketing Strategy; (4) Marketing Strategy for Specific (Thematic or Regional) Source Markets, (5) Tourism Diversification Strategy; (6) Digital Marketing Strategy and (7) Incentives Programme to Stimulate Travel

7. Capacity Building for Local Communities to Develop and Promote Local Tourism Products
8. Women Empowerment through Tourism
9. Youth Employment Project in Tourism
10. Incentivize the private sector to provide skills through internship and apprenticeship programs.

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CHAPTER 14:

Implementing local content in Uganda's oil and gas sector: Challenges and opportunities

By Moses Kabanda (Ministry of Finance, Planning and Economic Development, Macro-Economic Policy Department)

1. Introduction: Challenges and opportunities in Uganda's Oil and Gas sector

Natural resources offer countries a unique opportunity to drive socio-economic transformation. If well managed, revenues from the exploitation of natural resources as well as rising demand for local goods and services from incoming foreign investors can act as a powerful driver of growth, create jobs and improve livelihoods. However, the global experience clearly demonstrates that reaping the benefits of natural resources is not automatic. Rather than act as an engine of economic growth, resource discoveries – especially in oil and gas – often result in developments that impede on economic growth, such as a decline in export-oriented sectors due to an appreciating exchange rate. In the literature this phenomenon has been labelled as the "resource curse" or "Dutch disease". Crucially, many scholars[48] have argued that the 'Dutch disease' and resource-related conflicts are a result of poor management of natural resources, specifically when policy fails to link exploitation to other sectors of the economy. The ramifications of a 'Dutch disease' are of serious concern not only to governments but also to oil companies that are increasingly willing to work towards strengthening partnerships in the environments they operate in.

The first commercially viable oil in Uganda was discovered in the Albertine Graben in 2006. To date, 6.5 billion barrels of oil have been confirmed in the 21 discoveries made, out of which 1.4 billion barrels are estimated as recoverable.[49] The recoverable oil reserves can support production of up-to 260,000 barrels of oil production per day for 15 years. In per capita terms, Uganda's proven reserves convert to about 46 barrels per person over this period.[50] Cumulatively, the sector has already attracted investments amounting to US$ 3.8 billion into exploration, appraisal, and development activities.

The Covid-19 pandemic seems not to have affected progress towards first oil production in Uganda. Indeed, some of the key investment decisions have been taken during this period, including the sign-off on *Tullow's* farm-out and the signing of three key agreements[51] relating to the crude oil export pipeline. With these agreements in place, the awarding of construction contracts (EPC) is expected to follow. This will open-up opportunities for the participation of Ugandans, with Ugandan companies in position to greatly benefit from the involvement of world-class service companies, expected joint-venture partnerships and sub-contracting opportunities. An additional US$ 15-20 billion is to be invested in the development and production phases, leading up to first oil now expected in 2025. In addition, analysis based on a long-term price assumption of US$ 60 per barrel suggests

48 See, for instance Stevens, P (2003) "Resource Impact: Curse or Blessing? A Literature Survey".

49 Forty percent of the prospective resource has been explored, and 10 percent has been licensed. Forthcoming licencing rounds are expected to yield more oil discoveries, given that in the previous exploration, Uganda has had an 88% success rate of finding oil, compared to a 25% global average.

50 See World Bank (2020) "Uganda Oil Revenue Management – Closing Gaps in the Fiscal and Savings Frameworks to Maximize Benefits."

51 Host Government Agreement, Transport & Tariff Agreement and Shareholders agreement signed on April 11, 2021, by the governments of Uganda and Tanzania together with the international oil companies.

that government revenue would average US$ 1.3 billion per year and reach a peak of about US$ 2.3 billion during the peak production year.

While Uganda's proven reserves do not rank among the world's large producers, the benefits to the economy are potentially large, directly through revenues, investments, oil exports and the wider linkages to the non-oil economy. However, these benefits are neither automatic nor guaranteed, unless the resource is managed appropriately. The government has a crucial role to play through establishment and strengthening of appropriate institutions, mechanisms and policies that supports the development of synergies with domestic industries that can harness these benefits.

