

How should Uganda finance infrastructure development?

Executive Summary

Although Uganda has made progress in infrastructure development, the country still faces huge deficits across all sectors, including in transport, energy, water and information and communication technology that require financing beyond the public budget ceilings. These deficits in infrastructural provisioning affect the business climate and increase the cost of doing business with implications for enterprise growth and job creation. In addition, infrastructural deficits exacerbate poverty and inequality and could therefore hinder the attainment of the sustainable development goals (SDGs). Addressing these deficits will require financing beyond the available public budget ceilings. This policy brief, based upon a recent research paper¹, explores options for financing the scaling up of infrastructure development in Uganda. The analysis highlights the opportunities for scaling up domestic resource mobilization, improving efficiencies in public investments, options in private financing, and the potential role of the natural resource sectors.

Introduction

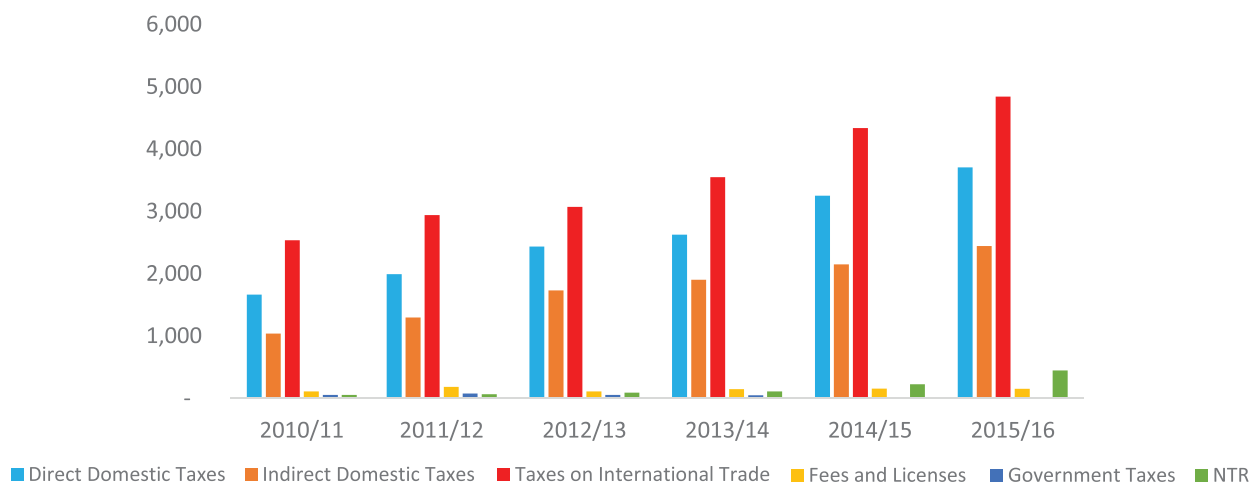
Recent evidence shows that Uganda's infrastructure gaps will require sustained expenditure of approximately USD 1.4 billion per year over the next decade.² This figure far exceeds the budget provisions in the medium term expenditure framework. Uganda plans to spend about UGX 8.5 trillion - approximately 37 percent of the proposed 2017/2018 budget on the works & transport (24.3 %) and energy & mineral development (13.2 %) sectors.³ These planned expenditures are huge and will necessitate the consideration of innovative financing mechanisms to avoid crowding out other developments in the economy, such as service delivery in agriculture, health and education. In exploring a diversity of options for infrastructure financing, policy makers should be cautious not to draw Uganda into excess debt burden. Further, the discourse on financing infrastructure investments in Uganda must be cognizant of the changing global dynamics with respect to global cooperation. Traditional development assistance from members of the Organisation for Economic Co-operation and Development's Development Assistance Committee (OECD-DAC) is becoming less important⁴. The changing traditional

donor dynamics have two implications: first, cheaper and patient financing is no longer readily available; and second, the drying up of traditional financing requires greater capacity in Public Investment Management (PIM), which was previously not necessarily true because traditional financing was accompanied by this capacity. In addition, the East African Community (EAC) convergence and macroeconomic constraints imply that Uganda cannot adequately finance all its infrastructure needs in the medium to long term through deficit financing alone.

What financing options can Uganda consider?

Improving domestic revenue mobilisation is the primary available option for financing infrastructural development in Uganda. However, efforts in this area have been hampered by, among others, weaknesses in the legal and regulatory frameworks; the narrow tax base; a large informal sector; tax exemptions; and institutional weaknesses. The three most important sources of domestic revenue in Uganda are international trade taxes, direct domestic taxes, and indirect taxes (figure 1). These three tax-heads contributed 95 percent

Figure 1: Domestic resource mobilization 2010/11-2015/16, Billion UGX



Source: Uganda Revenue Authority

of all revenue collections in 2015/16. International trade taxes continue to be the most important sources of domestic revenues. In 2015/16, international trade taxes contributed UGX 4.8 trillion, equivalent to 42 percent of revenue collections in 2015/16.