Cognizant of the opportunities and challenges associated with the country's nascent Oil and Gas sector, since 2013 the Government of Uganda has taken deliberate actions aimed at promoting local content within the sector. Already prior to that, the *2008 National Oil and Gas Policy* set a strong emphasis ensuring national participation in the sector. While it is too early to determine the effectiveness of the policies in place, the current framework can be compared to international best practices and lessons can be drawn that will allow the country and oil companies to effectively prepare for future exploitation of Oil and Gas.

The remainder of this paper examines local content development in Uganda including a review of the country's regulatory framework. This chapter also discusses the progress and challenges faced during the implementation of local content policies and provides recommendations targeted at enhancing local content.

2. Local content management in Uganda's Oil and Gas sector

Nearly all resource-rich countries are engaged in efforts to promote local content to secure benefits in the form of employment and higher incomes for their citizens. The call for policies to strengthen local content reflects the widespread impression that policies aimed at simply attracting investment in extractive industries – with the prospective to raising government revenue through taxing these firms – have yielded insufficient results in creating benefits for the wider population. Uganda's approach towards promoting local content focuses primarily on legal and regulatory frameworks.

2.1 Regulatory framework

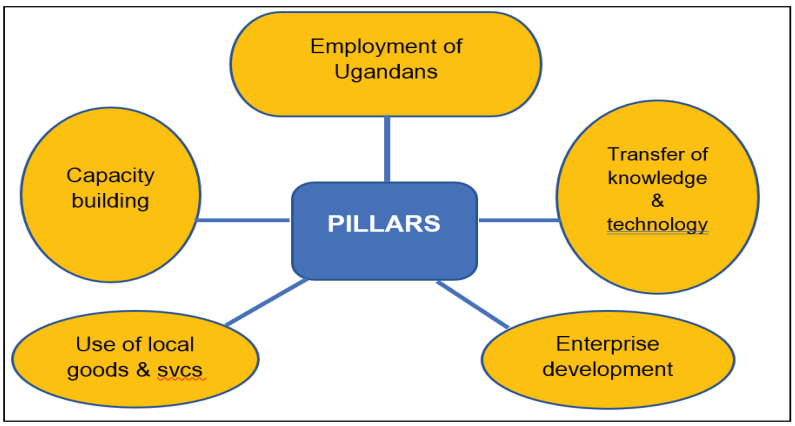
The *2008 National Oil and Gas Policy* (NOGP) lays the foundation for Uganda's local content regime. The policy emphasizes national participation in oil and gas activities through its objectives number 7 and 8, which relate to optimum country participation in sectoral activities, the expansion of employment opportunities for Ugandans, and support for the development of competencies for national entrepreneurs and the workforce to

competitively supply goods and services to the Oil and Gas sector. The policy lays out deliberate government actions to support local content focusing on three main areas:

(i) Establishing a regulatory framework for state participation in the exploitation of natural resources and implementation of national content,[52]
(ii) Establishing an institution to take charge of state participation in the sector and monitor compliance; and
(iii) Identifying opportunities for national content in the sector and plan for its implementation.[53]

While the Uganda's petroleum laws contain some specific provisions relating to local content in the petroleum sector, a comprehensive piece of legislation that will govern local content issues is contained in the National Local Content Act (NLCA). The NLCA was passed in 2020 but awaits assent by the President by the time of writing. The NCLA is the outcome of extensive consultations and dialogue between all key stakeholders in the oil and gas sector. The act defines local content to include 'the quantum or percentage of locally produced goods, locally produced services and the utilisation of personnel, financing, goods and services by a local content entity in any operation or activity carried out in Uganda'. By doing so, the goal is to drive in-country value creation and retention whilst ensuring competitiveness, efficiency, and effectiveness. The development of local content is regarded as a crucial effort towards encouraging linkages in the extractives sector thereby enabling Ugandans to derive maximum gains from the development of the industry. The overriding objective is to promote active participation of Ugandan citizens and businesses in the sector to at-least 80 percent of total jobs and economic activity in the same within 10 years. Figure 1 illustrates key pillars of Uganda's local content strategy for the oil and gas sector.

Figure 1: Key pillars of national content in Uganda.



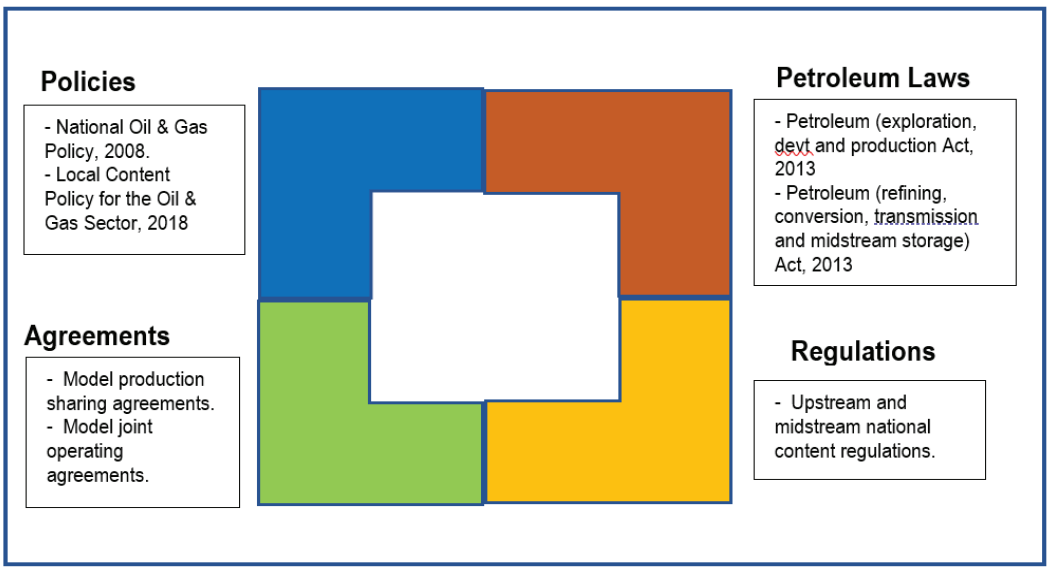
Source: National Oil & Gas Policy, 2008.

52 The terms "National content" and "local content" are used interchangeably for the purposes of this paper.
53 National Oil and Gas Policy, 2008.

The promotion of Ugandan content is also embedded in the two petroleum legislations - the *Petroleum (exploration, development, and production) Act, 2013* and the Petroleum (refining *conversion, transmission, and mid-stream storage) Act, 2013*. These pieces of legislation provide for state participation in petroleum activities and require preference for the provision of goods and services to be granted to Ugandan entrepreneurs (Part VII of the mid-stream law and VIII of the upstream law). The acts also contain sections on training and employment of Ugandans and on technology transfer. The model production sharing agreements and joint operating agreements contain provisions that guarantee state participation in petroleum activities and sourcing of goods and services by international oil companies from Ugandan owned businesses. Relevant regulations under the upstream and midstream laws were completed in 2014 and require operating oil companies to present a program for the recruitment and training of Ugandans that needs to be approved by government. The regulations also require presentation of procurement plans that demonstrate preference for goods which are produced and are available in Uganda, and services which are offered by Ugandan citizens and companies.[54]

To steer and monitor implementation of these provisions targeted at increasing local content, the government created a unit within the *Petroleum Authority of Uganda* (PAU). The unit is also responsible for working with local contractors and Ugandan companies to develop their capabilities. Figure 2 provides an illustration of Uganda's national content regulatory framework.

Figure 2: Uganda's national content regulatory framework.



Source: Petroleum Authority and Ministry of Energy and Mineral Development.