Two interventions that can support improved domestic resource mobilization include: leveraging the contribution of non-tax revenues (NTR) and curtailment of capital flight.

An important source of non-tax revenue accrues from collections by self-accounting bodies such as the Uganda Communications Commission (UCC), Civil Aviation Authority (CAA), among others. Such bodies collect NTR and spend at the source. This practice potentially undermines efforts to improve revenue mobilization. For instance, ministries departments and agencies (MDAs) submitted only 76 percent of the 2012/13 NTR assessment, largely due to retention of NTR at source by MDAs. Consequently, NTR’s contribution to revenue is small (0.2 percent of GDP per annum), possibly due to non-remittance to the centre. However, the contribution of NTR has the potential to double to 0.4 percent of GDP by 2019. This strategy will require NTR to contribute an additional UGX 130 billion per annum.

With regard to capital flight, available evidence shows that for the six years during 2005 – 2010, cumulative losses amounted to USD 6.26 Billion in 2010 constant prices. This loss in revenues is large and to put it in perspective, is sufficient to finance the current budget allocations to the ministry of works and transport by six fold. In this respect, we propose measures to strengthen the institutions of governance, including in the

extractive sectors, so as to avoid the challenges of capital flight. In addition, we propose reforms to strengthen the capacity of the local private sector and to develop policy and regulatory frameworks to deepen local content in government procurement.

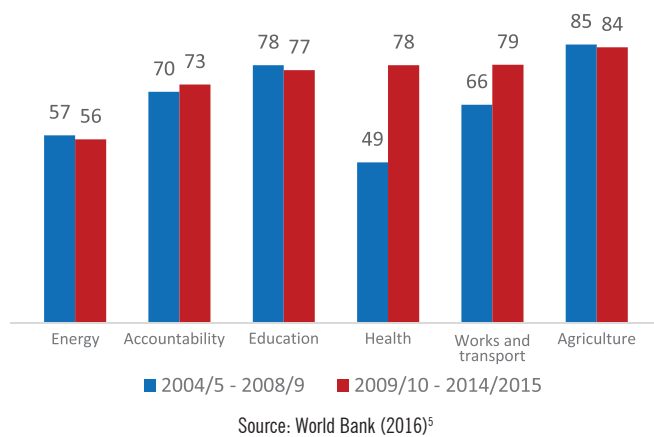
Improving public investment efficiency can free up funds and create opportunities for enhanced infrastructure investments. Currently, Uganda loses up to one-half of public resources allocated to various infrastructure projects due to challenges in public investment management. This loss is caused by a number of weaknesses including inefficient planning, absorptive capacity constraints, poor project selection and execution, inflated unit costs, issues with compensation and fraud. In addition, projects are usually riddled with the propagation of self-interests, which lead to leakages and wastage. Consequently, there are large budget executions gaps in public investments, particularly in the transport and energy sectors (Figure 2).

When projects are delivered, provisions for operations and maintenance are often neglected, leading to faster depreciation. Another challenge affecting public investment management is the lack of coordination between the different agencies and local governments. The costs of these inefficiencies are huge, and eliminating them could easily double the stock of delivered infrastructure for the same cost.

We propose reforms to improve capacity for public investment management. In addition, we propose carefully crafted land reforms that would allow government compulsory land acquisition but ensure that any rightful owners are fairly and

expeditiously compensated and/or resettled. This arrangement would circumvent the current challenges with respect to compensation for land and property.

Figure 2: Public investment budget execution rates, %



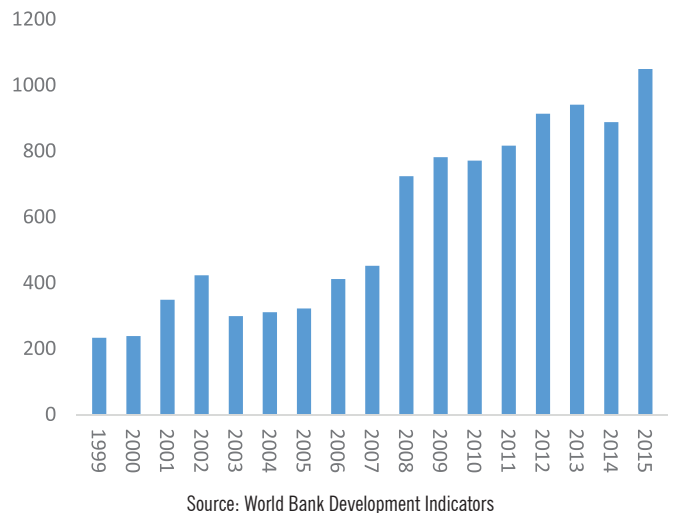
Private financing opportunities from both the domestic and international markets remain unexploited. However, addressing opportunities would require Uganda to build capacity in project management as an important first step. One source of private finance that can potentially play a critical role in infrastructure development is the pensions sector. It is estimated that member contributions to Uganda's leading pension fund – National Social Security Fund (NSSF) – reached UGX 6.7 trillion in 2015. This amount is the equivalent of approximately 7 percent of GDP. Although this figure is small by international comparisons, it represents tremendous growth in the pension sector. The advantage of borrowing from pension funds is that the government will be able to pay the loans in domestic currency, and the risk of fluctuating interest rates that comes with depreciating exchange rates for foreign currency denominated loans would be mitigated.