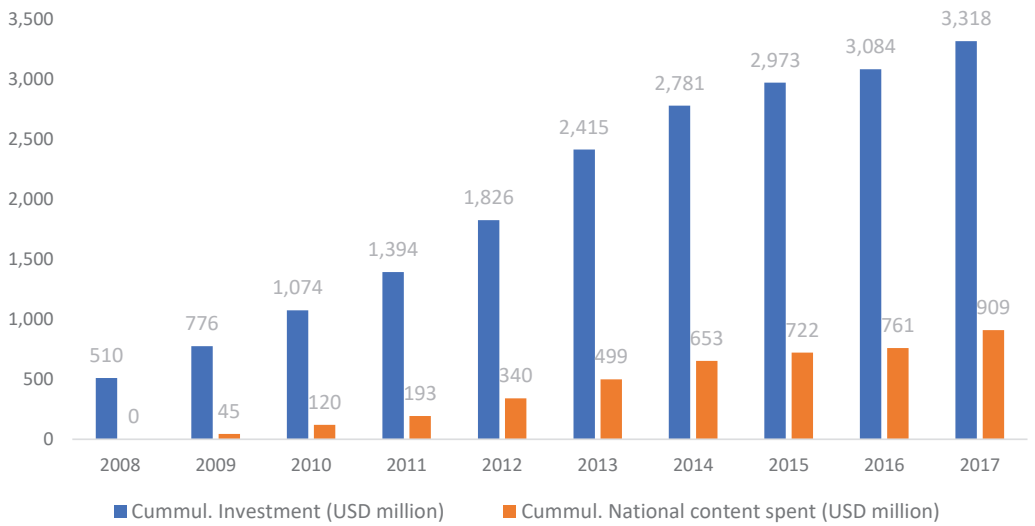
54 Where goods and services required are not available in Uganda, these shall be provided by a company which has entered into a joint venture with a Ugandan company.

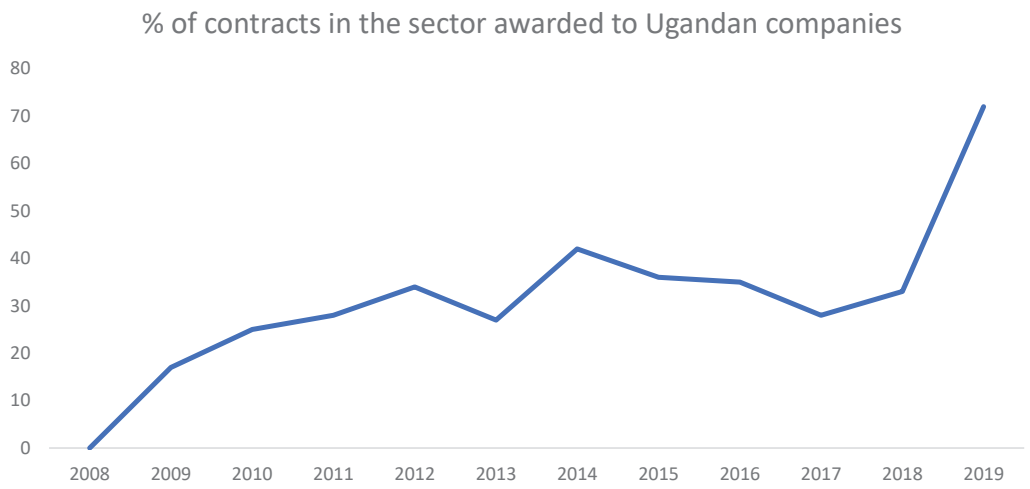
2.2 Progress on local content implementation

While many resource-rich countries have enacted regulatory frameworks on local content, implementation of such policies have often failed to achieve the desired results, especially in developing countries. For example, the high level of skills, knowledge and technology required to actively partake in procurement activities for the oil and gas sector poses a significant implementation challenge.

In Uganda, given that commercial exploitation is yet to begin, it is too early to fairly assess the full impact of the national content framework vis-à-vis its goals and objectives. However, results during the exploration phase give reason to be optimistic. For example, between 2008 and 2017, the *Petroleum Authority of Uganda* (PAU) reported an upward trend in the value spent on national content in the oil and gas sector which cumulatively amounted to nearly one-third of investments in the sector in 2017 (*cf.* Figure 3). PAU also reports that the share of procurement contracts to Ugandan companies has been increasing, doubling in the first 5 years of activities, and was reported at 72 percent in 2019. This progress can partly be attributed to the commitment of oil companies (*CNOOC*, *Total E&P* and *Tullow*) over the years to foster national content development in Uganda and has been accomplished by actively engaging with the local business community through supplier expansion and contracting activities. Through these engagements, the oil companies have provided direct assistance to strengthen capacity of domestic companies and offered appropriate support to specific sectors.

Figure 3: **Use of Ugandan goods and services in the country's oil and gas sector.**





Source: Petroleum Authority of Uganda, 2019.

Further, in 2013, an industry baseline survey was undertaken to identify the sectors likely to be directly or indirectly impacted by oil and gas projects in Uganda. The survey revealed 25 critical industries with a high potential for national content based on an assessment of both their benefits to the country (number of jobs created and skill-level of jobs) and feasibility (investment intensity and ramp up time required to reach oil and gas standards).[55] Some of the areas that local companies have been engaged in include: freight forwarding and customs clearance, legal advisory services, hospitality and catering services, waste collection and management, provision of personal protective equipment, and survey services. The development of capacity in hazardous waste management in Uganda has emerged as a success story from efforts to integrate domestic suppliers into the value chain. The country moved from having no capabilities in waste management in 2013 to a pioneer and *state-of-the-art* oil waste treatment plant in Nyamasoga[56] by the end of 2015.

To enhance the visibility of the Ugandan companies with potential to supply goods and services in the oil and gas sector, in 2017 PAU established a register – the national suppliers database, as a *one-stop centre* from which oil companies can seek qualified contractors for supply of goods and services.[57] The register includes Ugandan and foreign registered entities that have been fully vetted by the PAU as meeting the minimum standards to

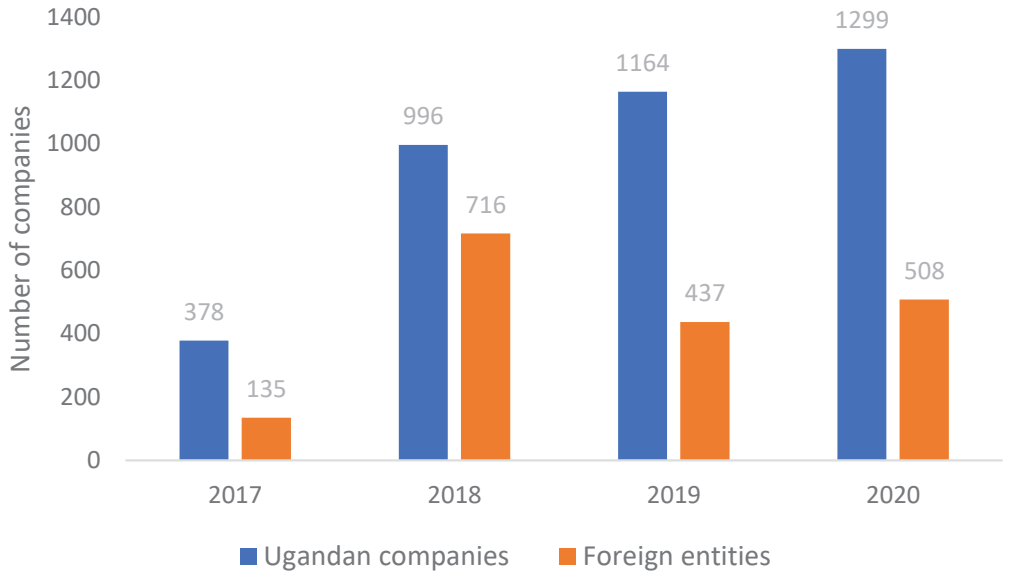
55 Industry Baseline Survey, 2013.

56 A $20 million waste treatment plant set up by a South African waste management company in partnership with a Ugandan company.