Relatedly, remittances could be a feasible window for improving Uganda's external financing flows in the country. Available data indicate that personal remittances reached approximately USD 1 billion in 2015 from slightly above USD 200 million in 2000 (Figure 3). Despite the potential for remittances to finance domestic development, there are no established mechanisms or strategies to harness these resources for development.

Uganda can draw lessons from Ethiopia, where a diaspora bond was successfully issued in 2011 to finance the grand renaissance dam, whose project cost was estimated at USD 4.8 billion. This experience shows that Diaspora bonds could be an important fundraising vehicle critical to the successful mobilization of revenues for infrastructure investments. In

this regard, we propose that government considers floating a domestic infrastructure bond as a means of attracting long-term infrastructure financing.

Figure 3: Personal remittances, received (current million USD)



Using natural resource revenues to ramp up investments in infrastructure is well articulated in Uganda's policy documents. Oil for infrastructure will boost the productivity of the economy by unleashing the productivity of capital and labour and mitigate any Dutch Disease effects by harnessing idle productive capacity to unlock the productive potential of the economy and satisfy any resource-induced demand. However, using oil revenues is subject to risks, particularly price volatility, which could result in investment uncertainty. Another risk relates to political capture. Mitigating these risks requires that Uganda focusses on building and strengthening the requisite institutional and policy space, ensure strict adherence to the rule of law, and eliminate rent seeking, political capture and elite capture to ensure transformative gains from expenditures of natural resources wealth.

Botswana is among few African countries that have exploited natural resources wealth to transform infrastructural developments. In general, Botswana adopted an expenditure drive that favoured investments in physical infrastructure across a range of assets, as shown in Figure 4, the largest three of which included electricity and water (21 percent), housing and urban infrastructure (15 percent), and roads (12 percent).

Such expenditures ensured that investments in reproducible capital were prioritized. The composition of spending gradually changed once the infrastructure deficit was

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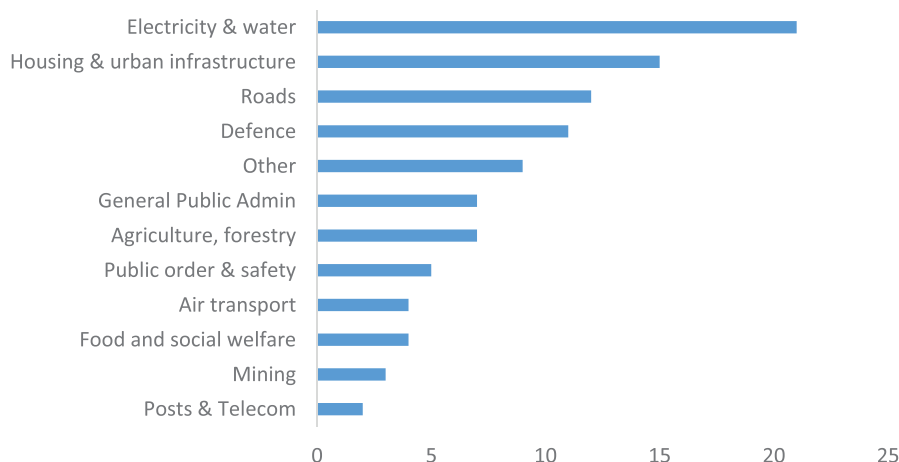
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Figure 4: Botswana’s allocation of development spending, excluding education and health, 1983/84–2014/15, %



Source: African Development Bank (2016)⁶ Conclusions

gradually addressed and the need for new infrastructure accordingly reduced. Following such investment paths would help Uganda to leverage its natural resources wealth to finance deficits in infrastructure development.

economy presents good opportunities, there are significant risks of investment uncertainty that could arise from unfavourable price fluctuations.

Conclusions

The best available options for financing infrastructure are enhanced domestic resource mobilization and improved efficiency of public investment management. The dwindling availability of concessional financing and options in private financing could complicate the debt sustainability dynamics if challenges in public investment management and execution are not addressed. Although the oil

Endnotes

- 1 Maweje, J. and Munyambonera, E. (2017). “Financing infrastructure development in Uganda”. Research Series No. 130. Economic Policy Research Centre: Kampala.
- 2 Ranganathan, R., and Foster, V. (2012). “Uganda’s infrastructure: a continental perspective”, Policy Research Working Paper 5963. The World Bank: Washington, DC
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- 6 African Development Bank (2016). “Botswana’s Mineral Revenues, Expenditure and Savings Policy: A case study”, African Development Bank, African Natural Resources Center. Abidjan

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