57 The practice of providing incoming and potential foreign investors with a database of possible suppliers through websites or comprehensive publications is a practice that has been spearheaded in Africa by the International Growth Centre. For example, Sutton et al (2010 – 2014) create Enterprise Maps listing leading suppliers of goods and services in five African countries (Ghana, Ethiopia, Mozambique, Tanzania and Zambia) to provide investors with a detailed overview of local capacity and opportunities. These Enterprise Maps are accessible online: https://www.theigc.org/project/the-enterprise-map-series/

supply to the sector. Contractors on the list are expected to meet other procurement and technical requirements of the specific supplies required by the oil companies. By 2020, the number of entities that qualified and are registered on the database were 1 807, up from 513 entities in the first year of registration. Out of these, 1 299 entities or (72 percent) are Ugandan companies. Figure 4 illustrates trends in the entities registered on the database.

Figure 4: Number of companies on the National Suppliers Database.



Source: Petroleum Authority of Uganda.

Another milestone in the country's efforts to promote local content is related to building capacity and creating employment opportunities for Ugandans. The national content regulations require licence holders to develop and submit detailed plans on recruitment and training. Within the first five years of operations, companies are expected to increase recruitment of Ugandans in management and technical positions to 85 percent and 70 percent, respectively, from 30 percent and 40 percent at the outset of operations, while all mid-level and support positions should be occupied by Ugandans. Employment data compiled by PAU indicates that between 2008 and 2017, the number of persons in direct employment in licenced companies[58] was above 1 000, out of which more than 70 percent were Ugandans. Since 2018, there was a slow-down in upstream activities in the sector as the companies prepared to transition from the exploration to the development phase. With the scaling-down in the volume of activities, data on overall employment was not readily available. However, according to an industry baseline survey, the development phase is expected to generate more than 160 000 jobs, provided sufficient domestic

58 CNOOC, Total E&P and Tullow.

supplier integration into the value chain is achieved. To harness these opportunities, PAU has put initiatives in place geared towards facilitating well-qualified Ugandans to position themselves to take up offers. Key among these was the establishment of an oil and gas national talent register to capture qualified individuals that could pick up employment opportunities.[59] Other efforts have included supporting capacity development for government officials in various agencies, support for certification of technicians and international accreditations of training institutions, and support to private sector business incubation.

2.3 Challenges to increasing local content in Uganda's Oil and Gas sector

Local content strategies – as an avenue to maximise social and economic benefits from oil and gas extraction in Uganda – face implementation hurdles related to the specificity of the sector. Some of the key constraints preventing local suppliers from catering to the sector include insufficient skills, lack of capacity and access to finance as well as the absence of internationally recognized certification.

With respect to labour, the extractives sector has high requirements for a wide range of technical skills-set which are in short supply and take time to develop, for instance drilling rig operators, welders, and instrumentation technicians. The shortage of skilled labour in Uganda hurts local companies, as they find it difficult to hire Ugandans with requisite qualifications in technical disciplines needed to supply to the Oil and Gas sector. Regarding the use of local goods and services, obstacles related to sourcing locally are mostly due to the low standards of local enterprises. As with labour, the goods and services required in oil and gas projects are highly specialised and involve sophisticated technologies (such as seismic acquisition, rig and well management services) that may not be readily available or on offer by the local suppliers. In absence of these, oil companies continue to rely on global and long-established supply chains for certain goods and services to ensure that inputs used meet global quality standards and that projects are delivered on time. Other non-technical capacity issues include complex procurements systems and challenges of delivering at the scale required by the large nature of contracts in the sector. This challenge has been partially mitigated through local enterprise development and training facilitated by government and the private sector, and by encouraging local enterprises to form joint ventures with foreign companies with supply capacity.[60]

Beyond capacity constraints, local businesses are faced with funding challenges. The inability to raise capital has made it difficult for them to expand and meet the demands necessary to supply to the sector. Furthermore, local businesses are challenged by lacking international quality certifications. Without an accredited institution in-country for certifications, would be domestic suppliers rely on international institutions, greatly delaying the conduct of business. Other internal factors such as high costs of production

59 At the time of writing the register had more than 2 800 Ugandans listed.

60 Examples of successful joint ventures include Atacama a local company partnering with Digby wells on undertaking Resettlement Action Plans and Geotechn (local) with Geomechanics on undertaking geotechnical works.

impact on their ability to supply in bulk and as a result many companies have lost business to more competitive large and foreign companies.

3. Towards more local content in Oil and Gas: Options for policy

For local content policies to be effective it is essential that government pro-actively creates an environment that promotes strong links between local labour and businesses with international oil and gas companies. Until now, the focus has been on the use of legal and regulatory instruments to "force" such linkages. Especially in a *low-capacity* environment such regulations and local content requirements have the potential to undermine the development of Uganda's oil and gas sector into a globally competitive industry. Instead, emphasis should shift towards promoting market-enabling policies that actively support local businesses in their aspirations to become suppliers to the industry. This paper concludes with presenting a range of policy responses available to the government to strengthen local content management in Uganda's oil and gas sector.

- Successful policies to support local content have generally focused on building the capacity of local businesses and investing in human capital. Deliberate efforts should be dedicated towards improving the performance of Ugandan businesses with a long-term goal of making these businesses more competitive. Local businesses should be supported to understand how to do business with firms in the oil and gas sector, for instance by producing goods to the required standard in terms of quality and safety, adapting themselves to international extractives companies' bidding processes, and taking steps to acquire international certification.

- For investments in human capital, capacity should be built in training institutions which target to train the labour force for the oil and gas sector, especially in vocational fields. Such efforts should be ramped up beyond the *Petroleum Institute* in Kigumba and include other institutions. The focus should also be extended to strengthening capacity of training institutions involved with sectors that will provide support services to oil and gas, such as Ugandan agriculture, manufacturing, transport, insurance, and other service providers.

- Local content policy will be more effective if oil companies are aware of the capabilities of local companies. The already existing *National Suppliers Database* should be extended to include information on individual domestic firm capabilities (firm performance, markets served, transaction history) in areas relating to the oil industry to better guide multinationals' decisions.
- Prioritise high-potential productive industries and firms for targeted *Supplier Development Programmes*. Government should work with industry to identify parts of the value chain where local firms have capabilities for timely delivery of the required quality or where the potential to build capacity exists. Such an

identification process allows for the design of capacity building measures and the removal of administrative barriers to entry. The sectors identified need not be high technology industries; agriculture is one of the sectors that should be targeted since additional demand for this sector allows local farmers to invest and raise their productivity.

- Develop interventions to target supply-side constraints to domestic business growth and productivity, including access to affordable credit and standards certification. With many would-be domestic suppliers lacking access to funding required to reach the scale of production necessary to enter the oil and gas supply chain, deliberate efforts to improve access to finance for qualifying businesses should be explored in partnership with financial institutions.[61] Beyond financing, there is need to strengthen the regulatory environment to include standards certification. An effective standards system would strengthen the case of oil companies to using domestic suppliers and ensure that domestic industries follow standards which are in accordance with international practices.

61 One example would be establishing a suppliers financing scheme, which is supported by local banks to assist potential suppliers in accessing affordable finance.

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Summary for the EGF book

Many sub-Saharan African (SSA) countries are less resilient to global shocks such as pandemics and economic depressions, resulting into substantial financial blow to households and businesses. The global Covid 19 pandemic and the corresponding economic ramifications severely hit SSA countries, Uganda inclusive. At the same time, economic downturns and general uncertainty across the globe have cut into exports and depressed foreign investments. Responding to these challenges and strengthening the emerging economic recovery requires decisive evidence-based policy action.

This book outlines some key recommendations for necessary policy reforms taking the case of Uganda. The various chapters draw on the insights and ideas presented at four Economic Growth Forums – an annual high-level exchange hosted by the Ministry of Finance, Planning and Economic Development in collaboration with the International Growth Centre. The objective of the book is to provide policy options that can be adopted by low income countries like Uganda to deal with growth challenges as well as take advantage of opportunities that arise, like new markets and technologies. It also outlines strategic interventions that can be adopted by governments to support a brisk and robust economic recovery that benefits all citizens.